Financial Outlook for the Metropolitan Transportation Authority

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- **The State budget could direct $3 billion in new resources to the MTA over a five-year period to help finance both its operating and capital budgets.**
- **The Executive Director has instructed the operating agencies to identify actions that could save $50 million in 2006 and $100 million annually thereafter from internal management improvements.**
- **The MTA should be able to balance its budget through 2007 without the need for service reductions that were proposed for 2006. Nonetheless, the MTA will face new fiscal challenges beginning in 2008.**
- **New State resources would permit the MTA to move forward with a $21.1 billion five-year capital program.**
- **The capital program would total $6.7 billion less than recommended by the MTA Board in September 2004, but the "state of good repair" program would be nearly fully funded.**
- **Proceeds from new money bonds ($9.3 billion) would represent 44 percent of the funding for the capital program—more than any previous capital program.**
- **Debt service would grow from $848 million in 2004 to $1.6 billion in 2008, and could reach $2.2 billion by 2015. The debt burden would rise from 11 percent in 2004 to 23 percent in 2015.**
- **The MTA may have to choose between scaling back the capital program and issuing more debt if voters reject the transportation bond act, or if the cost of the No. 7 subway line extension exceeds the estimated cost of $2 billion.**

The current four-year financial plan for the Metropolitan Transportation Authority (MTA) projects a surplus of $76 million for 2005 out of a budget of $8.3 billion, but then projects deficits of $813 million in 2006, $1.1 billion in 2007, and $1.4 billion in 2008.[1]

To narrow these budget gaps, the MTA proposed draconian service cuts beginning in 2006, such as eliminating 33 bus routes, abandoning certain Long Island Rail Road branches and removing the tracks, and reducing late-night subway and bus service. It also proposed a 5 percent increase in fare and toll revenue in 2007. Even assuming the implementation of these actions, the MTA projected remaining gaps of $607 million in 2006, $689 million in 2007, and $991 million in 2008.

In September 2004, the MTA Board proposed a $27.8 billion capital program for calendar years 2005 through 2009. The program was designed to continue the progress made over the past 20 years in restoring and modernizing the regional mass transit system, and also to begin a number of major network expansion projects. The proposed capital program, however, had a funding gap of $16.2 billion.

In January 2005, the Governor proposed actions to help the MTA balance its operating budget through 2007 and to finance a new five-year capital program. The proposals would have helped the MTA balance its budget through 2007, but were insufficient to rescind service reductions planned by the MTA for 2006 and a 5 percent fare and toll increase scheduled for 2007.[2]

The State Legislature built upon the Governor's recommendations and advanced proposals to assist

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[1] The budget also includes reimbursable expenses, but these expenses do not contribute to the surplus or gaps because they are matched by reimbursable revenues.

[2] See Report 10-2005, *Financial Outlook for the Metropolitan Transportation Authority*, February 2005.

the MTA that were acceptable to the Governor. The result is that the MTA should be able to manage its budget through 2007 without the need for service reductions, as long as it remains committed to achieving substantial savings from internal management improvements.

The Governor and the State Legislature also reached agreement on new sources of funding that should allow the MTA to move forward with a new $21.1 billion five-year capital program.[3] The capital program would be $6.7 billion less than requested by the MTA Board in September, but it would permit restoration, modernization, and network expansion projects to move forward.

Our analysis shows that the MTA should have no difficulty balancing the 2006 operating budget and that the MTA is on the right track to close the budget gap projected for 2007. Beginning in 2008, however, the MTA will face new fiscal challenges.

We estimate that the MTA could face a budget gap in excess of $400 million in 2008 even after it balances the 2006 and 2007 budgets. The gaps would widen quickly and could reach $1.1 billion by 2010. Gaps reappear after 2007 because the amount of additional assistance provided by the State is insufficient to close the budget gaps projected in the MTA's current financial plan, which are driven largely by borrowing for the 2000-2004 capital program, and to fund the debt service on bonds to be issued for the 2005-2009 capital program.

Nonetheless, the MTA has come far over the past two years, and the financial outlook is stable through 2007. This conclusion is based on the following observations.

