



VIRGINIA RAILWAY EXPRESS
OPERATIONS BOARD

Agenda Item 10-A
Information Item

To: Chairman Skinner and the VRE Operations Board

From: Rich Dalton

Date: July 17, 2020

Re: FY 2022 Key Budget Issues

Introduction:

VRE staff will present a preliminary FY 2022 budget in September 2020 for the Operations Board's consideration, with final budget approval and referral to the Commissions scheduled for December 2020. VRE's financial planning process provides for initial consideration and discussion of key budget issues well before the preliminary budget presentation, which ensures challenges can be identified, publicly vetted, and fully addressed before final approval.

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 regularly with staff members from the jurisdictions to develop the proposed budget. The Finance Committee will also review major budget issues for referral to the Operations Board as required. In accordance with the Master Agreement, a consolidated financial projection over a six-year time frame is provided each year as a component of the annual budget.

The budget adoption process for FY 2022 will be unlike any in recent years as a result of the COVID-19 pandemic and its significant impacts on the economy and VRE's ridership. Staff continues to address certain key issues raised in last year's budget (e.g., diesel fuel hedging, the new DRPT methodology for capital grants), but broader economic and policy issues will be paramount. Accurately forecasting ridership and revenue in this environment will be difficult, and staff will likely select an approved projection for ridership/revenue relatively late in the process in order to have as much current information as possible. Amending the current year's (FY 2021) budget will also be a more substantive part of this



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year's process, as whatever is projected for FY 2022 must also incorporate projections for the rest of FY 2021.

Issue 1: Revenue Shortfalls and CARES Act Support

Fare revenue in June 2020 remained down approximately 80% compared to a normal month, though it has dropped less than ridership, which is still down approximately 95% (though slowly and steadily rising). There is great uncertainty about how and when ridership may return – it is likely to depend on the overall economy, riders' perception of safety on trains (and VRE's ability to provide "distanced" capacity), and whether workers are required and able to return to their workplaces, which includes increases in telework, the need to care for other family members, and many other challenges. Given the uncertainty over the pace of growth and the final "equilibrium" level of daily ridership, as well as events that might change the current recovery trajectory (e.g., a successful vaccine, a major "second wave" in the fall), staff will examine a range of possible scenarios.

VRE must also prepare for a possible reduction in state support as a result of tax revenue shortfalls. The Commonwealth has been working to reprogram existing funds to support critical current operations, and operating assistance for the first quarter of FY 2021 has remained at the same level as FY 2020, but future funding levels are uncertain.

The CARES Act has provided VRE with funding equal to approximately two years' worth of fare revenue to backstop lost revenues and support additional COVID-related expenses. Thanks to this funding, VRE will remain committed to providing safe and reliable commuter rail service to customers in FY 2021 and 2022 while also ensuring local jurisdictions do not bear the burden of a fare revenue shortfall.

Issue 2: Policy of Alternating 3% Fare and Subsidy Increases

The approved FY 2021 budget included a 3% increase in total jurisdictional subsidy and kept passenger fares unchanged. Subsidy payments for the first half of FY 2021 were received on time and in full from all nine jurisdictions despite the financial challenges posed by the pandemic.

Under the Board's existing policy direction to consider fare and subsidy increases in alternating years, the starting point for a "normal" FY 2022 would be zero change to the total subsidy and consideration of a 3% fare increase. However, given the challenges faced by both riders and jurisdictions, other alternatives will be considered.

At the outset of the pandemic, VRE committed that no request would be made for additional jurisdictional subsidy in FY 2021. In that same spirit, VRE will not ask for any jurisdictional subsidy increase in FY 2022. However, decisions must be made about subsidy allocation. A master agreement survey in October 2020 (which would generate the required data on the residence of riders) is unlikely to produce reliable results for the allocation of subsidy. VRE could instead use prior year data, which is similar to the

approach being taken by the Federal Transit Administration for federal funding allocations, but other approaches could be used.

