COVER STORY

WARNING: BIG BUDGET GAPS AHEAD

Ridership remains down. Federal aid is fading. How can the region fix Metro's fiscal plan?

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Randy Clarke walked into a job to oversee an inherently flawed fiscal structure, where for five decades before him, his predecessors had been sounding a very unnerving alarm. And he knew it from the start.

The new general manager and CEO of the Washington Metropolitan Area Transit Authority also knows he oversees one of the region's biggest economic engines, one that heavily influences new development and land use, the real estate market and return-to-work efforts, climate and pollution, and community and equity.

It can't fail. And yet, it's nearly teetering on a budgetary brink as Covid-era ridership remains deflated and federal relief funds trail off. If the regional leaders can't solve this problem, the transit system will face a minimum $500 million annual gap starting in July 2024, likely prompting cutbacks in one of its biggest expenses, its workforce. That, in turn, would translate to massive cuts in service, dragging the cycle of cutbacks around a few more turns.

Ultimately, such drastic cuts would likely send catastrophic waves through Greater Washington's economy. WMATA itself employs about 11,500 people, making it the region's 18th largest employer, Washington Business Journal research shows. Industry, governments and real estate values regionwide also heavily depend on it. Many of the region's megadevelopments – which represent huge private investment sums and are widely considered crucial for business and workforce attraction and retention – strategically target locations near transit stations.

CONTINUED ON PAGE 24

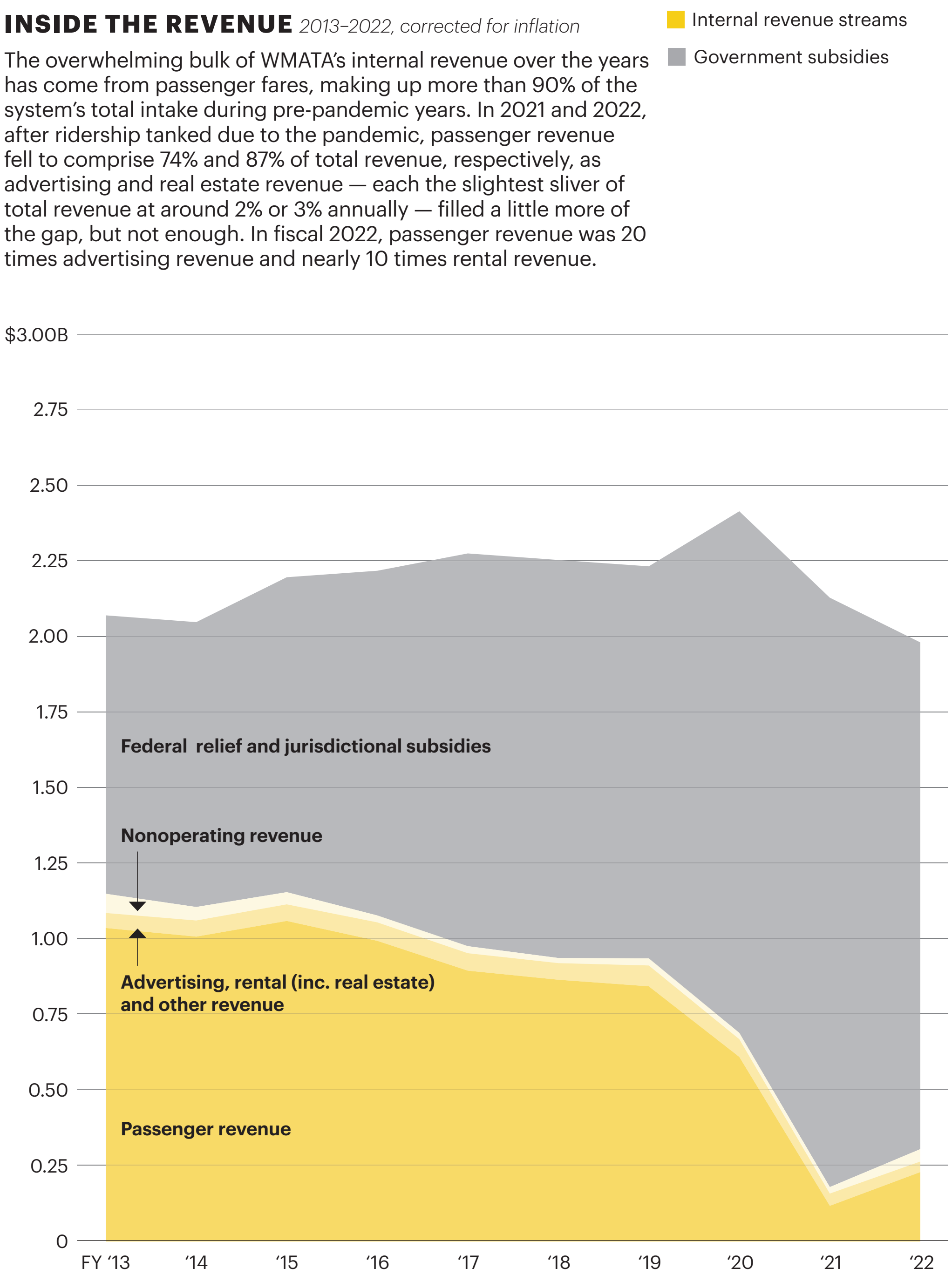
Pictured: *Randy Clarke became WMATA general manager and CEO in July.*

