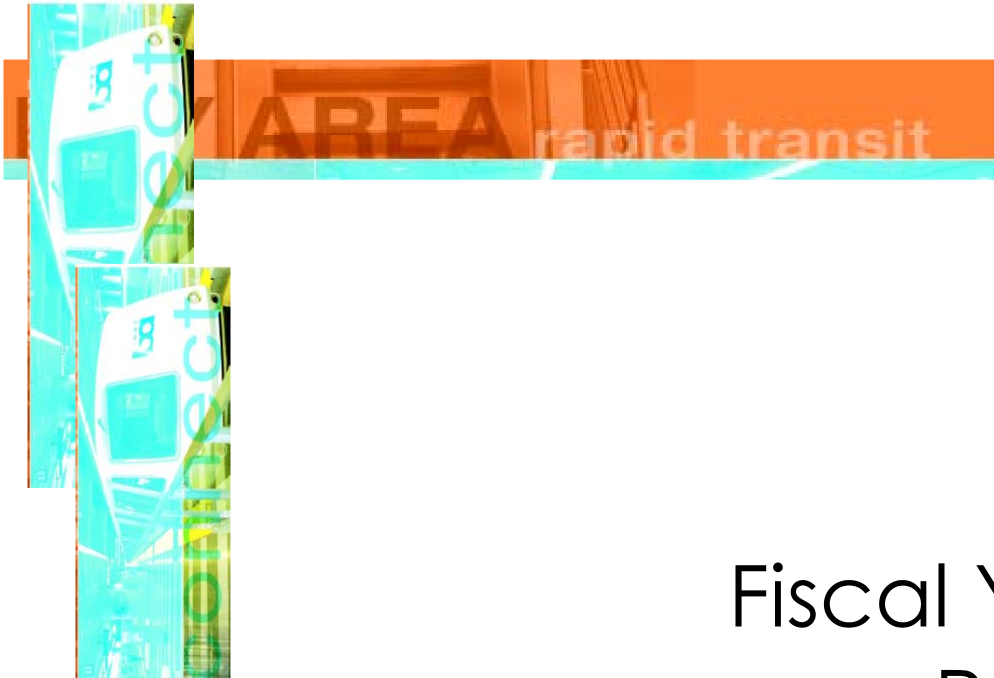


Fiscal Year **2006** Preliminary Operating Budget

San Francisco Bay Area Rapid Transit

March 31, 2005

BART BAY AREA rapid transit

CONTENTS

SAN FRANCISCO BAY AREA RAPID TRANSIT DISTRICT

MEMORANDUM

TO: Board of Directors **DATE:** March 31, 2005

FROM: General Manager

SUBJECT: **Fiscal Year 2006 Preliminary Operating Budget**

In January, staff presented the FY 2006 Pro Forma Budget to the Board. As detailed then, the next fiscal year continues a trend that we have experienced for the past four years, in which expenses are growing faster than revenues. Unfortunately, this sobering trend does not improve over time. Indeed, without changes to current policies, we expect operating deficits averaging $50 million (M) annually to continue for the next several years. In the 2005 Short Range Transit Plan (SRTP), we projected that the cumulative ten-year deficit would total over $350M. Balancing this year's budget with ongoing actions for revenue increases and expense reductions would reduce the ten-year deficit substantially.

After three years of cutting both operating positions and non-labor expenses, the task of balancing this year's budget without impacting service has become ever more challenging. In fact, the FY06 Preliminary Budget, unlike the budgets of recent years, is not balanced—it still has a projected deficit that totals $30.4M. While this represents a significant improvement to the $51M pro forma deficit provided to the Board in January, more difficult decisions will be required to bring expenses and revenues into line. The Preliminary Budget does not incorporate potential revenue sources presented to the Board at the March 3 Revenue Enhancement Workshop. If the recommended enhancements are approved, they could reduce the deficit by $3-4M. Given the limited opportunities for revenue enhancements further reductions will be essential to close the remaining difference.

A modest fare increase of 3.7%, which will add $0.05 to the shortest trip and $0.20 to the longest trip, is built into both the Pro Forma and Preliminary Budgets. No further action is required to implement the fare change, based on the Board's action in May 2003 that approved fare increases every other year based on the growth in the Consumer Price Index (CPI) less ½% to ensure District productivity improvements.

Unlike most transit agencies in the Bay Area, BART has been able to avoid reductions to service levels for the past four years, despite increasing financial pressures. Once again, the FY06 Preliminary Budget assumes no reduction in safety, service reliability, frequency, or number of trains. Service on the West Bay extension may be reduced, depending upon the outcome of discussions with SamTrans. We are committed to protecting the service levels, so that as the economy improves, we will be poised to capture riders and reduce congestion in the Bay Area. To maintain service levels, however, the Preliminary Budget relies on increased efficiencies at all levels of the District. Train lengths will be adjusted to align more closely with the District load factor policy.

For the fourth straight year, staff is recommending position cuts -- next year 115 operating positions would be eliminated, saving about $13M. We hope to continue the success of previous years, in which only 15 people have actually been laid off and not returned to jobs in the District, even though 418 operating and 143 capital positions have been eliminated. Approximately half of 115.5 positions slated for elimination are currently vacant. We would expect that number to grow by year-end due to attrition.

In developing recommendations for the Preliminary Budget, we noted four key elements of the Financial Stability Policy adopted by the Board of Directors that continue to be particularly applicable:

- Adjust operating expenses as needed to reflect changes in service demand, technology and productivity improvements.
- Implement technology and productivity advancements designed to reduce or avoid increasing operational costs.
- Provide for an allocation to capital programs adequate to meet baseline reinvestment needs for programs that are essential to ensure system performance.
- Use reserves in times of significant revenue decline to preserve the District's ongoing ability to deliver safe and reliable service to the customer.

Over the past several years we have been able to achieve expense reductions while maintaining basic service frequency, safety, reliability and on-time performance. We are confident that the reductions we proposed for FY06 do not compromise these priorities. However, with a smaller workforce resulting from prior year cuts we have had to re-examine and streamline functions in order to ensure adequate resources to focus on the most important priorities of customer service. Therefore, as we began the FY06 budget process, we reviewed the management structure of the entire District, with an eye towards streamlining management, and consolidating functions where possible to achieve savings without impacting service.

To that end, we are proposing to reorganize functions in several departments. The most significant changes include restructuring the Real Estate Department and allocating its functions to other existing departments, merging the Human Resources and Performance and Learning departments, consolidations of small administrative groups within the Planning and Budget Executive Office and System Safety, and reconfiguration of the Operations Liaison Department into an Operations Planning Department which will merge several service and capacity planning functions from Transportation, Operations Liaisons, and the Planning and Budget Executive Office.

As part of the proposed position reductions for next year we are eliminating 20 manager positions, 12 through position elimination with an additional 8 manager positions to be downgraded. In total, manager positions will be reduced by over 16%. With these reductions, manager positions represent about 3% of the operating budget funded workforce.

Ridership & Sales Tax

Turning to resources, revenues are more stable, as the Bay Area continues to slowly recover from the economic downturn of several years ago. Sales tax assistance and other revenues have slowly begun to grow again. In the first six months of FY05 we saw a slight growth in ridership. However, in recent months, the District is seeing a slowdown in the rate of growth of ridership, a cause for concern for the FY06 budget.

Operating Expense

Regarding expenses, benefit costs continue to escalate at alarming rates (a 66% rate increase in the past four years) and are projected to increase by over 70% over the next four years. Retiree medical benefits are an area of particular concern, as we develop a better understanding of the unfunded liability for this benefit in accordance with upcoming accounting changes for post-employment benefits. (The unfunded liability is currently projected at $284M over the next 30 years.) There is growing concern that this benefit will not be sustainable without future changes. There is also a major unknown factor for FY06 – labor contracts expire June 30, 2005, and labor costs represent 75% of the operating expense budget. Negotiations offer opportunities to address difficult issues of wage and benefit growth, sustainable funding for retiree medical benefits, and productivity enhancements.

Preliminary Budget Recommendations

The FY06 Pro Forma Operating Budget presented to the Board of Directors in January had a shortfall of $51M. The deficit was subsequently revised to $53M, based on adjustments described later in this memo. Staff recommends the following actions to reduce the projected deficit to about $31M:

- Do not assume any wage increase, lowering the deficit by **$8.5M**
- Eliminate 115.5 operating positions, saving about **$13.1M**
- Reduce non-labor costs by **$0.5M** (The Pro Forma Budget did not assume any increase for inflation in non-labor expenses, which amounts to approximately $2M so, in essence, they have already been cut by about 3%.)

Unlike the past few years, the Preliminary Budget does not propose any use of reserves. In the past three years, the budgets have relied on a small amount of reserves as the final step to balance the budget (about $5M in each year). However, until this year, we have been able to end the year without using the reserves. At the end of FY05, we expect to have less than $20M in operating reserves, $10M serving as a backstop for implementing Phase 1 of the Business Advancement Plan (BAP) until the Millbrae building is sold. A small portion of the reserves could be used in FY06, but they would only be sufficient to close the gap if other measures are first employed to reduce the deficit beyond that shown in the Preliminary Budget.

Potential Revenue Increases

At the March 3 workshop the Board reviewed a variety of potential revenue enhancements. The proposals included possible changes to parking programs, new advertising sources, a fare surcharge to help fund critical capital reinvestment needs, and a reduction to the fare discount for seniors, disabled passengers and children (currently a 75% discount). Based on feedback from the Board at that workshop, a public hearing will be held on April 28 to receive comments on the potential revenue items. On May 12, the Board could consider some or all of those revenue enhancement items for approval, and they would then be incorporated into the final budget that the Board will consider for adoption on June 9, 2005.

Capital Budget

The Preliminary Budget assumes an operating allocation to capital of $13.8M. The allocation would cover local match for federal funds ($6.5M), station improvements and facility renovation, non-revenue vehicle replacements (primarily for BART police), and inventory items. These funds are essential if the District is to maintain its facilities and equipment in a state of good repair, as external funding is not available to pay for these types of investments.

The District is also committed to modernizing our outdated business information systems and streamlining our business practices, and has embarked on the BAP. We anticipate that we will complete Phase 1 in the Fall of 2005, with a three-month period of postproduction support (Phase 1 includes new payroll, time & labor and Human Resource systems). By the beginning of calendar 2006, we are committed to embarking on the second phase of the program, which will cover the remainder of the District's business systems, including the accounting and the material management systems. Although the Board has approved the entire program, no specific funding has been identified to complete Phase 2, which is estimated to cost about $17.5M. To date, staff has identified about $6.5M in available funding primarily from the completed A & B Car Rehabilitation project that can be re-allocated to the BAP Phase II, and we will continue to look for other funds that can be re-allocated. The balance of the funding, however, will likely require use of a portion of the District's capital reserves.