- The MTA has adopted a rolling four-year financial planning process and other budgetary reforms since April 2003, when the State Comptroller revealed that the MTA had misled the public about its financial condition. The MTA has also implemented budget regulations promulgated by the State Comptroller that are designed to improve transparency and accountability.
- An on-time State budget and quick agreement between the Governor and the State's legislative leaders regarding new sources of funding for the 2005-2009 capital program will permit needed capital investments to move forward without unnecessary delay.
- The State authorized new revenue streams that will help balance the operating budget in the short term and will help fund the 2005-2009 capital program in the long term.
- The portion of the capital program devoted to restoring and maintaining the regional mass transit system in a state of good repair would be funded at 93 percent of the level recommended by the MTA Board.
- The current fiscal year is off to a good start, with revenue from real estate transactions exceeding expectations, and other positive developments. We estimate that 2005 could end with a cash balance of up to $500 million, which will be needed to help close the budget gap projected for 2006.

Our review, however, identified the following budget risks.

- The statewide transportation bond act, which would allocate $1.45 billion to the MTA's capital program, requires voter approval. If the act is rejected by voters in November, the MTA may increase planned borrowing or defer planned expansion projects.
- The labor agreements between the MTA and its unions begin to expire in December 2005. The financial plan assumes that future labor agreements will be funded at the projected inflation rate.
- A significant shortfall from the MTA's target of $1 billion in proceeds from the sale of assets may necessitate an increase in planned borrowing or scaling back the capital program.
- During the course of the four-year plan period the economic recovery could stall, or there could be a downturn in regional employment. Such developments could adversely affect projected tax revenues and fare and toll collections.

[3] The capital program still requires unanimous approval by the Capital Program Review Board, which includes representatives of the Governor, the Speaker of the State Assembly, the Senate Majority Leader, and the Mayor of the City of New York. The Mayor is entitled to vote only with respect to plans for NYC Transit and SIRTOA.

- Energy costs increased by 13.7 percent in 2004, and remain volatile.
- The capital program counts on $6.6 billion in federal funding, but these resources are subject to annual appropriation.

Finally, we have the following concerns.

- The MTA continues to rely heavily on debt to finance its capital programs. The amount of outstanding MTA debt has more than doubled in the last decade, from $9.8 billion in 1995 to $20.9 billion as of April 2005, and 44 percent of the 2005-2009 capital program would be funded with new money bonds—more than any other program.

  In total, debt service on bonds issued to help fund past capital programs and the 2005-2009 program would nearly double, from $848.1 million in 2004 to $1.6 billion in 2008, and then rise to $2.2 billion by 2015. The debt service burden would rise from 11 percent in 2004 to 18.6 percent in 2008, and would reach 23 percent by 2015.
- The regional mass transit system is greatly improved since 1982, with investment of $54.5 billion, but important elements of the system have yet to reach a state of good repair, and target dates have been pushed into the future. Reduced funding levels will delay efforts to restore the system to a state of good repair and may result in higher costs.
- Network expansion projects should stay within budget and on schedule. The cost of East Side Access has already grown from $4.3 billion to $6.3 billion, and while the City of New York has agreed to fund the $2 billion estimated cost of extending the No. 7 subway line, the MTA could be responsible for any cost overruns. The MTA, along with its funding partners, should develop a long-term financing strategy to ensure that expansion projects are financed to completion.
- The MTA must remain committed to achieving planned savings from internal management improvements. As a first step, we find it encouraging that the Executive Director has instructed the presidents of the operating agencies to prepare actions for inclusion in the July financial plan that would reduce costs by $50 million in 2006 and by $100 million in subsequent years. The MTA should build on these efforts to address the growing budget gaps beyond 2007.
- The actions taken by the State will address the MTA's short-term financial difficulties, but the MTA's budget still suffers from a structural imbalance. As a result, budget gaps reopen in 2008 and grow rapidly in subsequent years.

Impact of the State Budget

The State budget could direct $3 billion in new resources to the MTA over the next five years to help finance both its operating and capital budgets. The budget approved the following new resources.

- Sales tax in the 12-county MTA district is increased by 0.125 percent, which will generate an estimated $230 million annually. Taxpayers in the district will still experience an overall reduction in the sales tax rate because a statewide 0.250 percent sales tax surcharge was permitted to expire as scheduled.
- Several types of motor vehicle fees are increased (effective January 1, 2006), as proposed by the Governor, with the exception of a proposed increase in registration fees. The approved increases generate $60 million annually beginning in 2006.
- The mortgage-recording tax (MRT 1) rate is raised 20 percent, from $0.25 per $100 of outstanding principal to $0.30 per $100 of outstanding principal, for borrowers in the MTA 12-county transportation district. (The Governor proposed a 40 percent increase in the tax rate.) This initiative will generate about $50 million annually.
- A $2.9 billion transportation bond act is authorized for the November ballot. If approved, half of the proceeds would be allocated to the MTA and the other half to statewide highway and bridge projects.

