



Board Report

File #: 2021-0815, **File Type:** Informational Report

Agenda Number: 11.

FINANCE, BUDGET, AND AUDIT COMMITTEE FEBRUARY 16, 2022

SUBJECT: FISCAL YEAR 2023 BUDGET DEVELOPMENT PROCESS

ACTION: RECEIVE AND FILE

RECOMMENDATION

RECEIVE AND FILE the Fiscal Year 2023 (FY23) Budget Development Process.

ISSUE

This is the first of a series of monthly updates to the Board to kick-off the FY23 Budget development process, culminating in a planned May 2022 Board Adoption. This report lays the framework for the annual budget development, with the primary objective of the annual budget to achieve Metro's transit and transportation goals in a fiscally sound and financially responsible manner.

This report sets up the economic context for the upcoming fiscal year by beginning the report with the forecast of sales tax revenues and other resources, cost inflation and key program expense assumptions. An outline of the planned budget process and schedule follows to address the delivery of Metro objectives in the next fiscal year. A comprehensive and transparent public outreach program runs concurrently during the budget development process to maximize public input and ensure that Metro's stakeholders have an active role in the process.

DISCUSSION

Planning for the upcoming fiscal year, Metro faces a rare golden but one time funding opportunities, while taking on yet bigger challenges to deliver transit services and transportation infrastructure programs in terms of higher than anticipated cost increases, supply chain delivery delays, staffing shortages and the lingering negative impact of the pandemic to Metro Operations and the financial bottomline. With the potential relief from the Federal infrastructure bill and State budget surplus, Metro will pick up the pace again and continue the nation's most ambitious transit expansion plan. As the County's residents are eager to come out from under the cloud of pandemic, transit service improvements are carefully evaluated to answer the changing transit travel pattern, address staffing shortage to maintain service reliability, and meet customer expectations of higher cleaning standard and safety/security practice. The FY23 Budget Process, therefore, is designed to thoroughly weigh

the priorities in curating Metro's programs and operations in the best form for a fair share of the golden funding opportunities from Federal and State sources, while ensuring transit services remain relevant and equitable.

Sales Tax Revenue Assumptions

Metro relies on sales taxes for over 60% of its total revenues. In addition, cities and transit providers in Los Angeles County plan their operations based on our revenue projections. Local sales tax is less restrictive than many one time revenues such as Federal and State Grants; therefore, the demand for sales tax to match grant requirements, higher cost escalation in operations and transit expansion experienced in the last years can exhaust the sales tax funding faster than it can be generated. These facts necessitate a careful evaluation and forecasting of the sales tax growth rate to determine the funding levels for FY23.

Given the continuing uncertainty in the pandemic environment, careful examination of the individual economic sector performance is used to isolate and evaluate the economic changes in specific segments of the economy. The following assumptions were used to develop the model projections:

- Remaining COVID-19 restrictions will have a minimal impact on the economy by the start of FY23.
- Economic growth will slow from rapid recovery to pre-pandemic growth rates. Outside of a few hard-hit sectors, such as leisure and hospitality, revenues have reached or exceeded pre-pandemic trends, limiting continued growth.
- Stimulus funds from the American Recovery Plan Act (ARPA) will indirectly increase sales tax revenues in the same way previous Federal stimulus funding did. Conversely, continued supply chain bottlenecks and changes in consumer behavior such as purchasing more services and fewer goods will slow sales tax revenue growth.
- As measured by the Consumer Price Index (CPI), inflation will gradually fall from currently high levels to more typical growth rates throughout FY23.

A technical multiple regression analysis is then added to the economic sector performance forecast to validate the results. This technical model determines the relationship between the sales tax revenue, unemployment rate, CPI, and population in Los Angeles County. Historical actuals since FY94 are employed as observations and a regression equation is derived. Internet sales tax impact from the Wayfair decision is also factored. The FY23 sales tax revenue prediction reconciles closely with the economic sector model projection. Long term and short term historical receipts, leading professional forecasts of economic trends, and leading professional forecasts of economic trends are also considered in the sales tax growth rate development.

