To: Chairman Skinner and the VRE Operations Board  
From: Doug Allen  
Date: September 16, 2016  
Re: Referral of Preliminary FY 2018 VRE Operating and Capital Budget to the Commissions

Recommendation:

The VRE Operations Board is asked to authorize the Chief Executive Officer to refer the Preliminary FY 2018 VRE Operating and Capital Budget to the Commissions for their consideration, so the Commissions, in turn, can refer these recommendations to the jurisdictions for their review and comment.

Background:

In accordance with the VRE Master Agreement, which outlines the process for annual budget approval, the preliminary FY 2018 VRE Operating and Capital Budget is attached for review. The Budget Key Issues considered by the Operations Board in July are also provided as an attachment. Since July, VRE staff has met with the CAO Taskforce to discuss jurisdictional budget issues and concerns and to review current VRE budget projections.

During the last year, a Financial Plan was developed to forecast the cost of current operations and various growth scenarios through FY 2040, the period covered by the VRE System Plan. The Financial Plan established that even to maintain the current level of service, VRE requires substantial operating and capital funding that cannot be met with currently identified funding sources. The chart below shows the average annual need if
VRE were to maintain service, enhance the system capacity to meet the future growth in the region, or implement the full System Plan.

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Average Annual Operating Gap</th>
<th>Average Annual Capital Gap</th>
<th>Total Average Annual Gap</th>
</tr>
</thead>
<tbody>
<tr>
<td>Steady State</td>
<td>21.2M</td>
<td>20.5M</td>
<td>41.7M</td>
</tr>
<tr>
<td>Natural Growth</td>
<td>9.7M</td>
<td>34.8M</td>
<td>44.5M</td>
</tr>
<tr>
<td>System Plan 2040</td>
<td>14.3M</td>
<td>52.1M</td>
<td>66.4M</td>
</tr>
</tbody>
</table>

These funding gaps over a long term horizon are also apparent in the preliminary FY 2018 operating and capital budgets and the FY 2018 – FY 2023 six-year forecast and CIP.

The Financial Plan forecast is being used to inform efforts to develop new sources of operating and capital funding. During FY 2017, the Commonwealth Transportation Board will review the forecast and report back to the General Assembly.

VRE’s *Financial and Debt Principles* addresses the prioritization of projects within the Capital Improvement Program and states:

*Projects included in VRE’s Capital Improvement Program will be prioritized with emphasis on regulatory requirements, the maintenance of equipment and facilities to support current service levels, and provisions for passenger safety.*

In addition to these first level priorities, the CIP decision-making emphasizes the commitment to ensure the development of the railroad infrastructure in the CSXT territory; project readiness; funding availability; and the identification of funding to complete projects with some but not total funding.

During the FY 2018 budget year, VRE will operate 34 daily trains and continue our safety and customer service outreach programs. Five expansion railcars will be in service at the beginning of the fiscal year and some or all of an additional nine rail cars will be received during the year.

The major budget issues for FY 2018 are adequate and timely funding of the replacement facility for mid-day storage of rolling stock equipment, while also advancing other crucial projects, and meeting required and necessary increases to operating expenses.

**Discussion:**

The FY 2018 preliminary budget totals $137.2 million. The budget includes a 3% fare increase with no subsidy increase and has a current net unfunded amount of $4.39M. As in the past, VRE will submit a balanced budget to the jurisdictions in the beginning of December for evaluation prior to submission to the Operations Board later that month.
Both revenue and expenses are still under review and these projections could change considerably over the next several months. The assumptions used in preparing the preliminary draft are as follows:

1. **Fare revenue:** Fare revenue is budgeted at $38.9 million with a 3% fare increase. The last fare increase of 4% occurred at the beginning of FY 2016. Ridership is estimated at 18,000 Average Daily Riders (ADR) with service at the current budgeted level of 34 daily trains (32 revenue trains). ADR in FY 2016 was 17,767. Current and projected ridership trends, combined with operating cost increases, raise concerns about attaining the required 50% fare ratio. We will continue to review and monitor as we proceed through the budget process.

2. **Jurisdictional subsidy:** The subsidy is currently budgeted at $17.25 million, with no increase from FY 2017. The last subsidy increase was 5% in FY 2017.

3. **Federal funds:** The FY 2018 preliminary budget is based on the most recent funding level of $29M, an increase from the FY 2016 budgeted amount of $27M.