PHOTO BY ABDULLAH KONTE / WBJ

COVER STORY

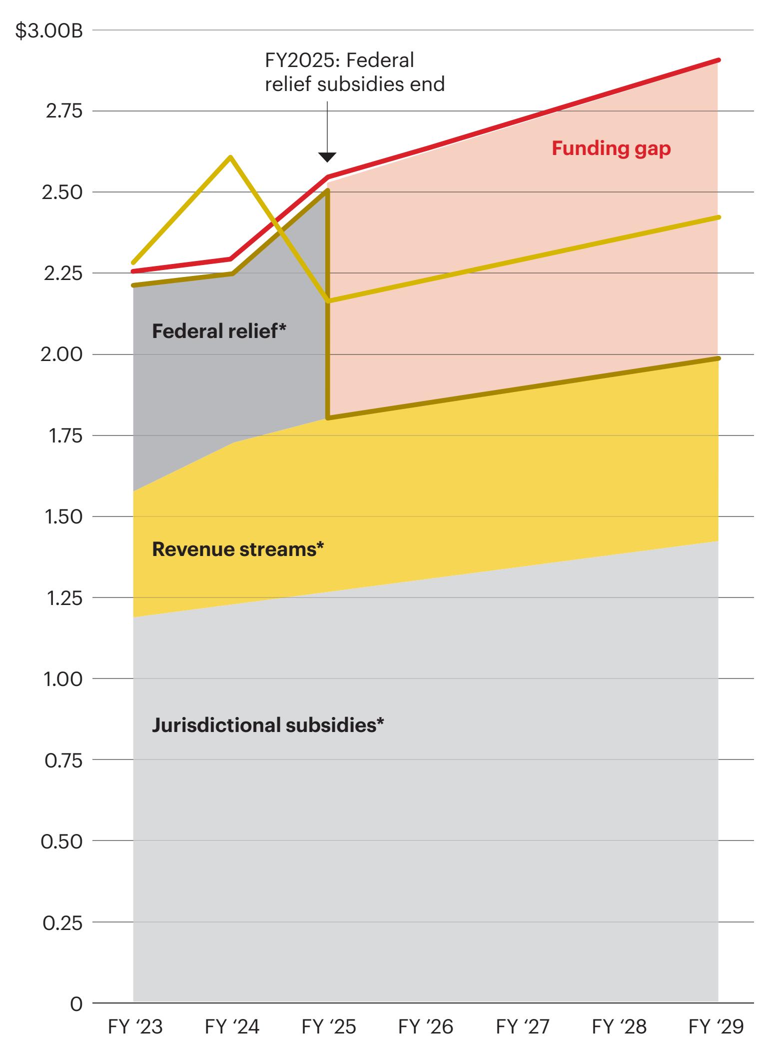
INSIDE THE REVENUE *2013–2022, corrected for inflation*

The overwhelming bulk of WMATA's internal revenue over the years has come from passenger fares, making up more than 90% of the system's total intake during pre-pandemic years. In 2021 and 2022, after ridership tanked due to the pandemic, passenger revenue fell to comprise 74% and 87% of total revenue, respectively, as advertising and real estate revenue — each the slightest sliver of total revenue at around 2% or 3% annually — filled a little more of the gap, but not enough. In fiscal 2022, passenger revenue was 20 times advertising revenue and nearly 10 times rental revenue.



