Review of the Financial Plan For The Metropolitan Transportation Authority

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I. Executive Summary

On October 28, 2003, the MTA released a revised budget for 2003 and a four-year financial plan for calendar years 2004 through 2007. The October Plan shows year-end cash balances of $225.1 million for 2003 and $36.2 million for 2004—slightly improved over the July forecast. But only six months after raising fares and tolls, the MTA projects large and growing out-year budget gaps of about $840 million in 2005, $1.3 billion in 2006, and $1.5 billion in 2007 (see Table 1).

These gaps, however, are actually larger because the MTA is counting on speculative resources in those years. The MTA's revenue projections assume that fare and toll revenue will grow by about $230 million (5 percent) more than the increases already assumed by its agencies in their budgets for calendar years 2005 and 2006, and by $475 million (10 percent) more than the assumptions for 2007. If utilization does not increase fast enough to generate these additional revenues, the MTA has said it might curtail fare and toll discounts. In addition, expenditures are underestimated because the MTA has included the benefit of savings from unspecified cost-reduction actions, which are valued at $80.1 million in 2005, $129 million in 2006, and $174.4 million by 2007. When these factors are taken into account, the projected gaps total $1.1 billion in 2005, $1.7 billion in 2006, and $2.1 billion in 2007.

The projected gaps, which range on an accrual basis from 17.7 percent of revenues in 2005 to 28.9 percent of revenues in 2007, are largely due to the absence of $498 million in nonrecurring resources that were used to balance the 2004 budget; new spending needs; and rapidly rising debt service, pension, and health insurance costs. Expenditures are projected to grow at an average annual rate of 6.9 percent during calendar years 2005 through 2007, but recurring revenues are projected to increase by only 0.2 percent during the same period.

About one third of the projected budget gaps are attributable to new spending needs that were identified in the July and October plans, which will increase costs by $531.2 million in 2007 alone. Debt service costs are projected to more than double, from $797.2 million in 2003 to $1.7 billion in 2007, owing to a heavy reliance on debt to finance the 2000-2004 five-year capital program in response to a lack of State support and only a nominal contribution from the City of New York. By 2014, debt service costs could reach $2.5 billion—more than three times the 2003 level. Pension fund contributions are also expected to more than double during the financial plan period, from $317.8 million in 2003 to $763.6 million in 2007.

The October Plan also assumes that wages for those employees who have not yet reached new agreements with the MTA will increase during calendar years 2003 through 2005 at the same rate as the pattern set by the Transport Workers Union—

and, in subsequent years, that wages will increase for all employees at the projected inflation rate. The October Plan does not anticipate any savings from changes in work rules or other collectively bargained productivity improvements.

The MTA cooperated fully during the course of this review and continues to make improvements to its budget presentation. The October Plan included, for the first time, an MTA-wide financial plan, detailed reconciliations, a breakdown of personal service costs into their major components, and detailed narrative that describes the major budget assumptions.

Although the October Plan represents a significant leap forward, it still suffers from a number of notable deficiencies that must be addressed to improve transparency. MTA agencies still prepare their financial plans and budgets using different formats and there are a number of inconsistencies in their presentations. In addition, the October Plan does not disclose the sources of nonrecurring resources, even though legislation proposed by the MTA last June would have required such a disclosure, and the plan does not clearly identify transactions that shift resources from one year to another. The State Comptroller has proposed regulations that would ensure transparency by requiring the MTA to present, document, and report on its budget and financial plan estimates in a manner that is consistent with well-established and prudent budgeting practices.

The October Plan also does not disclose that the temporary franchise tax surcharge, which generates about $450 million annually for the MTA, is scheduled to effectively expire on December 31, 2004. While it is not unreasonable for the MTA to assume that the State will renew this temporary tax as it has done eight times since 1982, the MTA should have disclosed this budget assumption because there is always a risk that the tax might not be renewed. In addition, the October Plan does not address the Mayor's proposal that the MTA assume the operational and financial responsibility for the seven private bus companies currently subsidized by the City.

The October Plan includes a number of other budget risks that represent an even greater threat to the MTA's budget. The Plan assumes the receipt of $121.3 million in additional governmental assistance in 2004 for New York City Transit, which is not likely to materialize given the budget gaps faced by the State and City. The MTA also has not substantiated its savings estimates from corporate restructuring and, as we previously discussed, the October Plan includes speculative fare and toll revenues, and unspecified savings. If these risks materialize, the budget gap could reach $1.2 billion in 2005, $1.7 billion in 2006, and $2.1 billion in 2007 (see Table 2). On a positive note, tax and toll revenues are likely to exceed the estimates in the October Plan by $50 million in 2003 and pension fund investment performance is also likely to exceed expectations.

Even if the MTA curtails fare and toll discounts in 2005 and the State extends the temporary franchise tax surcharge, the MTA would still face a budget gap of $840 million. To close that gap, the MTA intends to initiate an extensive analysis to reduce costs while maintaining service levels, and to seek additional financial assistance from the State and City, probably in the form of a tax increase. Unless these actions are successful, the MTA would need to raise base fares and tolls in 2005.

For the first time, the MTA has included in its debt service projections an estimate of the cost of funding the 2005-2009 capital program. Since the program is only in the initial stages of development, the estimates are based on broad assumptions about the size, composition, and sources of funding. The October Plan assumes that the 2005-2009 capital program would total $26.6 billion—40 percent more than the current program—and include $9.3 billion for East Side Access and the Second Avenue Subway. It assumes, however, that the City of New York will finance the extension of the No. 7 subway line.

The October Plan also is silent on the sources of funding needed to plug a $6.7 billion gap in the 2005-2009 capital program, which represents about 25 percent of the resources needed to fully fund the program. Since the October Plan already makes optimistic assumptions about federal and City contributions, the MTA would most likely look to the State, either in the form of a direct contribution or a tax dedicated to fund debt service on bonds, to help fill the funding gap. Unless the MTA obtains additional outside assistance, it would have to rely more heavily on its own bonds, which would further strain the operating budget, or cut the size of the proposed capital program. In addition, our review found that the MTA could reach its debt ceiling in 2005, and that unless the ceiling is raised by the State the MTA may not be able to finance $1.7 billion, or 9 percent, of the 2000-2004 capital program.

Before any debate can take place on new resources for the operating and capital budgets, the MTA must continue to improve its budget presentation and scrutinize spending to identify opportunities to reduce costs without adversely affecting services.

Table 1
Metropolitan Transportation Authority
Financial Plan for Calendar Years 2003 Through 2007

(in millions)

	2003	2004	2005	2006	2007
REVENUES					
Fare & Toll Revenue	$ 4,203.9	$ 4,500.8	$ 4,539.2	$ 4,583.3	$ 4,635.7
Increased Fare & Toll Yields	- - -	- - -	227.0	229.2	475.2
Tax Revenue	1,775.7	1,801.1	1,745.7	1,759.4	1,784.8
Gov't Subsidies & Reimbursements	781.2	778.3	807.4	831.4	858.4
New Government Assistance	- - -	121.3	- - -	- - -	- - -
Other	179.7	208.7	182.7	188.8	194.9
Subtotal	**6,940.5**	**7,410.2**	**7,502.0**	**7,592.1**	**7,949.0**
Inter-Agency Subsidies	(31.6)	(46.3)	(55.0)	(59.4)	(63.3)
Total Revenues	**6,908.9**	**7,363.9**	**7,447.0**	**7,532.7**	**7,885.7**
EXPENSES[1]					
Salaries & Wages	3,624.1	3,656.6	3,777.9	3,905.5	4,035.6
Health & Welfare	715.5	765.9	828.5	897.1	971.9
Pension Contributions	317.8	463.6	614.5	715.0	763.6
Other Fringe Benefits	392.4	388.1	405.3	421.2	435.9
Debt Service	797.2	1,149.2	1,405.1	1,574.0	1,706.8
Depreciation[2]	356.8	393.5	420.9	445.0	459.6
General Reserve	- - -	30.0	30.0	30.0	30.0
Other	1,623.7	1,685.0	1,765.3	1,851.5	1,953.0
Subtotal	**7,827.5**	**8,531.9**	**9,247.5**	**9,839.3**	**10,356.4**
Capital Reimbursement [3]	(326.8)	(322.0)	(327.1)	(334.2)	(346.1)
Unspecified Cost Reduction Savings	- - -	- - -	(80.1)	(129.0)	(174.4)
Total Expenses	**7,500.7**	**8,209.9**	**8,840.3**	**9,376.1**	**9,835.9**
Surplus/(Gap)	**(591.8)**	**(846.0)**	**(1,393.3)**	**(1,843.4)**	**(1,950.2)**
Cash Adjustments	782.9	657.1	517.4	504.7	498.9
Prior Year Cash Balance	34.0	225.1	36.2	- - -	- - -
Closing Cash Balance	**$ 225.1**	**$ 36.2**	**$ (839.7)**	**$ (1,338.7)**	**$ (1,451.3)**

Sources: Metropolitan Transportation Authority; OSDC analysis

[1] Long Island Railroad, Long Island Bus, Bridges & Tunnels, and MTA Headquarters include costs associated with the capital program in their expense budget categories (e.g., salaries and wages), while New York City Transit, Metro-North and Staten Island Railway do not include such costs in their expense budget categories.

