Los Angeles County
Metropolitan Transportation
Authority
One Gateway Plaza
3rd Floor Board Room
Los Angeles, CA

File #: 2024-0023, **File Type:** Informational Report **Agenda Number:** 8.

FINANCE, BUDGET, AND AUDIT COMMITTEE
FEBRUARY 14, 2024

SUBJECT: FISCAL YEAR 2025 BUDGET DEVELOPMENT STATUS UPDATE

ACTION: RECEIVE AND FILE

RECOMMENDATION

RECEIVE AND FILE the Fiscal Year 2025 (FY25) Budget Development Status Update.

ISSUE

This continues the monthly updates to the Board on the FY25 Budget development process. This report sets up the economic context for the upcoming fiscal year with the forecast of sales tax revenues and other resources, cost inflation, and other financial risks. 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.

Metro will focus on aligning to a common set of strategic imperatives and priorities, working collaboratively across their respective departments to maximize funding availability by program.

BACKGROUND

Revenues set the framework for what we are working with for FY25. Metro's primary revenue source is sales tax, and current economic conditions are signaling slowing sales tax growth in the upcoming fiscal year. Federal stimulus funding from the last few years has helped Metro's resources by stimulating consumer spending and providing essential funding for transit operations. However, those funds have now been exhausted.

The first step of the FY25 Equitable Zero-Based Budget (EZBB) process is to establish the assumptions surrounding sales tax, operating and other revenues, grant reimbursement, bond proceeds, as well as prior year carryover. These assumptions help gauge the FY25 funds available for eligible projects and programs.

DISCUSSION

Metro is committed to maximizing the use of revenues for all programs, based on each of the ordinances that govern the eligibility and use of funds. However, the most critical step is to develop accurate projections of sales tax revenues.

Sales Tax Revenues

Sales taxes are the primary source of revenues for Metro representing close to two-thirds of the total annual resources. Metro's local sales tax ordinances (Proposition A, Proposition C, Measure R, and Measure M) have voter approved directives on how each sub-fund should be spent, which determines the funding available for programs. Metro utilizes multiple modeling approaches and sources to estimate sales tax revenues.

Economic Sector Model

During the pandemic, Metro staff developed an economic sector model to isolate and evaluate the local sales tax impacts of changes in specific sectors of the economy. A list of the sector breakdowns is given in Attachment A. Post-pandemic, this model has continued to prove valuable in refining the agency's annual budget projections. The FY25 sales tax revenue projection assumptions considered the following external factors:

- The region's economic growth slowed significantly over the past year and faces growing headwinds from continued high interest rates, office vacancies, housing costs and a slowdown in logistics.
- Consumer spending has slowed as a result, with year-over-year sales tax revenues flat since January 2023.
- Online sales continue to eat away at brick-and-mortar retail.
- Spending on services and housing continues to grow faster than taxable retail sales.
- Increases in consumer debt and delinquencies will be a drag on growth in the near term.
- Gasoline and other fuel prices have a larger impact on taxable sales than the transition to EVs. They have been trending down on a year-over-year basis but are notoriously volatile and influenced by a wide variety of factors.
- FY25 cost inflation, as measured by the Consumer Price Index (CPI), is expected to slow down but remains above the Fed's 2% target as mitigating efforts of the Federal Reserve continue.

Multiple Regression Model

Metro staff also developed a statistical multiple regression analysis model to validate the business sector model results. This regression model determines the correlations between sales tax revenues and other independent variables such as unemployment rate, CPI, and personal income in Los Angeles County, and derives a formula using historical data to make future projections.

Trend Analysis

Trend analysis is also used to develop projections, which evaluates long and short-term historical receipts. These trends are compared to professional forecasting agencies (UCLA Anderson, Muni Services and Beacon Economics) to ensure projections are within range. Historical trend analysis indicates that the average ten-year nominal sales tax growth of 5.1% was primarily due to inflation, while the average real growth was 2.1%. See Attachment A.