A TROUBLING GAP *FY2023–FY2029*

To the left is what's been. Below is what's to come. This chart, at a glance, is a separately sourced snapshot shared by WMATA that shows the growing gulf between projected revenue and expenses, once federal Covid relief ends in fiscal year 2025. Note that there's still a deficit even if Metro ridership returns to 100% of pre-pandemic levels, though even a 75% return may be ambitious.



NOTE: *The chart above shows data from WMATA's Annual Comprehensive Financial Report for fiscal 2022, with revenue corrected for inflation. "The Troubling Gap" chart was separately provided by WMATA as a snapshot.

SOURCE: Washington Metropolitan Area Transportation Authority

CONTINUED FROM PAGE 22

But even as its most stark financial question mark, perhaps ever, hangs over the authority's core operations, which include Metrorail, MetroBus and MetroAccess transit services, neither government officials nor developers, not everyday riders nor its own leaders can agree on a workable solution. And that will come at a heavy cost.

"In fiscal year '25, we do not have enough money to run what we run today," Clarke said in an interview. "We have a fiscal structural issue, and one way or the other, this region's going to have to come to grips with that."

Like plenty of regional landowners and developers keyed into transit-oriented development, Comstock Holding Cos. Inc. officials can't help but be worried for Metro's future, said COO Tim Steffan.

"If the federal government paid its fair share as a [WMATA] Compact member in terms of an operating subsidy, we could provide instant and significant relief."

U.S. REP. GERRY CONNOLLY, D-Va.

The Reston developer, he said, has put "a tremendous amount of capital and quite frankly confidence in the promise of continued Metro operations."

Anatomy of the problem

Metro's financial crisis specifically rests with its operating budget.

Its capital funding needs, or money that goes toward bus stop or railway station renovations, for instance, already have a long-term funding plan in place through the local jurisdictions and federal dollars.

In 2018, as they aspired to lure Amazon.com Inc.'s transit-hungry HQ2 campus, D.C., Maryland and Virginia leaders reached a historic deal to provide Metro its first-ever "dedicated" capital revenue stream – meaning future funding availability is planned and legislatively committed years in advance. That agreement provides $500 million annually for 10 years for Metro's capital investment program, which Clarke said will be largely expended, except for debt service, by 2030.

But Metro has never enjoyed a similar dedicated funding stream to meet its operational needs, certainly none from the federal government – much to the consternation of many regional leaders, who point out that the federal workforce nevertheless has benefited enormously from Metro's services. And contributions to Metro's operations from the local and state jurisdictions are limited.

"The federal government is a free rider when it comes to operating subsidies," said U.S. Rep. Gerry Connolly, D-Va. "If the federal government paid its fair share as a [WMATA] Compact member in terms of an operating subsidy, we could provide instant and significant relief, and not on a one-time basis, but on an ongoing basis."