[2] The financial plans for New York City Transit, Bridges & Tunnels, and Staten Island Railway exclude depreciation, while those for Metro-North, Long Island Rail Road, Long Island Bus, and MTA Headquarters include depreciation.

[3] Estimates include a credit that New York City Transit receives from the capital budget for indirect costs associated with the capital program, such as time-keeping.

Table 2
OSDC Budget Risk Assessment
(in millions)

Better/(Worse)

	2004	2005	2006	2007
MTA Projected Budget Surplus/(Gaps)	**$ 36.2**	**$ (839.7)**	**$ (1,338.7)**	**$ (1,451.3)**
OSDC Risks and Offsets:				
Higher 2003 Year-End Cash Balance	50.0	- - -	- - -	- - -
Increased Governmental Assistance	(121.3)	- - -	- - -	- - -
Increased Fare & Toll Yields	- - -	(227.0)	(229.2)	(475.2)
Unspecified Cost Reduction Savings	- - -	(80.1)	(129.0)	(174.4)
Corporate Restructuring	(5.0)	(25.0)	(25.0)	(25.0)
Debt Service	- - -	- - -	(24.0)	(55.0)
Pension Contributions	10.0	19.0	30.0	44.0
Total	**(66.3)**	**(313.1)**	**(377.2)**	**(685.6)**
OSDC Estimate of Potential Budget Gaps[4]	**$ (30.1)**	**$ (1,152.8)**	**$ (1,715.9)**	**$ (2,136.9)**
Additional Risks:				
New York City Private Bus Subsidy	$ (75.0)	$ (150.0)	$ (150.0)	$ (150.0)
Extend Temporary Franchise Tax Surcharge	- - -	(442.0)	(460.3)	(479.3)
Total	**$ (75.0)**	**$ (592.0)**	**$ (610.3)**	**$ (629.3)**

[4] The financial plan includes an annual reserve of $30 million in each of calendar years 2004 through 2007.

II. Background

On December 18, 2002, the Metropolitan Transportation Authority released a revised budget for 2002 and a two-year financial plan for calendar years 2003 and 2004. The 2002 budget projected a small year-end cash balance of less than $25 million and large budget gaps for 2003 and 2004. To close these gaps, the MTA proposed a large increase in fares and tolls.

An examination of MTA records, which were obtained by subpoena, found that the MTA had two versions of its December Plan: one that it showed the public and one that it kept to itself. A report by the State Comptroller, based on a review of the internal version of the December Plan, revealed previously undisclosed transactions that moved resources off budget and from one year to another (see *An Examination of the Finances of the Metropolitan Transportation Authority*, Report 4-2004, April 2003).

These transactions had the effect of reducing the projected size of the 2002 surplus by shifting resources to 2003 and 2004. If not for these transactions, the 2002 surplus would have totaled $537.1 million, which was $512.5 million more than acknowledged by the MTA. Of the undisclosed surplus, $248.3 million was transferred to 2003 and $264.2 million was transferred to 2004. The resources that were shifted to 2004, combined with other undisclosed resources, would have been sufficient to avoid a fare hike in 2003. The report concluded that the MTA misled the public and its elected officials about its true financial condition during the debate over increased fares and tolls.

On March 27, 2003, the MTA released a revised two-year financial plan for calendar years 2003 and 2004. The March Plan included the revenues from the proposed increase in fares and tolls, and the cost of the new labor agreement with the Transport Workers Union. The March Plan also shifted to 2003 a portion of the resources that previously had been transferred from 2002 to 2004 to help pay for the labor agreement with the Transport Workers Union.

In the wake of the report by the State Comptroller, the MTA has made a commitment to make its finances transparent and to restore public confidence. The steps already taken by the MTA include:

- Naming a new budget director.
- Establishing a vice chairman of the MTA Board for Finance to focus on financial reporting and corporate transparency.

- Establishing an informal group of advisors who have broad experience with New York City's budgeting procedures to provide guidance in developing the new budgeting and reporting procedures.
- Initiating a search for a Chief Financial Officer, a position that has been vacant for over two years.
- Adopting new budgeting and financial reporting procedures based on the system used by New York City.

On July 30, 2003, the MTA released a financial plan for calendar years 2003 and 2004. The July Plan did not cover calendar years 2005 through 2008, even though we believe that Section 1269-d of the Public Authorities Law requires the MTA to prepare, each July, a strategic operation plan that includes calendar-year estimates of capital and operating resources and costs for the upcoming five-year period. The MTA response to our draft report acknowledged that it is required to update its strategic operation plan at least annually, but disagreed with our interpretation that the plan should be released in July. The MTA notes that a strategic operation plan was issued in March 2003; however, that plan was released only in response to the State Comptroller's demand that the MTA comply with the Public Authorities Law. Prior to March 2003, the MTA had not issued a five-year plan since September 1999. Moreover, in our view the March Plan was deficient because it concealed the size of the projected budget gaps. The MTA response to our draft report stated that the MTA intends to issue a strategic operations plan in December 2003 and to update the plan in July 2004.

The July Plan was the first financial plan to be issued since the MTA adopted new budgeting and financial reporting procedures. Importantly, the July Plan included the internal version of the MTA's financial plan—commonly referred to as the "super spreadsheet." It was the super spreadsheet, which we obtained through subpoena, that revealed how the MTA planned to shift surplus resources in the December Plan from 2002 to future years. The inclusion of the super spreadsheet is a positive step, but the document by itself does not render the MTA's financial plan transparent.

While the commitments made by the MTA are encouraging, they do not go far enough. A compelling need exists for regulations that will ensure transparency by requiring the MTA to present, document, and report on its budget and financial plan estimates in a manner that is consistent with well-established and prudent budgeting practices. Toward that end, the State Comptroller has proposed regulations that would support and build upon the efforts of the MTA, and most importantly would institutionalize these improvements.

III. Financial Plan Transparency

On October 28, 2003, the MTA released a revised budget for 2003 and a four-year financial plan for calendar years 2004 through 2007. The October Plan included for the first time an MTA-wide financial plan, detailed reconciliations and cash adjustments, a breakdown of personal service costs into their major components, and detailed narrative that describes the major budget assumptions, including collective bargaining. The MTA also is committed to the timely implementation of a new comprehensive accounting system that would improve the preparation and oversight of the MTA budget.

While the October Plan represents a significant leap forward, it still suffers from a number of notable deficiencies.

- The size of the projected gaps was underestimated by including in the baseline estimates speculative resources that require future actions. The October Plan assumes that fare and toll revenue will grow by about $230 million (5 percent) more than the increases already assumed by the agencies in their budgets for calendar years 2005 and 2006, and by about $475 million (10 percent) more than the assumptions for 2007. In addition, expenditures are underestimated because the MTA has included the benefit of savings from unspecified cost-reduction actions, which are valued at $80.1 million in 2005, $129 million in 2006, and $174.4 million by 2007.
- The October Plan did not disclose that the franchise tax surcharge, which generates about $450 million annually for the MTA, is scheduled to expire on December 31, 2004 for most corporations, and the MTA did not disclose that the October Plan assumes the State will renew this temporary tax.
- The October Plan did not disclose that the MTA will reach its debt ceiling of $16.5 billion in 2005 and, unless the ceiling is raised by the State, the MTA may not be able to finance $1.7 billion (9 percent) of the 2000-2004 capital program. (The MTA responded that it will reach the debt ceiling in 2006, but the documentation supporting the October Plan does not support this conclusion.)
- The legislation proposed by the MTA last June would have required the MTA to disclose all nonrecurring resources with a value in excess of $500,000, but such a listing was excluded from the July and October plans.
- Bridges and Tunnels, New York City Transit, and Staten Island Railway exclude depreciation from their financial plan projections, but Long Island

Bus, Long Island Rail Road, Metro-North, and MTA Headquarters include depreciation in their estimates.