The 2005-2009 Capital Program

The 2005-2009 capital program, as amended by the MTA Board on April 28, 2005, totals $21.1 billion, or $6.7 billion less than initially proposed by the MTA Board in September 2004. The amended capital program allocates $16 billion to the core program, or 93 percent of the amount recommended by the MTA Board in September 2004; $4.5 billion for network expansion, or less than half the amount recommended by the MTA Board; and the same amounts as recommended by the MTA Board for security and interagency projects (see Table 1).

Table 1

2005-2009 MTA Capital Program

(in billions)

	Dec. 2004 Proposal	Apr. 2005 Amendment	Difference
Core Program	$17.2	$16.0	$ 1.2
Expansion Projects	9.9	4.5	5.4
Security	0.5	0.5	- - -
Interagency	0.1	0.1	- - -
Total	**$ 27.8**	**$ 21.1**	**$ 6.7**

Note: Columns may not add due to rounding.
Sources: Metropolitan Transportation Authority; OSDC analysis

Since 1982, the MTA has invested $54.5 billion in its capital assets and has made impressive progress toward restoring the regional mass transit system to a state of good repair. Certain elements have yet to be restored, however, and in some cases the target dates for achieving a state of good repair have been pushed back.

Even after assets achieve a state of good repair, investments are still needed on an ongoing basis to maintain normal replacement cycles. While the amended 2005-2009 capital program will permit projects to move forward, the reduced levels of funding will slow down efforts to restore, modernize, and expand the transit system, and could increase the overall cost of these projects.

The core program is designed to restore the regional mass transit system to a state of good repair and then to maintain assets through normal replacement cycles. The amended 2005-2009 capital program allocates $16 billion to the core program, which is $1.2 billion less than recommended by the MTA Board in September 2004 and is less than the size of the 2000-2004 core program, after adjusting for inflation. The lower level of funding translates into 11 fewer subway station rehabilitations and the deferral of a subway maintenance shop rehabilitation project, the Port Jefferson train yard, the purchase of 12 M-7 cars for the Long Island Rail Road, and other planned projects.

Moreover, the amended capital program is $10.1 billion less than requested by the MTA's own agencies. It remains to be seen how these funding shortfalls will translate into further delays in achieving a state of good repair.

Facing fiscal constraints, the State appropriately placed greater importance on funding the core capital program than the network expansion program. According to the MTA, the projects that will bear the brunt of the cuts are the Second Avenue Subway, East Side Access, and the JFK rail link from Lower Manhattan; only $2.5 billion of the $7.9 billion recommended for these projects by the MTA Board in September 2004 would be funded. The Governor and the State's legislative leaders have yet to reach agreement on the allocation of the proceeds from a state-wide transportation bond act, but funding for these projects could be partly contingent upon passage of the bond act. The No. 7 subway line extension was funded by the City at the estimated cost of $2 billion, as requested by the MTA.

Financing the Capital Program

The 2005-2009 capital program is expected to be funded with a combination of federal and City capital grants, as well as with proceeds from the sale of MTA assets and a proposed state-wide transportation bond act (see Table 2). These sources are expected to contribute $11.9 billion, which would still leave a balance of $9.3 billion to be funded with debt.

Table 2

Financing the 2005-2009 Capital Program

(in billions)

Capital Grants	
Federal	$ 6.6
New York City	2.4
Transportation Bond Act	1.5
Subtotal	**10.5**
Bond Proceeds	
MTA Bonds	4.2
MTA Bonds Backed by New State Revenues	5.1
Subtotal	**9.3**
Other	
Proceeds from Asset Sales	1.0
Prior-Year Rollover	0.4
Subtotal	**1.4**
Total	**$ 21.1**

Sources: Metropolitan Transportation Authority

The State's $6.55 billion contribution, including proceeds from the transportation bond act and proceeds from MTA bonds backed by new State-authorized revenues, would represent 31 percent of the funding for the program. The State's share would be nearly twice the amount in the prior capital program and more than any other program.

Although the program is fully funded, there is still a risk that some of the funding may not materialize or that costs could be higher than estimated. In that event, the MTA would have to choose between scaling back the capital program and issuing more debt. The financing program is based on the following assumptions.