As always, the FY06 annual budget will include both an operating and a capital budget. Updating of the capital budget forecast continues at this time as we receive additional information on the changing funding outlook at the federal, state and local levels. The capital budget will also be affected by action on the proposed operating-to-capital allocation included in this Preliminary Budget. The scope of the original system renovation program is essentially complete, but ongoing work will continue in FY06 using primarily federal funds for the train control, traction power, and trackway programs. The largest single capital project in the coming year will be the Earthquake Safety Program, which benefits from passage last year of both Regional Measure 2 (RM2) and the BART general obligation bond measure. The State Route 4 project will advance into environmental assessment and preliminary engineering using RM2 funds. Grant-funded project development will continue on the Warm Springs, Oakland Airport Connector, and Silicon Valley extension projects as well, although all three projects face uncertainty in their funding programs. Further refinement of the capital budget continues, but it currently appears that there will be a reduction of 17.5 capital positions next year.

Next Steps

To date, I have met with the leadership of each union to review the Pro Forma budget challenges facing the District. We had productive discussions, including suggestions of new potential revenue sources, most of which were included in the March 3 Revenue Enhancement Workshop. In addition, we have provided extensive information in response to detailed requests for current and historic financial data.

Staff anticipates the following schedule for the FY06 Budget:

- April 14: The Board will begin discussing the Preliminary Budget at the Administration Committee. Staff will present the highlights of the budget, and incorporate Board comments.
- April 28: The Board will hold a public hearing on both the FY06 Preliminary Budget (as required by Board policy), and on potential revenue enhancements.
- May 12: The Board could consider approving revenue enhancements to be included in the final budget. The Board could also continue discussion on the budget, and provide additional direction to staff for developing the Final FY06 Budget.
- June 9: The Board would consider approving the Final FY06 Budget.

Since labor negotiations will likely not be completed by June 9, the Board could consider several options regarding the Final FY06 Budget, including approving an unbalanced budget. Staff recommends that the Board make decisions as early as possible on the revenue items that will be considered at the public hearing, so that we can begin implementation steps and maximize revenue in the first year. Additionally, given that expense reductions will be necessary in any case, staff recommends that the Board decide on the expense reductions that are presented in the Preliminary Budget. After contract negotiations are completed, staff will incorporate the changes into the budget and determine what additional measures may be needed.

If you have any questions on this memo, or any other aspect of the budget, please call me or Kathleen Kelly at 287-4752, or e-mail her at kkelly@bart.gov.

T. E. Margro

Thomas E. Margro

1. FY06 Preliminary Budget

Update from Pro Forma

The projected shortfall of $51.0M reported in the January Pro Forma Budget Memo was revised upwards to $53.4M after a thorough technical review and updating of assumptions. Sources increased $1.2M in the revised estimate:

- Sales tax: Increased $2.0M due to stronger than budgeted year-to-date growth
- Passenger revenue: Reduced by $3.7M due to lower than expected FY05 ridership, net of an additional $0.3M from final CPI figures used to calculate the January 2006 fare increase. The reduction is offset by an increase of $1.9M in the SamTrans-SFO Operations payment and a $0.4M reduction in the allocation of Premium Fares to the CAPRA reserve.
- Interest: Increased $0.7M, due to higher interest rate projections
- Advertising: Increased $0.1M, due to the tunnel advertising
- Other small miscellaneous changes lowered sources approximately $0.1M

However, adjustments increased expenses $3.6M, more than offsetting the revenue changes:

- Outside legal costs: $1.4M, for litigation currently underway
- Contractual cost of living adjustments (COLA): $1.2M, per current labor contract
- Debit/credit fees for ticket sales and outside ticket sales commissions: $0.8M
- Other small miscellaneous changes increased uses approximately $0.2M

The $53.4M shortfall is a result of the fact that expenses continue to grow faster than revenues, reflecting the trend of the past four years. Compared to FY05, expenses are projected to increase by $70.9M while revenues are growing by only $17.5M. As articulated in the Pro Forma Budget Memo and presentation, the current year total budget for operating sources is still 2% lower than actual sources in 2001, core system ridership is below that of four years ago, and sales tax is below 2001 levels by 8%. Meanwhile, costs for wages and benefits (75% of the operating expenses) have continued to rise. Over the same four-year time period, wage rates increased 24% and benefit rates increased 66%. To bring expenses in line with revenues in each of the past three years, BART has had to cut operating positions and non-labor expenses.

An additional challenge for this year, as well as upcoming years, is funding the $284M liability for the District's retiree medical benefit. This benefit began for BART employees in 1993 (somewhat later for some bargaining units). Unlike other post-employment benefits, such as pension benefits, which are strictly tied to the employee's tenure, and for which the District accrues funding from the date that the employee begins working, the retiree medical benefit was available immediately upon enactment to all employees vested in PERS. Until now, the District has paid for the benefit on a pay-as-you go basis. In the near future, though, BART and other public agencies will need to fund the benefit in a manner more similar to pension payments for two reasons: 1) the pay-as-you-go rate is growing rapidly and will soon outpace the District's ability to cover the costs, and 2) new accounting standards will require public agencies such as BART to fund an actuarially determined "annual required contribution" or recognize the unfunded liability on its balance sheets. More information is shown in the Retiree Medical Insurance Funding Attachment.

I N C O M E   S T A T E M E N T

	Budget FY05 Adopted	Budget FY06 Preliminary	Change $	Change %
S O U R C E S				
Passenger Revenue	239.3	**247.9**	8.6	4%
Other Operating Revenue	11.3	**12.1**	0.8	7%
Parking Revenue	3.8	**3.8**	0.1	2%
REVENUE TOTAL	**$ 254.4**	**$ 263.9**	**$ 9.5**	**4%**
Sales Tax Proceeds	176.0	**188.5**	12.5	7%
Property Tax Proceeds	22.6	**23.1**	0.5	2%
SamTrans SFO - Operations	16.8	**15.7**	(1.1)	-7%
Other Assistance	1.4	**1.5**	0.1	10%
Leaseback Revenue Allocations	3.9	**-**		
TAX & FINANCIAL ASSISTANCE TOTAL	**$ 220.7**	**$ 228.8**	**$ 8.1**	**4%**
SOURCES TOTAL	**$ 475.2**	**$ 492.7**	**$ 17.5**	**4%**
U S E S				
Labor	308.8	**307.2**	(1.6)	-1%
Purchased Transportation	15.1	**15.1**	0.0	0%
Traction & Station Power	21.3	**25.0**	3.6	17%
Other Non-Labor	67.2	**74.8**	7.6	11%
OPERATING EXPENSES TOTAL	**$ 412.5**	**$ 422.1**	**$ 9.6**	**2%**
Debt Service	59.5	**60.6**	1.1	2%
Capital Rehabilitation Allocations	-	**13.8**	13.8	
Retiree Medical Allocation	-	**24.6**	24.6	
Other Allocations	3.2	**2.0**	(1.2)	-37%
ALLOCATIONS TOTAL	**$ 62.7**	**$ 101.0**	**$ 38.3**	**61%**
USES TOTAL	**$ 475.2**	**$ 523.1**	**$ 47.9**	**10%**
N E T R E S U L T	**$ -**	**$ (30.4)**	**$ (30.4)**	
KEY PERFORMANCE INDICATORS				
Operating Ratio	61.7%	**62.5%**		1.4%
Rail Farebox Recovery Ratio	60.1%	**60.8%**		1.1%
Farebox Recovery Ratio	58.0%	**58.7%**		1.2%
Average Weekday Trips	316,593	**320,454**	3,861	1.2%
Passenger Miles (billions)	1.27	**1.29**	0.02	1.8%
Rail Cost / Passenger Mile	31.3¢	**31.5¢**	0.2¢	0.6%

Note:

The Preliminary Budget Memo is organized in terms of sources and uses. This view is summarized in the income statement as well as shown in the pie charts at the end of this report. Please note that the numbers throughout this report are generally rounded to the nearest $0.1M and some variation might occur due to rounding.

Below are the major assumptions used in preparing the FY06 Preliminary Budget:

Sources

- **Total annual ridership growth** over FY05 actual/estimates projected at 2.8%.
- **Rail passenger revenue** is based on a CPI-based 3.7% fare increase effective January 1, 2006.
- **Sales tax revenue growth** of 4.8% over FY05 actual/estimate, based on historical trends.
- **Property tax revenue growth** of 5.5% over FY05 actual/estimate, based on historical trends.
- **The BART-SamTrans Comprehensive Agreement** continues to be neutral to the BART budget.
- **Proposed revenue enhancements** are not included in Preliminary Budget.

Uses

- **The service plan** assumes tighter control over the use of car hours and more careful scheduling of special event trains, resulting in reduced power and maintenance costs. Concurrently, we are more closely matching train lengths to our load factor standards to size trains to demand.
- **No wage increase** is included.
- **Benefit** rates for pension are known. Medical rates are known for the first half of the year and are estimated for the second half of FY06.
- **Retiree medical** is budgeted at $9M for the "pay as you go" insurance premiums for current retirees, a 34% increase over the FY05 budget of $6.7M.
- **Retiree medical liability funding** is included at $24.6M, which represents the total for both operating and capital positions. The capital budget pays for $2.6M of this total through labor charged to capital projects, making the net impact to the operating budget $21.9M. This is $0.9M lower than the $22.8M included in the FY06 Pro Forma Budget because of the removal of the wage increase assumption, which affects the retiree medical funding since it is based on base pay.
- **Non-labor** base budget items in department budgets are not inflated 3% for inflation, unlike most years.
- **Power** is based on historical usage and scheduling, and reflects projected rates for electricity, delivery/transmission, and authorized regulatory charges.
- **Proposed budget reductions** of $13.6M are included in the Preliminary Budget.

2. Operating Sources

This section covers each of the operating sources listed in the Income Statement.

Much of BART's revenue from ridership and financial assistance depends on interrelated factors including employment levels, business activity, population growth, housing, tourism, and freeway congestion. The economic downturn that began in 2000 hit the Bay Area particularly hard. Over 450,000 jobs were lost and approximately 20,000 residents continue to leave each year because of reduced employment opportunities.

