On July 22, 2015, the Metropolitan Transportation Authority (MTA) released a preliminary budget for 2016 and an associated financial plan (the “July Plan”). The July Plan shows that the short-term outlook for the MTA’s operating budget has improved with the economy, but the 2015-2019 capital program still has a $9.8 billion funding gap.

To close the funding gap, the MTA has suggested that New York State increase its contribution to the MTA’s capital program by $7.3 billion and that New York City increase its contribution by $2.5 billion. While both the Governor and the Mayor recognize the importance of funding the MTA’s capital program, the State and City have not yet approved the MTA’s request for additional resources.

How the funding gap is closed will have implications for commuters, taxpayers and the regional economy. Failure to invest adequately in the transit system may jeopardize reliability and expansion projects that are critical to the regional economy, and closing the gap through additional borrowing without new sources of funding would put added pressure on fares and tolls.

Under the MTA’s current funding proposal, debt service and other operating budget resources devoted to the capital program are already expected to reach $3.5 billion by 2019, $1 billion more than in 2014. Even with planned biennial fare and toll increases of 4 percent, the capital program would account for 21 percent of operating revenues during the financial plan period, compared with 17 percent in 2014.

While the MTA anticipates balanced operating budgets through 2017, it projects growing budget gaps of $175 million in 2018 and $224 million in 2019 despite the planned fare and toll hikes. The MTA has not yet indicated how it intends to close these gaps, and the potential exists for even larger operating budget gaps because the MTA is assuming the economy will continue to grow without interruption.

The national economic recovery, however, has already lasted longer than the average length of all post–World War II recoveries and the global economy has begun to weaken. While the local economy currently shows no signs of weakening, there is the possibility of an economic setback during the financial plan period.
MTA revenues are very sensitive to changes in the economy, making the MTA vulnerable to an economic slowdown. During the last recession, MTA tax revenues fell by $1.3 billion (36 percent) over a two-year period. In response, the MTA cut services and raised fares and tolls by 10 percent, and the State raised dedicated transit taxes by more than $1 billion. The MTA’s general reserve averages $155 million annually, only 1 percent of expenditures. Given the current economic environment, the MTA should consider increasing its reserves, as the State and the City have done.

While maintenance and modernization must remain top priorities, the MTA must also expand the regional transit system to accommodate ridership growth and to spur economic development. To achieve these objectives, the MTA will have to work closely with its funding partners to ensure that the 2015-2019 capital program (along with subsequent capital programs) are adequately funded and that the financing program does not place excessive pressure on fares and tolls. The operating and capital budgets are already strained by heavy borrowing for past capital programs, as well as cost overruns on projects such as East Side Access.

Without adequate funding, the MTA may not be able to make the investments necessary to ensure reliability, and planned expansion projects may not be completed. While much of the transit system operated by the MTA has been restored to a state of good repair, some assets that the MTA had hoped would be restored by now remain in poor condition because of insufficient funding. Signal systems are antiquated, ventilation plants are inadequate and subway stations are still in need of repair.

In the absence of new sources of capital funding to close the $9.8 billion funding gap, the MTA could be required to borrow additional funds to finance its capital needs. Every additional $1 billion borrowed by the MTA would increase debt service by an amount comparable to a 1 percent increase in fares and tolls.

While the MTA has largely recovered from the recent recession, there is the possibility of an economic setback during the financial plan period. Whether the MTA will be able to limit biennial fare and toll increases to 4 percent as planned will be determined by the state of the economy and the amount of capital funding made available by New York State and New York City.

A. Overview

Over the past two years, the short-term outlook for the MTA’s operating budget has improved with the economy as ridership has grown, tax collections have exceeded expectations, and the costs of fringe benefits, debt service and energy have grown more slowly than expected. In addition, the MTA’s cost-containment efforts have helped to hold down fare and toll increases. While the MTA continues to increase its savings targets, the increments in recent years have been modest. Nonetheless, the cumulative savings target for 2019 now totals $1.8 billion.