- Bridges and Tunnels, Long Island Bus, Long Island Rail Road, and MTA Headquarters include expenses reimbursed by the capital budget within each expense category, but Metro-North, New York City Transit, and Staten Island Railway exclude such expenses from their expense categories.
- New York City Transit is the only MTA agency that shows a "credit" from the capital budget for indirect personal service costs, such as time-keeping, for activities that support the capital program.
- In our April 2003 report, we found that the MTA planned to shift $512.5 million in resources from 2002 to calendar years 2003 and 2004, but the October Plan does not show the degree to which it relies on such transfers. For example, the October Plan shows an opening cash balance of $34 million in 2003, but this estimate excludes $399.8 million in resources that were transferred from 2002 to 2003 through other transactions (see Table 3). In addition, while the actual amount that was shifted from 2002 to future years increased by only $0.8 million since the December Plan, the October Plan reveals that the MTA intends to transfer $8.7 million to 2005.

Table 3
Resources Transferred To Future Years

(in millions)

	2002	2003	2004	2005
Stabilization Fund	$ (289.6)	$ 289.6	$ - - -	$ - - -
Corporate Account	(129.3)	59.3	61.3	8.7
Debt Service Prepayment	(94.4)	50.9	43.5	- - -
Total	**$ (513.3)**	**$ 399.8**	**$ 104.8**	**$ 8.7**

Sources: Metropolitan Transportation Authority; OSDC analysis

- Insurance proceeds from losses related to the attack on the World Trade Center were accounted for differently by the MTA agencies. In some cases, the insurance proceeds were reflected in the estimates for fare and toll revenue, and in other cases the proceeds were included in the cash adjustments.
- The MTA was not prepared to substantiate the estimates in the October Plan in a timely manner, and the quality of the working papers in a number of cases was unsatisfactory. The State Comptroller has proposed regulations that would require the MTA and its agencies to prepare working papers contemporaneously with the release of the budget or financial plan and to prepare them in accordance with prudent budgetary practices.

IV. Calendar Years 2003 and 2004

On March 6, 2003, the MTA board voted to raise subway, bus, and commuter railroad fares by an average of 20 percent, and to raise tolls on its major bridges and tunnels by $0.50. The March Financial Plan reflected the higher fares and tolls and projected a year-end cash balance of $91.9 million for 2003 and $19.7 million for 2004. Since then, the MTA has increased its revenue estimates over the two-year period by $236.8 million, and has identified cost-reduction initiatives valued at $283 million. These additional resources, however, were mostly offset by an increase of $503.4 million in planned spending over the two-year period.

A. July Financial Plan

The July Plan projected a year-end cash balance of $186.2 million for 2003, twice the amount projected in the March Plan (see Table 4). The higher 2003 year-end cash balance was largely due to a $123.1 million increase in real estate–related taxes, which reflected high refinancing activity and the sale of commercial properties.

Table 4
Financial Plan Reconciliation
July Plan Compared with the March Plan
(in millions)
Better/(Worse)

	FY 2003	FY 2004
Closing Cash Balance per March Plan	**$ 91.9**	**$ 19.7**
Revenues		
Fare Revenue	(38.1)	(35.7)
Toll Revenue	7.6	11.8
Real Estate–Related Tax Revenue	123.1	37.5
Drawdown Reserves	7.5	40.0
Other	3.3	(39.6)
Subtotal	**103.4**	**14.0**
Expenses		
Security Costs	(15.7)	(27.2)
Pension Contributions	(13.5)	(36.1)
Debt Service	1.3	(12.1)
Corporate Restructuring	(5.0)	(20.0)
Agency Spending	(96.0)	(131.3)
Subtotal	**(128.9)**	**(226.7)**
Net Change Since March 2003	**(25.5)**	**(212.7)**
Gap-Closing Program	119.8	102.7
Change in Prior Year Cash Balance	- - -	94.4
Closing Cash Balance per July Plan	**$ 186.2**	**$ 4.1**

Sources: Metropolitan Transportation Authority; OSDC analysis

Overall, revenues in the July Plan were projected to exceed the estimates in the March Plan by $117.4 million over the two-year period, but the MTA also identified new spending needs of $355.6 million. Even with the addition of $222.5 million in new cost-reduction measures over the two years, the impact of the new spending needs reduced the projected 2004 year-end cash balance from $19.7 million in the March Plan to $4.1 million in the July Plan.

B. October Financial Plan

The October Plan projects a year-end cash balance of $225.1 million for 2003, which is $38.8 million more than projected in the July Plan (see Table 5) and primarily due to a $23.8 million increase in projected real estate–related taxes. Overall, revenues are projected to exceed the estimates in the July Plan by $119.4 million over the two-year period, but the MTA identified additional spending needs of $147.8 million in the October Plan. With the addition of $60.5 million in new cost-reduction measures over the two years, the net impact of these transactions increased the projected 2004 year-end cash balance from $4.1 million in the July Plan to $36.2 million in the October Plan.

Table 5
Financial Plan Reconciliation
October Plan Compared with the July Plan
(in millions)

Better/(Worse)

	FY 2003	FY 2004
Closing Cash Balance per July Plan	**$ 186.3**	**$ 4.1**
Revenues		
Fare Revenue	9.2	2.6
Toll Revenue	16.2	16.9
Real Estate–Related Tax Revenue	23.8	25.9
LI Bus Subsidy	- - -	(4.9)
Drawdown NYC Transit Reserve	- - -	20.0
Other	8.2	1.5
Subtotal	**57.4**	**62.0**
Expenses		
Losses from August Blackout	(20.6)	- - -
Pension Contributions	(0.7)	(31.9)
Health & Welfare	(2.2)	(16.9)
Debt Service	2.1	12.6
Establish General Reserve	- - -	(30.0)
Agency Spending	(34.8)	(25.4)
Subtotal	**(56.2)**	**(91.6)**
Net Change Since July 2003	**1.2**	**(29.6)**
Gap-Closing Program	37.6	22.9
Change in Prior Year Cash Balance	- - -	38.8
Closing Cash Balance per October Plan	**$ 225.1**	**$ 36.2**

Sources: Metropolitan Transportation Authority; OSDC analysis

C. New Spending Needs

Since the March Plan, the MTA has identified new agency spending needs of $136.4 million in 2003, $165.9 million in 2004, $303.8 million in 2005, $415 million in 2006, and $531.2 million in 2007 (see Table 6). The October Plan assumes that administrative costs will be higher than projected in the March Plan, by $62.9 million in 2003 and as much as $161.6 million in 2007, largely as a result of higher costs for health and welfare, computer systems, and fuel and power. Spending on services is projected to be higher by $19.7 million in 2003 and as much as $172.5 million in 2007, primarily because of a projected increase in utilization of the paratransit program. In addition, maintenance costs are projected to be higher than projected in the March Plan, by $37.8 million in 2003 and as much as $164.4 million in 2007, because of planned preventive maintenance on newer trains and buses that were put into service in 2003 and 2004.

Table 6
New Spending Needs Since the March Plan
(in millions)

	2003	2004	2005	2006	2007
Administration	$ 62.9	$ 87.6	$ 127.1	$ 138.8	$ 161.6
Customer Convenience	5.1	4.6	9.2	13.0	11.8
Service	19.7	17.3	54.3	107.5	172.5
Maintenance	37.8	38.7	94.6	132.8	164.4
Safety and Security	10.1	17.6	18.6	22.9	20.9
Revenue	0.8	- - -	- - -	- - -	- - -
Total	**$ 136.4**	**$ 165.9**	**$ 303.8**	**$ 415.0**	**$ 531.2**

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

D. Program to Eliminate the Gaps

The October Plan includes gap-closing measures that would reduce costs and increase revenues since the March Plan by a total of $184.9 million in 2003, $250 million in 2004, $356.9 million in 2005, $440 million in 2006, and $535.4 million in 2007 (see Table 7). Of these amounts, however, unspecified actions account for about 22 percent of the resources in 2005 and about 30 percent of the resources in calendar years 2006 and 2007.