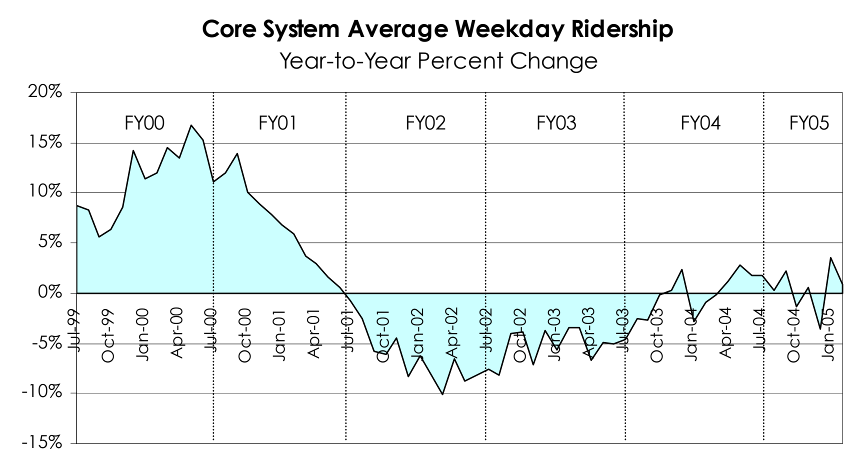
After nearly five years, the Bay Area's economy is slowly recovering from this downturn. Short-term expectations for the Bay Area include slow-to-moderate job growth in 2005 and 2006, with inflation remaining in check. The local recovery remains slow because of rising energy prices, continuing concerns about security and terrorism, high regional cost structure, impact of Silicon Valley's contraction, and concerns related to the State budget and business climate. Additionally, job growth has been uneven. Taxable sales appear to be slowly recovering, with consumer confidence remaining stable during the past year, the outlook for jobs improving, and business investment increasing.

2.1 REVENUE

2.1.1 Ridership and Passenger Fare Revenue

After several years of steep declines, rail ridership is slowly improving. The chart below indicates the steep rise, and then equally steep decline, in ridership over the past several years. The final four stations of the SFO Extension opened in FY04 and adds, on average, 28,000 trips per weekday to the system. However, to facilitate multi-year comparisons, the chart below maps only the 38-station core system.

During the past few months, ridership has fallen slightly behind the FY05 budget. Total annual trips are estimated to end the year 0.6% below budget for the core system and 3.5% below budget on the SFO Extension. As a result, the ridership forecast for FY06 has been revised downward since the Pro Forma Budget was developed.



Working off the revised lower FY05 base, average weekday trips in FY06 are projected to grow 2.8% over the FY05 year-end estimate. This reflects an average growth rate of 2.2% at core stations and 8.6% at SFO Extension stations, where ridership is expected to grow at a faster rate for the first several years of service.

Rail passenger fare revenue generates 50% of the District's total revenue sources and is budgeted to cover 61% of rail operating expense.

Passenger Fare Revenue

($millions)	Budget		
	FY05		FY06
	Adopted	Actual/ Estimated	Preliminary
Net Rail Passenger Revenue:			
Core	$ 212.9	$ 211.7	**$ 219.7**
SFO Extension	25.9	25.0	**27.6**
Subtotal, Rail Fare Revenue	238.8	236.7	**247.3**
ADA Paratransit Revenues	0.5	0.5	**0.6**
TOTAL	**$ 239.3**	**$ 237.2**	**$ 247.9**

Rail passenger revenue is projected to grow $10.6M from the FY05 year-end estimate. Approximately $4.3M of the projected growth is based on a fare increase averaging 3.7% effective for half the fiscal year, on January 1, 2006. Annual revenues for a full year of the fare increase are projected at $8.6M. This increase is the first of four Board-approved biennial productivity-adjusted CPI-based fare increases scheduled to occur over the next eight years, which are based on changes in both national and local inflation, reduced by one-half percent to ensure continued improvement to District productivity. In accord with the Board's direction, before the implementation of the first such increase, staff will bring to the Board in fall 2005 a review of the fare structure, including issues of distribution and equity.

The remaining passenger revenue increase of $6.3M is due to projected ridership growth, both on the core system and on the SFO Extension. The FY06 budget for total annual trips projects growth of 2.8% over the FY05 year-end estimate, based in part on continuation of FY05's strong weekend ridership.

Annual Ridership

	Fiscal Year	Annual Trips (millions)	Year-to-Year %
Actual	FY00	91.1	12.0%
	FY01	97.3	6.8%
	FY02	90.8	-6.7%
	FY03	87.4	-3.8%
	FY04	91.0	4.2%
	FY05 Budget	93.7	2.9%
	FY05 Actual/Estimate[1]	92.9	2.0%
	FY06 Preliminary[2]	**95.4**	**2.8%**

[1] FY05 Act/Est vs. FY04 Actual

[2] FY06 Preliminary Budget vs. FY05 Act/Est

ADA Paratransit Revenue

BART directly collects approximately $0.5M in fare revenue from East Bay Paratransit Consortium trips. This is projected to grow to about $0.6M by FY06. Paratransit revenues cover 6% of the paratransit operating cost paid by BART.

2.1.2 Other Operating Revenue

The District also generates operating revenue from non-passenger revenue sources, which are used to help offset the District's operating costs. The sources are detailed below.

Other Operating Revenue
($millions)

	Budget		
	FY05		FY06
	Adopted	Actual/ Estimated	Preliminary
Telecommunications	$ 4.2	$ 3.9	**$ 4.0**
Advertising	2.8	2.8	**3.1**
Other	3.0	2.7	**2.9**
Interest Earnings	1.3	1.8	**2.1**
TOTAL	**$ 11.3**	**$ 11.2**	**$ 12.1**

Telecommunications Revenue

- Agreements include just under $3.5M in revenues from ten fiber optics carriers and $0.4M in revenues from cell sites on BART property.
- An underground wireless program, using newly installed infrastructure in downtown San Francisco stations, currently generates $0.1M annually. Additional revenue could be generated in the future if additional carriers decide to sign on.

Advertising Revenue

- Revenues are based on a five-year contract with Viacom, which expires in September 2008, to sell and post advertising in the BART system.
- The Board recently approved a tunnel advertising program. During FY06, this program is anticipated to generate $120K.
- A ticket advertising program will also be implemented in FY06. Staff estimates this program will generate $20K in FY06.
- For all advertising programs, an additional $0.1M of management fee revenue is anticipated to offset an equal amount of startup and administration costs.
- Several additional advertising options are currently being pursued, however, these are not expected to generate net revenues until FY07.

Other Revenue

- Includes police fines and forfeitures, public telephones, rental buildings, concessions, other miscellaneous revenues, and parking at Coliseum and Lake Merritt stations.

Interest Earnings

- Interest earnings proceeds have improved as rates have risen. This trend is forecast to continue for the FY06 budget.

2.1.3 Parking Revenue

BART currently has over 46,000 parking spaces at 32 of its 43 stations. Parking fees were first implemented in FY03. Current parking programs are described below.

- The Monthly Reserved parking program is in place at all East Bay and Daly City stations.
- The Daly City parking program includes both Daily and Monthly Non-Reserved elements.
- The West Bay parking program includes monthly reserved, daily, and monthly non-reserved at SFO extension stations. Currently, parking fees are waived at all SFO extension stations with the exception of Colma station. Net revenues from the West Bay program are shared with SamTrans per the Comprehensive Agreement.
- The Core Long-term East Bay parking program was designed to accommodate passengers using the airports who need to park for more than 24 hours.

Parking Revenue
($millions)

	Budget		
	FY05		FY06
	Adopted	Actual/ Estimated	Preliminary
Core Reserved Paid Parking	$ 2.3	$ 2.4	**$ 2.4**
Daly City Parking	0.7	0.7	**0.7**
West Bay Parking	0.6	0.5	**0.5**
Core Long-Term East Bay Paid Parking	0.2	0.2	**0.2**
TOTAL	**$ 3.8**	**$ 3.8**	**$ 3.8**

2.2 TAX & FINANCIAL ASSISTANCE

2.2.1 Sales Tax Proceeds

Sales tax revenue is the second largest source of revenue for the District, after passenger fares, and represents 38% of total sources. The proceeds are derived from a dedicated 75% share of a one-half cent sales tax levied in San Francisco, Alameda and Contra Costa counties.

- Sales tax receipts for the third quarter of FY05 indicate that this revenue may finally be improving. Year-to-date receipts for FY05 have increased 6.2% from the same period in the prior year (still a 6.7% decrease from the same period in FY01, the peak of BART sales tax revenue).
- FY05 is currently estimated to

Sales Tax Proceeds
($millions)

		Sales Tax	Year-to-Year Change
Actual	FY00	$ 170.9	12.6%
	FY01	191.6	12.1%
	FY02	172.8	-9.8%
	FY03	167.4	-3.1%
	FY04	170.6	1.9%
	FY05 Budget	176.0	3.2%
	FY05 Actual/Estimate[1]	179.9	5.5%
	FY06 Preliminary[2]	**$ 188.5**	**4.8%**

[1] FY05 Act/Est vs. FY04 Actual

[2] FY06 Preliminary Budget vs. FY05 Act/Est

complete the year 5.5% over FY04 actual.

- Since growth continues to be unpredictable, and the strength of the recovery is unknown, FY06 growth is budgeted at 4.8% over the FY05 actual/estimate.

2.2.2 Property Tax Proceeds

Property tax revenues come from a permanent, dedicated assessment in the three BART counties.

- Despite job losses and other economic concerns, the local housing market is still robust, and real estate prices are higher than ever. This has resulted in strong property tax growth over recent years and is expected to continue into FY06.
- After BART's FY05 budget was finalized, the State redirected 3% of BART's property tax to an Education Realignment Augmentation Fund (ERAF), created as part of the State budget balancing process for FY05.
- The effect of this loss is seen in the FY05 actual/estimate. This State imposed reduction will also affect FY06.

Property Tax Proceeds
($millions)

		Property Tax	Year-to-Year Change
Actual	FY00	$ 15.5	7.2%
	FY01	17.0	9.9%
	FY02	18.7	10.0%
	FY03	20.3	8.2%
	FY04	21.4	5.5%
	FY05 Budget	22.6	5.7%
	FY05 Actual/Estimate[1]	21.9	2.6%
	FY06 Preliminary[2]	**$ 23.1**	**5.4%**

[1] FY05 Act/Est vs. FY04 Actual

[2] FY06 Preliminary Budget vs. FY05 Act/Est

2.2.3 SamTrans SFO Operations

The operation of rail service and the five stations south of Daly City Station into San Mateo County is governed by a comprehensive agreement between BART and SamTrans. The Colma Station opened in 1997 and four other stations, including the San Francisco International Airport and Millbrae stations, opened in 2003.

SAMTRANS-SFO OPERATIONS
($millions)

	Budget		
	FY05		FY06
	Adopted	Actual/ Estimated	Preliminary
BART-SamTrans Comprehensive Agmt	$ 16.4	$ 17.3	**$ 15.5**
Caltrain-Millbrae Station Joint Use	0.5	0.5	**0.5**
Ancillary Revenues[1]	-	(0.2)	**(0.3)**
TOTAL	**$ 16.8**	**$ 17.5**	**$ 15.7**

[1] Ancillary revenues were initially reported as a use of funds during the FY05 Budget process.