Forecasting Results

These models and trend analysis indicate a slow or flat growth in sales tax in the upcoming fiscal year, projected at 2.0%.

FY24 Sales Tax Update

Metro monitors actual monthly sales tax receipts from the California Department of Tax and Fee Administration (CDTFA) and the first quarter actual receipts for FY24 are below budget. The FY24 year-end receipts are projected to be $1,133.0 million per ordinance, rather than $1,200.0 million, 5.6% below budget.

Preliminary FY25 Sales Tax Assumption

Sales tax is projected to be $1,156.0 million per ordinance, an increase of 2.0% over the FY24 reforecast of $1,122.0 million. This conservative increase is based on the forecast modeling that indicated a slow and flattened growth in the next year. Figure 1 displays Metro's historical sales tax revenue actuals and latest projections for FY24 and FY25.

Figure 1:

	($ in Millions)	FY22 Actual	FY23 Actual	FY24 Reforecast	FY25 Preliminary
1	Sales Tax Revenue per Ordinance(1)	$ 1,091.5	$ 1,111.5	$ 1,133.0	$ 1,156.0
2	% Change	19.7%	1.8%	1.9%	2.0%

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

Figure 2 compares Metro's historical and current budget estimates to actual receipts and leading regional forecasts. FY25 sales tax revenue projections from UCLA, Beacon Economics and Muni Services are between $1,011.0 million to $1,203.3 million per ordinance, and Metro's preliminary assumption of $1,156.0 million falls within range.

Figure 2:

Sales Tax Revenue per Ordinance Forecast Comparison

($ in Millions)

Forecast Source	FY19	FY20	FY21	FY22	FY23	FY24 Reforecast	FY25 Preliminary
Actual	$ 846.8	$ 824.7	$ 911.7	$ 1,091.5	$ 1,111.5	$ 1,133.0 [1]	
Metro- Adopted	844.0	873.0	778.1	865.0	1,031.8	1,200.0	1,156.0 [2]
UCLA	863.6	838.1	770.2	794.4	1,058.1	1,103.8	1,144.4
Beacon Economics	835.4	843.5	892.3	896.7	1,013.4	1,091.7 - 1,232.4	1,011.0 - 1,082.2
Muni Services	827.7	868.1	737.3	881.7	1,017.1	1,145.1	1,099.7 - 1,203.3

(1) FY24 sales tax revenues per ordinance Reforecast as shown in Figure 2.

(2) FY25 preliminary assumption.

Other Resources

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 FY25 preliminary assumption of $236.9 million will be revised at the end of February 2024 to reflect the State Controller’s Office (SCO) FY25 allocations.

STA funding is partly apportioned by revenue share (qualifying revenues reported by transit agencies) across the state. The use of federal stimulus funding over the last few years to support transit operations may impact STA apportionments, as these are not qualifying revenues. Apportionments will be dependent on the use of federal stimulus funding throughout the state and the revised estimates that factor in the qualifying revenues will be available in August, after budget adoption.

Passenger Fares

Anticipated increased usage of public transit by Angelenos can be attributed to improved and expanded service, enhanced connectivity, improved safety, cleanliness, availability and reliability of bus and rail service. The addition of the Airport Metro Connector station through the K Line (Crenshaw/LAX) is anticipated to positively impact ridership and connectivity within the rail system.

Currently, boardings are increasing, but fares may not increase commensurate to the number of boardings because of the following factors:

- Fare capping - Limits the amount a rider pays each day and each week, resulting in free rides after the cap is reached.
- Fare policy - The newly adopted fare policy lowered fares for riders.
- GoPass - A K-14 pilot program that offers unlimited free rides to students.
- Low Income Fare is Easy (LIFE) Program - Expanded program for low-income riders that offers free 20 trips each month and free 90-day passes for new enrollees.
- Other economic conditions (employment, disposal income, telecommuting policies) may

impact overall ridership.