These resources permitted the MTA to fund new labor agreements with its employees, help fund the capital program, reduce projected budget gaps, and add funding to improve service, reliability and safety. The July Plan, which covers 2015 through 2019, projects a balanced budget through 2017, but budget gaps of $175 million in 2018 and $224 million in 2019, even with fare and toll increases of 4 percent in 2017 and 2019.

B. Revenue Trends

The MTA receives revenue from a variety of sources, including fares and tolls, dedicated taxes, and state and local government subsidies. More than half of the cost of the MTA is funded from fares and tolls (52 percent), with more than one-third funded with dedicated taxes (36 percent). Government subsidies and other revenue sources (e.g., advertising) account for the remainder (12 percent). Overall, the July Plan assumes that revenues will grow at an average annual rate of 2.5 percent through 2019 to reach $16.5 billion. The MTA’s estimates assume uninterrupted growth in the regional economy, and biennial fare and toll increases of 4 percent. The July Plan does not anticipate an increase in operating subsidies from either the State or the City.

1. Fare and Toll Revenue

The MTA raised fares and tolls by less than the inflation rate between 1996 and 2007, but since then it has raised fares and tolls by 33 percent, more than twice the inflation rate. The MTA has adopted a policy of biennial fare and toll increases, with projected increases of 4 percent in both 2017 and 2019. These increases are relatively small and less than the projected inflation rate for each biennial period (5.2 percent). Fare and toll revenue will total $7.9 billion in 2016, and each fare and toll increase is expected to generate about $300 million annually.

Besides higher fares and tolls, the MTA expects continued growth in the utilization of its services to generate additional revenue. Since 1991, subway ridership has grown by 76 percent (faster than job growth in New York City) as the subway system has become more reliable and crime has been reduced. Subway ridership, which accounts for two-thirds of mass transit utilization, is expected to reach 1.77 billion riders in 2015 (see Figure 1), the highest level since 1949. Subway ridership has grown at an average annual rate of 2 percent over the past five years and is projected to grow by nearly 2.6 percent in 2016. The July Plan assumes ridership growth will slow to less than 0.4 percent during the period from 2017 through 2019.
After setting a record in 2008, ridership on the Long Island Rail Road (LIRR) declined by 6.3 million riders (7.2 percent) over the next three years (see Figure 2) because of the recession. Ridership has been growing slowly since then, and the July Plan assumes it will exceed the prerecession peak in 2017. Although ridership grew by 2.5 percent during both 2013 and 2014, growth is expected to slow to less than 1 percent in 2015 and 2016, and then slow further to 0.2 percent through 2019.

Ridership on the buses operated by the MTA (including the seven formerly private bus lines taken over by the MTA in 2006) declined by 8.7 percent between 2008 and 2014, in part because the MTA shortened or eliminated a number of bus lines to help balance the budget during the recession. The MTA has stated that these actions were directed at routes where ridership was lowest and where customers, for the most part, could avail themselves of alternative public transportation (e.g., subways). Although many of the services have been restored, bus ridership is not expected to reach its 2009 peak during the financial plan period.

Bridge and tunnel crossings hit an all-time high in 2007 (see Figure 4), but then fell by nearly 22 million vehicles over the next five years as a result of the recession, higher gas prices and three toll increases. Despite toll increases in 2013 and 2015, crossings have increased as job growth has resumed and gas prices have fallen. The July Plan assumes crossings will reach 301 million by 2019, slightly less than the 2007 peak.

