To: Chairman Nohe and the VRE Operations Board

From: Doug Allen

Date: July 20, 2018

Re: FY 2020 Key Budget Issues

Recommendation:

The VRE Operations Board is asked to provide feedback and direction for the development of the FY 2020 budget and six-year Capital Improvement Program (CIP).

Summary:

VRE staff will present a preliminary FY 2020 budget in September 2018 for the Operations Board’s consideration, with final budget approval and referral to the Commissions scheduled for December 2018. VRE’s financial planning process provides for initial consideration and discussion of key budget issues and assumptions early in the budget cycle, prior to the preliminary budget.

Background:

VRE has adopted a financial planning process that provides for early consideration of key budget issues and assumptions. During the budget cycle, VRE staff will meet monthly with the member jurisdictions’ Chief Administrative Officers (CAO) Budget Taskforce to develop the proposed budget. An independent CAO recommendation will be provided to the Operations Board and Commissions in conjunction with the final budget submission in December. The Capital Committee also reviews major capital needs and issues for referral to the full Operations Board as required. The Capital Committee met in June and discussed several key issues related to the FY 2020 capital program.
In accordance with the VRE Master Agreement, a consolidated financial projection over a six-year time frame is provided each year as a component of the annual budget. In 2016, a Financial Plan was developed to forecast the cost of current operations and various growth scenarios through 2040. The Financial Plan established that VRE requires substantial additional operating and capital funding (beyond the sources in place at that time) in order to maintain service levels, enhance system capacity, and implement the full System Plan expansion.

In 2018, the Virginia legislature took a significant first step toward addressing this funding need. As part of the passage of HB1539 in March 2018, the legislature approved the creation of the new Commuter Rail Operating and Capital (CROC) Fund. VRE is the only commuter railroad currently operating in Virginia and the only eligible recipient of funding from the CROC Fund. CROC funding may be used to support the cost of VRE’s operations as well as to make necessary capital investments and improvements, either on a pay-as-you-go basis or through the issuance of debt.

HB1539 also authorized changes to the regional gasoline tax collected by NVTC and PRTC. These changes raise the gasoline price floor used to determine the total tax collected. From the gasoline tax revenues that are generated, HB1539 dedicates $15 million annually to the CROC Fund. This $15 million of new funding will then be disbursed from the CROC Fund to VRE for its use on operating and capital projects. The new price floor went into effect on July 1, 2018.

VRE staff will be working with the members of the Capital Committee over the next few months to develop formal principles to guide the use of the new CROC funds. These new principles will be an important counterpart to the existing Financial and Debt Management Principles that were adopted by the Operations Board and Commissions in 2013. Among these existing principles is a statement on prioritization in the CIP, which directs that the budget should prioritize funding towards those projects that meet regulatory requirements, that maintain or improve passenger safety, and that maintain equipment and facilities in support of current service levels. These priorities are directly reflected in the proposed FY 2020 key issues identified below.

**Proposed FY 2020 Key Issues**

**Key Issue #1 – Programming of CROC Funds in FY 2019 and FY 2020:** VRE will begin receiving CROC funds following the July 1 change to the gas tax floor, and decisions will be needed about the programming of those funds for current and future needs.

As noted above, VRE staff is working with the Capital Committee to develop principles to guide the use of CROC funds. These principles will inform not only the immediate programming of CROC funds for FY 2019 and FY 2020, but also the longer-term budgeting and planning of the funds for use on major initiatives.
Also, as discussed previously, VRE staff is undertaking an update of the Financial Plan from 2016. This update will refresh key assumptions regarding ridership, project costs, schedules, and funding sources. Once the baseline model has been refreshed and an updated assessment of future funding needs is in place, the new CROC funding will be incorporated into the model and the best opportunities to ‘leverage’ the CROC funds will be identified.

Staff will return to the Operations Board with results from the updated Financial Plan scenarios in the fall as part of the FY 2020 budget process.

Operating Budget Key Issues

Key Issue #2 – Planned Fare Increase and Ridership Projection: To offset annual operating cost increases in an equitable manner while maintaining a farebox recovery ratio above 50%, VRE generally increases fares and jurisdictional subsidy contributions in alternating fiscal years. After a subsidy increase was approved in the FY 2019 budget, a moderate fare increase of 3% is planned for FY 2020.

VRE must achieve an annual farebox recovery ratio (that is, the share of operating expenses covered by passenger fares) of at least 50%. In order to maintain this ratio over time as operating costs increase, VRE institutes regular fare increases. VRE has had three fare increases in the last seven fiscal years (FY 2014, 2016 and 2018). In those years where fares are not increased, VRE requests an increase in the jurisdictional subsidy. This alternating pattern of increases in fares and subsidy is generally viewed to produce an equitable sharing of the burden of supporting VRE’s operating expenses. Riders also tend to prefer moderate and predictable increases in fares to larger, irregular increases.