BART-SamTrans Comprehensive Agreement

- The operation of the extension is revenue neutral to the budget for the operation of the other 38 stations on the BART system.
- Operating costs not covered by fare revenues are paid by SamTrans. As ridership grows and fare revenues increase, the SamTrans payment decreases.
- Service levels are currently under review with SamTrans. Depending on the outcome, service levels and the associated FY06 budgeted payment from SamTrans may change.

Caltrain-Millbrae Station Joint Use

- As part of operating service to the joint Caltrain station at Millbrae, Caltrain is required to pay for the use, operating, and maintenance costs (UOM) at the station applicable to Caltrain service and passengers.

Ancillary Revenues

- Net revenues generated by ancillary programs on the extension, including parking, advertising, and concessions, are split equally with SamTrans.

2.2.4 Other Assistance

State Transportation Assistance (STA)/Transportation Development Act (TDA)/Other

- The District does not claim STA and TDA funds for which it is eligible until the local bus operator expense associated with express and feeder bus service has been funded.
- Due to large declines in these funding sources, the Metropolitan Transportation Commission (MTC) currently estimates there will be no funding available to BART after covering the feeder bus expense in FY05 and FY06.
- Other assistance includes a one-time grant of $0.1M to fund attended bicycle parking areas at Embarcadero and Berkeley stations.

Measure B Funding

- Alameda County voters renewed this sales tax-based funding source until 2022.
- Provides funds, estimated at just under $1.4M in FY05, growing to just over $1.4M in FY06, for paratransit service within Alameda County.

2.2.5 Leaseback Revenue

The FY06 Preliminary Budget does not include any leaseback revenue reserves.

2.3 REVENUE ENHANCEMENTS

At a Board workshop in March 2005, staff presented revenue-generating ideas for FY06 and years beyond. For revenue generation in FY06, the Board chose the following items to be developed for further consideration. A public hearing is scheduled for April 28 to obtain comments on these proposals. If the Board approves any of these proposals, projected revenue increases will be included in the Final FY06 Budget.

FY06 Revenue Enhancement Options

- Fare surcharge to fund capital allocations
    - A surcharge of a nickel applied to core system trips, implemented in conjunction with the January 2006 fare increase, is estimated to generate nearly $2M in FY06 ($4M annually).
    - The Board directed staff to review a percentage increase to fares that could generate revenue similar to the nickel surcharge, as well as a surcharge level that would generate revenue closer to $13.8M, the allocation to capital currently planned from the operating budget.
    - Surcharge revenue would help fund planned $13.8M capital allocations for required work such as station renovation.
- SamTrans is reviewing increasing the $1.00 San Mateo County Surcharge by an amount equivalent to any BART capital surcharge to help offset operating costs on the SFO extension.
- Reductions to the discount level offered to senior, disabled and child passengers
    - Current discount for senior, disabled, and child passengers is 75% ($24 ticket sold for $6).
    - Discount levels ranging from 70% to 50% are being examined.
    - Lowering the discount to 60% is estimated to generate an additional $2.5M in annual revenue ($1.25M if implemented for half of FY06). A reduction to 50% could generate nearly $3.6M in annual revenue.
    - Consideration will be given to Board interest in mitigating the impact of any discount reduction on low-income seniors, disabled, and children through some form of lifeline service.
- New Paid Parking Programs under consideration include: Single Day Reserved and Reserved Parking Area Expansion/ Daily Paid Parking at six stations / West Bay Long Term/Airport Parking
    - Net parking revenues are minimal in FY06 due to one-time, capital startup costs for signage and installation of parking machines. In addition, despite an accelerated implementation schedule, for FY06 only three months of parking revenues for the single day reserved and the daily paid parking programs are assumed.
    - Further analysis of cost and revenue are underway and will be provided to the Board on April 28.
    - West Bay Long Term/Airport Parking requires joint approval of the SamTrans and BART Board of Directors and a sharing of net revenues.

3. Operating Uses

This section provides an overview of Operating Uses, which include Operating Expenses and Other Uses of Funds. “Operating Expenses” include wages, benefits, materials, power and other labor and non-labor expenses. “Other Uses of Operating Funds” are allocations for debt service, retiree medical reserves and capital.

Operating Use Summary
($millions)

	Budget				
	FY05 Adopted	Base Incr. (Decr.)	Proposed Reductions	Remove Wage Assumption	FY06 Preliminary
Labor	$ 308.8	$ 19.9	$ (13.1)	$ (8.5)	**$ 307.2**
Purchased Transportation	15.1	-	-	-	**15.1**
Traction & Station Power	21.3	4.0	(0.4)	-	**25.0**
Other Non-Labor	67.2	7.8	(0.1)	-	**74.8**
TOTAL - OPERATING EXPENSES	**$ 412.5**	**$ 31.7**	**$ (13.6)**	**$ (8.5)**	**$ 422.1**
Debt Service	$ 59.5	$ 1.1	$ -	$ -	**$ 60.6**
Capital Allocations	-	13.8	-	-	**13.8**
Retiree Medical	-	25.5	-	(0.9)	**24.6**
Other Allocations	3.2	(1.2)	-	-	**2.0**
TOTAL - ALLOCATIONS	**$ 62.7**	**$ 39.2**	**$ -**	**$ (0.9)**	**$ 101.0**
TOTAL - OPERATING USES	**$ 475.2**	**$ 70.9**	**$ (13.6)**	**$ (9.4)**	**$ 523.1**

Base Cost Increase

Prior to recommended actions that are included in the Preliminary Budget, total uses of funds were projected to increase by $70.9M. Operating expenses were projected to increase $31.7M over FY05, mainly due to increased costs for labor and benefits. Total allocations were projected to increase by $39.2M, primarily due to allocations to build up retiree medical reserves and make essential capital investments in the maintenance of the system.

Budget Reductions

The Preliminary Budget incorporates $13.6M in proposed ongoing budget reductions, and also removes the assumption for a 3% wage increase that was included in the Pro Forma Budget, saving $8.5M in wage and benefit cost increases and also lowering the retiree medical reserve allocation (the reserve allocation is based on a percentage of wages) by $0.9M. These two recommended actions total $23M and reduce the projected operating budget shortfall to $30.4M.

Expense growth has been a major factor in budget challenges for BART over the past several years. In particular, costs for health insurance, retiree medical and pension benefits have risen dramatically. Details of the operating expense budget, recommended budget reductions, and allocations are included in the sections that follow.

3.1 SERVICE PLAN

The FY06 Preliminary Budget maintains the current route structure, service levels and number of trains. Service frequencies are unchanged except for the addition of one AM rush period round trip on the Pittsburg/Bay Point line.

A modest reduction in annual car miles is included in this budget and will be achieved by several means. Special event service will be more precisely sized, accomplished in part by the in-house development of systems that provide real time passenger flow information. Improved performance in meeting the scheduled resizing requirements for off-peak trains will allow a reduction in the contingency factor built into the car mile budget. Lastly, some rush hour train lengths will be reduced, resulting in a slight increase in load factors. The resulting rush period load factors, on both a system-wide and a line-by-line basis, will still be lower then the District standard.

Rail Service Plan

	Budget		
	FY04 Actual	**FY05 Adopted**	**FY06 Preliminary**
Peak Trains	60	61	**61**
Peak Cars	514	500	**486**
Total Cars	559	560	**534**
Total Car Hours *(millions)*	2.1	2.1	**2.0**
Passengers *(millions)*	91.0	93.7	**95.4**
Passenger Miles *(billions)*	1.2	1.3	**1.3**

3.2 OPERATING EXPENSES

3.2.1 Operating Expense Summary

The following table summarizes the initial expense increase projected for FY06 and two actions that are incorporated into the Preliminary Budget as recommendations to address the operating shortfall. These actions reduce the initial 8% operating expense increase to 2%, and limit the overall operating expense budget increase to $9.6M. (Increases in allocations, which represent an additional $37.3M increase in uses, are not included in this chart and are discussed later in this document.)

Operating Expenses

($millions)

FY05 Adopted Budget	**$ 412.5**	% incr.
Base Budget Cost Increase	31.7	8%
Remove 3% Wage Increase Assumption	(8.5)	-2%
Proposed Budget Cuts	(13.6)	-3%
FY06 Preliminary Budget	**$ 422.1**	2%

3.2.2 Labor (Wages and Benefits)

The FY06 Pro Forma Budget presented in January assumed a 3% wage increase. In light of the fact that no decision has yet been made regarding wages for next year, and that will not be decided until labor negotiations are complete, the Preliminary Budget assumes a 0% wage increase, for estimated savings of $8.5M in wages. The removal of the 3% wage increase assumption also causes the retiree medical actuarial reserve allocation to decline by $0.9M, as retiree medical funding is based on a percentage of wages.

Even with no wage increase assumed, the increased cost of maintaining existing benefits for FY06 is projected to cause an overall labor increase of $11.4M, or 3.7%, not including the funding to support the unfunded liability related to the retiree medical insurance program that is budgeted as an allocation and discussed later in the document. The primary factors in the increase are active employee health insurance and PERS pension costs. The proposed budget reduction in operating positions offsets the cost increases, and would reduce wage and benefit costs by 4.1%, or $13.1M. Labor and benefit expenses make up 75% of FY05 Adopted Budget operating expenses.

Labor ($millions)	**Budget**		**Change**	
	FY05 Adopted	**FY06 Preliminary**	**$**	**%**
Wages, Overtime & Other Pay	$ 251.2	**$ 251.3**	$ 0.1	0%
PERS Health Insurance	29.3	**33.0**	3.7	13%
PERS Pension	28.0	**42.3**	14.3	51%
Worker's Compensation	12.5	**8.7**	(3.8)	-30%
Other Benefits	27.0	**28.3**	1.3	5%
Capital Labor Credits	(39.2)	**(43.4)**	(4.2)	11%
Sub-total	**$ 308.8**	**$ 320.3**	$ 11.4	4%
Proposed FY06 Reductions		**(13.1)**	(13.1)	-4%
Total	**$ 308.8**	**$ 307.2**	$ (1.6)	-1%

PERS Health Insurance

Health insurance rates have risen by 84% over the past four years based on the composite rate for all BART health plans. This large rate increase is a big driver of the District's overall benefit cost increase of about 66% for the same time period. For FY06, an overall 13% increase in benefit cost from FY05 is estimated. PERS has released the rate for calendar year 2005, and so the rates for the first half of FY06 are known. For the second half of FY06, however, BART must estimate the rates. The January 2006 rate increase for BART employee health plan selections is estimated to be about 14%, but the overall increase budgeted for FY06 is 13% because of a slight change in the mix of health plan assumptions.

