To: Chair Cristol and the VRE Operations Board  
From: Doug Allen  
Date: July 19, 2019  
Re: FY 2021 Key Budget Issues

Introduction:
VRE staff will present a preliminary FY 2021 budget in September 2019 for the Operations Board’s consideration, with final budget approval and referral to the Commissions scheduled for December 2019. 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 Finance Committee also reviews major budget issues and needs for referral to the full Operations Board as required.

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 comprehensive financial analysis was developed to forecast the cost of current operations and various growth scenarios through 2040. This analysis is currently being refreshed in conjunction with an update to the System Plan.
In 2018, the Virginia legislature created the Commuter Rail Operating and Capital (C-ROC) Fund, and $15 million in gasoline tax revenues from the NVTC and PRTC regions are now dedicated annually to C-ROC for VRE’s use. These important changes were reflected in VRE’s adopted FY 2020 budget and FY 2020-2025 CIP, and VRE staff worked closely with the Operations Board to develop formal guidelines for the use of C-ROC funds.

There were not any changes of similar magnitude in the 2019 legislative session, so VRE’s fiscal environment is relatively unchanged from last year. However, there have been recent changes to the methodologies used by the Department of Rail and Public Transportation (DRPT) for allocation of both operating support and capital grants. These issues are explained in further detail below.

**FY 2021 Key Issues:**

**Key Issue #1 – Programming of C-ROC Funds and Federal State of Good Repair (5337) Funds:** As discussed earlier in the spring with the Finance Committee, based on initial results from the financial analysis refresh, VRE can continue focusing its commitment of C-ROC funds for the next few years towards pay-as-you-go capital projects rather than operations or as backing for a debt issuance. As part of the FY 2020 budget, the Operations Board committed a total of $45 million of FY 2019–2021 C-ROC funds to the Crystal City and L’Enfant Station projects ($15 million and $30 million, respectively.) However, VRE was unsuccessful in its application for a Rail Enhancement Fund (REF) grant for Crystal City, so the funding for that project will need to be revisited. At the same time, updated cost estimates are expected for the Midday Storage (New York Avenue) and L’Enfant projects as they progress through the engineering and environmental processes. During the FY 2021 budget cycle, VRE staff will be evaluating these updated costs, determining where C-ROC funds and FTA 5337 funds might be applied (since all the projects have a state of good repair component,) and deciding whether to apply to outside funding partners and programs (such as NVTA or the federal BUILD grant program) for additional support.

**Key Issue #2 – Planned 3% Jurisdictional Subsidy Increase:** VRE service is supported primarily through a combination of passenger fares, state and federal funds, and local jurisdictional contributions. To offset annual operating cost increases in an equitable manner while maintaining a farebox recovery ratio at or above the required 50% minimum, VRE generally increases fares and jurisdictional subsidy contributions in alternating fiscal years. A 3% fare increase was approved in the FY 2020 budget, and the FY 2020 six-year financial forecast projected a subsidy increase of 3% in FY 2021. The jurisdictional subsidy amount was last increased in FY 2019 by 3%. Staff views these moderate and predictable increases in fares and subsidy as preferable to periods of no change followed by large increases.
Although C-ROC funds can be used to support VRE operations, the guidance received from the Operations Board to date has been to use C-ROC to advance key near-term capital projects, not to support operations. Staff will continue to assess this potential jurisdictional subsidy increase ahead of the Board’s review of the preliminary FY 2021 budget in September.

**Key Issue #3 – Ridership, Fare Revenue and 50% Farebox Recovery Requirement:** As mentioned above, VRE is required by the Master Agreement to budget for a minimum 50% recovery of operating costs from passenger fare revenues. To maintain this ratio over time as operating costs increase, VRE institutes regular fare increases and closely monitors ridership trends.