In our April report, we criticized the MTA for taking credit in its gap-closing program for resources that resulted not from management improvements but rather from baseline reestimates. The MTA, however, continues to include such reestimates in its October gap-closing program. For example, the gap-closing program includes $28.7 million in additional toll revenue in 2004 from a revised projection of bridge and tunnel crossings.

Table 7
October Plan Gap-Closing Program
(in millions)

	2003	2004	2005	2006	2007
Administration	$ 93.6	$ 103.8	$ 107.5	$ 106.9	$ 110.1
Customer Convenience	6.6	22.4	20.8	21.7	22.2
Service	4.1	24.5	34.9	51.5	77.4
Maintenance	41.4	45.9	49.3	51.6	61.8
Revenue	36.9	49.2	58.3	72.3	82.3
Other	2.2	4.2	6.0	7.0	7.2
Unspecified Savings	- - -	- - -	80.1	129.0	174.4
Total	**$ 184.9**	**$ 250.0**	**$ 356.9**	**$ 440.0**	**$ 535.4**

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

Almost half of the gap-closing program in 2004 concerns administrative actions valued at $103.8 million, which the MTA claims will have no direct impact on services. These savings will be achieved by not filling managerial vacancies, and from reestimates of fuel, power, and other non–personal service costs. The October Plan also anticipates savings of $45.9 million in 2004 from lower maintenance costs as older trains and buses are phased out and new rolling stock is placed into service.

Initiatives categorized by the MTA as “customer convenience” and “service adjustments,” which are valued at $46.9 million in 2004 and $99.6 million in 2007, will have a direct effect on services. Among the initiatives contemplated are reductions of subway, bus, and station cleaners, platform controllers, and station elevator operators. Since the MTA budget is not tied to performance, it is impossible to gauge the impact these actions will have on service levels.

E. Budget Risks

The October Plan projects a year-end cash balance of $225.1 million for 2003, but tax and toll collections are likely to be higher by $50 million. For 2004, the October Plan assumes that New York City Transit will receive $121.3 million more in governmental subsidies, but given the financial problems facing the State and City, this expectation is unrealistic. In fact, New York City’s financial plan assumes that the MTA will take on the operational and financial responsibilities of the seven private bus companies currently subsidized by the City, which would save the City $75 million in 2004 and $150 million annually thereafter. The Governor had suggested that the MTA assume half the cost as part of a proposal to reduce the amortization period on refinanced MAC bonds (see Report 9-2004). While the MTA has expressed a willingness to operate the bus lines, it is opposed to assuming the financial responsibility. The City and the MTA are continuing to negotiate, but have made little information public about the status of their discussions.

V. Out-Year Budget Gaps

The MTA projects year-end cash balances of $225.1 million in 2003 and $36.2 million in 2004, but budget gaps of $839.7 million in 2005, $1.3 billion in 2006, and $1.5 billion in 2007. These gap estimates, however, are understated by $307.1 million in 2005, $358.2 million in 2006, and $649.6 million in 2007, because the MTA has included in its baseline estimates for those years speculative resources that would come from future actions.

The revenue projections assume that fare and toll revenues will grow above the increases already assumed by the agencies in their budgets, by 5 percent in calendar years 2005 and 2006 (about $230 million) and by 10 percent ($475.2 million) in 2007. If utilization does not increase fast enough to generate these additional revenues, the MTA has indicated that it would consider curtailing fare and toll discounts to meet its revenue target. In addition, the growth in projected expenditures has been held down by savings from yet-unspecified cost-reduction actions of $80.1 million in 2005, $129 million in 2006, and $174.4 million in 2007. After adjusting for these factors, the projected budget gaps, on a cash basis, total about $1.1 billion in 2005, $1.7 billion in 2006, and $2.1 billion in 2007.

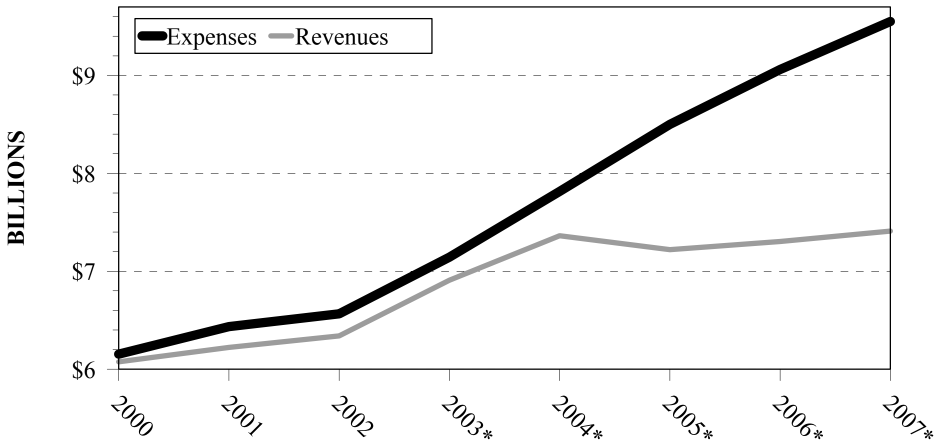
On an accrual basis, which presents a clearer picture of an entity's financial condition, the MTA has a gap of $235.1 million in 2003 and almost twice that amount, $452.6 million, in 2004.[5] In subsequent years the gaps grow rapidly and total about $1.3 billion in 2005, $1.8 billion in 2006, and $2.1 billion in 2007. These gaps represent 3.4 percent of MTA revenues in 2003, 6.1 percent in 2004, 17.7 percent in 2005, 24.1 percent in 2006, and 28.9 percent in 2007.

As shown in Graph 1, the MTA has a large and growing imbalance between recurring revenues and expenses, which accounts for the budget gaps. The budget was essentially in balance in 2000, but expenses began to grow more rapidly than revenues in subsequent years. Consequently, the gap between recurring revenues and expenses widened to $235.1 million in 2003. The structural imbalance has been masked in recent years by the rollover of cash balances from prior years, the use of non-recurring resources, and the debt-restructuring initiative that pushed debt costs into future years. The structural imbalance, however, is projected to widen even further in future years and would reach a gap of $2.1 billion by 2007.

[5] Estimates exclude depreciation.

Graph 1

GROWING STRUCTURAL IMBALANCE



* MTA forecast

Note: Accrual estimates exclude anticipated fare and toll yield revenues, unspecified savings from future actions, and depreciation.

Sources: Metropolitan Transportation Authority; OSDC analysis

While revenues are projected to increase by 6.6 percent in 2004, expenditures are projected to grow at an even faster rate of 9.4 percent. Spending is projected to outpace revenue growth in subsequent years as well, with revenues growing at an average annual rate of only 0.2 percent and expenditures growing at an annual rate of 6.9 percent.[6] The major factors behind the structural imbalance include the following.

- **New Spending Needs.** The July and October financial plans included new spending needs of $165.9 million in 2004, which will widen the projected budget gaps by $531.2 million by 2007. Most of the new spending needs represent higher maintenance costs and a large increase in the cost of the paratransit program, which is projected to increase from $150.6 million in 2003 to $272.5 million in 2007.

- **Debt Service.** Costs are projected to rise from $797.2 million in 2003 to $1.1 billion in 2004—an increase of 44.2 percent—and then rise by another $557.6 million by 2007. This represents an average annual increase of 21 percent during calendar years 2004 through 2007, owing to the MTA's increased reliance on borrowing to finance the capital program in response to the diminished contributions from the State and City.

[6] Estimates exclude anticipated fare and toll yields, unspecified savings from future actions, and depreciation.