PERS Pension
For FY06, as in FY05, BART must also absorb a significant increase in pension costs. Like employee health insurance, the California Public Employee Retirement System (PERS) administers the District's retirement plans. Pension rates are based on a percentage of wages.

PERS has released the FY06 official rates for PERS retirement costs, and even without a budgeted wage increase, the pension budget is 51% higher for FY06 than FY05. The primary driver for this increase is the reinstatement in FY05 of the employer share of PERS, which is a direct result of the ending of the Miscellaneous Plan's super funding status. PERS has also decreased its long-term estimate for its investment return from 8.25% to 7.75%. The phase-in of the Employer share and the lowering of the investment return assumption, combined with demographic actuarial factors such as actual wage increases vs. PERS estimates, caused the employer share to increase substantially from FY05 - from 2.6% to 8.7% for the Miscellaneous Plan, and from 28.9% to 32.3% for Safety employees. The District, according to the current labor contracts, also pays the employee share payment. The employee share payment is fixed at 7% of wages for the Miscellaneous Plan and 9% for Safety.

PERS Pension

($millions)	Budget		Change	
	FY05 Adopted	FY06 Preliminary	$	%
Employee	$ 17.3	**$ 17.3**	$ -	0%
Employer	10.7	**25.0**	14.3	134%
TOTAL	**$ 28.0**	**$ 42.3**	**$ 14.3**	**51%**

Workers' Compensation
BART is self-insured for workers' compensation insurance, and each year an actuarial study is done to establish the level of reserves that must be maintained. The District estimates annual funding for workers' compensation to cover both the annual claims and to increase reserves to cover future payments. In FY05 this funding was increased dramatically (about 50%) to $12.5M, as BART, and all California employers in general, faced large increases in benefit payments. Workers' compensation and general liability reserves are combined when setting the reserve levels for each year. Due to cost-limiting changes to the State workers' compensation system, initial analysis suggests that the level of funding can be reduced to about $9M for FY06. An updated actuarial report will be available in mid-May, and at that time the District will further analyze reserve levels based on more current information, and make a final determination for FY06 funding levels.

Other Benefits
Other benefits have increased by $1.3M or 5% for FY06. The "other benefits" category includes all other benefits, including dental, vision, life insurance, buy-back programs for sick leave and holiday, Medicare, and other employee benefits.

Capital Labor Credits

Capital and Reimbursable credits reflect labor charges that are reimbursed by a capital project or reimbursed by a third party. FY06 Preliminary Budget capital credits are $4.2M higher than in FY05. The main reason is the $2.7M capital labor share of the retiree medical reserve allocation, which is charged back through capital labor to capital projects. Otherwise, the change in capital labor credits is due to a combination of reduced capital positions and the offset of higher benefit costs for staff.

3.2.3 Purchased Transportation

BART pays for certain transportation services other operators provide. Purchased transportation expenses consist of paratransit, which covers the District's share of local ADA paratransit (mainly East Bay Paratransit Consortium and Muni Paratransit); Muni purchased transportation for feeder service that brings passengers to and from BART; express bus service by East Bay bus operators that brings passengers to and from BART; and the AirBART shuttle service that connects the Coliseum Station to the Oakland International Airport. The Purchased Transportation FY05 Adopted Budget and FY06 Preliminary Budget are virtually identical.

Paratransit

- Paratransit ridership is flat in FY05 but is expected to increase in FY06
- Strategies are under development to reduce costs while complying with the federal requirement to provide for 100% of ADA paratransit demand with a high level of service quality

Muni Purchased Transportation

- Payment is based on the percent change in District sales tax receipts over the last two fiscal years, with the exact value determined in June 2005 upon receipt of BART's FY05 4th quarter sales tax receipts

Express Bus

- The capped payment of $2.5M is in addition to the allocation from BART's apportionment of STA and TDA monies that MTC makes to bus operators for express bus service

AirBART Shuttle Service

- Passenger fares continue to cover operating expenses

Purchased Transportation

($millions)	Budget		Change	
	FY05 Adopted	FY06 Preliminary	$	%
Paratransit	$ 10.3	**$ 10.3**	$ (0.0)	0%
Muni Purchased Transportation	2.5	**2.6**	0.1	0%
Express Bus	2.5	**2.5**	-	0%
AirBART	(0.1)	**(0.2)**	(0.1)	65%
TOTAL	**$ 15.1**	**$ 15.1**	**(0.0)**	**0%**

3.2.4 Traction & Station Power

The FY06 Traction & Station Power budget is based on FY05 experience, reflecting power usage and scheduling for the core system as well as the West Bay extension. BART's access to 84 megawatts (MW) of federal electric power continues to benefit the system by providing electric power at a relatively low cost.

- This federal power is comprised of 80 MW in allocations from the Bonneville Power Administration (BPA) and approximately 4 MW from the Western Area Power Administration (Western). Any remaining balance of the District's power needs is supplied by PG&E under bundled retail rates, as supplemental power.
- $1.8M of the FY06 budget and $0.5M of actual FY05 charges may not be needed depending on an upcoming California Public Utilities Commission (CPUC) ruling in response to BART's protest of charges.
- A one-time $3.8M reversal of prior-year accruals in FY05 (savings) produces the majority of the budget increase for FY06.

Traction & Station Power

($millions)	Budget		Change	
	FY05 Adopted	**FY06 Preliminary**	**$**	**%**
Power Suppliers:				
BPA	$ 15.2	**$ 14.7**	$ (0.5)	-3%
Western	0.8	**0.2**	(0.6)	-75%
PG&E Supplemental	0.9	**0.6**	(0.3)	-33%
Transmission Services	3.0	**3.0**	0.0	0%
Distribution Services	4.2	**3.8**	(0.4)	-10%
Regulartory Pass-Through Costs	0.3	**2.1**	1.8	600%
Power Support Expenses	0.7	**0.6**	(0.1)	-14%
Subtotal Power	25.1	**25.0**	(0.1)	0%
Prior Year Adjustment	(3.8)	**-**	3.8	-100%
TOTAL	**$ 21.3**	**$ 25.0**	**$ 3.7**	**17%**

3.2.5 Other Non-Labor

Other Non-Labor consists of the main non-labor budget items other than Purchased Transportation and Traction and Station Power. The following list separates Other Non-Labor into the major account groupings, along with a description of the types of expenses in the account groups.

Material Usage: Primarily maintenance-related inventory withdrawals and purchases

Insurance: Non-labor insurance includes premiums and self-insured losses for public liability and damage to District property. It also includes risk related services. It does not include employee health insurance, workers' compensation, Medicare, unemployment and other types of insurance that are budgeted in the labor budget as direct current employee benefits. It also does not include retiree medical actuarial liability funding, which is budgeted as an allocation.

Professional & Technical Services: Benefit & insurance administration fees, audit and legal services, printing, computer hardware & software service contracts, specialized consulting contracts.

Maintenance, Repair & Other Contracts: graffiti removal, traction motor rewinds, painting, equipment overhaul, elevator pit cleaning, etc.

Building Space Rental: Administrative building leases, other lease expense.

Equipment Rental: Rental of equipment, vehicles, etc.

Miscellaneous Other Non-Labor: Utilities, trash collection, natural gas, telephones, miscellaneous supplies

In the annual budget BART typically inflates non-labor budget items by 3% to cover non-discretionary cost increases due to contractual increases or general inflation. However, for FY06, non-labor budgets were not increased by the 3% factor. This will force departments to absorb general inflation for non-discretionary cost increases and is in effect a budget reduction. This inflation adjustment would have resulted in approximately $2M in additional budget for FY06 if it had been implemented.

The following table summarizes the Other Non-Labor expense category:

Other Non-Labor ($millions)	Budget		Change	
	FY05 Adopted	FY06 Preliminary	$	%
Material Usage	$ 19.7	$ 21.7	$ 2.0	10%
Insurance	12.8	15.5	2.7	21%
Professional and Technical Fees	12.2	14.3	2.1	17%
Maint., Repair & Other Contracts	8.9	6.4	(2.5)	-28%
Building Space Rental	4.9	7.8	2.9	59%
Equipment Rental	1.0	1.1	0.1	10%
Misc. Other Non-Labor	7.7	8.0	0.3	4%
TOTAL	**$ 67.2**	**$ 74.8**	**$ 7.6**	**11%**

Although no inflation was applied to basic budgets, there are a large number of non-discretionary Other Non-Labor expenses that must be budgeted, which cause an overall $7.6 million increase for FY06. The following summarizes the major non-labor increases and reductions:

Material Usage

- Reflects a one-time transfer of funds between accounts that does not affect the bottom line. In FY05, Rolling Stock and Shops transferred $2.5M from the Material Usage account to the Maintenance, Repair and Other Contracts account to fund a one-time traction motor rewind program. The FY06 increase in Material Usage and decrease in Maintenance, Repair and Other Contracts represents the return of these funds to Material Usage.

Insurance

- Retiree medical "pay-as-you-go" premiums: +$2.3M
- Domestic partner medical insurance policy premiums: +$0.4M

Professional & Technical Services

- One-time outside counsel legal services for litigation currently underway: +$1.4M
- Marketing services for the Commuter Check Program and various advertising programs, offset by the same amount of administration fee revenue: +$0.4M
- Parking program and bike station operation fees, partially offset by revenue: +$0.4M

Building Space Rental

- Lakeside building lease increase for FY06 from low FY05 as one-time benefits from first year's free rent gradually phase out: +$2.9M

Miscellaneous Other Non Labor

- Debit/credit card and offsite ticket sales fees: +$0.8M

Various Accounts

- Other small non-labor budget corrections: +$0.2M
- Reduction of FY05 one-time items: -$1.1M

3.3 ALLOCATIONS

Allocations

($millions)	Budget		Change	
	FY05 Adopted	FY06 Preliminary	$	%
Debt Service	$ 59.5	$ 60.6	$ 1.1	2%
Capital Rehabilitation	-	13.8	13.8	-
Retiree Medical	-	24.6	24.6	-
CAPRA	2.6	1.8	(0.8)	-31%
Parking Capital Repayment	0.2	0.2	0.0	6%
SamTrans Ancillary Revenues[1]	0.3	-	(0.3)	-100%
TOTAL	$ 62.7	$ 101.0	$ 38.3	61%

[1] SamTrans Ancillary Revenues were initially budgeted as a use of funds during the FY05 Budget process. This line item is now reported as an offset to Financial Assistance (SamTrans-SFO Operations).

3.3.1 Debt Service

BART has periodically sold bonds backed by the District's dedicated sales tax revenues. The revenues from these bonds fund the capital costs associated with improving and renovating the system.

- Debt expense reflects debt service for bonds sold in 1990, 1995, 1998, 1999, 2001 and 2002.
- A restructuring of the existing sales tax debt is currently underway which could result in a reduction in annual debt service.