Figure 1 displays Metro's historical sales tax revenue actuals and latest projections for FY22 and

FY23. As the economy continues to recover, unemployment declines, COVID-19 vaccinations continue to rise, along with the fiscal stimulus and relief packages provided by the U.S. government and Federal Reserve, strong economic recovery is expected in FY22 with sales tax revenue re-estimated from the adopted budget of \$865 million to \$995 million per ordinance. Economic growth is anticipated to stabilize from the FY22 rapid recovery given multiple interest rate hike projections in 2022 and 2023, and sales tax revenue is anticipated to increase moderately at 3.7% from the FY22 Reforecast of \$995 million to \$1.03 billion per ordinance in FY23. Despite the estimated sales tax revenue growth, operating and construction cost increases are expected to outgrow as a result of the recent inflationary pressure and supply chain turmoil associated with the COVID-19 pandemic. According to the Bureau of Labor Statistics and Department of General Services (DGS), wages and salaries for private industry workers in the Los Angeles area have increased 6.5% for the 12-month period ended September 2021 and the California construction cost index has increased 13.4% from December 2020 to December 2021.

Figure 1:

(\$ in Millions)	FY20 Actual	FY21 Actual	FY22 Reforecast	FY23 Assumption
1 Sales Tax Revenue per Ordinance ⁽¹⁾	\$ 824.7	\$ 911.7	\$ 995.0 ⁽²⁾	\$ 1,031.8
2 % Change	-2.6%	10.5%	9.1%	3.7%

⁽¹⁾ Proposition A , Proposition C, Measure R and Measure M. Transportation Development Act (TDA) sales tax revenue is approximately 50% of the other ordinances.

⁽²⁾ The FY22 Reforecast of \$995 million per ordinance is 15% above the FY22 Adopted Budget of \$865 million per ordinance.

Figure 2 compares Metro’s historical and current budget estimates to actual receipts and leading regional forecasts. FY23 sales tax revenue projections from UCLA, Beacon Economics and Muni Services are between \$1.01 billion to \$1.06 billion per ordinance while Metro’s estimate of \$1.03 billion falls within range.

Figure 2:

Sales Tax Revenue per Ordinance Forecast Comparison

(\$ in Millions)

Forecast Source	FY17	FY18	FY19	FY20	FY21	FY22	FY23
1 Actual	\$ 789.4	\$ 836.7	\$ 846.8	\$ 824.7	\$ 911.7	\$ 995.0 ⁽¹⁾	\$ -
2 Metro- Adopted	795.7	802.0	844.0	873.0	778.1	865.0	1,031.8 ⁽²⁾
3 UCLA	807.4	810.0	863.6	838.1	770.2	794.4	1,058.1
4 Beacon Economics	806.2	816.9	835.4	843.5	892.3	896.7	1,013.4
5 Muni Services	806.2	803.6	827.7	868.1	737.3	881.7	1,017.1

(1) FY22 Reforecast as shown in Figure 1.

(2) FY23 Assumption.

The growth in sales tax revenues that created a large budget-to-actual variance in FY21 has continued in FY22. Year-to-date revenues are well above projections leading to a reforecast with a similar variance. The FY23 Assumption is 19.3% above the FY22 Adopted, but only 3.7% above the FY22 Reforecast. As more economic data becomes available, these growth rates will be reviewed and adjusted during the budget development process. We will continue to monitor any COVID-19 impacts, sales tax receipts and inflation trends, updates from the economic forecast sources, and report back to the Board as needed.

Other Resource Assumptions

Toll, Advertising and Other

Toll revenues include ExpressLanes usage and violation fees from the existing I-10, I-110. Meanwhile, advertising revenue is based on new and existing contracts as well as corporate sponsorships. Other revenues include bike program, Union Station, park and ride, lease, film, Service Authority Freeway Emergencies (SAFE), auto registration fees, transit court fees, investment income, and other miscellaneous revenues. Office of Management and Budget (OMB) coordinates with the departments responsible for these functional areas on the FY23 revenue estimates and will update the Board as more information becomes available.

Passenger Fares

Passenger fares are assumed to grow as transit ridership continues to increase with the opening of schools, businesses, and resumption of fare collection. The projection is still under development as staff works to finalize the analysis based on further evaluation of ridership growth, changes occurring in various economic segments, and the various initiatives that Metro has in place for FY23.