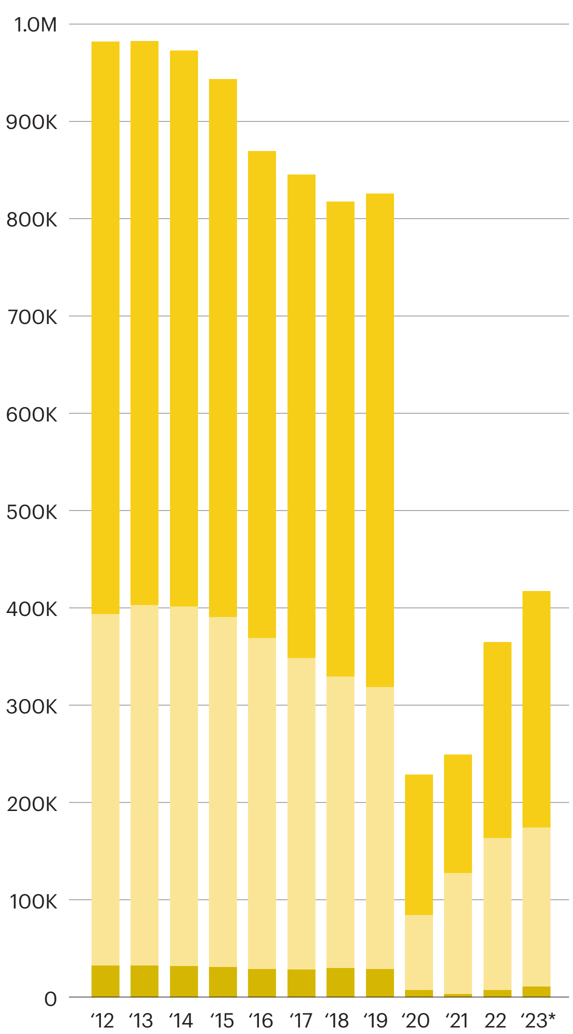
The Covid pandemic – and the resulting tanking ridership and fare revenue facing the country's transit systems – prompted the federal government to issue several rounds of transit relief, including more than $2.4 billion for Metro through the CARES Act, American Rescue Plan and the Coronavirus Response and Relief Supplemental Appropriations Act. That's buoyed the authority's operating budget since 2021, preventing major staff and service cuts. But the last of that relief is running out in the next year, with no clear plan to replace those dollars in the near term, let alone stabilize them over the long term.

"The extent of the gap in

COVER STORY

EMPTY CARS, COFFERS

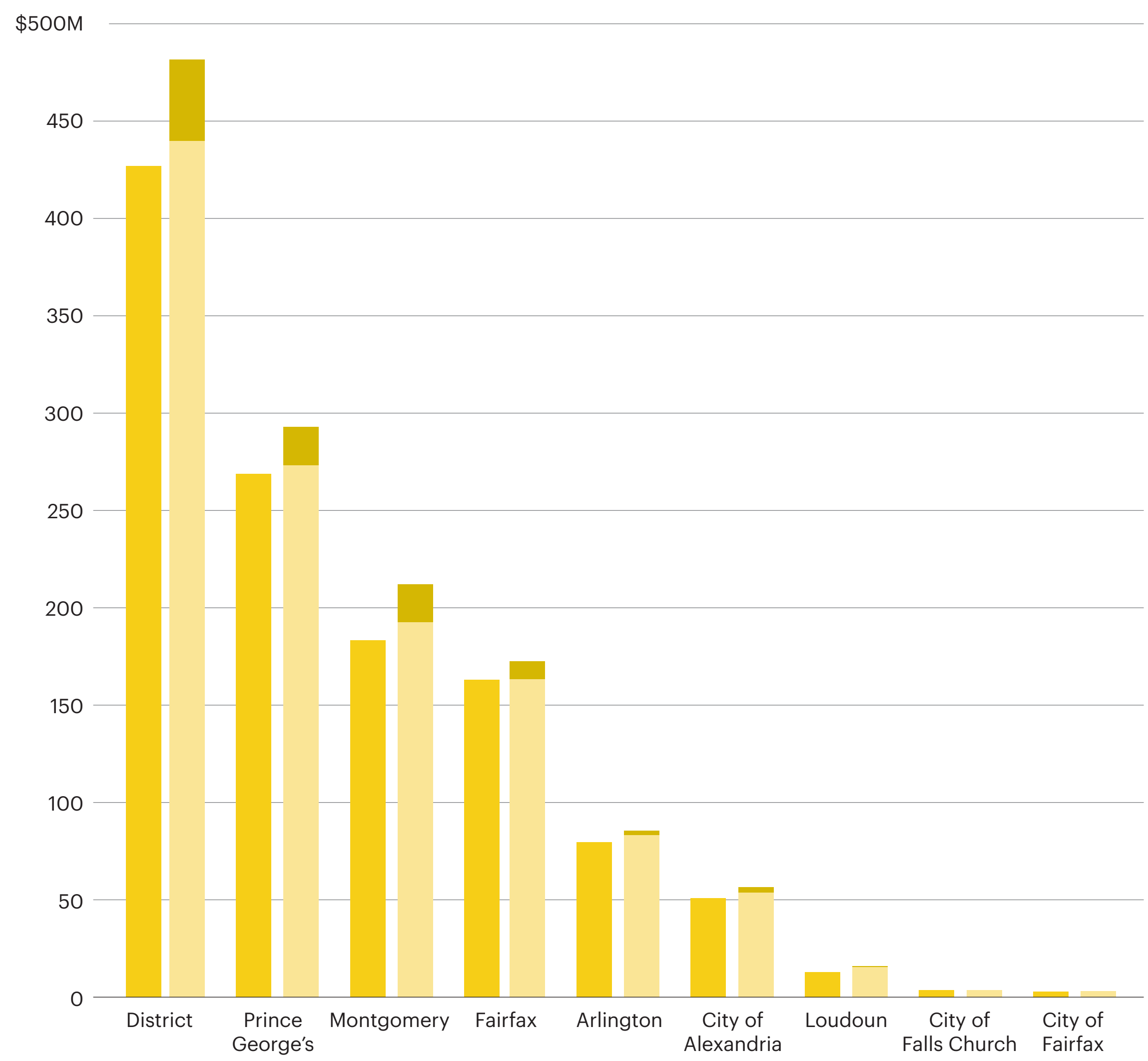
These ridership numbers, which parallel the revenue shifts in the charts to the left, should come as no surprise. Metro's overall ridership and main revenue source had already been slipping before the pandemic brought both to their knees. This year offers a rebound with more riders in the first quarter than all of 2022.