There are three alternatives to consider with respect to passenger fares in FY 2022: 1) an increase of 3% or less; 2) no change; 3) a reduction in fares, either temporary or permanent. Staff will present these scenarios to the Operations Board and solicit feedback as the budget process continues.

Issue 3: Expense Reductions in FY 2021 and FY 2022

Staff will be looking closely at all discretionary expenses in the operating budget, particularly consulting, professional services, any new non-critical initiatives, and the replacement or upgrade of existing items (furniture, equipment, etc.), and will be deferring or eliminating these expenditures where practical. In addition to COLA and merit increases, the previously approved hiring of five new employees in FY 2021 has also been deferred.

Issue 4: Transforming Rail in Virginia Program

As discussed previously with the Operations Board, the Commonwealth's rail transformation program will have a substantial impact on VRE's six-year Capital Improvement Program (CIP), and changes to project scopes, timelines, and funding sources will be fully fleshed out during the upcoming budget process. In addition, a track access agreement with the new Virginia Passenger Rail Authority is being negotiated and is expected to come into effect during FY 2021.

As part of the FY 2021 budget approval, the Operations Board also authorized staff to continue discussions with DRPT about a contribution to the rail transformation program from VRE's Commuter Rail Operating and Capital (C-ROC) funds. These discussions – which contemplate a combination of debt issuance proceeds and pay-as-you-go cash – will occur separately from, but in parallel with, the budget adoption process. We do not expect to recommend any further C-ROC commitments to specific VRE capital projects (currently \$15 million is committed to the Crystal City Station and \$30 million to the L'Enfant Station and Fourth Track, covering FY2019-2021 C-ROC funds) until these negotiations are resolved.

Issue 5: Insurance

VRE is required to have at least \$295 million of liability insurance coverage in order to operate. In recent years, VRE has been able to get the necessary coverage through international underwriters without much change year-to-year in premiums.

However, VRE faced significant challenges this year (FY 2021) in securing the required coverage, as did other commuter and freight rail properties. These challenges are unrelated to our operations or safety record, but instead are the result of major capacity constraints in the insurance markets related to West Coast wildfires and other claims. Ultimately, all the required coverage was secured, but the premiums increased substantially, and significant uncertainty remains about future years.

VRE and other operators cannot wait and hope these issues resolve themselves. VRE staff will be working with representatives of the Commuter Rail Coalition, the Federal Railroad Administration, and Virginia's Department of Risk Management to identify and implement alternative approaches to securing liability insurance that provide the necessary coverage at a sustainable cost.

Issue 6: Baseline Capital Charge Contributions for Northeast Corridor

Capital renewal is the ongoing repair/replacement of the existing railroad infrastructure in the Northeast Corridor (NEC) that is required to ensure reliable and safe train operations. VRE is included in NEC through our use of Union Station. A key component of capital renewal is the Baseline Capital Charge (BCC) Program, which is funded by ongoing capital contributions of Amtrak and the commuter railroads, including VRE. VRE makes this BCC contribution as part of its access agreement with Amtrak.

The BCC amount is determined by the "NEC Commuter and Intercity Rail Cost Allocation Policy," and the NEC Commission has recently changed that cost allocation policy. The preliminary result of the changes is that VRE's required annual contribution could increase from approximately \$600,000 to over \$3 million. Discussions are ongoing with Amtrak and the NEC Commission on the allocation methods and the timing of any costs that may be incurred.

Next Steps:

September 2020: Present preliminary FY 2022 budget and CIP to the Operations Board

October/November 2020: In-depth review of preliminary budget with Operations Board, Finance Committee, and jurisdictional staff