4. **State operating funds:** Commonwealth operating assistance of $10.5 million was received in FY 2017. The FY 2018 preliminary budget is based on $10.0 million.

5. **State capital funds:** For the last several years, Commonwealth capital funding has been projected at either: a) 16% of the total project cost, when used as match to 80% federal funding; or b) one of the three funding tiers of 68%, 34% or 17% of gross project costs, regardless of the amounts of federal funding assigned to the project. However, in their most recent Six-Year Plan the State projected a decrease to these percentages beginning in FY 2018 and decreasing even more substantially in FY 2019 and FY 2020. The preliminary budget for FY 2017 is based on current levels, although this will be further evaluated during the course of the budget cycle. The most significant impacts of a decrease would be: delays in funding the midday storage project, which is currently relying on 34% State funds; and considerable decreases in the amount of funding for access fees and match funds for the equipment asset management program.

6. **Access fee funding:** Since FY 2015, DRPT has allowed VRE to apply for multiyear agreements for track access fee reimbursement. For FY 2018, reimbursements are currently being estimated at a level similar to FY 2017, with an 84% combined rate for both federal STP funds allocated through the state and a state capital match. Both Norfolk Southern and Amtrak access costs remain under existing multi-year agreements. CSX access fees will be paid under a new five year agreement beginning in FY 2018; VRE will request that the State continue to fund CSX access at the 84% rate, despite a possible decrease to the funding tiers as described above.

7. **Capital program:** Capital needs have been identified and prioritized and funding sources have been considered within the available federal formula funds and existing
allocations through CMAQ, NVTA regional funds or other sources. The multi-year CIP will also include needed projects for which funding has not yet been identified. The largest capital expense is $18.7M for the equipment storage project. An annual capital reserve contribution of $3 million is also included.

8. **Contractual increases:** The CSX access fees currently have an annual contractual increase of 4%. VRE is negotiating a new five year agreement to begin in FY 2018. Access fees paid to Norfolk Southern are based on changes to the AAR, a nationally published index of railroad costs, and increases to Amtrak access fees for FY 2018 will be based on a three year average of their annual costs, inflated to the budget year, and apportioned to all users of Washington Union Terminal. Norfolk Southern and Amtrak increases are budgeted at 4% in the preliminary budget. The bulk of the Keolis contract costs increase by the annual change to the CPI, currently budgeted at 3%. The actual AAR and CPI rates will be available prior to budget adoption.

9. **Fuel costs:** Fuel expenses of $4.9 million are budgeted based on a per gallon cost of $2.95.

10. **Legal costs:** Budgeted amounts for legal costs have been increased to reflect the actual costs in recent years due to procurement activities and other activities related to an active capital construction program.

11. **Staff changes:** The preliminary budget includes no additional staff for FY 2018. We will continue to review resource needs as we proceed through the budget process.

The major significant changes in the FY 2018 proposed budget compared to the adopted FY 2017 budget are as follows, including those issues discussed in more detail above:

**Revenue:**
- No increase in Jurisdictional Subsidy.
- $30K decrease in Fare Revenue due to the revised projected level of ridership and the budgeted 3% fare increase, as described above.
- $1.07M decrease in Other Sources, primarily capital reserve funded capital projects and one-time expenditures. Additional one-time funds will be included in future drafts of the FY 2018 budget, as appropriate.
- $2.3M decrease in grant funds for CMAQ and REF projects; these decreases are offset by a decrease in project costs.
- Increase of $2M to the budget for federal formula funds, as noted above.
- Increase of $1M to the $9M budgeted in FY 2017 for state operating assistance. (Actual amount received in FY 2017, as noted above, was $10.5M.)
Operating and capital expenses:

- $1.2M increase related to expected planning, development and project implementation needs.
- $200K increase for projected legal costs as noted earlier in this memorandum.
- $1.66M for contractual increases for train operations and maintenance, mid-day services and access fees.
- $854K increase in Facilities Maintenance, primarily for projected contractual custodial and snow removal cost increase.
- Increases of $194K in IT primarily for software maintenance and communication costs; and $168K primarily for increased ticket sales costs/commissions and credit card processing related to fare media purchases.
- Restoration of a 2% operating contingency, an increase from FY 2017 of $798K.
- The total capital budget is projected at $49.1 million.

