STAFF REPORT

MEETING DATE: 2/26/2025 **Staff Report No.** 24-480a

TO: AC Transit Board of Directors

FROM: Kathleen Kelly, Interim General Manager/Chief Executive Officer

SUBJECT: FY 2025-26 Budget Guidelines (formerly Budget Goals) and updated financial projection.

BRIEFING ITEM

AGENDA PLANNING REQUEST: ☐

RECOMMENDED ACTION(S):

Consider receiving an overview of staff's proposed FY 2025-26 Budget Guidelines and updated financial projection.

Staff Contact:
Chris Andrichak, Chief Financial Officer

STRATEGIC IMPORTANCE:

Goal - Financial Stability and Resiliency
Initiative - Financial Efficiency and Revenue Maximization

Budget Guidelines help focus the budget process and how staff considers the value and need of expenses.

BUDGETARY/FISCAL IMPACT:

There is no fiscal impact associated with this report.

BACKGROUND/RATIONALE:

Fiscal Year 2025-26 will be a crucial year for the District, marking the first year of anticipated operating deficits. It is essential that the Budget Guidelines not only address the immediate challenges of FY 2025-26 but also lay the groundwork for navigating expected deficits in the years ahead.

A note on the new terminology ("guidelines" instead of "goals"): guidelines are more specific than goals and will be used to frame the budget development process in key areas such as service levels, headcount, service reliability, finding new revenues, and use of reserves.

A review of the financial projections and expected revenues is provided below, as context for the proposed Budget Guidelines.

Financial Projection

The updated financial projection in FY2026 (see Attachment 1) is worse compared to the one presented to the Board during the October 2024 Board Retreat. The four-year deficit has grown by 55% from $149 million to $238 million. Just weeks ago, the Metropolitan Transportation Commission (MTC) issued revenue updates just weeks ago for the three sales taxes that flow through them: Transportation Development Act (TDA), State Transit Assistance (STA), and AB1107 (the original BART District sales tax). Each February, MTC issues their adjustments for the current fiscal year and projections for the coming fiscal year, and this year those adjustments were lower for both years than originally forecast. AC Transit staff also lowered internal estimates for Alameda County Transportation Commission (ACTC) Measure BB and Contra Costa Transportation Authority (CCTA) Measure J revenue by 6% for next fiscal year, based on lower cash receipts in the first half of the current fiscal year, even though those agencies have not yet issued projections for the coming year.

The combined effect is that total FY 2024-25 sales tax revenue is projected to be lower by $15 million (less than budgeted) and FY 2025-26 projected revenue by $18 million, as shown in Attachment 2. These reductions have a devastating impact on future year projections. The updated projection shows these increased deficits even after reducing expected expenses not directly related to supporting operations or service reliability. The reductions were based on experience with professional services expenses and lower Paratransit contract costs than initially expected.

Although the deficit amounts have increased, the multi-year trend remains the same. Once Federal Emergency funding and SB 125 funding are depleted in FY 2025-26, the District is projected to face ongoing deficits. These deficits will spike in FY 2026-27 before decreasing slightly in subsequent years, largely due to planned reductions in pension contributions.

This projection assumes that the District maintains the same level of service hours as the current year, which is about 85% of pre-pandemic service levels. The projection also assumes historically consistent wage increases for all employees, no changes in pension expense (smoothing), and no additional revenues from external sources (e.g., a new regional measure). The ongoing deficits after FY 2026-27 are of greatest concern as the District must either have new revenue and/or reduce expenses and services to address them. One-time/one-off fixes, such as the use of reserves, may help in the initial years but not over the long run.

Due to the very high levels of projected deficits, it is important that the District provide clear budget guidelines to staff.

FY 2025-26 Budget Guidelines

In November 2024, the Board adopted a budget development calendar that included the development of goals (renamed as guidelines) for the FY 2025-26 Operating and Capital Budgets. Staff believes the five proposed budget guidelines listed below focus on the key areas necessary for the District's long-term financial stability. The proposed guidelines are as follows and detailed below:

- Fund approximately 2 million service hours, which is 85% of pre-pandemic service levels, the same as we are delivering today and consistent with the service changes adopted through Realign. Additional service hours will only be added if new revenue becomes available.
- Reconcile headcount with service level and proactively control hiring and vacancies.

- Prioritize service reliability and safety when programming discretionary budget.
- Support efforts to increase revenues under District control, including farebox.
- Allocate funding from reserves in FY 2025-26 and FY 2026-27 to support financial stability during limited deficit periods.

Fund approximately 2 million service hours which is 85% of pre-pandemic service levels, the same as we are delivering today, and consistent with Realign. Additional service hours will only be added if new revenue becomes available.

Funding planned service hours and ensuring service reliability are top priorities for the District. It is crucial that the District continue to provide dependable service while maintaining high service levels for the community that relies on our buses. Service levels must be supported within the financial constraints of the budget.

Reconcile headcount with service level and proactively control hiring and vacancies.
Nearly 70% of the District's operating expenses are driven by labor costs, which grow and shrink with changes in service levels. To effectively manage these expenses, it is crucial to carefully monitor headcount and control vacancies as they relate to service levels.

Prioritize service reliability and safety when programming discretionary budget.
The "discretionary" budget is composed of department initiatives and other elective items. Their impact on service reliability and safety will be prioritized during the budget development process. There will be difficult choices to reduce or defer initiatives that may be good ideas but do not sufficiently support service reliability and safety. This guideline helps make the focus and reasoning clearer.

Support efforts to increase revenues under District control, including farebox.
The District has limited control over most revenue sources, such as subsidies from Sales Taxes and Property Taxes, but there are opportunities to increase revenue from the farebox or other programs. The District needs to show its funding partners that it is doing its part to fill in deficits.

Allocate funding from reserves in FY 2025-26 and FY 2026-27 to support financial stability during limited deficit periods.
The District has maintained a focus on strategically managing reserves since early in the pandemic when it was clear that deficits were coming. This effort remains a key focus of the budget moving forward. Reserves can provide crucial support for operations during initial periods when revenues fall short of expenses, buying time to secure additional revenue and implement cost-saving measures, but it is important to understand this is only a temporary part of the solution.

These guidelines will be the starting point for a comprehensive budget review conducted with input from Management, Departments, and the Board. The final budget will align with and support the District's Strategic Plan and its overarching goals.

Staff will present a financial update to the Board in March 2025 with additional revenue and expense details.

ADVANTAGES/DISADVANTAGES:

This report is a briefing and there are no disadvantages to receiving this report.

ALTERNATIVES ANALYSIS:

There are no alternatives to the report, as this report is being provided to the Board as part of the scheduled activities in the development of the FY 2025-26 Operating and Capital Budget.

PRIOR RELEVANT BOARD ACTION/POLICIES:

24-480 FY 2025-26 Budget Calendar
Board Policy 311 - Budgets

ATTACHMENTS:

1. Financial Projection
2. Sales Tax Trend

Prepared by:
Richard Oslund, Director of Management and Budget

In Collaboration with:
Mary Archer, Budget Manager

Approved/Reviewed by:
Chris Andrichak, Chief Financial Officer