The Metro-North Railroad did not experience a ridership decline as sharp as the LIRR’s during the recession, and its ridership has been growing steadily (see Figure 3). Metro-North is expected to set a new record in 2015 with nearly 84 million riders. Over the past 30 years, Metro-North ridership has grown by more than 70 percent, and according to MTA forecasts it could exceed the LIRR’s by 2018. The July Plan assumes that Metro-North ridership growth will accelerate in 2016 to 2 percent, but will ease in subsequent years.
2. Dedicated Tax Revenues

Over the years, New York State has imposed taxes on payrolls, real estate transactions, petroleum businesses and sales to help fund the MTA’s operations. Dedicated taxes and fees are expected to account for 36 percent of total revenue in 2016. The July Plan assumes that dedicated tax collections will increase by $591 million over the next four years to reach $6 billion in 2019. This represents an annual growth rate of 2.6 percent, virtually the same growth rate as projected for 2015, which may be overly optimistic in light of recent economic developments.

While the recent recession caused a sharp drop in tax collections (see Figure 5), revenues were propped up by the imposition of new taxes and fees. For example, the State imposed a new tax on payrolls (i.e., the Payroll Mobility Tax, or PMT). PMT collections have grown rapidly in recent years, reflecting strong job and wage growth in New York City. New York City has added more than 500,000 jobs over the past five years, four times more than were lost during the recession, pushing employment to record levels. The July Plan assumes PMT collections (including replacement funds) will grow at an annual average rate of 3.7 percent between 2015 and 2019 to reach nearly $1.9 billion (31 percent of all dedicated tax revenues), based on the assumption of continued job and wage growth.

Revenue from taxes on commercial and residential real estate transactions in the MTA’s 12-county region peaked at $1.6 billion in 2007, but then fell below $400 million in 2009 as the real estate market collapsed (see Figure 6). Collections have increased steadily in recent years, reflecting Manhattan’s strong commercial market, and are projected to reach $1.3 billion in 2015. While tax collections from real estate transactions continue to be strong, raising the possibility of higher-than-planned revenues in the short term, these taxes are very sensitive to changes in the economy, as evidenced by the sharp drop in collections in 2008 and again in 2009. While the MTA assumes collections will decline by 7.1 percent in 2016, collections are expected to resume growing in subsequent years.

3. Government Subsidies

New York State provides operating assistance to New York City Transit and the commuter railroads, which is matched by the 12 counties that make up the transportation district. In 2016, the MTA expects to receive $188 million from the State, an amount that has not changed since 1994. Since then, the State has used dedicated transit tax funds to make a portion of the contribution, rather than moneys from the general fund as originally envisioned.

The State and the City also partially subsidize the cost of subway and bus discounts for schoolchildren in New York City, and New York City partially subsidizes the cost of providing fare discounts to the elderly. New York City funds the full cost of operating seven formerly private bus lines (i.e., MTA Bus, operated by the MTA at the City’s request), which is not covered by fares and other revenue sources.

The MTA also receives grants (adjusted annually for inflation) from New York City and seven counties in the transportation district to help maintain commuter railroad stations. Connecticut provides a subsidy to Metro-North for its share of costs associated with the New Haven line.
C. Expenditure Trends

Expenditures increased by 53 percent during the five-year period ending in 2008, but were held in check during the recession as the MTA implemented an aggressive program to hold down costs. As the recession ended, spending picked up, and is now projected to reach $15.1 billion in 2016 (33 percent more than in 2010 despite the MTA’s cost-containment efforts).

Spending has been driven by a relatively rapid increase in nondiscretionary costs, particularly debt service to help fund the capital program and higher fringe benefit costs. Nondiscretionary costs are projected to account for more than half (52 percent) of total revenue by 2019. Debt service alone will consume 18 percent of total revenue beginning in 2016. The MTA has also made significant investments in service, safety and maintenance.

1. Personal Service Costs

Operating and maintaining the transit system is labor-intensive. As a result, labor costs account for almost two-thirds of total expenditures. Personal service costs (e.g., salaries and wages, plus fringe benefits) are projected to grow from $8.6 billion in 2015 to $9.7 billion by 2019, a slower annual rate of growth (3.2 percent) than in recent years (4.4 percent).