Projects funded with federal formula funds include:
- $2.76M for facilities asset management
- $4.9M for equipment asset management
- $386.4K for replacement and addition of security cameras
- $18.7M for mid-day equipment storage
- $3.6M for additional Positive Train Control funding
- $5M for improvements at Washington Union Terminal
- $105K for security enhancements (a 5307 grant requirement) to be used for LED lighting improvements
- $3.0M annual contribution to the capital reserve

Projects funded primarily with other sources include:
- Broad Run parking improvements – CMAQ - $5.25M
- Brooke and Leeland second platforms – REF - $5.3M
- Rippon platform improvements – CMAQ - $0.8K

Fiscal Impact – FY 2018 Budget:

Additional draft budgets will be formulated during the fall and reviewed with the CAO Budget Task Force resulting in a balanced budget by December 2017.

Attached are the following:

- FY 2018 Key Budget Issues
- FY 2018 Sources and Use
- FY 2018 Summary Budget
Virginia Railway Express
Operations Board

Resolution
8A-09-2016

Referral of Preliminary FY 2018 VRE Operating and Capital Budget to the Commissions

WHEREAS, the VRE Master Agreement requires the VRE Operations Board submit to the Commissions a preliminary fiscal year budget by September 30 each year; and,

WHEREAS, the VRE Chief Executive Officer has provided the VRE Operations Board with the preliminary FY 2018 Operating and Capital Budget;

NOW, THEREFORE, BE IT RESOLVED THAT, the VRE Operations Board refers the preliminary FY 2018 Operating and Capital Budget to the Commissions for their consideration; and,

BE IT FURTHER RESOLVED THAT, the VRE Operations Board recommends the budget be forwarded to the jurisdictions for further formal review and comment; and,

BE IT FURTHER RESOLVED THAT, VRE staff is directed to consider and address comments by the jurisdictions and to forward a final recommended budget to the VRE Operations Board at the December 2016 meeting for consideration and referral to the Commissions for adoption in January 2017.

Approved this 16th day of September 2016.

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Gary Skinner
Chairman

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Maureen Caddigan
Secretary
Proposed FY 2018 Key Issues

The key issues described below apply to the development of the FY 2018 Budget and CIP and to the six-year financial plan, which provides a consolidated financial projection over a multi-year time frame.

**Key Issue #1: Level of service:** Some trains are currently at or over 100% capacity. Planned service improvements include the lengthening of peak trains as additional rail cars are received.

The addition of the Fredericksburg line train in FY 2016 was expected to minimize the overcrowding and the capacity issues at stations further up the line, and we continue to monitor this effect. Five rail cars were ordered in FY 2015 and an additional nine were ordered in FY 2016. These additional rail cars along with infrastructure improvements to stations and storage yards will allow for the lengthening of existing peak trains and provide an opportunity to convert two existing “deadhead” trains on the Manassas line to revenue service. No new trains are funded during the FY 2018 – FY 2023 time frame.

**Key Issue #2: Jurisdictional subsidy and fare increases:** The VRE service currently must be supported within the confines of jurisdictional budget constraints and a competitive and equitable fare structure. As noted above, the Financial Plan forecast was the first step in quantifying the need for additional ongoing dedicated funding sources to support both the operating and capital needs of the commuter rail service.

VRE has had three fare increases in the last six fiscal years (FY 2013, FY 2014 & FY 2016) in order to maintain the level of service without being excessive in cost to the rider. The FY 2017 six-year financial forecast projected a fare increase of 3% in FY 2018. This increase will be evaluated as the budget process continues, with consideration given to market factors, system funding needs, commuter benefit levels, comparison to relevant indices, and a preference for biennial increases.

The jurisdictional subsidy amount was increased by 5% in FY 2017 to approximately the total subsidy amount paid in FY 2009. The FY 2017 six-year financial forecast projected no change to the total subsidy amount in FY 2018, and a subsidy increase of 3% for FY 2019. With the decreased gasoline costs over the last two years, several of the jurisdictions who were exclusively relying on the fuel tax to pay the VRE subsidy are no longer able to do so.

**Key Issue #3: Maintenance and Replacement of VRE Assets:** As noted above, the maintenance of equipment and facilities to support current service levels is a priority in the VRE capital program. Federal formula funds devoted to maintaining transit assets in a “State of Good Repair” are expected to provide for these costs over the life-cycle of VRE’s assets. However, replacement of the fleet at the end of the expected useful life of the equipment will require additional funding mechanisms.
The federal priority of maintaining transit systems in a “State of Good Repair” has been continued in the Fixing America’s Surface Transportation (or FAST) Act, the current federal transportation authorization, and the funds to adequately maintain equipment and facilities will be available from this source. VRE’s ongoing transit asset management initiatives will be used to refine the costs that were included in the prior year budget and CIP for related projects.