The initial consensus among VRE staff is that a 3% fare increase should be proposed for FY 2020, which would be the same percentage increase that was approved by the Board and instituted for FY 2018. Staff will continue to assess this potential fare increase ahead of the Board’s review of the preliminary FY 2020 budget in September, including consideration of economy-wide inflation (both actual and projected), ridership trends, changes to major VRE expense items, and potential policy changes at the federal or state level.

Ridership will also be a key issue for FY 2020. Ridership in FY 2018 was down slightly from FY 2017, although the broader drop-off in ridership that was anticipated after the conclusion of Metro’s SafeTrack efforts did not occur. Transit ridership in general has been dropping in recent years in the Washington region and nationwide, though VRE has largely avoided those declines and remains a competitive option in the congested I-95 and I-66 corridors. Staff will be watching ridership closely in early FY 2019 to inform the projections for FY 2020.

Key Issue #3 – Potential Reduction in State Operating Assistance: The recent legislative changes to transit funding in the Commonwealth require all transit operating assistance
(rather than only a portion) be allocated on the basis of service delivery factors. This may result in a reduction in funding to VRE if the methodology remains unchanged.

Effective July 1, 2019, 100% of statewide operating funds must be allocated on the basis of service delivery factors. The current factors being used are passengers per revenue hour, passengers per revenue mile, and net cost per passenger. Based on preliminary analyses by VRE and NVTC, VRE’s state operating assistance (budgeted at $9.5 million for FY 2019) could be materially reduced if the methodology remains unchanged from the current approach. VRE staff are participating in the Transit Service Delivery Advisory Committee (TSDAC) process that is evaluating how to implement this new requirement, and staff will update the Board as the process moves forward.

**Key Issue #4 – Renewal of Operating Access Agreement with CSX:** As of July 1, VRE renewed its access agreement with Norfolk Southern for another five years, and the current access agreement with Amtrak will continue through June 30, 2020. However, following the expiration of a five-year agreement with CSX Transportation on June 30, 2016, VRE continues to operate under a series of one-year extensions with CSX.

Throughout this third one-year extension period, VRE, CSXT, and DRPT will meet to review planned capacity enhancement projects, determine the resources necessary to complete these projects (including flagging services provided by CSXT), and prioritize the projects across the coming years. VRE anticipates these elements will be integrated into a new Amended and Restated Agreement. The potential fiscal impact will be monitored throughout the FY 2020 budget process and reflected as appropriate.

**Key Issue #5 – Diesel Fuel Price Uncertainty:** While diesel fuel prices are below the levels reached in the 2012-2014 period, prices have increased steadily from the lows of 2015-2017, and macroeconomic uncertainty remains.

Diesel fuel represents about 5% of VRE’s total annual operating expenses, but its potential price volatility makes it one of the larger sources of uncertainty in the budget. VRE’s positive operating budget performance over the last two fiscal years was due in part to lower than expected diesel fuel prices, with VRE’s actual cost at well under $2.00 per gallon in FY 2016 and 2017. Prices increased steadily in FY 2018, however, and further increases are possible.

VRE is able to enter into fixed-price contracts that can mitigate some of the short-term volatility in fuel price. Over the longer term, however, VRE is exposed to risk from fuel price increases. VRE staff have also been focused on budgeting fuel more conservatively given the variances of the past two years. Staff will be watching the market closely during the budget process and conferring regularly with VRE’s fuel consultant about the likely trajectory of prices to determine appropriate price and utilization assumptions for FY 2020.

**Capital Program Key Issues**
**Key Issue #6 – Staffing to Support Growth:** VRE must ensure it has the resources – through a combination of permanent staff and contracted support – to advance the capital program in accordance with Board direction and funding commitments.

Since its inception, the safe and efficient administration and oversight of VRE has been accomplished by a relatively small permanent staff, supplemented at times with assistance on a contract or temporary basis. In recent years, as ridership has grown, and as internal and external requirements have increased, VRE has selectively added staffing in key positions. For the current year (FY 2019), VRE added one new position for grant accounting, a reflection of the range of new funding sources that are being tapped to support the expansion of capacity.

VRE management is currently reviewing existing staffing resources and potential needs for FY 2020 to advance the capital program. In particular, DRPT and NVTA, who are the primary funding partners for many VRE projects, expect to see timely and substantial progress on the projects to which they have committed funding. VRE must have the full range of staffing support, from procurement and project management through grant reimbursement, to ensure that progress. VRE also must continue to make sustained progress on the New York Avenue midday storage project to meet Amtrak-imposed deadlines to move out of the current Ivy City storage facility.

**Key Issue #7 – Changes to State Capital Matching Funding:** No legislative action was taken in 2018 to address the expiration of the Capital Project Revenue (CPR) bonds that have supported transit capital funding over the past decade, and the Commonwealth is now changing how it allocates its limited capital matching funds.