Between December 2010 and May 2015, the MTA hired 3,683 additional employees, mostly to improve service, safety and maintenance. However, 1,141 positions remain vacant, including 819 nonadministrative positions. The July Plan assumes that staffing will increase by 1,538 to 69,802 by the end of 2016, the highest level in more than 25 years (excluding MTA Bus, which was established in 2006).

Collective Bargaining: The MTA has labor agreements in place with most of its unions. It has estimated that these agreements and the pattern they set for the remaining unions that have not yet reached agreement on new contracts will cost $1.5 billion more than originally budgeted for 2014 through 2018. To fund these agreements, the MTA reallocated $1.2 billion that had been set aside to reduce long-term liabilities (e.g., other postemployment benefits or OPEBs) and to help fund the capital program. The agreements will begin to expire as soon as 2016, and, although the MTA has set aside resources to fund annual wage increases of 2 percent, the actual cost of future labor agreements is subject to negotiation and could be higher. The labor agreements with most LIRR unions expire in December 2016 and the agreement with the Transport Workers Union expires in January 2017.

Pension Contributions: After growing rapidly, pension contributions have leveled off at $1.3 billion, twice the 2005 level (see Figure 7). The MTA’s estimates reflect better-than-expected returns on pension fund investments and the implementation of lower-cost pension plans, as well as changes in the methodologies and assumptions used by the New York City Employees’ Retirement System (NYCERS). The July Plan assumes that pension contributions will total $1.3 billion in 2016 and then decline slightly in 2017 and 2018 before increasing in 2019. However, NYCERS earned about 3 percent on its investments during the fiscal year ending June 30, 2015, considerably less than the 7 percent rate of return that was anticipated. As a result, member employers (including the MTA) may be required to increase their planned contributions.

Most MTA employees belong to four pension systems. Overall, 67 percent of the liabilities of these systems were funded on an actuarial basis in 2014 (the latest year for which data are available). The MTA Defined Benefit Pension Plan was funded at the highest level (80 percent), while the LIRR Pension Plan was the least well-funded (29 percent). The four pension plans had unfunded liabilities of more than $8.3 billion in 2014 (33 percent of total liabilities). The MTA has invested $295 million in surplus resources into the LIRR plan, which is expected to increase the plan’s funding to 47 percent by the end of 2015.

Health and Welfare Benefits: The cost of health insurance and welfare benefits (e.g., dental insurance) for active employees and retirees continues to grow rapidly (see Figure 8). The July Plan assumes that these costs will total $1.6 billion in 2015 and then grow at an average annual rate of 7.8 percent to more than $2.1 billion in 2019. These estimates are based on recent increases in health insurance premiums and historical growth trends.
The MTA, like most public-sector entities, funds postemployment benefits other than pensions (OPEBs) on a pay-as-you-go (PAYGO) basis. The MTA estimates that these costs will grow by 40 percent to $715 million between 2015 and 2019.

The amount paid by the MTA on a PAYGO basis is less than one-quarter of the contribution that would be required if these costs were funded on an actuarial basis (estimated at $3.1 billion for 2014). The total unfunded OPEB liability has grown by 46 percent to $19.9 billion between 2007 and 2012 (the most recent valuation year).

While the MTA established a Retiree Health Benefits Trust to help fund future OPEB costs, it has deposited only $300 million into the trust (another $148 million remains in reserve). The MTA suspended contributions to the trust from 2014 to 2017 to help fund recent labor agreements, and plans to make only small contributions of $10 million in 2018 and $20 million in 2019.

**Overtime:** In 2010, the MTA made a concerted effort to reduce overtime spending after setting a record of $545 million (excluding costs associated with the capital program) in the prior year. Although those efforts reduced overtime to $491 million in 2010 (see Figure 9), overtime spending has risen every year since, and is expected to set a new record in 2015 of $759 million, an increase of $268 million (54 percent) since 2010.