American Rescue Plan Act (ARPA)

ARPA, the third of three Federal COVID-19 relief packages, was signed into law in March 2021. The Act provided approximately \$30 billion nationwide to transit. At the July 2021 meeting, the Metro Board approved the allocation and distribution of \$1.483 billion to transit operators throughout Los Angeles County including funding for transit, local community para-transit operators, Access Services, and Metrolink. Among these funds, Metro transit will apply its allocation of \$1.097 billion, to support Bus and Rail Transit Operations and Maintenance, including payroll. ARPA also includes additional capital funds that will be applied to Measure R and Measure M projects once those applications are approved.

State Transit Assistance (STA)/Senate Bill 1 (SB1) Revenues

STA and SB1 are sales tax revenues dependent on actual consumption and the price of diesel and gasoline. The FY23 projection will be determined around mid-February 2022 to reflect the State Controller's Office (SCO) estimates.

One-Time Revenues

Local, State and Federal grant resources are used to support Metro's transit planning, operating, State of Good Repair and construction activities. In addition to ARPA mentioned above, the recently approved Infrastructure Investment and Jobs Act (IIJA) significantly increases Federal funding from the levels in the Fixing America's Surface Transportation (FAST) Act. Over the next five years starting in FY23, it will provide up to \$108 billion nationwide for transit and up to \$365 billion for highways through existing and new formula and discretionary programs.

Governor Newsom's recently proposed budget includes \$9.1 billion in new transportation spending. However, about \$3.7 billion are IIJA funds that will be distributed through the state. These funds will be discretionary capital grants spread across a variety of programs.

While these expected increases are encouraging and welcomed, it is important to note that many of them are one-time only revenues. Most discretionary grant programs are competitive grants requiring local match funds to qualify. Also, Metro has significant commitments on the expense side to provide safe and efficient transit Operations and maintain momentum on the Measure R and M programs.

Since the state budget is not final, the IIJA provisions have not yet taken effect and the Public Employees' Pension Reform Act (PEPRA) challenge continues to work its way through the courts, staff is still working to determine how much funding will become available in time for Metro's FY23 Budget. In particular, the new programs may take time to get up and running and may only provide limited amounts in the coming fiscal year. The estimate for FY23 will be presented as we receive more information from the Federal Transit Administration (FTA), state and other local agencies. Please see Attachment A for the discussion of Federal Stimulus Relief Funding Update.

Bond Proceeds and Prior Year Carryover

Debt issuance is authorized by applicable Federal and State legislation and the local sales tax ordinances. The Board-adopted Debt Policy establishes parameters for issuing and managing debt that follow best practices and set affordability limits. New debt issuance will be used as a last resort to mitigate the shortfalls in State of Good Repair, transit construction and highway activities.

In FY22, \$1,660.1 million of debt proceeds and prior year carryover are available for transit construction, highway and State of Good Repair projects. The debt amounts for FY23 will be determined at a later stage as we finalize the FY23 expense budget and are subject to CEO approval.

Resource Assumption Summary

Figure 3:

Resources (\$ in Millions)	FY22 Adopted	FY23 Assumption	% Change
1 Sales Tax and TDA Revenues ⁽¹⁾	\$ 3,892.5	\$ 4,643.1	19.3%
2 CRRSAA/ARPA ⁽²⁾	776.4	1,097.0	41.3%
3 Subtotal Resources	\$ 4,668.9	\$ 5,740.1	22.9%
4 Toll, Advertising and Other	179.9	TBD	
5 Passenger Fares ⁽³⁾	73.2	TBD	
6 STA and SB1 Revenues ⁽⁴⁾	127.8	TBD	
7 Grant Resources ⁽⁴⁾	1,330.4	TBD	
8 Bond Proceeds and Prior Year Carryover ⁽⁴⁾	1,660.1	TBD	
9 Total Resources	\$ 8,040.2		

Note: Totals may not add due to roundings.