- **Pension Contributions.** Contributions are projected to total $614.5 million by 2005, almost double the 2003 amount, and then reach $763.6 million by 2007. This represents an average annual increase of 24.5 percent during calendar years 2004 through 2007, owing to higher pension fund contributions to offset pension fund investment losses and unfunded pension liabilities.
- **Fare and Toll Revenues.** Although fare and toll revenue is projected to grow by 7 percent in 2004, the growth mostly represents the full-year value of higher fares and tolls, which were increased in May 2003. Fare and toll revenues, however, are projected to increase by only 0.7 percent during calendar years 2005 through 2007 based on the MTA's assumptions of a slow increase in regional employment.
- **Tax Revenues.** Revenues from dedicated transit taxes are projected to decline by 3 percent in 2005 and then increase by only 2.2 percent during calendar years 2006 and 2007, compared with the annual growth rate of 11 percent during calendar years 1996 through 2002.
- **TBTA Surplus.** The portion of the surplus from the Triborough Bridge and Tunnel Authority that is used to subsidize the operating budgets of the Transit Authority and the commuter railroads is projected to decline to $209.7 million by 2007, down from a peak of $400.6 million in 2000, because of rising debt service costs.
- **Nonrecurring Resources.** The 2004 budget includes $498 million in nonrecurring resources to support recurring expenses. These nonrecurring resources include resources transferred from 2002 to 2004; insurance proceeds from the attack on the World Trade Center; pension fund prepayments; prior year cash balances; and interest income on reserves. Beginning in 2005, these resources will have to be replaced with recurring resources in the form of higher revenues or lower costs.

VI. Revenue Trends

More than 60 percent ($4.5 billion) of the MTA's revenue in 2004 comes from fare collections on its subways, buses, and commuter trains, and toll collections at its bridges and tunnels. Tax revenues account for another 25 percent ($1.8 billion) of the MTA's revenue in 2004. As a result, 85 percent of the MTA's revenue comes from economically sensitive sources—leaving government subsidies and reimbursements, which make up 9.9 percent of the budget, as the only stable source of revenue.

The October Plan assumes that revenues will increase by 6.6 percent in 2004, primarily owing to the full-year impact of fare and toll increases enacted in 2003. Revenues, however, are projected to decline in 2005 and then increase slowly in subsequent years. Overall, revenues are projected to increase at an average annual rate of 0.2 percent during calendar years 2005 through 2007, excluding revenues from increased fare and toll yields (see Table 8).

Table 8
Sources of Revenue
(in millions)

	2003	**2004**	**2005**	**2006**	**2007**	**3-Year Avg. Growth Rate**
Fare and Toll Revenue	$ 4,203.9	$ 4,500.8	$ 4,539.2	$ 4,583.3	$4 ,635.7	1.0 %
Tax Revenue	1,775.7	1,801.1	1,745.7	1,759.7	1,784.8	-0.3 %
Gov't Subsidies/Reimb.[7]	749.6	732.0	752.4	772.0	795.1	2.8 %
New Gov't Assistance	- - -	121.3	- - -	- - -	- - -	NA
Other	179.7	208.5	182.7	188.5	194.9	-2.2 %
Total	**$ 6,908.9**	**$ 7,363.7**	**$ 7,220.0**	**$ 7,303.5**	**$ 7,410.5**	**0.2 %**

Note: Excludes revenue from additional fare and toll yields. Columns may not add due to rounding.
Sources: Metropolitan Transportation Authority; OSDC analysis

The MTA has included in its baseline estimates—inappropriately in our view—additional fare and toll revenue above the increases already assumed by the agencies in their budgets. The October Plan assumes that fare and toll revenue will be 5 percent greater than the increases already included by the agencies in their budgets for 2005 and 2006, and a 10 percent increase over the assumptions for 2007. The agency projections were based on economic forecasts prepared by *Global Insight*, a private consulting firm used by the State and City in preparing their revenue forecasts. The MTA concedes that these additional revenues are not likely to materialize from a dramatic increase in utilization and that it might have to curtail toll and fare discounts to generate the additional revenue.

[7] Estimates exclude MTA cross-subsidy for Long Island Bus and Staten Island Railway.

A. Fare and Toll Revenue

MTA revenues from bridge and tunnel tolls and subway, bus, and commuter train fares grew slowly from 2000 to 2002. Ridership slowed as a result of the slumping economy and the World Trade Center attacks, and bridge and tunnel closures caused toll revenues to drop. In May 2003 the MTA raised fares by 20 percent, on average, and raised tolls on the largest bridges and tunnels by $0.50. As a result, fare and toll revenue is projected to rise from $3.8 billion in 2002 to $4.5 billion in 2004. In addition, fare and toll revenue, excluding revenue from additional fare and toll yields, is expected to increase by an average of 1 percent during calendar years 2005 through 2007, reflecting the October Plan assumption that ridership on the subways, buses, commuter railroads, and bridge and tunnel crossings will increase by about 1 percent per year.

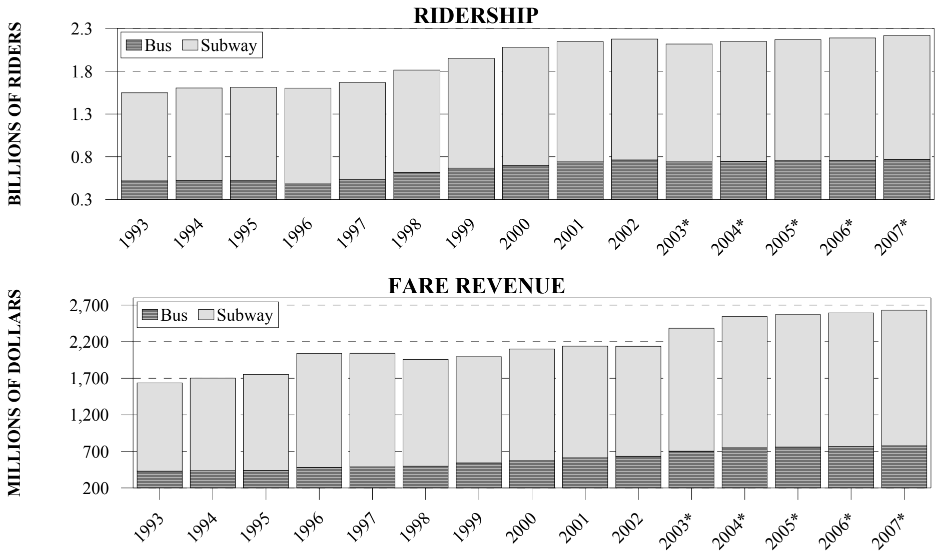
New York City Transit

Subway and bus ridership increased at an average annual rate of 8.3 percent during calendar years 1997 through 2000, and bus ridership grew at an average of 10 percent (see Graph 2). The increase is due to the rapid expansion in the regional economy during this period, but also to the introduction of *MetroCard* and free transfers between subways and buses in 1997. Subway and bus fare revenue, however, grew by only 2.9 percent during this period, as riders took advantage of *MetroCard* discounts. However, the attack on the World Trade Center in September 2001 and the economic slowdown that began a few months earlier greatly affected the regional economy and disrupted subway service, particularly on the Nos. 1 and 9 lines. New York City lost about 150,000 jobs during calendar years 2000 through 2002, which limited the growth in subway and bus ridership to 3.1 percent in 2001 and 1.3 percent in 2002.

The October Plan assumes that subway and bus ridership will decline by 57.1 million riders during 2003 as a result of higher fares and a continuation of the economic slowdown. The MTA's ridership projections assume that the number of jobs in New York City will decline by 1.8 percent during 2003, but then increase by 1.1 percent in 2004. As a result, New York City Transit projects that subway and bus ridership will increase by 1.4 percent during 2004 compared with the forecast for 2003. In addition, New York City Transit assumes that New York City will add 160,000 jobs during calendar years 2004 through 2007—an average annual increase of 1 percent—and that ridership will grow at a commensurate rate. Fare revenue is projected to increase by 6.7 percent in 2004, reflecting the full-year impact of the fare hike in 2003, and then increase by 1 percent annually thereafter based on assumptions about employment growth and continued growth in the market share of the 30-day *MetroCard*.