Overtime has risen as a percentage of salaries and wages from 11 percent in 2010 to 14 percent in 2015. While inclement weather has been a factor, the MTA has failed to meet its own hiring targets. The July Plan assumes that overtime spending will decline slightly to $732 million in 2016, but even this modest goal may be difficult to achieve in light of recent trends.

2. **Judgments and Claims**

Each year the MTA estimates its potential liability for claims arising from injuries to customers and employees, and from property damage. This estimated liability now totals more than $2.5 billion, more than twice the estimated liability in 2005. The growth has been driven by workers’ compensation payments to its employees, which reflects increases in the maximum benefit, and an increase in the cost of claims filed by the public.

Liabilities impact the operating budget when claims are settled and paid. The cost to settle claims has more than doubled from 2005 to 2014, growing from $153 million to $386 million. These costs are likely to continue to grow (at least in the short term) as a result of the increase in estimated liabilities in recent years.

3. **Debt Service**

Since 1982, the MTA has committed more than $100 billion to maintain, improve and expand the regional transit system. On September 24, 2014, the MTA proposed a $32.1 billion capital program for 2015-2019. The proposed program, however, had a funding gap of $15.2 billion, nearly half of the program’s value.

The MTA proposed allocating $23.5 billion (nearly three-quarters of the program) to maintain and modernize the existing subway, bus and commuter rail systems. Another $3.1 billion would be allocated to maintain the bridges and vehicular tunnels operated by the MTA. Expansion projects would be allocated $5.5 billion, including $2.8 billion to complete East Side Access, $1.5 billion to begin Phase 2 of the Second Avenue Subway, and $743 million for Metro-North Penn Station Access.

Since the 2015-2019 capital program was first proposed, there has been ongoing debate regarding the size of the program and how to close the funding gap. The MTA Chairman has suggested closing the gap by reducing the cost of the program through efficiencies and from higher contributions from the State, the City and the MTA.
The MTA has suggested that making greater use of alternative delivery methods, such as design-build, public-private partnerships and streamlined procurement processes, could reduce the cost of the program by $2 billion to $30 billion. The July Plan also sets aside additional operating budget resources to fund the capital program, reducing the funding gap to $9.8 billion.

The Chairman also suggested that the State increase its contribution by $7.3 billion (the State has already agreed to contribute $1 billion), and that the City increase its contribution by $1 billion and fund the nonfederal share of the next phase of the Second Avenue Subway (estimated at $1.5 billion, although the actual cost could be higher). The City had already agreed to the MTA’s initial request to contribute $657 million, but the MTA increased its request just days before the City released its ten-year capital program.

While both the State and the City recognize the importance of funding the MTA’s capital program, they have not yet approved the MTA’s request for additional assistance or identified potential sources of funding. As a result, the impact on the State and City budgets cannot be determined at this time. While the Governor has endorsed the Chairman’s proposal for additional State support, State legislative approval is also required.

Over the years, the share of the capital program funded by the MTA and each of its funding partners has varied (see Figure 10). The MTA’s contribution has ranged from 22 percent to 49 percent of the program’s total value, and has averaged nearly 39 percent since 1982. The Chairman has suggested that the MTA contribute $11.7 billion to the 2015-2019 program, which would represent almost 39 percent of the program’s total value, a substantially larger share than any of the MTA’s funding partners.

The second-largest contribution has historically come from the federal government, whose contribution has ranged from 26 percent to 37 percent, and has averaged 32 percent since 1982. The MTA assumes that the federal government will fund 23 percent ($6.8 billion) of the 2015-2019 capital program based on current funding levels, though federal authorization is scheduled to expire in October 2015 and will need to be renewed.

The State’s contribution (as measured by direct capital grants and borrowing supported by State-authorized taxes) has ranged from 7 percent to 31 percent, and has averaged 20 percent since 1982. The Chairman has suggested that the State fund 28 percent of the 2015-2019 capital program, similar to the State’s contribution to the past two capital programs.