⁽¹⁾ Sales Tax (Propositions A, C, Measures R and M) and TDA Revenues reflect current year revenues only. The Percentage Change of 19.3% compares the FY23 Assumption of \$1.03 billion per ordinance to the FY22 Adopted of \$865 million per ordinance. The Percentage Change between the FY23 Assumption and the FY22 Reforecast of \$995 million per ordinance as indicated in Figure 1 is 3.7%. Any (estimated) prior year carryover amounts are reflected on line 8 and will continue to be revised throughout the remainder of the annual budget process.

⁽²⁾ Metro received \$776.4 million from the Federal Coronavirus Response and Relief Supplemental Appropriations (CRRSA) Act in FY22 and \$1.097 billion from the Federal ARPA in FY23.

⁽³⁾ Passenger fares are assumed to grow as transit ridership continues to increase with the opening of schools, businesses and resumption of fare collection. FY23 revenue projection is still under development.

⁽⁴⁾ The estimates for FY23 STA/SB1, Grants and Bond Proceeds and Prior Year Carryover will be updated when information becomes available.

Cost Inflation Indicator as in Consumer Price Index (CPI) and Other Expense Change Factors

On the expense side, Metro program cost and cash flow requirements are impacted by cost inflation, existing labor contracts and program guidelines. The most common indicator of cost inflation is the CPI as published by the Bureau of Labor Statistics. Accurate sales tax revenues and CPI projections

are important to provide a sound revenue and expenditure budget plan.

Historical trends, recent year’s high inflation, and leading regional forecasts are taken into account when estimating cost inflation. The economic factors that most impact CPI include employment, wages, prices of goods, interest rates, and consumer confidence. Tight labor market, rising demand for consumer goods, low interest rate, and supply chain disruptions continue to push prices up to the highest in more than three decades in FY22. To tackle the uncomfortably high inflation, the Federal Reserve projects multiple interest rate hikes in 2022 and 2023. CPI rate is therefore expected to increase less drastically at 3.3% in FY23 (Figure 4). We will continue to monitor CPI trends and updates from the economic forecasts as we go through the budget process.

Figure 4:

Annual Change in Consumer Price Index (CPI)

Forecast Source	FY17	FY18	FY19	FY20	FY21	FY22	FY23
1 Actual	2.10%	3.48%	3.40%	2.48%	2.30%	5.12% ⁽¹⁾	
2 Metro	1.85%	1.75%	2.25%	2.28%	2.30%	2.00%	3.30% ⁽²⁾
3 UCLA	2.70%	2.78%	2.42%	2.60%	2.19%	1.68%	3.78%
4 Beacon Economics	1.98%	2.00%	2.15%	1.83%	2.30%	2.07%	3.86%

(1) Reforecasted figure. FY22 Adopted Budget is 2%.

(2) FY23 Assumption.

Other Expense Assumptions

Wages and Benefits

Metro's labor and fringe benefit costs will adhere to the respective collective bargaining agreements (CBA). AFSCME, ATU, TCU, and Teamsters represented employees have valid CBAs applicable to FY23 Budget. Collective bargaining for a new contract to begin in FY23 for SMART represented employees is in progress.

Escalated Cost in Project and Service Deliveries in FY23

In November of 2021, the U.S. economy experienced the highest Consumer Price Index (CPI) increase since 1982. As the report described earlier, CPI directly impacts employment, wages, prices of goods, interest rates, and consumer confidence. Tight labor market, rising demand for goods, and supply chain disruptions continue to push prices in delivery of Metro services and projects higher than the historical average.

In addition to higher cost in delivery existing service and programs, Metro is planning to carry out Board adopted motions and is anticipating operations of two new rail lines in FY23, Crenshaw and Regional Connector. The added services will strain Metro operations, workforce and financial resources further than before. These challenges and the uncertainty caused by the on-going

pandemic have specific financial implications to the available funding for FY23. The trade offs for each program and transit services will be thoroughly reviewed in the monthly reports in the upcoming budget development.