FY24 year-to-date revenues are meeting budget projections and year-end boardings are projected to exceed budget by over 14%. Given the implementation of fare capping in July 2023 and the various programs in place, the preliminary fare revenue projections will be based on the six months of data we have collected to date. Fare per boarding and projected ridership will be used to estimate fare revenues.

The fare revenue projection is still under development as staff works to finalize the analysis based on further evaluation of ridership growth, fare capping impacts, and Metro Micro changes. Assuming a 5% increase in ridership over estimated year-end actuals, preliminary projections of passenger fares for FY25 are estimated at $172.5 million.

Advertising

The overall FY25 advertising revenue from bus and rail is expected at $27.2 million which is based on the adjusted minimum annual guarantee (MAG) payments from the new advertising contract modifications approved by the board in March 2023. Metro staff successfully renegotiated permanent and final contract terms to ensure the viability of the advertising program and preserve long-term revenue sources. The new and approved contract terms focus on right-sizing revenue estimates based on lingering negative impact of COVID-19 including loss of advertisers, vandalism to digital and static advertising equipment, and digital screen procurement delays. When revenues exceed the MAG estimates, an annual true-up revenue share is activated resulting in additional end of the year revenues to Metro.

The estimate for corporate sponsorship revenue is unknown at this time and will be updated when information becomes available. Metro staff continue to explore opportunities to increase advertising revenues including policy changes to expand and expedite revenue business, consider longer sponsorship terms, and monetize new assets and services as they reach revenue operations.

Toll and Other

Toll revenues are projected to be $81.7 million in FY25 which include ExpressLanes usage and violation fees from the existing I-10, I-110. Other revenues include bike program, Union Station, park and ride, lease, film, Service Authority Freeway Emergencies (SAFE), auto registration fees, transit court fees, federal Compressed Natural Gas (CNG) tax credit for calendar year 2024, Low Carbon Fuel Standard (LCFS) credit sales, investment income, and other miscellaneous revenues are anticipated at a total of $85.8 million in FY25.

Grant Resources

The FY25 projection for grant revenues is still being developed and will be finalized at a later point in the budget development process. Local, state and federal grant resources are used to support Metro's transit planning, operating, State of Good Repair and construction activities. Federal grants include Federal Transit Administration (FTA) formula grants, Capital Investment grants for new construction and a variety of discretionary grant programs.

State grants include the Transportation Development Act (TDA), State Transit Assistance (STA), State of Good Repair and other discretionary grants funded through Senate Bill 1 (SB1). Senate Bill 125 (SB125) amended the 2023 Budget Act to provide new funding through the Transit and Intercity Rail (TIRCP) program and a new Zero-emission Bus (ZEB) program.

Looking ahead the grant funding environment is likely to get tighter and more competitive in FY25 and beyond. Growing deficits at the federal level and election-year politics will increase the uncertainty of future federal funding. The state's sudden reversal of economic fortunes casts a shadow over future funding levels of many state grant programs.

Metro staff continue to aggressively pursue discretionary grant opportunities at both the state and federal levels. Metro's significant local funding can be used as matching funds to leverage our local commitment to continue providing safe and efficient transit service and maintain momentum on the Measure R and M programs.

Bond Proceeds and Prior Year Carryover

Debt issuance is authorized by applicable federal and state legislation and local sales tax ordinances. The Board-adopted Debt Policy establishes parameters for the issuance and management of 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 FY24, $764.2 million of debt proceeds and prior year carryover are available for transit expansion, highway, State of Good Repair and Transit Improvement/Modernization projects. The debt and carryover amounts for FY25 will be determined at a later stage as we finalize the FY25 expense budget and are subject to CEO approval.

Resource Assumption Summary

Refer to Figure 3 below, sales tax and TDA revenues are projected to increase conservatively at 2.0%. Line 6 represents a total increase of 2.9% in overall resources excluding grant resources, bond proceeds and prior year carryover.