NOTE: *Metrorail riders and parking transactions for 2023 are as of April 4. Metrobus riders are as of March 28.

FROM THE JURISDICTIONS

These fiscal 2024 base subsidies reflect the preprescribed 3% rise from the prior year across each of D.C., Maryland and Virginia — an annual cap on allotments that's challenged Metro's ability to keep pace with its expenses. But at the locality level, some pay bigger shares than others or saw bigger increases year over year, especially those with smaller bills like Loudoun County, Fairfax City and Alexandria. Each also chips in for debt service payments and costs legislatively excluded from the cap, such as $24 million in bus and rail improvements and $200,000 for the Potomac Yard station.



SOURCE: Washington Metropolitan Area Transportation Authority

FY2025, when combined with the high percentage of fixed costs to maintain transit infrastructure, would require such deep service reductions that significant portions of the region would be without any transit service," Metro spokeswoman Sherri Ly said.

Financially, what goes out is vastly outpacing what comes in. That's always been the case, but now the gap, exacerbated by Covid, is widening.

"Metro had a structural issue that preexisted Covid, and Covid just accelerated it," WMATA board member and Loudoun County Supervisor Matt Letourneau, R-Dulles, said in an interview. "Even if Covid hadn't happened, at some point in time, probably in a couple of years from now, we would have reached the point where revenue for Metro is not enough to cover the expense growth."

Preexisting conditions

Before the pandemic, in 2019, rail and bus ridership were already on their way down.

Rail had fallen by about 15% and bus by 22%, from highs earlier that decade, according to data from Metro's website. That coincided with passenger revenue sliding by some 19% from 2013 to 2019, according to figures derived from Metro's annual financial report, corrected for inflation.

Metro is currently forecasting a 75% recovery of ridership to pre-pandemic levels by fiscal 2025 – perhaps an ambitious climb. But even if it recovered 100%, Metro would still face a structural operating deficit under today's formula.

As is common among employers, personnel costs are Metro's largest operating

CONTINUED ON PAGE 26

DECADES-OLD REPORT WARNED OF METRO'S FINANCIAL DOOM

Randy Clarke keeps a copy of a key report that urges for actions to "make Metro work."

It was written in 1976.

The report, which calls for a regionwide gas tax to cover Metro's operating deficit, was published by a then-local research group, the Washington Center for Metropolitan Studies. It was authored by Edwin T. Haefele, then a consultant to the center and a professor of political science and public policy at the University of Pennsylvania. It was commissioned by the Eugene & Agnes E. Meyer Foundation and the Ford Foundation — "out of a growing conviction that the unfolding troubles of Metro potentially pose one of the gravest fiscal and political crises ever confronted by Washington."