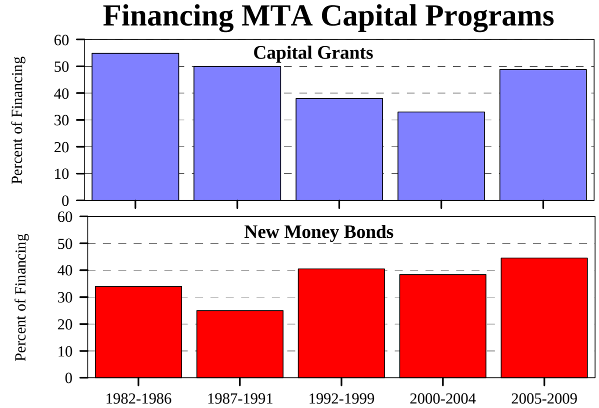
- The federal government will fund $5.1 billion of the core program, a level that is consistent with legislation currently under consideration in the House and Senate.
- The federal government will provide $1 billion to fund the cost of both East Side Access and the Second Avenue Subway. The MTA, however, will need federal approval to proceed at a slower-than-previously-planned pace as a result of reduced funding levels for these projects. Funding is also subject to the annual appropriation process, which has fallen short of expectations in the past.
- The federal government will fund the entire cost of the $495 million security program. Congress, however, appropriated less than one third of the $633 million cost of security projects in the 2000-2004 capital program.
- The $2 billion allocated by the City of New York will fund the full cost of extending the No. 7 subway line. While the City has volunteered to fund the estimated $2 billion cost of this project, the MTA could be responsible for all or part of any cost overruns. Major transportation projects have a history of costing more and taking longer than initially estimated.
- The state-wide transportation bond act, which is expected to generate $1.45 billion for the MTA, will be approved by voters in November. A similar transportation bond act was rejected by voters in 2000.
- The MTA will receive $1 billion from the sale of assets. The MTA unanimously approved a $210 million bid by the New York Jets for one third of the development rights over the western rail yard, and subsequent negotiations raised the bid to $250 million, but the award is the subject of litigation. While the MTA would retain the remaining development rights, whether it will ever obtain the full appraised value of $923 million for the entire site remains to be seen. The sale of the air rights over the western rail yard may also compete with plans to sell the air rights over the eastern rail yard.

Reliance on Debt

The portion of the capital program funded with direct capital grants from the federal government and the State and City would increase in the 2005-2009 capital program, which reverses a long-term historical trend (see Graph 1). The 2005-2009 program, however, would still rely on new money bonds to a greater extent than any prior program because there has been a decline in extraordinary resources, such as those gained from debt restructuring. Graph 1 shows that 44 percent of the financing for the 2005-2009 program would come from new money bonds.[4]

Graph 1

Financing MTA Capital Programs



Source: Metropolitan Transportation Authority; OSDC analysis

It is expected that the MTA will borrow $9.3 billion to help finance the 2005-2009 capital program. Of this amount, $5.1 billion would come from bonds issued by the MTA and backed by new sources of revenue. The remaining $4.2 billion would also come from MTA bonds, but these bonds would be backed by existing

[4] This analysis excludes some $4.5 billion in bond proceeds that were freed up from restructuring existing debt and used to help finance the 2000-2004 capital program.

pledged revenues. The amount of new money bonds backed by existing pledged revenues is projected to be 22 percent less than in the prior capital program.

The debt service on all of these bonds would rise from $33 million in 2008 to $558 million by 2015. In total, debt service for past capital programs and the 2005-2009 program would rise from $848.1 million in 2004 to $1.6 billion in 2008, and then to $2.2 billion by 2015 (see Graph 2).

Assuming that the MTA borrows another $8 billion to support the 2010-2014 capital program (which is less than the amounts borrowed for the 2005-2009 and the 2000-2004 capital programs), debt service costs would reach $2.8 billion by 2020. The debt burden (i.e., debt service as a percent of revenues) would grow from 11 percent in 2004 to 18.6 percent in 2008, jumping to 26.1 percent by 2020 (see Graph 3).

Internal Management Improvements

An October 2004 report by the State Comptroller found numerous opportunities for the MTA to reduce costs without adversely affecting services. For example, the MTA's operating agencies employed a total of 698 people in human resources, 444 in public relations and marketing, 443 in legal services, 359 people in budget and accounting, and 166 in labor relations. An October 2004 report to the Audit Committee by the MTA's own staff found that many agency functions, with a total cost of $708.9 million and more than 2,700 employees, were duplicative.