Figure 3:

	Resources ($ in Millions)	FY24 Reforecast	FY25 Assumption	% Change
1	Sales Tax and TDA Revenues [(1)]	$ 5,098.5	$ 5,202.0	2.0%
2	STA and SB1 Revenues [(2)]	214.6	236.9	10.4%
3	Passenger Fares [(3)]	146.8	172.5	17.5%
4	Advertising [(4)]	27.7	27.2	-1.6%
5	Toll and Other [(5)]	156.3	167.5	7.1%
6	**Subtotal Resources**	**$ 5,643.9**	**$ 5,806.1**	**2.9%**
7	Grant Resources [(6)]	2,338.9	TBD	
8	Bond Proceeds and Prior Year Carryover [(6)]	764.2	TBD	
9	**Total Resources**	**$ 8,747.1**	**TBD**	

Note: Totals may not add due to roundings.

[(1)] Sales Tax (Proposition A, C, Measure R and M) and TDA Revenues reflect current year revenues only. The Percentage Change of 2.0% compares the FY25 Assumption of $1.15 billion per ordinance to the FY24 Reforecast of $1.13 billion per ordinance. Any (estimated) prior year carryover amounts are reflected on line 8 and will continue to be revised throughout

[(2)] Preliminary STA and SB1 FY25 projections are based on State Controller's Office (SCO) January estimates for FY24 allocations and will be revised around mid-February 2024 to reflect the SCO FY25 estimates.

[(3)] Fare revenue is projected at $172.5 million, a 17.5% increase over the FY24 Budget. This includes a preliminary estimate for TAP card fee revenues of $2.5 million.

[(4)] Bus and Rail Advertising revenue is projected at $27.2 million. The adjusted minimum annual guarantee (MAG) is based on contract modifications from COVID negative impact on system ad sales which was approved by Metro board in March 2023 (#2023-0074).

[(5)] Toll and Other FY25 revenue estimates are projected at $167.5 million, a 7.1% increase from the FY24 Reforecast of $156.3 million primarily due to increased ExpressLanes toll revenues, which offsets the decrease in federal CNG tax credits for calendar year 2024.

[(6)] The estimates for FY25 Grants, Bond Proceeds and Prior Year Carryover will be updated when information becomes available.

Consumer Inflation and Other Financial Risks

Cost Inflation Indicator - Consumer Price Index (CPI)

On the expense side, Metro program cost and cash flow requirements are impacted by cost inflation, labor contracts agreements 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 years' high inflation, and leading regional forecasts are taken into consideration when estimating cost inflation. In its December 2023 policy meeting, the Federal Reserve indicated that inflation is still elevated but has been cooling faster than initially anticipated and is expected to reduce further in 2024 and 2025. FY25 CPI growth is therefore expected to slow and settle in between UCLA and Beacon Economics' projections at 3.0% in FY25 (Figure 4). Metro staff 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	FY19	FY20	FY21	FY22	FY23	FY24 Reforecast	FY25 Preliminary
1	**Actual**	3.40%	2.48%	1.98%	6.54%	5.43%	2.15% [1]	
2	**Metro**	2.25%	2.28%	2.30%	2.00%	3.30%	3.71%	3.00% [2]
3	**UCLA**	2.42%	2.60%	2.19%	1.68%	3.78%	3.71%	3.82%
4	**Beacon Economics**	2.15%	1.83%	2.30%	2.07%	3.86%	2.36%	2.32%

[1] Reforecasted figure based on FY24 YTD actual. FY24 Adopted Budget is 3.71%.

[2] FY25 preliminary assumption.

Other Financial Risks

One fiscal challenge that Metro faces is slowing growth in sales tax revenues. Los Angeles County is trailing other Southern California counties such as Riverside and Orange Counties in terms of sales tax growth. Out-migration leads to countywide population decline and Los Angeles County could lose up to 74,000 residents in 2024 and 2025 combined according to recent data from the State of California Department of Finance. High inflation also erodes consumers’ purchasing power while high housing costs reduce their disposable income.