And it now has a permanent place in Clarke's office.

Here's an excerpt from the summary of the "Making Metro Work" report, arguing for implementation of a gas tax for the system's financial viability: "The tax on gasoline would 'cover a reasonable deficit, act as an incentive for WMATA [Metro] to keep the deficit within bounds, relieve the present strained local tax sources (particularly the property tax), absolve the local jurisdictions from unlimited responsibility for the operating deficits, and force WMATA to think seriously about pricing policies on a systemwide basis.'

"Enactment of a gas tax is, however, only one of a number of interdependent actions recommended in the report as necessary to make Metro work. And the central point of the report is that "the whole enterprise must be renegotiated if it is to succeed."

Metro, says the report, can no longer be made to work under the present agreements among participating governments. The principal reason for this is that change is being forced on the system by major events, like greatly increased capital cost, the mounting operating deficit, new requirements for federal cost sharing and slowed growth. Thus, it said, "facing up to the task of putting together a new agreement on Metro is the first order of business for the region."

– Hannah Denham

COVER STORY

Pictured: *Riders climb on and off a railcar at L'Enfant station. Given the rate of federal riders over the years, localities have long appealed for more federal funds.*

CONTINUED FROM PAGE 25

expense, and some of its labor obligations require it to factor in inflation salary and wage boosts. In fiscal 2022, which started July 2021, "labor and fringe benefits" cost $1.4 billion, accounting for about 45% of operating costs, according to the authority's most recently available financial statements.

Metro has sought to diversify its revenue, such as through joint development of pieces of its considerable real estate portfolio. It collects smaller pots of money through leases and advertising, as well. But none of those pools can measure up to the oceanic gap, and there seems little hope of discovering an untapped revenue goldmine internal to the transit system.

Even as its revenue falls and its expenses inflate, Metro can't send the contributing local governments a bigger bill. By state law in Virginia and Maryland, Metro cannot ask for more than a 3% increase in operating subsidy from one year to the next. Some things are excluded. In Virginia, for example, the cap doesn't apply to "major capital projects" or "service increases," per a 2020 report from the Northern Virginia Transportation Commission – covering the Silver Line extension is an example. But in general, increases to Metro's operating subsidies are legislatively constrained for existing operations, Letourneau said.

The result is that Metro would operate at a considerable loss, without significant government subsidies – which is common for U.S. metro transit systems. Between July 2021 and June 2022, jurisdictional and federal subsidies clocked in at around $1.7 billion, plus another $1.3 billion toward Metro's capital needs.

"When you have growth that is faster than 3%, and you have a cap on subsidy growth of 3%, the math just doesn't work," said Allan Fye, NVTC's director of programs and policy. "That's one of the structural challenges."

The operating subsidy growth cap also means that, even if Metro's presence improves local and state tax bases – such as by attracting new construction and jobs that boost local real estate and state income tax revenue reserves – there's a ceiling to how much of that gain Metro itself can reap.

New development around Metro stations might increase transit ridership, and thus direct revenue to the transit authority by "a little bit," said P.S. Sriraj, director of the Urban

COVER STORY

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Transportation Center at the University of Illinois at Chicago. But "the benefit goes mainly to the community, not to the transit authority."

New development around transit stations will "affect favorably the image of transit, and some ridership," but in terms of the transit authority's own fiscal health, he added, "it's not going to be a big mover and shaker as it plays out in the long run."

'We're working on it'

So, what's the solution? And how does Metro sustain itself in the meantime? Greater Washington's government leaders have a few ideas and say they're working on it – but nothing tangible is ready yet.

"State and local jurisdictions need to just get their head around the notion that it is going to cost more money to provide the funding necessary for us to have a world-class public transportation system."

TERRY CLOWER, director of the Center for Regional Analysis at George Mason University

Whatever the solution, the warning signs seem to point to Metro's participating states and localities eventually needing to kick in more money – whether through their own budgets or dedicating some other funding stream, Clarke said. Some local and state leaders agreed in interviews and statements to the Washington Business Journal that the solution requires the jurisdictions working together in that way, including the Democratic Maryland Gov. Wes Moore, Republican Virginia Gov. Glenn Youngkin, Maryland House Majority Leader Marc Korman, D-Montgomery County, U.S. Rep. Don Beyer, D-Va., and U.S. Sens. Tim Kaine and Mark Warner, both Virginia Democrats.