Because VRE’s current fleet of railcars and locomotives were purchased during a compressed time period, the replacement of the fleet at the end of its useful life is projected to be needed during a five-year period beginning in FY 2030, at an estimated cost of approximately $450M. Although this need falls well beyond the projection period in the annual budget and CIP, this issue was highlighted in the longer-term Financial Plan forecast.

**Key Issue #4: Midday Storage:** The construction of alternate midday storage facilities will require a significant funding commitment over the next several years.

The current agreement with Amtrak includes provisions for Amtrak to reclaim VRE’s midday storage space at the Ivy City yard for their own use during the next several years. As a result, VRE must proceed expeditiously to replace the storage yard now used at Ivy City. Work done on the project thus far indicates that it will require a substantial portion of available federal formula funds over the term of the FY 2018 – FY 2023 CIP and may require the identification of other funding sources.

In addition to the replacement of the current storage tracks, VRE needs to increase midday train storage beyond what is currently available in order to provide for storage of all existing trains. This will be accomplished with the completion of storage tracks north and south of the L’Enfant station during FY 2017.

The new storage yard is expected to have the capacity to accommodate future growth as well as replace the current storage slots.

**Key Issue #5: Resources needed to implement the capital program:** Capital improvements needed to support the current level of VRE service, to increase railroad infrastructure capacity in the VRE service territory or to grow the system to meet future expected demand require the identification and commitment of funds beyond those currently available to VRE.

Each of the existing sources of capital funding that VRE relies on has inherent limitations. State capital funding is expected to drop off sharply in FY 2019 and FY 2020 when bond funding supporting the state matching percentage is no longer available. Federal funding has increased considerably over the last several years, but the limitations on the use of our major source of federal funds, the 5337 or State of Good Repair program, will further complicate our capital funding picture. NVTA regional funding continues to be available on a discretionary basis for certain VRE capital projects, but only for those located within the
NVTA jurisdictions, which has created an imbalance of funding sources within VRE. Local sources of funding are limited and must compete with other jurisdictional funding priorities.

**Key Issue #6: VRE staff level:** VRE needs the staff resources necessary to operate and administer the commuter rail system safely, efficiently and in compliance with all federal and state requirements and to advance the capital program in accordance with system needs and funding commitments.

Since inception, the administration and oversight of the commuter rail system has been accomplished by a relatively small permanent staff, supplemented at times with assistance on a contract or temporary basis. For a number of years, as the system itself grew and developed, along with a continuing increase in internal and external requirements, the staff level did not keep pace. However, three new permanent positions and the replacement of three contract positions with VRE staff positions were funded in FY 2016 and an additional four new full time positions were funded in FY 2017. VRE management is currently reviewing existing staffing resources and potential needs for FY 2018, particularly in regard to resources needed to advance the capital program.

**Key Issue #7: Renewal of CSX operating access agreement:** The VRE five-year operating access agreement with CSX Transportation expired on June 30, 2016. In May 2016, the VRE Operations Board approved a one-year extension of this agreement through June 30, 2017.

Throughout this one-year extension period, VRE, CSXT and DRPT will meet to determine capacity enhancement projects, to prioritize these projects, to establish methodologies to identify how the capacity enhancements will result in additional service for VRE and to identify potential funding sources. VRE staff anticipates these elements will be integrated into the new Amended and Restated Agreement. The potential fiscal impact will be monitored throughout the FY 2018 budget process and reflected as appropriate.

**Key Issue #8: Statewide transit funding:** Projections of available statewide transit funding for operations and capital projects in FY 2018 and future years indicate the possibility of substantial decreases in certain years.

In the latest information presented to the Commonwealth Transportation Board (CTB) on June 13, 2016, the total level of operating assistance available statewide is projected to increase slightly through FY 2022. However, the expansion of WMATA’s Silver Line (Phase II scheduled to open 2020) will materially impact the amount received by VRE and other transit providers in future years. Despite some additional revenue as a result of legislation passed in the 2015 session, state capital funding is expected to drop off sharply in FY 2019 and FY 2020 when bond funding supporting the state matching percentage is no longer available, as noted above. One significant issue for VRE is the matching percentage for state grants for track access in any multi-year agreements entered into during this time frame. VRE staff will continue to monitor future levels of available state funding.