3.3.2 Capital Rehabilitation

In FY05 the District's planned allocation to capital rehabilitation was funded by federal grant funds in excess of the normal amount received by the District, which were available on a one-time basis for FY04 and FY05 only. These excess funds are no longer available, and in order to meet the system investment requirements and Board policy to adequately fund the capital program, the budget increase to fund the allocations is required. The FY06 capital allocation is $13.8M, and is used to fund the following projects:

- $6.5M to match and leverage approximately $37M of federal funds and bridge tolls in the FY06 grant program. This includes traction power and train control rehabilitation, rail replacement and trackway rehabilitation and the annual ADA/accessibility funding.
- $5M for stations and facilities renovation, which funds work such as station signage, station and shop re-roofing, re-lamping and other similar projects that are not competitive to receive grant funds.
- $1M for non-revenue vehicle replacement, including police vehicles and maintenance vehicles, not fundable from external grant funds.
- $1M for inventory buildup, planned primarily for Auxiliary Power Supply units. These funds are also not available from capital grant sources.
- $0.3M for capital tools and equipment, primarily for maintenance departments. Like the prior three categories, grant funds do not fund these items.

3.3.3 Retiree Medical Allocation

The FY06 Preliminary Budget includes an actuarially determined contribution towards the District's retiree medical liability. This contribution is calculated on an actuarial basis and includes both a contribution of 7.46% towards the "normal cost", and a 6.75% contribution for funding (over 30 years) the actuarially projected unfunded liability of $284M for the benefit. The two percentages combine for a 14.21% total of base pay to calculate the annual required contribution. The contribution is made for both operating and capital positions. The total contribution is calculated to be $33.6M for FY06, with $9.0M already budgeted as the FY06 "pay as you go" component, so the net remaining allocation is $24.6M. This amount appears in the allocation line items on the FY06 Income Statement. The allocation covers both operating and capital positions, with $2.7M of the total being for capital labor positions, and the net operating portion of the allocation is $21.9M. This is $0.9M lower than the $22.8M allocation assumed in the FY06 Pro Forma Budget because removing the assumption for a 3% wage increase lowered the base pay that the retiree medical allocation is based on.

There has been an accounting correction in terms of how the retiree medical allocation is shown on the District Income Statement since the FY06 Pro Forma Budget was issued in January. The Pro Forma Budget showed only the operating portion of the allocation. The Preliminary Budget now shows the full allocation, with the capital share of the allocation reducing operating labor through capital labor credits. The full allocation is shown in the budgeted allocation line, with the capital share of $2.7M reducing net labor by charging the capital position-related cost to capital projects via capital labor credits. If the retiree medical allocation was not in the budget, the capital credits would be lower, and the net operating labor would increase by $2.7M.

3.3.4 Other Allocations

CAPRA

The CAPRA (capital reserve account) was established to cover increased costs relating to the construction of the SFO Extension. In FY06, $1.8M is estimated to be allocated to the CAPRA after applicable debt service is paid from the Daly City Surcharge (currently $0.88) and the $1.50 SFIA Premium Fare revenues. The annual debt service expense, set according to the bond debt service payment schedule, increased in FY06, reducing the revenue available for the CAPRA allocation.

Parking Capital Repayment

Net parking revenue generated by the West Bay Parking program is split equally with SamTrans. BART's share of $0.2M is allocated to repay the District's capital program for BART's 50% share of the costs of the original parking capital equipment needed to collect parking charges.

3.4 PROPOSED BUDGET REDUCTIONS

Over the past three years BART has implemented budget cuts totaling nearly $60M, and reduced operating positions by 418. Even with the addition of 292.5 new positions for SFO extension operations, the District is operating with 125.5 fewer total operating positions than in FY02. The major focus has been to reduce the budget with no impacts on safety and reliability and minimal impacts on customer convenience and system cleanliness. These reductions were spread fairly evenly across the organization, with all areas cutting back. As the projections for FY06 were put together, it was clear that expenses needed to be cut back further, as expense growth is still not in line with revenue growth. However, further "across the board" cuts would begin to severely impact our ability to serve our customers, as departments have already cut their budgets significantly.

This year's internal budget process began with taking a hard look at the organization, and at our core functions. The resulting recommended budget cuts stem from this process. A major focus was looking at the organization and improving efficiency, with some reorganization resulting from that process. In addition, after several years of position reductions we needed to look at the resulting management span of control. In some cases, it made sense to combine departments or divisions. Because staff is committed to reducing costs without cutting service and with minimal impacts on system performance measures, there was a definite focus on administrative reductions vs. our core operating areas. The major Operations departments continue to align their resources and service with current ridership levels. Finally, departments continue to look at cutting back vacant positions wherever possible, and to eliminate positions that are not directly connected to the District's core business. As has been the case the past several years, because safety and security are high priorities, there are no proposed cuts to the Police Department.

The proposed reductions total $13.6M, with $13.1M in position reductions and $0.5M in non-labor. Wages and benefits make up 75% of the operating budget, so a focus on position reductions is essential if we are to close the deficit. In addition, over the past three years non-labor budget cuts of $16M (about 8% of the base department non-labor budgets) have been made, as departments first looked at non-labor expenses when deciding where to reduce their budgets. The majority of BART's non-labor budget is materials and service in the large Operations departments. Continued significant reductions in non-labor for FY06 could not be made without impacting maintenance of system performance.

3.4.1 Position Reductions

The FY06 Preliminary Budget assumes 114 operating positions are eliminated, and 1.5 operating positions are converted to capital funding, with an associated cost savings of $13.1M. In addition to operating position reductions, capital positions will be reduced by 19.0 positions, due to reduced capital funding. Combined with the operating reductions of 115.5 positions, this brings the total reduction to 133.0 positions for FY06.

Many of the positions are budgeted but are currently vacant; however, at this time approximately half of the 133.0 positions slotted for reduction are currently vacant. As was the case in prior year reductions, the number of filled positions should decrease through normal attrition before final adoption of the budget.

The District expects to continue its history of success in minimizing the number of layoffs associated with the position cuts. Of the 418 operating and 143.5 capitally funded positions eliminated from FY03 to FY05, most were recalled or reinstated to the District. Severance packages were offered to encourage retirement by individuals who were ready to retire from positions targeted for reduction. In the end, of the employees in eliminated positions who did not retire or accept severance packages, only 15 did not return to the District.

The table below shows the FY06 Preliminary Budget position totals, including the proposed reduction in operating positions and capital positions slotted for reduction due to decreased capital funding.

FY06 Preliminary Budget Positions

	Operating	Capital	Total
FY05 Adopted Budget	**3,014.5**	**314.5**	**3,329.0**
Convert Operating to Capital	(1.5)	1.5	-
Proposed Operating Reductions	(114.0)	-	(114.0)
Capital Reductions:	-	(19.0)	(19.0)
FY06 Preliminary Budget	**2,899.0**	**297.0**	**3,196.0**

The following table shows the proposed operating position reductions by bargaining unit totals. The focus on management consolidation and reducing administrative positions means that administrative positions were impacted to a greater degree than line positions given their relative proportions in the workforce. Of FY05 budgeted positions, line positions comprise 83% and administrative positions 17%.

FY06 Preliminary Budget Reductions

	Operating	% of Reductions	% of FY05 Adopted Budget Workforce
SEIU	49.0	42%	49%
ATU	24.0	21%	26%
BPOA	-	0%	8%
BPMA	-	0%	2%
AFSCME	19.5	17%	6%
Sub-total Represented	92.5	80%	91%
Non-Represented	23.0	20%	9%
TOTAL	**115.5**	**100%**	**100%**

3.4.2 Streamlining the Organization

As discussed earlier in this memo, in order to avoid reductions that would impact service, the District took a hard look at its organizational structure to identify opportunities for management streamlining, consolidation, and resulting expense reductions. Three years of across the board cuts have reduced some areas and functions to the point where further cuts would be detrimental to our core mission and priorities of safety and reliability of BART service. Another approach was needed this year.

In addition, prior position reductions – especially in some of the smaller administrative groups – have resulted in the need to review resulting managerial span of control ratios, the size of different administrative units and opportunities for consolidation and/or streamlining of administrative and support functions.

Restructuring has achieved substantial reductions in the number of manager positions. These organizational changes realign functions to increase effectiveness and establish appropriate span of control ratios, and as a result, enable a reduction of 20 manager positions. Twelve manager positions are eliminated from the budget. In addition, eight working manager positions were reclassified to non-manager positions (AFSCME) and merged with another unit. For FY06, operating manager positions are reduced by 16.5%, from 121.3 to 101.3, causing the overall percentage of managers to drop from 4% to 3% of operating positions.

FY06 Operating Budget Managers

	FY05 Budget	% of Workforce	Proposed Cuts	Reclass	FY06 Preliminary	% of Workforce
Managers[1]	**121.3**	**4%**	**(12.0)**	**(8.0)**	**101.3**	**3%**

[1]Non-represented Division Managers and above

Streamlining is proposed in three main support functions: Administration, Planning and Budget, Transit System Compliance, and Operations.

Administration

In the Office of Administration, the Real Estate Department will be restructured to better align its many varied functions. Joint Development will be transferred to the Office of Planning and Budget to better facilitate coordination between Planning, Access and Station Area Development. Telecommunications will be transferred to Maintenance and Engineering and the print shop will be consolidated with Documentation in Operations. The District Secretary's Office will assume the duties of the Custodian of District Records. Records Storage, Office Services and the Mail Room functions will move to the Procurement Department. Real Estate/Right of Way will continue to report directly to the AGM of Administration, as a division level function.

The training and employee development functions currently situated in Performance and Learning will be consolidated into the Human Resources Department. The media and audio/visual functions of Performance and Learning will be transferred to the Office of External Affairs. Smaller divisions within Human Resources will be consolidated and report to fewer managers.

Planning and Budget

In addition to the transfer of Joint Development into the Planning and Budget Executive Office, the System Capacity Division will move from Planning and Budget into the Operations Executive Office. Other changes proposed to occur in this area include a move from a geographically focused Planning Department to an organization in which staff will be matrixed to multiple projects.

Merging several small groups/divisions within Planning and Budget creates the opportunity to consolidate administrative responsibilities and to reduce the number of overall management positions.

Transit System Compliance

Within the Office of Transit System Compliance, the System Safety Department is also consolidating divisions without eliminating safety functions. Where there are administrative division heads managing only a few staff persons, these administrative responsibilities are being consolidated and centralized under a single manager.