The Commonwealth Mass Transit Fund is being restructured, with funding for WMATA operating and capital needs now separate from the rest of the statewide program. The TSDAC is still deliberating on its recommendation to the Commonwealth Transportation Board (CTB), but it is likely going forward that all projects requesting state capital funding support will be categorized as either State of Good Repair (SGR), Minor Enhancement, or Major Expansion. Allocation of funding to SGR projects would be based on asset management principles, including the federal requirements for Transit Asset Management, while allocation to expansion projects will follow a ranking process very similar to SmartScale. Most of the funding in the program is expected to go to SGR projects in an effort to reduce the existing backlog.

VRE staff are working with staff from DRPT along with other stakeholders to understand how these changes to the program would likely affect available funding in FY 2020 and future years. Certain key areas of the budget that require state support, including railcar debt service payments and track access fees, are not expected to be impacted by the new program structure. But other projects and programs, such as equipment and facilities asset management, midday storage, and future rolling stock replacements, may be affected. As the expected impacts of the changes are clarified during the budget process, staff will provide updates to the Operations Board.
Key Issue #8 – Stakeholder Consensus on Long Bridge: While the need for additional railroad capacity across the Potomac River at Long Bridge is generally agreed upon, key questions regarding the ownership and funding of an expanded bridge remain to be answered. The funding structure for this mega-project could impact VRE’s long-term budgeting and programming of funds.

The expansion of the Long Bridge is critical not just to VRE’s future, but to the long-term operation of freight and intercity passenger rail along the East Coast. VRE is working closely with other stakeholders – including CSX, DRPT, DDOT, and federal agencies – not only on the initial planning and environmental studies for the expansion of bridge capacity, but also on a review of potential governance structures for the new asset once it is completed. These structures would incorporate responsibilities for funding of construction, ownership, and ongoing operations and maintenance. Reaching consensus on the likely long-term governance structure of Long Bridge will help VRE to plan for its future financial responsibilities.

Key Issue #9 – Maintenance and Replacement of VRE Assets: The maintenance of rolling stock, equipment, and facilities to support current service levels is a priority in the VRE capital program, and federal formula funds are devoted to maintaining these assets in a state of good repair. However, future replacement of the existing fleet is expected to require significant additional funding beyond the available federal funds.

The federal priority for maintaining transit systems in a State of Good Repair has been continued in the Fixing America’s Surface Transportation (FAST) Act, the current federal transportation authorization. VRE will draw on these federal funds to adequately maintain its rolling stock, other equipment, and facilities. VRE will utilize the information in its federally-required Transit Asset Management Plan (TAMP) to prioritize investments, refine cost estimates, and ultimately populate the FY 2020 budget request in this area.

VRE’s current fleet of railcars and locomotives was purchased during a relatively compressed time period. As a result, the replacement of the fleet is projected to be needed during a similarly compressed period beginning in FY 2030. VRE is working with consultants now to assess the trade-offs between undertaking major overhauls (which would extend the useful life of the rolling stock but also require expensive upgrades to meet new environmental and crashworthiness standards) and purchasing new rolling stock. Under either approach, hundreds of millions in funding will be required that will exceed the expected available federal and state funding. Although this need falls well beyond the projection period of the six-year CIP, this issue was highlighted in the Financial Plan forecast and is a key input to the assessment of potential uses of the CROC Fund.

Next Steps:
- Continue working with Capital Committee on principles to guide use of CROC funds.
- Continue discussions of FY 2020 budget and CIP with CAO Budget Task Force.
• Provide preliminary FY 2020 budget and CIP to the Operations Board in September 2018 and to the Commissions in October 2018.

_Fiscal Impact:_

The fiscal impact of the FY 2020 budget and six-year CIP will be addressed at the September Operations Board meeting and as the budget process progresses.
Virginia Railway Express
Operations Board

Resolution
8B-07-2018

FY 2020 Key Budget Issues

WHEREAS, financing planning for the Virginia Railway Express (VRE) is based on a set of budget issues and assumptions discussed by the VRE Operations Board prior to the development of the annual operating and capital budget; and,

WHEREAS, the VRE Operations Board has directed that the development of each annual budget shall involve consultation and cooperation with the Chief Administrative Officers (CAO) Budget Task Force established by VRE’s participating and contributing jurisdictions; and,

WHEREAS, key budget issues and assumptions for the development of the FY 2020 operating and capital budget were reviewed by the CAO Budget Task Force prior to their presentation to the Operations Board; and,

WHEREAS, the Key Issues related to the CIP were reviewed by the Capital Committee prior to their presentation to the Operations Board;

NOW, THEREFORE, BE IT RESOLVED THAT, the VRE Operations Board directs VRE staff to develop the FY 2020 Budget and CIP in accordance with the Board’s direction.

Approved this 20th day of July 2018

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Martin Nohe
Chairman

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Maureen Caddigan
Secretary