Budget Process and Schedule

Facing the still uncertain outcome of the pandemic, uplifting but yet undefined Federal and State Grants, and the changing travel patterns and transit needs in the pandemic, the CEO has directed staff to thoroughly evaluate every part of Metro's budget. Under her new leadership, CEO is reshaping the budget process with a comprehensive review of Metro's deliverables and activities, initiating FY23 Equitable Zero-Based Budget (EZBB) process. EZBB is a new budgeting development process and cost control tool that applies an equity lens to develop a fiscally responsible budget to serve as a driving force that recenters Metro to its core focuses. The FY23 EZBB will continue Metro's core missions to improve transit services, keep transit assets in a state of good repair, fund and plan for regional transportation programs and construct transit/transportation infrastructure according to voter approved sales tax ordinances, State and Federal regulations, Board approved policies and guidelines.

The FY23 EZBB process begins with evaluating everything we do, providing flexibility to focus resources on Metro's core missions, key initiatives, and priorities. This strengthens the decision-making process when considering the forecasted resources available for the upcoming year based on the current economic environment, past historical performance, and projections from leading economic organizations. The CEO will be leading the Cabinet team to work collaboratively across the Agency to:

1. Evaluate and build the budget through several workshops
2. Align on the core focuses for FY23
3. Build consensus and alignment on key priorities

The team will also be undergoing a deep dive on cost evaluation through several task force creations. There are also efforts underway to engage all employees by submitting cost savings ideas for FY23 Budget consideration. Equity is also a top priority in these budget discussions as Metro considers how to carry out these initiatives and the impact on communities. With a focus on efficiencies and spending for a lasting sustainable growth in mind, the CEO has implemented a plan to move toward a proposed FY23 EZBB recommendation while developing accountability for cost control. Meanwhile, staff will provide regular updates to the Board, engage the public to ensure transparency of the budget in progress, and integrate the feedback to the FY23 EZBB before proceeding to the Board for final approval.

Below is a summary of the schedule of topics to be presented over the next few months, culminating in final Board Adoption in May.

Month	Topic
February	Budget Development Parameters: <ul style="list-style-type: none"> • EZBB Development Process and Schedule • Public Outreach Plan • Sales Tax Forecast, Resources Assumption • Cost Inflation Estimate • Other Expense Assumptions
March	Infrastructure Planning and Construction: <ul style="list-style-type: none"> • Transit Rail and Bus • Highway • Regional Rail • Subsidy Funding • Potential Trade Offs
April	<ul style="list-style-type: none"> • Metro Transit – Operations & Maintenance and State of Good Repair • Other Operating Programs • Potential Trade Offs
May	Public Hearing and Board Adoption: <ul style="list-style-type: none"> • Consolidated Agency-wide Expenses and FTEs Budget Proposal • Proposed Budget Book published on May 3, 2022 • Public Hearing on May 18, 2022 • Summary of Public Comment and Stakeholder Review • Final Board Adoption on May 26, 2022

Early and Expanded Public Engagement

Engaging our customers, key stakeholders and the public through an equitable, transparent, and comprehensive process is vital to fulfilling Metro’s vision and mission. This year’s budget outreach expanded our efforts to engage and inform customers, key stakeholders, and the public much earlier, immediately after the budget adoption of current fiscal year in September, 2021. The comments and survey results are sent to Metro staff and departments as part of the consideration to develop the FY23 Budget. With our goal of continuously improving the budget outreach process, below is a list of engagement and outreach efforts that have been accomplished in addition to those that will be conducted to continue to show how listening and learning from our customers, key stakeholders, and the public is an integral part of the budget development process.

Telephone Town Hall Meetings

At the thoughtful direction of CEO, Stephanie Wiggins, we took the extra step to engage early and hosted listening and learning sessions by conducting Telephone Hall Meetings in the fall of 2021. CEO Stephanie Wiggins, Metro Board Chair, Hilda Solis, Board Member, Katherine Barger, and the Senior Leadership Team members hosted two Telephone Town Hall meetings. The public was invited to attend to have their questions answered about the budget and Metro services. Valuable

input was received from the callers that will provide guidance towards a draft budget and will help influence how Metro will use public funds when developing the FY23 Budget. Callers provided comments pertaining to service and safety on the bus and rail system.