Operations

Several organizational changes are planned in the Operations Executive Office. The most significant of these is the reconfiguration of the Operations Liaison Department into an Operations Planning Department. As part of this reconfiguration, certain functions that previously resided in Transportation, Operations Liaison and the Planning and Budget Executive Office will be moved into the Operations Planning Department. The remaining Operations Liaison functions will be transferred to Transportation or merged into the Operations Training and Development Department, which will be recast as the Operations Training and Support Department.

3.4.3 Budget Reduction Impacts

In prior years, reductions have been achieved without reducing safety, service reliability, or frequency of service. The FY06 reductions, although labor intensive, have been designed to achieve the same results while working within our budgetary framework. Maintaining basic service and safety levels with reduced funding has been an ongoing priority.

Administrative Departments

Administrative and support functions are primarily budgeted for in the offices of the General Manager, Legal, Finance, District Secretary, Administration, External Affairs, Planning and Budget and Transit System Compliance.

Several administrative department budgets have continued the process of the last couple of years to reduce staffing to adjust to a lower volume of hiring, procurement and administrative activity throughout the organization. Administrative and support departments have had to continue to make some cuts which will adversely impact internal operations but will generally not be felt directly and immediately by customers. Routine personnel, procurement, and general analysis reporting work may be processed less quickly. Processes will be slower in some cases, and requests for reports and information will be delayed.

Operations

The reductions in the Operations budget continue to reflect the rank-ordered priorities of safety, reliability, customer convenience and cleanliness. Overall train service levels are maintained with slightly increased rush period load factors offset by an increase of two trips and improved base period capacity. System reliability will be maintained with selected areas, such as car reliability, slated for continued improvement. Several other factors should also contribute to improved on-time performance in FY06. These factors include the elimination of make/break operations on the Pittsburg/Bay Point line and the resulting reduction in the number of C-1 cars needed on a daily basis. The Integrated Control System (ICS) re-architecture effort, which is nearing completion, has begun to positively impact the number of computer-related train delays. The continued high reliability of the District's new fare collection equipment should lessen the customer convenience impact of a modest reduction in staffing at a few stations. Some reductions will be made in station, car and grounds cleaning staff, although not as large as last year's cuts. Unlike last year, when the Board was informed that several Quarterly Performance Report (QPR) goals for cleanliness would be revised slightly downward to reflect the impact of multi-year staffing cuts, no downward revision of QPR goals is proposed in this year's budget. However, the challenge of maintaining the overall performance of the system becomes even more daunting in FY 06, the fourth consecutive year of cuts in the Operations budget.

3.4.4 Balancing the Budget

While the Preliminary Budget proposes expense reductions of $23M, those reductions are still not adequate to balance the budget. A public hearing and further board consideration of several potential revenue generating items is scheduled for April. If adopted, these measures can help reduce the deficit but will not generate substantial revenue for FY06. Consideration of the use of one-time operating reserves as part of the solution to balance the budget is likely to be necessary again this year. However, given the size of the remaining deficit, the need to make budget changes that produce ongoing positive results and the limited amount of operating reserves, decisions regarding further expense reductions need to be made before considering use of operating reserves.

Further actions will be required to reach a balanced budget. As with the development of the Preliminary Budget, further steps to balance the budget should reflect and be guided by our commitment to preservation of safe, reliable service to our customers.

Given our financial condition of expense growth (especially in benefits) outstripping revenue growth, the uncertainty of the results of negotiations of new labor contracts for FY06 is an especially difficult factor in attempting to balance this budget. Negotiations offer opportunities to address difficult issues of wage and benefit growth, sustainable funding for retiree medical benefits, as well as productivity enhancements.

The results of this negotiation will clearly impact the balancing of the FY06 budget. However, they will likely not be known by June 9, the date scheduled for Board action on the budget. Therefore, the Board should consider the option of adopting an unbalanced budget. When contract negotiations are completed, resulting changes would be incorporated into the budget and determination of any additional measures that may be needed to balance would be identified and brought to the Board for further consideration.

4. Attachments

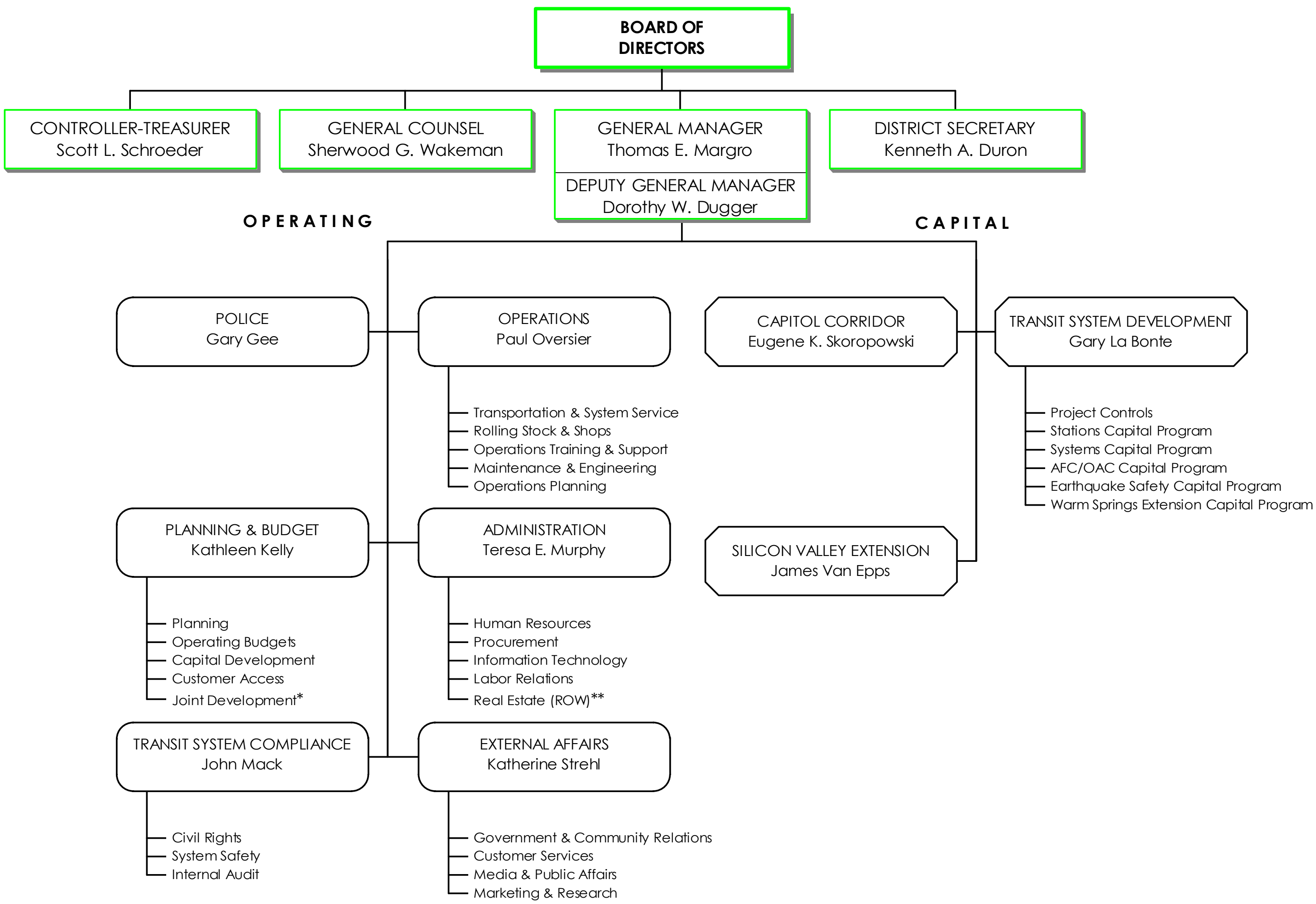
FY06 Budget Board Review Schedule

(Staff presentation unless otherwise noted)

2005	Held at	Purpose
1/13	Administration Committee	FY06 Budget Priorities
3/03	Administration Committee	Revenue Enhancement Workshop
4/14	Administration Committee	FY06 Preliminary Budget Overview Receive FY06 Preliminary Budget Resource Manual: Budget summaries, organization charts, goals and objectives Actions: Consider motion to release a Budget Pamphlet Consider motion to set date for public hearings on FY06 Preliminary Budget
	Board of Directors	Actions: Consider motion to release a Budget Pamphlet Consider motion to set date for public hearings on FY06 Preliminary Budget
4/28	Board of Directors	Public Hearings on FY06 Preliminary Budget and Revenue Enhancement Items
5/12	Administration Committee	FY06 Preliminary Budget Operating Sources FY06 Preliminary Budget Operating Uses FY06 Proposition 4 Limit: Calculation of annual spending limitation Actions: Submit FY06 Preliminary Budget to full Board
6/09	Administration Committee	Take public comment on Proposition 4 Limit Actions: Consider resolution to adopt annual Proposition 4 Limit Consider resolution to adopt the FY06 Annual Budget
	Board of Directors	Actions: Consider resolution to adopt the annual Proposition 4 Limit Consider resolution to adopt the FY06 Annual Budget

**Public hearing is held at special meeting of the Board of Directors prior to the regular committee meetings*

BART
FY06 Preliminary Budget
ORGANIZATION CHART



*Joint Development is a division-level unit reporting to the Planning & Budget Executive Office.
**Real Estate (ROW) is a division-level unit reporting to the Administration Executive Office.

OPERATING EXPENSE BUDGET: FY05 vs. FY06 COMPARISON		
Department / **Executive Office**	**FY05 Adopted Budget**	**FY06 Preliminary Budget**
General Manager	**$ 1,141,249**	**$ 1,314,457**
Legal	**$ 3,133,003**	**$ 4,623,040**
Finance	**$ 19,904,282**	**$ 21,059,703**
District Secretary	**$ 1,737,350**	**$ 1,110,471**
Administration	280,298	318,430
Real Estate (ROW)[1]		9,080,164
Performance & Learning	1,084,414	-
Human Resources	13,564,020	16,087,152
Procurement	8,793,330	9,940,365
Information Technology	8,012,322	8,407,550
Real Estate Services	9,230,189	-
Labor Relations		987,207
Administration	**$ 40,964,573**	**$ 44,820,868**
Administration	326,573	351,236
Marketing and Research	3,296,276	3,937,300
Media & Public Affairs	660,848	807,164
Government & Community Relations	1,857,598	1,662,473
Customer Services	2,142,185	2,295,433
External Affairs	**$ 8,283,480**	**$ 9,053,606**
Police	**$ 37,718,698**	**$ 38,476,229**
Administration	504,610	549,720
Maintenance & Engineering	75,062,150	76,867,358
Rolling Stock & Shops	75,080,928	75,849,565
Operations Training & Support	4,142,707	5,295,800
Transportation & System Service	95,497,614	94,717,680
Operations Planning	2,713,911	2,428,978
Operations	**$ 253,001,920**	**$ 255,709,101**
West Bay Extensions	**$ 0**	**$ 0**
Transit System Development	**$ 129,882**	**$ 431,083**
Administration	346,011	473,828
Joint Development[2]		670,447
Customer Access	16,386,380	16,597,044
Operating Budgets & Analysis (Includes Power)	26,909,136	28,359,065
Planning	1,656,785	1,322,805
Capital Development & Control	1,929,679	1,767,390
Planning and Budget	**$ 47,227,991**	**$ 49,190,579**
Administration	366,379	408,924
Internal Audit	1,328,869	1,345,807
System Safety	2,061,884	2,202,868
Civil Rights	1,123,032	928,749
Transit System Compliance	**$ 4,880,164**	**$ 4,886,348**
Capitol Corridor[3]	**$ 0**	**$ 0**
Silicon Valley Extension	**$ 0**	**$ 0**
Subtotal	**$ 418,122,592**	**$ 430,675,485**
Cost Allocation Plan	**$ (5,657,055)**	**$ (8,576,981)**
TOTAL	**$ 412,465,537**	**$ 422,098,504**

[1] Real Estate (ROW) is a division level unit reporting to the Administration Executive Office

[2] Joint Development is a division level unit reporting to the Planning & Budget Executive Office

[3] As governed and reimbursed by the Joint Powers Board and supervised by the Executive Director of the Joint Powers Board.