No fare increase is planned for FY 2021, following the 3% increase for FY 2020, but ridership levels will be critical. Average daily ridership (ADR) in FY 2019 was down from the same period in FY 2018, with ADR for the first eleven months of FY 2019 at 17,802, down approximately 6% from 18,948 over the same period in FY 2018.

This decline was caused by several factors, including the federal government shutdown in December and January and service delays associated with implementation of Positive Train Control (PTC) along with other service disruptions at various points during the year. However, the 11-month figures for FY 2019 also do not capture the uptick in ridership during June as a result of the WMATA Blue/Yellow shutdown. But even if one-time impacts are excluded, VRE ridership did not show any growth in FY 2019. The midweek “peak” of ridership also continues to become more pronounced, with ridership on Mondays and especially Fridays well below that of Tuesday through Thursday.

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. However, because of the material nature of fare revenue to the VRE operating budget, and the requirement to budget a 50% farebox recovery, VRE staff will be watching ridership closely in early FY 2020 to inform projections for FY 2021.

**Key Issue #4 – Renewal of Operating Access Agreement with Amtrak and CSX:** The operating access agreements with VRE’s host railroads are among the largest operating costs in the VRE budget, together totaling $18.5 million in the FY 2020 operating budget. As of July 1, 2018, VRE had renewed its access agreement with Norfolk Southern for another five years.

However, the current access agreement with Amtrak will end at the end of FY 2020. This agreement covers VRE access to Washington Union Station as well as Amtrak-owned Ivy City storage yard. As part of this final year of the Amtrak agreement, VRE and Amtrak will continue working towards a new agreement.
In addition, 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 fourth 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 2021 budget process and reflected as appropriate.

**Key Issue #5 – Diesel Fuel Price Uncertainty:** While diesel fuel prices remain 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 three 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, to $2.12 per gallon, and again in FY 2019 to $2.37 per gallon thru March data. Further increases continue to be possible.

VRE is able to enter into fixed-price contracts that can mitigate some of the short-term volatility in fuel prices. As discussed with the Finance Committee, VRE is also exploring options for diesel fuel hedging through investment in longer-duration futures contracts, which would provide significantly greater budget certainty and some cost savings. 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 2021.

**Key Issue #6: Staffing to Support Growth:** Through a combination of permanent staff and contracted support, VRE must a) operate and administer the commuter rail system safely, efficiently and in compliance with all federal and state requirements and b) advance the capital program in accordance with Board direction and funding commitments.

Since its inception, the safe and efficient administration of VRE has been accomplished by a relatively small permanent staff. In recent years, as both formula and discretionary funding sources have grown, the capital program has expanded, and internal and external requirements have increased, VRE has selectively added staffing in key positions. Since FY 2018 VRE has added only one new position despite the ongoing growth of administrative and regulatory requirements.

As the volume and complexity of the administrative and regulatory responsibilities of VRE continue to grow, VRE must look to the best methods to address these requirements. VRE management is currently reviewing existing staffing resources and potential needs for FY
2021, particularly regarding resources needed to advance and properly administer the capital program as well as to meet procurement, audit and administrative regulations and requirements.

**Key Issue #7 – Allocation of State Funding for Operating and Capital Support:** VRE staff is working closely with DRPT staff to navigate the new state operating and capital funding programs. On the operating side, VRE is receiving transition assistance of approximately $1 million in FY 2020, and staff are collaborating now to ensure that funding in future years is stable and predictable. On the capital side, VRE’s capital needs – particularly the Equipment Asset Management and Facilities Asset Management programs – are challenging to evaluate within the new MERIT (Making Efficient + Responsible Investments in Transit) program. VRE will be identifying additional information to submit as part of its FY 2021 grant applications to ensure that its requests can be effectively evaluated by DRPT.

**Next Steps:**

- Continue monthly discussions of FY 2020 budget and CIP with CAO Budget Task Force.
- Discussions with Operations Board Finance Committee.
- Provide preliminary FY 2020 budget and CIP to the Operations Board in September 2018 and to the Commissions in October 2018.