Graph 2

NEW YORK CITY TRANSIT



* MTA forecast

Source: Metropolitan Transportation Authority

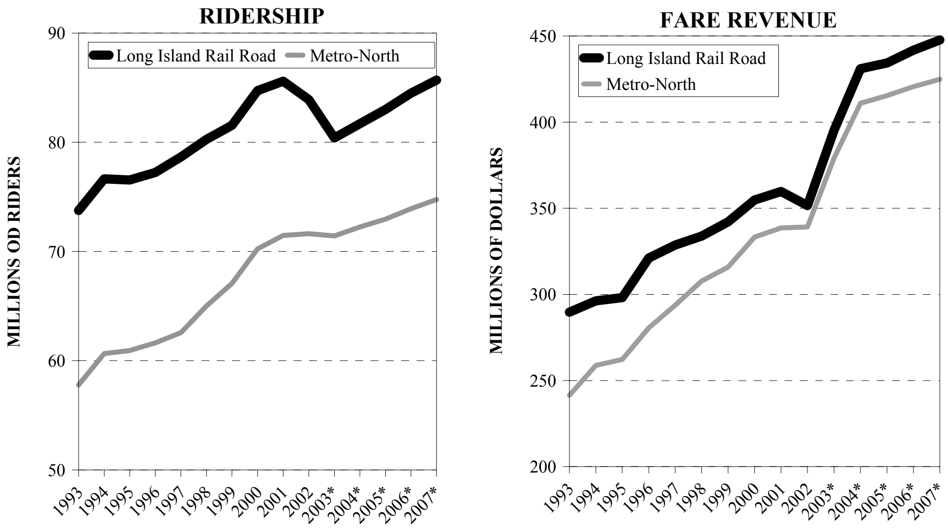
Commuter Railroads

Ridership on the MTA's commuter railroads is very sensitive to the state of the regional economy, and rose steadily as the economy improved following the recession in the early 1990s (see Graph 3). Metro-North ridership increased from 57.8 million riders in 1993 to 71.4 million riders in 2001—a rise of 23.5 percent. Ridership on the Long Island Rail Road also increased, albeit at a slower rate, from 73.8 million riders in 1993 to 85.6 million riders in 2001—an increase of 16 percent. In 2002, the Long Island Rail Road experienced a ridership loss of 2 percent—its first annual loss since 1995. Metro-North's ridership growth stalled, rising only slightly from the year before.

The October Plan assumes that ridership on the Long Island Rail Road will decline by 4.2 percent in 2003 and that Metro-North ridership will remain flat because of lower employment levels and higher fares. Ridership is projected to increase on both commuter rail lines by an average of 1.4 percent beginning in 2004, based on employment projections in the MTA region. Fare revenue is projected to increase at an average annual rate of 1.3 percent during calendar years 2005 through 2007.

Graph 3

COMMUTER RAILROADS



*MTA forecast

Source: Metropolitan Transportation Authority

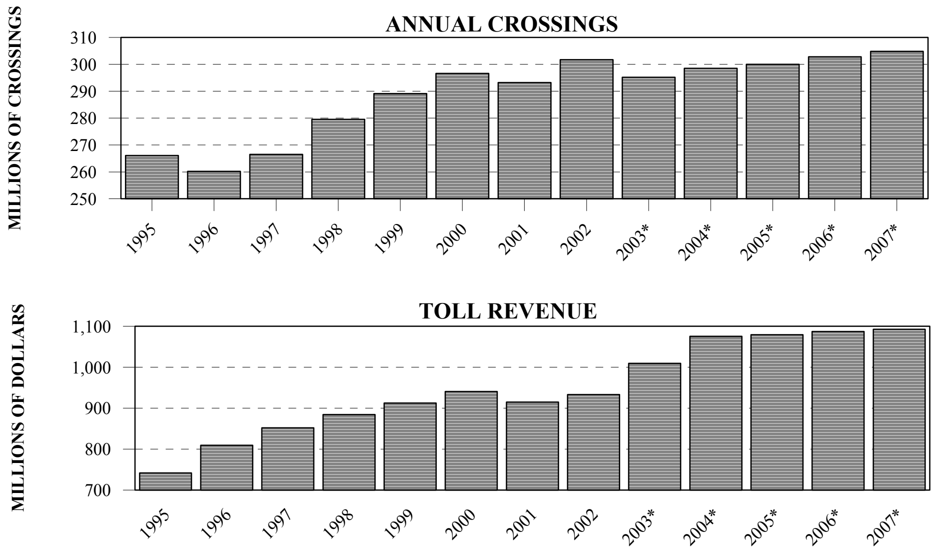
Bridges and Tunnels

Traffic volume on the MTA's bridges and tunnels rose by 11.6 percent between 1995 and 2000, increasing from 266.1 million crossings to 296.6 million crossings, before declining by 1.1 percent in 2001 due to the closure of some bridges and tunnels after the attack on the World Trade Center (see Graph 4). In 2002, traffic volume rose to 300 million cars—1.1 percent higher than the 2000 level. Bridges and Tunnels projects that crossings will decline by 1.6 percent in 2003 as a result of the weak economy, higher tolls, and diversions to the Port Authority–operated Holland Tunnel because that tunnel's truck restrictions are being lifted. The October Plan further assumes that bridge and tunnel crossings will increase by 1.2 percent in 2004 and then by an average annual rate of 0.7 percent during calendar years 2005 through 2007. Toll revenue is projected to increase by 6.4 percent in 2004, reflecting the full-year value of the May 2003 toll hike, and then increase at an annual average rate of only 0.5 percent in subsequent years.

Toll collections are expected to exceed the cost of operating and maintaining bridges and tunnels by $711.1 million in 2003, and the surplus will be used to help fund the operating and capital budgets of New York City Transit and the commuter railroads as required by law. Under the statute, New York City Transit receives the first $24 million of a toll surplus and the remainder is split evenly between New York City Transit and the commuter railroads.

Graph 4

BRIDGES AND TUNNELS



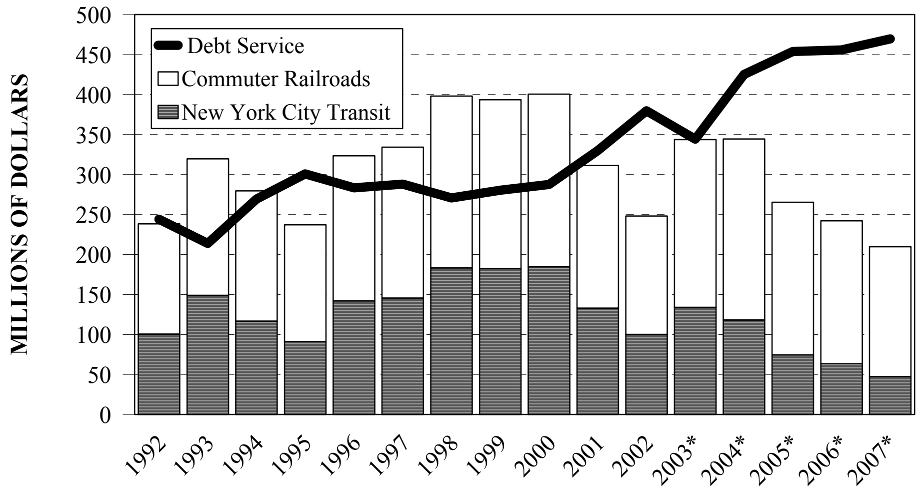
*MTA forecast

Source: Metropolitan Transportation Authority

As shown in Graph 5, the amount of surplus toll revenue available to support the operating budgets of New York City Transit and the commuter railroads is projected to decline from $400.6 million in 2000 to $209.7 million by 2007, as debt service costs increase from $287.7 million in 2000 to $469.6 million in 2007. The amount of surplus toll revenue available to support New York City Transit's operating budget is projected to decline from $184.6 million in 2000 to $47.5 million by 2007, a reduction of 74.3 percent. The amount of surplus toll revenue available to support the operating budgets of the commuter railroads is much higher because a larger portion of the surplus allocated to New York City Transit is used to fund debt service. The MTA has proposed legislation that would allow the MTA to allocate the surplus based on need rather than by applying the current statutory formula. Presumably, the MTA would allocate a larger share of the toll surplus to New York City Transit at the expense of the commuter railroads.