Spokespeople for the U.S. Department of Transportation and D.C. Mayor Muriel Bowser's office did not respond to multiple requests for comment. The Northern Virginia Transportation Authority declined to comment.

But others explain the reasoning behind that route: It's likely not enough for Metro to just structure its operations more efficiently.

"State and local jurisdictions need to just get their head around the notion that it is going to cost more money to provide the funding necessary for us to have a world-class public transportation system that will remain – that can remain – a key asset for attracting and retaining talented workers that our employers need to justify staying here to do business," said Terry Clower, director of the Center for Regional Analysis at George Mason University.

It's something Northern Virginia is seriously considering, Fye said. NVTC, which manages the funding for the six cities and counties that foot Metro's bill, is hiring an external contractor to partner with its working group on Metro's operating funding situation.

"But getting everybody on the same page for this type of structural reform is not an easy thing," Letourneau said, noting that similar past successes, such as the creation of the Washington Metrorail Safety Commission, Metro's independent oversight agency, in 2017, and the dedicated capital funding in 2018, took the business community's attention and vast political coalition-building. "Those both took a long time."

Korman, Montgomery County's representative to the Maryland House of Delegates, pointed out that in the past, the Metropolitan Washington Council of Governments has helped facilitate discussions, and he's hopeful it can again.

In the meantime, once Metro wraps up its current budget process for fiscal 2024, he said he wants to get an actual price tag on what's needed, and why, before the jurisdictions can figure out how to get there.

"We really need to have a better idea of what the total need here is," he said. "We'll have a lot of incentives from the jurisdictions to chart a path forward."

But Clarke said Metro doesn't have a specific number because its needs aren't monolithic and change year to year.

"What we need to do is figure out a model, that Metro doesn't do this every couple of years – go, if you will, hand to mouth or hand open to jurisdictions that also want predictability in their funding," Clarke said. "We need to work with our partners to define in a lot of ways, not just what the dollars are, but the sourcing of the revenue, so everyone is in this together and we don't just kind of do Band-Aid after Band-Aid."

GETTY IMAGES

A NATIONAL VIEW: HOW PEER TRANSIT SYSTEMS ARE COPING

Many transit systems across the United States have suffered post-Covid declines in ridership and watched fare revenue plunge — and now face the evaporation of federal relief dollars in the next several years.

New York City's subway system (pictured) is a common comparison for WMATA's system — though, Clarke has often pointed out its differences as well. But even this system is facing a cliff of deficits that could climb to nearly $3 billion by 2026. So far, per the system's financial plan for the next three years, New York Gov. Kathy Hochul has proposed increasing already-existing taxes and payments to the MTA system, adding more one-time, pandemic-related relief, and using licensing fees and annual tax revenues from casinos in the state to contribute to MTA's revenue starting in 2026.

MTA said in its three-year financial plan that this — along with more efficient operations, proposed fare and toll increases, and other actions — will balance MTA's operating budget through 2026, and potentially beyond. However, Hochul's budget, which was introduced in February, has yet to be approved.

Further west, Chicago's Regional Transportation Authority, which oversees the budgets for that metro area's three transit operators, collects funding for its operating budget — which totaled $3.4 billion in 2022 — in a variety of ways. One of those is a sales tax in six counties, which was expected to generate about $1.5 billion last year. The authority has said on its website that the sales tax funding avenue has produced "record levels" of funding, far beyond the operating budget's expectations.

Beyond federal relief expected to run out in the next few years, other operating funding sources for Chicago's transit system include fares, advertising, concessions, rentals, real estate transfer tax and several state pots of money, including a public transportation fund, reimbursement for the system's debt service payments on its capital program bonds and money for ADA Paratransit.

Even still, Chicago's transportation authority is sounding the alarm about a future $700-plus million budget shortfall each year starting in 2026, given plummeting ridership. It said it's working on a 10-year financial plan with its partners, to be finalized this year, to find solutions, per the authority's website.

– Hannah Denham