Since then, the MTA has taken a number of steps that begin to address the issue raised by the State Comptroller. In January 2005, the MTA Executive Director imposed a hiring freeze for nonsafety and noncritical operating positions, and also directed the presidents of the operating agencies to reduce nonpersonnel-related expenses. On April 18, 2005, she instructed the operating agencies to generate savings of $50 million in 2006 and $100 million in 2007 from internal management actions for inclusion in the July 2005 financial plan.

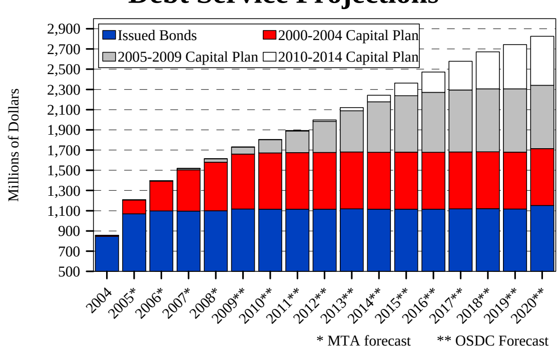
The MTA Board also recently approved a 90-day $832,283[5] contract with Booz Allen Hamilton Inc., to identify cost savings in the areas of finance, human resources, procurement, and information technology. MTA officials are hopeful that this "shared services" initiative will generate substantial savings by 2007 from consolidating and eliminating duplicative services. In addition, the MTA has hired, on a commission basis, Civic Entertainment Group LLC, and Octagon Worldwide Inc., to identify opportunities for corporate sponsorship of MTA assets.

Impact on the Operating Budget

In February 2005, the MTA released a financial plan ("the February Plan") that reflected the adopted budget for 2005 and revenue and expenditure projections through 2008. The February Plan projects a closing cash balance of $76 million for 2005 and budget gaps of $813 million in 2006, $1.1 billion in 2007, and $1.4 billion in 2008, excluding the impact of future actions proposed by the MTA to help

Graph 2

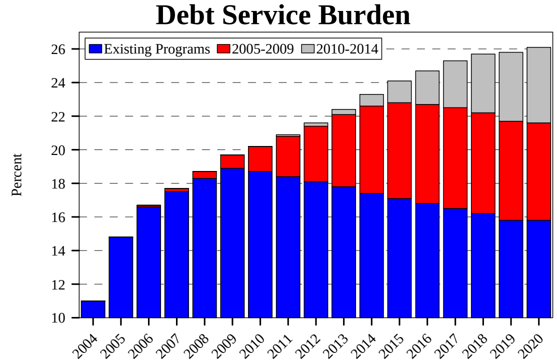
Debt Service Projections



Sources: Metropolitan Transportation Authority; OSDC analysis

Graph 3

Debt Service Burden



Sources: Metropolitan Transportation Authority; OSDC analysis

[5] The contract includes a $100,000 contingency reserve.

balance the budget in those years. These gaps are primarily due to rising debt service costs, but pension and health insurance costs are also projected to grow rapidly.

The State budget will provide the MTA with new tax revenues and fees of $125 million in 2005 and more than $300 million in subsequent years (see Table 3). In addition to these new resources, a number of other positive developments have occurred since the beginning of the year. Taken together, our analysis concludes that the MTA should have no difficulty balancing the 2006 budget without the need for previously planned service reductions. In addition, the MTA is on track to balance the 2007 budget, as long as it remains committed to achieving savings from internal management improvements. Budget gaps do reappear in 2008, however, and could reach $1.1 billion by 2010.

The following positive developments will help the MTA balance its budget through 2007.

- The Division of the Budget estimates that MTA tax revenues could be higher than forecast in the February Plan by $194 million in 2005 and by $140 million, on average, in subsequent years.

The current fiscal year is off to a good start. Despite rising interest rates, tax revenues from real estate transactions have exceeded expectations by $57 million during the first four months of 2005. In addition, the Metropolitan Life Insurance Company Inc., recently announced agreements to sell real estate for a combined $2.5 billion, which could generate between $30 million and $45 million in tax revenue for the MTA. Fare and toll collections have been slightly better than planned through the first quarter. However, subway and bus collections in March—which was the first month of the fare increase—were less than expected, reportedly in response to inclement weather and greater-than-expected use of monthly fare discounts.