The City’s direct contribution to the capital program has ranged from 2 percent to 13 percent, and has averaged 8 percent since 1982. The Chairman has suggested that the City fund 11 percent of the 2015-2019 capital program. The Mayor has pointed out that City residents also pay a large share of the taxes, fares and tolls that support the MTA’s operating and capital budgets.

The form of assistance is just as important as the size of the contribution. In the past, federal and City contributions have come in the form of capital grants, while State and MTA contributions have come mostly from borrowing. Additional borrowing in the absence of new sources of funding would place a heavy burden on the MTA’s operating budget, increasing pressure to raise fares and tolls.

The MTA has outlined how it would finance its contribution ($11.7 billion) to the capital program: additional borrowing ($8 billion); PAYGO financing ($2.3 billion); asset sales ($600 million); and other resources ($800 million). If the MTA’s contribution follows this outline, debt outstanding would rise from $26.6 billion in 2009 to $38.3 billion in 2019, an increase of 44 percent in ten years.
Debt service and other operating budget resources (e.g., PAYGO financing) devoted to the capital program would increase by $1 billion over five years to nearly $3.5 billion in 2019 (see Figure 11). The share of operating budget resources devoted to the capital program would also grow, averaging more than 21 percent during the financial plan period (even with biennial fare and toll increases of 4 percent), compared with 17 percent in 2014.

The 2015-2019 capital program still has a $9.8 billion funding gap. The State and the City have not yet approved the MTA’s request for additional assistance to close the gap. Without sufficient funding, the MTA may not be able to make the investments necessary to ensure reliability, and planned expansion projects may not be completed.

The MTA estimates that 84 percent of its transit assets, including subway cars, have been restored to a state of good repair, but certain assets that the MTA had hoped would be restored by now remain in poor condition because of insufficient funding. Signal systems are antiquated and ventilation plants are inadequate, and subway stations are in need of repair. Although still high by historical standards, the average distance traveled between subway car failures has declined by more than 18 percent in the past three years because of delays in purchasing new cars. The MTA reports that there has been some improvement during the first seven months of 2015.

If the requested funding is not made available, the MTA could be required to borrow to finance the capital program, placing an additional burden on the operating budget. Every $1 billion borrowed by the MTA would increase debt service by an amount comparable to a 1 percent increase in fares and tolls.

The MTA already faces growing long-term liabilities. In 2014, the MTA had outstanding liabilities of nearly $65 billion, 54 percent more than in 2007 (see Figure 12). Most of the growth has come from debt to finance the capital program, but liabilities for pensions, OPEBs, and judgments and claims have also grown.

**D. Risk Assessment**

The MTA’s operating budget is subject to a variety of risks, perhaps none greater than the health of the economy. MTA revenues are very sensitive to changes in the economy, as evidenced by the sharp falloff in tax revenues during the last recession. Tax collections (excluding the PMT, which was enacted in 2009) fell by 36 percent ($1.3 billion) between 2007 and 2009. The July Plan assumes uninterrupted growth in tax collections and utilization of MTA services through the end of the financial plan period (i.e., 2019). The July Plan includes a general reserve that averages $155 million annually, 1 percent of expenditures. Given the possibility of an economic setback during the financial plan period, the MTA should consider increasing its reserves, as the State and the City have done.

Current labor agreements begin to expire in 2016, creating uncertainty during the latter part of the financial plan period. While the MTA has set aside resources to fund annual wage increases of 2 percent, the actual cost of future labor agreements is subject to negotiation.

1 Metropolitan Mass Transportation Operating Assistance taxes include sales taxes, a temporary corporate surcharge, a portion of the state-wide tax on petroleum businesses, and a statewide corporate franchise tax on certain transportation and transmission companies.

2 Triborough Bridge and Tunnel Authority employees and most New York City Transit employees belong to NYCERS.