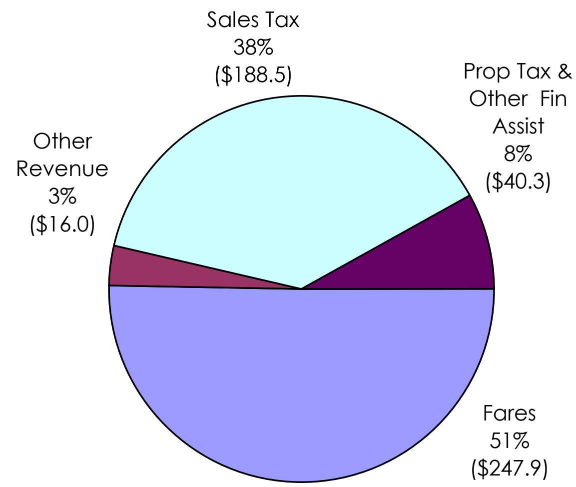
San Francisco Bay Area Rapid Transit District
FY06 PRELIMINARY BUDGET
STAFFING COMPARISON
High Water

OFFICE	FY05 ADOPTED BUDGET Operating Staff	FY05 ADOPTED BUDGET Capital/ Reimb.	FY05 ADOPTED BUDGET Total Staff	FY06 PRELIMINARY BUDGET Operating Staff	FY06 PRELIMINARY BUDGET Capital/ Reimb.	FY06 PRELIMINARY BUDGET Total Staff
General Manager	5.0	0.0	5.0	5.0	0.0	5.0
Legal	19.0	3.0	22.0	18.0	4.0	22.0
Finance	123.0	3.0	126.0	120.0	3.0	123.0
District Secretary	7.0	0.0	7.0	6.0	0.0	6.0
Administration	197.0	6.0	203.0	184.0	4.0	188.0
External Affairs	52.0	0.5	52.5	50.5	1.0	51.5
Police	292.0	0.0	292.0	292.0	0.0	292.0
Operations	2,270.5	163.0	2,433.5	2,194.5	155.0	2,349.5
West Bay Extensions	0.0	0.0	0.0	0.0	0.0	0.0
Transit System Development	1.0	57.0	58.0	1.0	48.0	49.0
Planning and Budget	63.0	7.0	70.0	46.0	7.0	53.0
Transit System Compliance	33.0	4.0	37.0	30.0	4.0	34.0
Capitol Corridor[1]	0.0	11.0	11.0	0.0	11.0	11.0
Silicon Valley Extension	0.0	12.0	12.0	0.0	12.0	12.0
Sub-total	3,062.5	266.5	3,329.0	2,947.0	249.0	3,196.0
Cost Allocation Plan	(48.0)	48.0	0.0	(48.0)	48.0	0.0
DISTRICT TOTAL	3,014.5	314.5	3,329.0	2,899.0	297.0	3,196.0

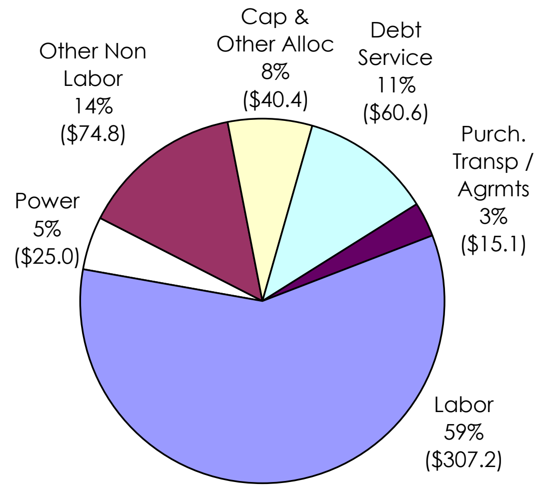
[1]As governed and reimbursed by the Joint Powers Board and supervised by the Executive Director of the Joint Powers Board.

Preliminary Operating Budget
Sources and Uses of Funds

FY06

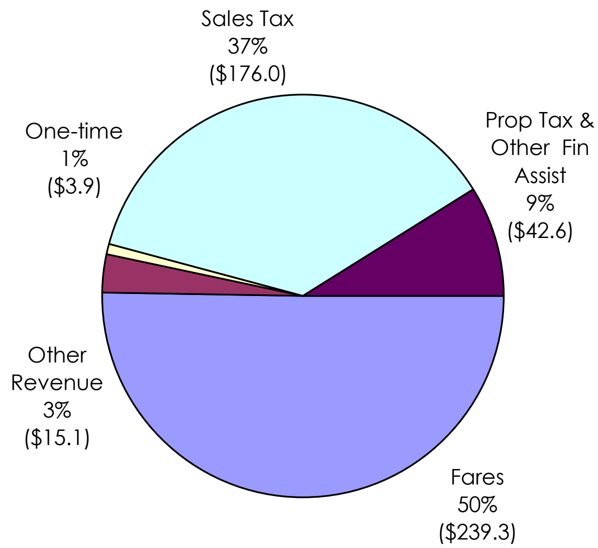


SOURCES
$492.7M

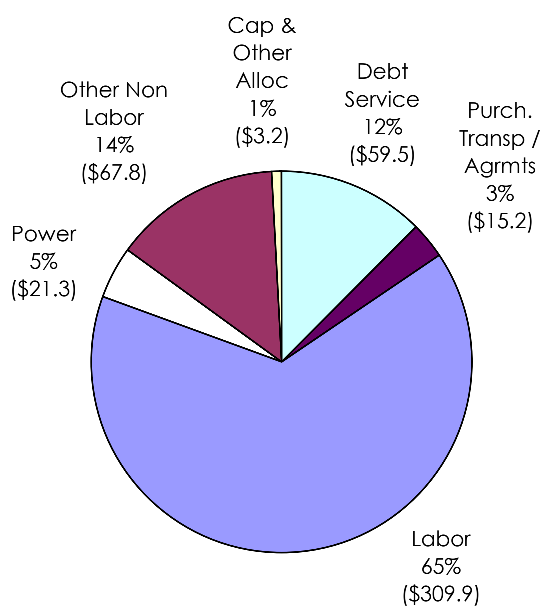


USES
$523.1M

FY05



SOURCES
$476.9M



USES
$476.9M

Retiree Medical Insurance Funding

Under accounting standards recently adopted by the Government Accounting Standards Board (GASB), government agencies such as BART are required to account for retiree medical and other post-employment benefits on an actuarial basis, starting in FY08. These standards are intended to provide potential investors (e.g. purchasers of District bonds) with transparency concerning the true financial health of the governmental entity whose securities are available on the market. The standards also force employers and employees to recognize often-massive unfunded liabilities that can result from post-employment benefits if they are insufficiently funded, which directly undermines the security of these crucial benefits, as costs grow less and less affordable over time.

The new GASB standards will apply to the District beginning in FY08. This means that if the District does not fund its actuarially determined annual required contribution (ARC) for retiree insurance, the District will be required to carry that amount as an unfunded liability on its 2008 financial statement. Failure to fund the liability, $248M over 30 years, on an actuarial basis would almost certainly jeopardize both the District's bond rating and grant funding opportunities.

Current and future District retirees have a vital interest in the stability of retiree health insurance benefits. For that reason alone, funding retiree insurance benefits on an actuarial basis is prudent fiscal policy regardless of the impact on BART's financial ratings of not doing so. But there are other reasons as well. If BART continues its PAYG methodology, the lack of investment returns and resulting cost increase rapidly place a huge and probably unsustainable burden on future budgets. To accentuate this point, although funding on an actuarial basis will initially cause a large increase to BART's costs, the PAYG payment will continue to increase dramatically each year, and will surpass the cost of GASB compliant funding in approximately 2012, based on current actuarial projections. These costs would continue to increase incrementally each year, and eventually would be difficult or impossible to fund. For example, by 2018 the annual cost of retiree insurance is projected to approach 30% of payroll. Funding on an actuarially sound basis will limit the amount to a relatively stable percentage (14.21%) of pay over that period. The 14.21% assumes that the retiree medical trust fund earns 6.75% on investment returns from the retiree medical trust's balance. Earning interest on the investment balance is the key principle behind the actuarial funding methodology, which is basically the same as retirement pension funding.

All of these actuarial projections assume that the District commences GASB compliant funding or dedicates equivalent funding to retiree health insurance by July 1, 2005. If the District does not do so, the figures for annual payments and total liability rise. The District receives actuarial evaluations annually to establish the annual contribution rates required to meet current liability estimates. Due to the newness of the regulations, technical issues regarding different methods for calculating actuarial funding requirements are still being discussed, which could affect the liability balances.

This year's evaluation is based on collective bargaining agreements, which contain a minimal retiree contribution towards retiree medical policy cost expense, with the bulk of the premium paid by the District. If there are changes in these levels as the result of future negotiations the District's liability balance will reflect that, as well as future changes in medical cost, payroll, number of retirees and other actuarial factors. In addition, position reductions proposed for FY06 would have an impact on the unfunded liability.

Funding retiree medical insurance expenses in a manner which complies with GASB helps limit the negative impact that granting unfunded benefits places on future generations of District employees and current employees who are many years from retirement. In other words, GASB compliant funding helps prevent one generation of employees and managers from giving themselves benefits and passing the bill on to others. For the foregoing reasons, staff recommends to continue to amortize the liability. This approach to funding retiree medical expenses is included throughout the forecast.