Graph 5

DISTRIBUTION OF BRIDGE & TUNNEL SURPLUS TO OPERATING BUDGETS



* MTA forecast

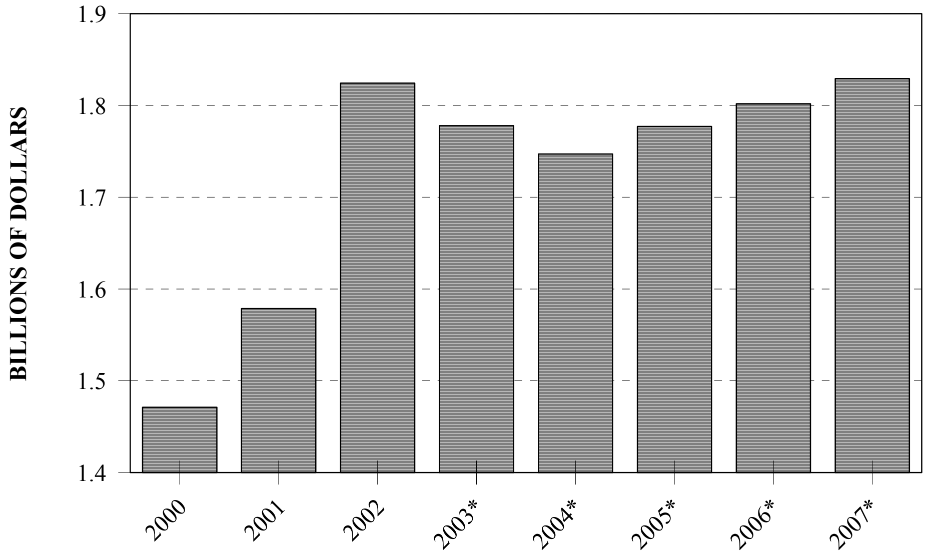
Sources: Metropolitan Transportation Authority; OSDC analysis

B. Tax Revenue

The MTA receives revenues from a variety of State and City taxes and fees. These revenues have increased from nearly $1.5 billion in 2000 to $1.8 billion in 2002 (see Graph 6), which is an average annual increase of 12 percent, primarily owing to additional State support in the form of motor fuel taxes and motor vehicle fees dedicated to mass transit and an increase in real estate–related taxes. Tax collections, however, are projected to decline in 2003, reflecting a projected decline in collections from the petroleum business tax, and again in 2004, reflecting a projected decline in real estate–related tax collections. Tax revenues are then projected to increase slowly at an average annual rate of 1.5 percent during calendar years 2005 through 2007 as the economy begins to improve. Although the distribution of dedicated tax revenue among MTA agencies is currently set by statute, the MTA has proposed legislation that would permit the MTA to distribute the revenue according to its needs and at its own discretion.

Graph 6

TAX REVENUE



* MTA forecast

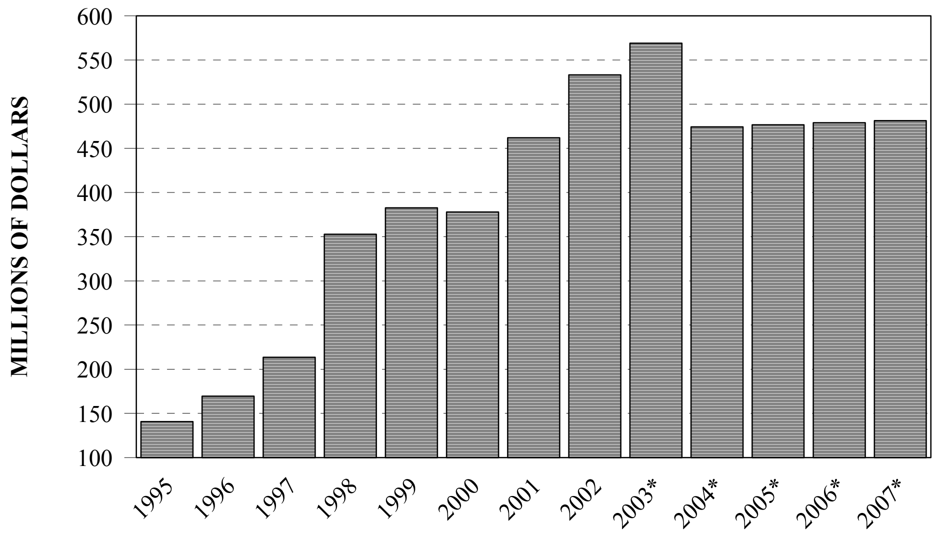
Source: Metropolitan Transportation Authority

Real Estate–Related Taxes

One of the fast-growing components of tax revenue for the MTA in recent years has been real estate–related taxes. Real estate–related tax revenue has grown from $140.6 million in 1995 to $533.2 million in 2002—a level never reached before, primarily because of continued strength in real estate values and sales and mortgage refinancing, which are all partly attributable to the lowest interest rates since the 1960s (see Graph 7). The New York region's mortgage activity has followed the national trend. From 2000 to 2002, national mortgage activity more than doubled with the increase of mortgage refinancings, from $197.5 billion in 2000 to almost $1.5 trillion in 2002. The October Plan assumes that revenue from real estate taxes will decline by 16.6 percent in 2004 and remain essentially flat through 2007. The City of New York, however, assumes in its financial plan that mortgage-recording tax receipts will increase by 5.8 percent in City FY 2006 and by 8.2 percent in City FY 2007. While the MTA has appropriately budgeted conservatively for this volatile tax, there may be potential for additional revenues in these years.

Graph 7

REAL ESTATE-RELATED TAX REVENUE



* MTA forecast

Source: Metropolitan Transportation Authority

C. Government Subsidies and Reimbursements

The MTA receives a relatively set amount of governmental subsidies and reimbursements every year based on legislative formulas and memorandums of understanding with New York State, the State of Connecticut, New York City, and other counties in the MTA transportation district. The October Plan assumes the receipt of $749.6 million in 2003, including reimbursement for reduced fares for schoolchildren and the elderly, and the paratransit program. The Plan, however, also expects an increase of $121.3 million in 2004 from the State or City, which would benefit New York City Transit exclusively.

The MTA receives an unrestricted subsidy under the State 18-b program, which is funded equally by the State and localities. In 2004, the 18-b program is expected to contribute nearly $375 million to the MTA's budget. The State and City, per a memorandum of understanding, each provide the MTA with $45 million to help fund the cost of providing free and reduced fares for schoolchildren. The City also provides the MTA with $13.8 million for reduced fares for the elderly and contributes to the MTA's paratransit program. In addition, the MTA receives funding from localities to maintain commuter railroad stations in their jurisdictions. The State of Connecticut also subsidizes the portion of Metro-North's operating deficit that is attributable to the New Haven Line, and Nassau County provides a subsidy to Long Island Bus.

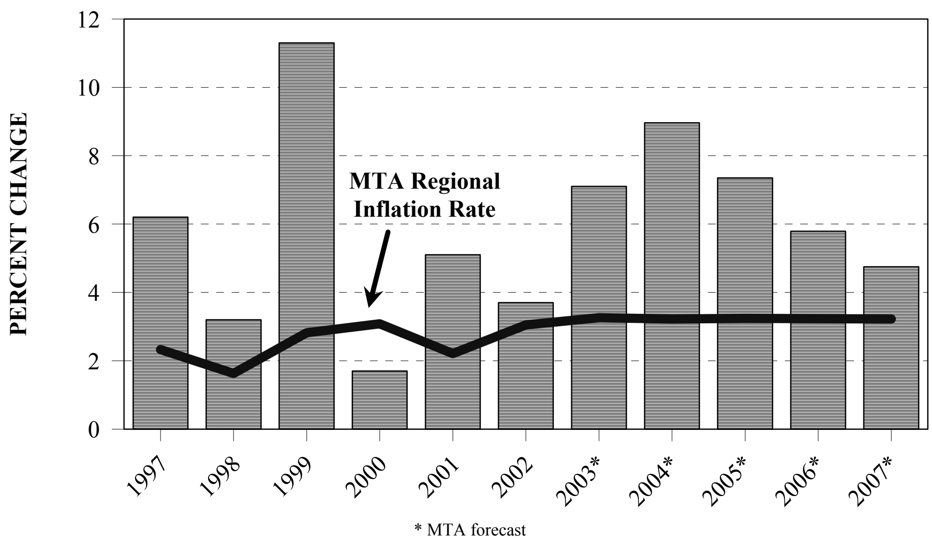
VII. Expenditure Trends

Expenditures, excluding depreciation, grew at an average annual rate of 4.9 percent during calendar years 1997 and 2002—twice the rate of inflation during that period (see Graph 8). The October Plan assumes that expenditures (excluding depreciation and unspecified savings) will grow much faster than the projected inflation rate—by 9.4 percent in 2004, and by 6.9 percent, on average, during calendar years 2005 through 2007.