- Calendar year 2004 ended with a cash balance that was $42 million higher than anticipated in the February Plan, due largely to continued strength in the real estate market and higher toll revenue, and 2005 will benefit by another $65 million from transactions made in 2004.
- Pension contributions to the New York City Employees' Retirement System could be $133 million less than assumed in the February Plan because the City Actuary has

Table 3
Developments Since the February Plan
(in millions)

	2005	2006	2007	2008
Surplus/(Gap) per the February Plan	**$ 76**	**$ (813)**	**$ (1,105)**	**$ (1,398)**
Tax Reestimates	194	141	162	125
New Taxes and Fees	125	313	338	338
Additional 2004 MTA Surplus	107	- - -	- - -	- - -
Estimated Pension Savings	56	71	13	(7)
Unallocated Reserve[1]	(20)	(30)	- - -	- - -
Drawdown of MTA Reserve	- - -	200	- - -	- - -
MTA-Proposed 5% Fare and Toll Increase	- - -	- - -	240	242
Internal Management Improvements	- - -	50	100	100
Debt Service 2005-2009 Capital Program	- - -	(3)	(9)	(19)
Prior-Year Surplus	- - -	538	467	206
Projected Surplus/Gap	**538**	**467**	**206**	**(413)**
Surplus Transfer	(538)	(467)	(206)	- - -
Projected Surplus/(Gap)	**$ - - -**	**$ - - -**	**$ - - -**	**$ (413)**

Sources: Metropolitan Transportation Authority; NYS Division of the Budget; OSDC analysis

[1] The MTA has set aside resources to cover shortfalls in achieving planned savings during 2005 and 2006. The financial plan also includes a $40 million annual general reserve.

proposed changes in actuarial assumptions and methodologies that are likely to be approved by the board of trustees.

- Given the continued strength in the real estate market, it now appears likely that the MTA will rescind, pursuant to an MTA Board resolution, planned service reductions for 2006 by drawing upon a $200 million reserve that was established to offset a potential sharp drop in revenues from real estate transactions resulting from rising interest rates.
- On April 18, 2005, the MTA's Executive Director instructed the presidents of each of the operating agencies to recommend actions for inclusion in the July 2005 financial plan that would provide savings of $50 million in 2006, and recurring savings of $100 million from internal management actions.[6] According to the Executive Director's instructions, these savings should not come at the expense of services, maintenance, safety, or from higher fares, tolls, or fees.

Pension Obligation Bonds

As of January 2004, the Long Island Rail Road and the Manhattan and Bronx Surface Transportation Operating Authority (a component agency of New York City Transit) had unfunded pension liabilities of more than $2 billion.

These liabilities are currently being funded with increased contributions to the pension funds with an implied interest rate of 8 percent. The Governor proposed that the MTA issue pension obligation bonds instead, presumably at a lower interest rate than the rate charged by the pension fund, to finance these liabilities.

The success of pension obligation bonds, however, depends on whether the bond proceeds, which are invested in the stock market and other financial instruments, earn more than the interest on the bonds. The Internal Revenue Service treats pension obligation bonds as arbitrage bonds, and the bonds are ineligible for tax-exempt status. While some states and localities have benefited from pension obligation bonds, too many have incurred higher costs and new liabilities.

The State Comptroller believes that it is inappropriate and ill-advised for the MTA to gamble with fare and toll revenue through arbitrage. Although the State Legislature did authorize the MTA to issue pension obligation bonds, it imposed restrictions that reduce the level of risk. Even with these restrictions, the State Comptroller still believes that the risks outweigh the benefits.

The restrictions imposed by the State Legislature on the MTA's use of pension obligation bonds are as follows:

- The MTA may issue pension obligation bonds in an amount of up to 60 percent of the total unfunded pension liability, or $1.2 billion, whichever is less.
- Pension bonds shall not be issued for a term longer than 20 years.
- The MTA may not issue bonds in any 12-month period in excess of 40 percent of the total amount to be issued.
- The economic benefits must be relatively uniform over the term of the bonds.
- Any operating budget savings realized between 2005 through 2010 must be used to mitigate planned service reductions.
- The Governor proposed that pension obligation bonds be exempt from the MTA's debt limit, but the approved bill does not include such an exemption.

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6 These targets represent about 1 percent of agency spending in 2006 (excluding depreciation and pension, health and welfare, and energy costs), and about 2 percent in 2007.