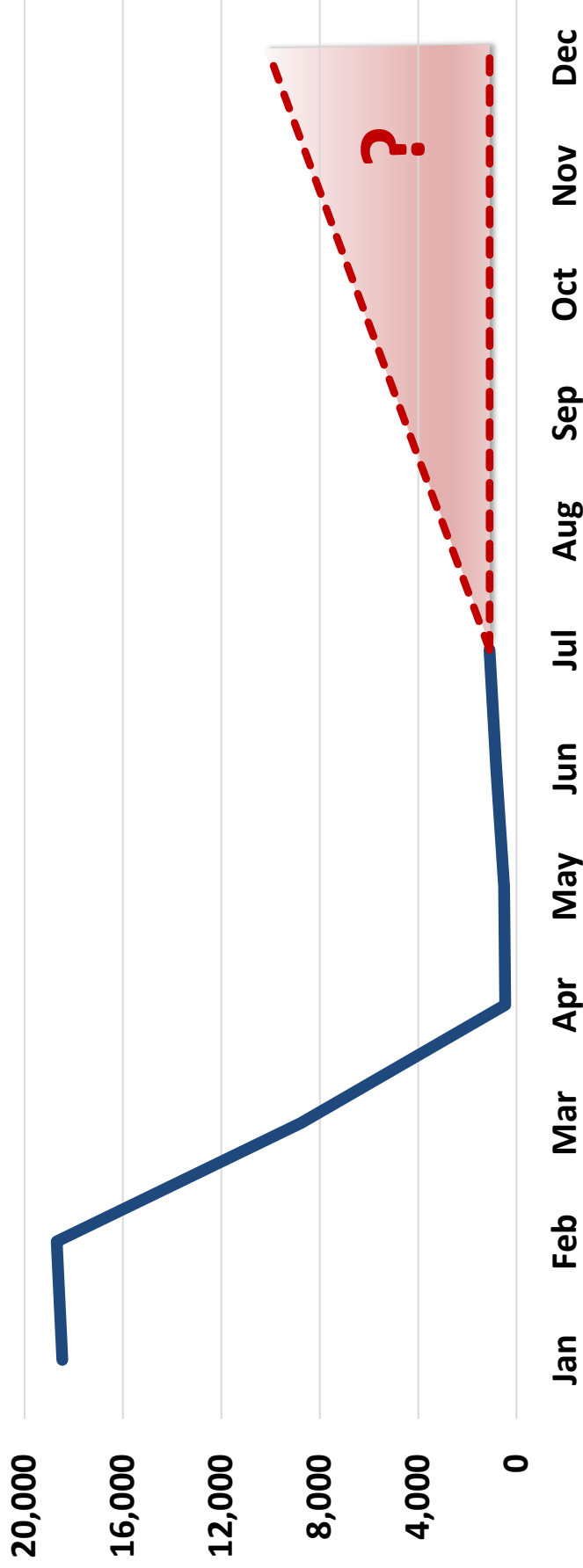
December 2020: Present final FY 2022 budget and CIP for Operations Board approval and referral to the Commissions

FY 2022 Key Budget Issues

- Broader economic and policy issues will be paramount
- Accurately forecasting ridership and revenue will be challenging, and we will select an approved projection near the end of the process
- Amending the current year budget (FY 2021) will be an important part of the process

Issue 1: Revenue Shortfalls and CARES Act Support

Average Daily Ridership CY 2020



Issue 2: Alternating Fare and Subsidy Increases

- No subsidy increase for FY 2022, but decision will be required on allocation
- Normally would be a year to propose fare increase but will more explicitly consider three options:
 - 1) Increase of 3% or less
 - 2) No change
 - 3) Reduction



Issue 3: Expense Reductions in FY2021 and FY 2022

- Deferring/eliminating consulting, professional services, non-critical initiatives, and replacement of existing items (IT, furniture, etc.)

Issue 4: Transforming Rail in Virginia Program

- Changes to project scopes, timelines and funding
- New track access agreements
- Commitment of C-ROC funds (cash and debt)

Issue 5: Insurance

- Secured required insurance for FY 2021 but with significant premium increase
- Will work with DRM, federal stakeholders and other commuter railroads to find sustainable solution

Issue 6: Capital Renewal Charges for Northeast Corridor (NEC)

- Change in methodology for required capital renewal charges paid through Amtrak access contract
- Discussions ongoing with Amtrak and NEC Commission