Discontinuation of the federal stimulus funds and uncertainty over grant funding are other concerns that Metro faces. Grant availability is dependent on the financial status of the government entities. The federal budget deficit totaled $510 billion in the first quarter of fiscal year 2024 and could end with an annual deficit of just more than $2 trillion if the current trend continues. The state government also anticipates a deficit of $38 billion in the year to come.

These challenges, combined with higher interest rates and higher borrowing costs for Metro’s capital projects, have specific financial implications to the available funding for FY25.

Outreach & Engagement Activities Update

Metro is committed to engaging customers and stakeholders in a meaningful and inclusive way. Recognizing that the budget development process is a critical opportunity for engagement, Metro aims to involve all stakeholders in the planning and decision-making process.

Equity Focus Communities Outreach

Equity Focus Communities (EFC) continue to be prioritized across all the budget outreach efforts Metro hosts. The goal is to create an open and transparent dialogue with customers and stakeholders (of all demographics), and Metro will continue to work closely to ensure the FY25 Budget reflects the priorities and needs of Los Angeles County.

<u>Outreach Platforms</u>

The development process for the FY25 Budget will persist in its promotion through various channels, encompassing the "My Metro Budget" activity, Telephone Town Hall, budget portal, e-blasts, social media campaigns, EFC oriented marketing, the distribution of business and post cards with quick response (QR) codes at stations by Metro station staff, Metro groups, and students, all aimed at informing every resident of Los Angeles County about Metro's budget.

<u>Public Comments</u>

The comments are being systematically collected from these methods while being maintained in a database. Furthermore, they are analyzed by the Office of Management & Budget (OMB) and distributed to the appropriate department for their further analysis via an interactive and filterable dashboard. The findings of the departments are then reported back to OMB and the insights gained are used to impact the FY25 budget.

Included in Attachment B are the multiple communication mechanisms Metro is utilizing to expand its reach.

DETERMINATION OF SAFETY IMPACT

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

EQUITY PLATFORM

Metro is committed to budgeting for equity as it strengthens its commitment to advancing equity through the distribution and implementation of equitable services and investments. OMB uses the Metro Budget Equity Assessment Tool (MBEAT) and EFC Budget Assessment as combined assessments for the annual budgeting process. The evaluation of the budget provides flexibility to focus resources on Metro's core missions, key initiatives, and priorities. MBEAT will also assess equity impacts that will identify access to opportunities and reduce potential barriers or harms. Applying an equity lens to Metro's FY25 Budget for programs, projects and initiatives means to integrate explicit consideration of racial and economic equity into the budget. Furthermore, it incorporates two of the four pillars of the equity principles, specifically "Listen and Learn" and "Focus and Deliver."

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.

NEXT STEPS

With the slow growth in sales tax revenues, the uncertainty of the availability of grant funding and risks associated with other resources, total funds available for FY25 are projected to increase nominally. The major cost drivers are outpacing the growth in revenues and Metro will focus on cost mitigation efforts through the EZBB process as program budgets are developed. These efforts will include:

- Evaluating the external environment and economic factors (controllable and non-controllable).
- Breaking down cost drivers by urgency, root cause and creating tailored made cost mitigation plans.
- Instilling a priority driven zero based review based on milestone achievements and program/project performance.
- Maximizing funding for Transit Operations and Capital Programs.

Next month's FY25 Budget process update will address Transit Infrastructure, Multimodal Highway Investments, Regional Rail, as well as Regional Allocations and Pass-Throughs.

ATTACHMENTS

Attachment A - Economic Sector Model & Sales Tax Growth Trend Analysis
Attachment B - FY25 Proposed Budget - Public Engagement and Outreach Forums

Prepared by: Jessica Lai, Senior Director Finance, (213) 922-3644
Linda Wang, Senior Director Finance, (213) 922-2464
Timothy Mengle, Executive Officer Finance, (213) 922-7665
Michelle Navarro, Sr. Executive Officer Finance, (213) 922-3056

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

Stephanie N. Wiggins
Chief Executive Officer