New Budget Survey

In a collaborative effort from a working group comprised of staff from the Office of Equity and Race, Communications, Customer Experience, and OMB, a new survey was developed and launched in early January 2022 with the goal of engaging customer and key stakeholders early in the budget development process. With this, the aim is to enhance budget outreach and education so that the Agency's budget reflects the priorities and values of riders and key stakeholders. Results from the survey will be shared with Metro departments for consideration in the development of the FY23 Budget.

Stakeholder Meetings and Outreach Efforts

Listening and learning will be paramount as we continue to conduct our public outreach for the FY23 Budget. Outreach will include tools and technologies to effectively reach our customers, represented employee union groups, Public Safety Advisory Committee (PSAC), Board appointed subcommittees, stakeholders, public interest groups and the general public. They will be provided opportunities to engage and provide feedback through public meetings, the public hearing, one-on-one meetings, the budget survey, and email. Schedules and information for public meetings and updated budget information will be provided in advance on the Finance and Budget portal at www.metrobudget.net. This early planning will accommodate people with disabilities and provide language interpretation. The FY23 Budget development process will also be advertised through multiple modes, including e-blasts, social media campaigns, traditional advertising, and advertisements aboard Metro vehicles to reach all Los Angeles County residents. See Attachment A for a list of the public forums and media channels that will be utilized.

All public meetings and budget briefings will continue to be conducted via a virtual platform in accordance with established safety guidelines that follow social distancing rules.

DETERMINATION OF SAFETY IMPACT

This recommendation will not have an impact on safety standards at Metro.

FINANCIAL IMPACT

The assumptions described above are the budget planning parameters and will guide the development of the FY23 Budget. They may be adjusted as more specific and updated information becomes available.

EQUITY PLATFORM

The FY23 EZBB process begins with evaluating everything we do by providing flexibility to focus resources on Metro's core missions, key initiatives, and priorities. Equity is also a top priority in these budget discussions as Metro considers how to carry out the many initiatives and the impact on communities. Applying an equity lens to Metro's FY23 Budget for programs, projects and initiatives means to look at all aspects of the budget. Furthermore, the FY23 Budget will align with principles that highlight how public transit can be equitable, sustainable, economically productive, safe, and accessible.

Additionally, the Metro Budget Equity Assessment Tool (MBEAT) has been incorporated in the development of the FY23 Annual Budget. Implementation of MBEAT will assess all FY23 budgetary requests for impacts to marginalized and/or vulnerable communities, help staff identify potential barriers or harms to address, and help staff consider how Metro budgets influence marginalized communities' access to opportunities and reduce potential barriers or harms. Furthermore, the annual budget is developed through a comprehensive process and supports pillars two (Listen and Learn) and three (Focus and Deliver) of the agency's Equity Platform framework.

IMPLEMENTATION OF STRATEGIC PLAN GOALS

Recommendation supports the following Metro Strategic Plan Goal:

Goal # 5: Provide responsive, accountable, and trustworthy governance within the Metro Organization.

ALTERNATIVES CONSIDERED

The annual budget serves as the legal authority to obligate and spend funds. Failure to adopt the budget would severely impact Metro's stated goal of improving transportation in Los Angeles County.

NEXT STEPS

As described earlier in this report, Metro staff will provide regular Budget briefings to Board members and their staff starting this month. Further, we will provide receive-and-file reports on a monthly basis, as previously detailed.

ATTACHMENTS

Attachment A - Federal Stimulus Relief Funding Update

Attachment B - Public Engagement and Outreach Forums

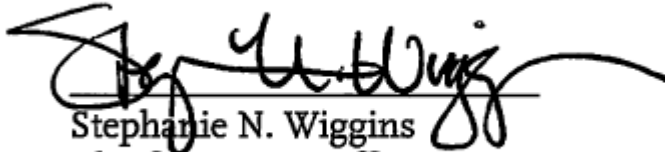
Prepared by: Jessica Lai, Director of Budget, (213) 922-3644

Timothy Mengle, Deputy Executive Officer of Finance, (213) 922-7665

Perry Blake, Senior Executive Officer of Finance, (213) 922-6171

Office of Management & Budget (OMB) Staff

Reviewed by: Nalini Ahuja, Chief Financial Officer, (213) 922-3088



Stephanie N. Wiggins
Chief Executive Officer