Personal service costs are projected to grow at an annual rate of 5.5 percent during calendar years 2004 through 2007, driven by higher pension and health insurance costs, but debt service costs are projected to grow even faster. Debt service expenses are forecast to increase by more than $900 million during the same period, an average annual rate of 21 percent. As a result, debt service will consume an increasing share of available resources, growing from 11.5 percent of revenues in 2003 to 23 percent in 2007.

Graph 8

GROWTH IN MTA EXPENDITURES



Note: Excludes depreciation and savings from unspecified cost-reduction actions.
Sources: Metropolitan Transportation Authority; OSDC analysis

The major factors behind the growth in spending are shown in Table 9 and described below.

- Debt service costs, which remained relatively stable during calendar years 1999 through 2003 at about $800 million, are projected to increase in 2004 by $352 million, or 44.2 percent, and reach $1.7 billion by 2007—an average annual rate of 21 percent during calendar years 2004 through 2007. By 2014, debt service costs could reach $2.5 billion—three times the 2003 level.

- Pension contributions are projected to increase by $145.8 million in 2004 (an increase of 45.9 percent) and by $300 million during calendar years 2005 through 2007 (an average annual growth rate of 18.1 percent), because the MTA will have to make up for pension fund investment losses in the past three years.
- Employee health and welfare costs are projected to increase at an average annual rate of 8 percent during calendar years 2004 through 2007.
- The cost of the MTA's paratransit program is expected to rise from $150.6 million in 2003 to $272.5 million by 2007, an increase of 80.9 percent, based on the assumptions of annual ridership growth of 15 percent and vendor cost increases of 3 percent annually.
- Salary and wage costs are projected to grow at an average annual rate of 2.7 percent during calendar years 2004 through 2007, but total personal service costs are forecast to rise at twice that rate—an average annual rate of 5.5 percent—reflecting rapidly rising health insurance and pension costs.

Table 9
Projected Growth in Expenditures
(in millions)

	2003	**2004**	**2005**	**2006**	**2007**	**4-Year Avg. Growth Rate**
Salaries & Wages	$ 3,624.9	$3,656.6	$ 3,777.9	$ 3,905.5	$ 4,035.6	2.7 %
Health & Welfare	715.5	765.9	828.5	897.1	971.9	8.0 %
Pension Contributions	317.8	463.6	614.5	715.0	763.6	24.5 %
Other Fringe Benefits	392.4	388.1	405.3	421.1	435.5	2.6 %
Debt Service	797.2	1,149.2	1,405.1	1,574.0	1,706.8	21.0 %
Paratransit Program	150.6	180.7	202.8	234.6	272.5	16.0 %
Fuel and Power	309.6	301.0	309.5	316.1	319.3	.8 %
Other	1,162.8	1,233.2	1,282.9	1,330.9	1,391.6	4.6 %
Capital Reimbursement	(326.8)	(322.0)	(327.1)	(334.2)	(346.1)	NA
Total	**$ 7,144.0**	**$ 7,816.3**	**$ 8,499.5**	**$ 9,060.1**	**$ 9,550.7**	**7.5 %**

Note: Excludes depreciation and anticipated savings from unspecified actions. Columns may not add due to rounding.
Sources: Metropolitan Transportation Authority; OSDC analysis

A. Salary and Wage Costs

Salary and wage costs are projected to total nearly $3.7 billion in 2004, including $341.4 million in overtime costs, which is an increase of only 0.9 percent over the 2003 forecast. In subsequent years, salary and wage costs are projected to increase at an average annual rate of 3.3 percent. In contrast, salary and wage costs grew at a much higher rate (4.7 percent) during calendar years 1996 through 2002, as a result of additions to the workforce and wage increases pursuant to collective bargaining agreements.

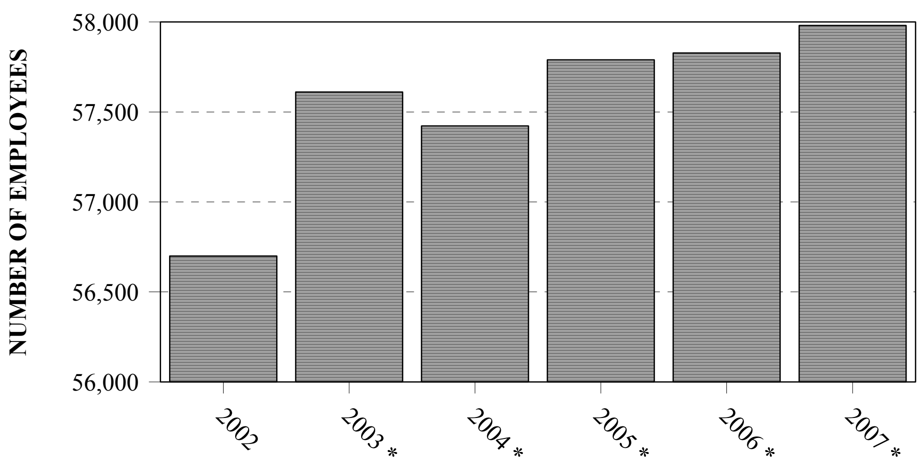
At the end of calendar year 2002, the portion of the MTA workforce funded by the operating budget totaled 56,699 full-time equivalents (see Graph 9). While staffing levels are projected to increase by 912 employees in 2003, the October Plan assumes the workforce will decline by 189 employees in 2004 and then increase slowly in subsequent years.

Graph 9

PERSONNEL LEVELS

Non-Reimbursable

(Full-Time Equivalents)



* MTA forecast

Sources: Metropolitan Transportation Authority; OSDC analysis

New York City Transit employed 41,745 full-time equivalents in 2002, which amounts to 73.6 percent of all MTA nonreimbursable employees. New York City Transit projects that its workforce will increase by 467 employees during 2003, but then decline by 550 employees during 2004 with the implementation of planned cost-reduction measures. By 2007, however, the workforce is expected to reach 42,066, which is slightly higher than the 2002 level.

The other MTA agencies employed 14,954 full-time equivalents in 2002, with 72.4 percent concentrated in the commuter railroads. The commuter railroads plan to increase their workforces by 381 employees during calendar years 2003 and 2004, and by another 117 employees during calendar years 2005 through 2007. Bridges and

Tunnels employed 1,548 full-time equivalents in 2002 and plans to add 147 employees during calendar years 2003 and 2004, mostly to enhance security. MTA Headquarters also plans to enhance security and to increase its workforce from 1,159 full-time equivalents in 2002 to 1,368 employees by the end of 2003.

Collective Bargaining

The MTA has more than 50 collective bargaining agreements that cover about 56,000 full-time equivalents, including those reimbursed by the capital budget. Most New York City Transit employees are represented by the Transport Workers Union, which represents about 33,000 employees. In December 2002, the Transport Workers Union reached a three-year labor agreement with the MTA that will expire on December 15, 2005. The agreement includes a $1,000 lump sum payment in the first year, and annual wage increases of 3 percent during the second and third years of the contract. New York City Transit also agreed to assume the obligations of the employee health benefit trust. Under the prior agreement, New York City Transit was required only to make a defined contribution to the trust, but now New York City Transit will be required to maintain the current level of benefits regardless of increases in health insurance premiums. Health insurance premiums are projected to grow faster than the annual increase in the defined contribution under the prior agreement.

The MTA financial plan includes only minimal savings from labor productivity. In addition, the MTA is unable to substantiate its savings estimate of $5 million in 2004 and $25 million annually thereafter from corporate restructuring, although the presumption is that a portion of the savings would in fact come from eliminating civil service protection for future bus operators. Also, the MTA included the cost of the labor agreement with the Transport Workers Union in its financial plan, but it did not include any savings from much-heralded productivity improvements that were cited at the time the agreement was announced. The MTA should either acknowledge that it will not realize any productivity savings from the agreement or include an estimate of the savings.

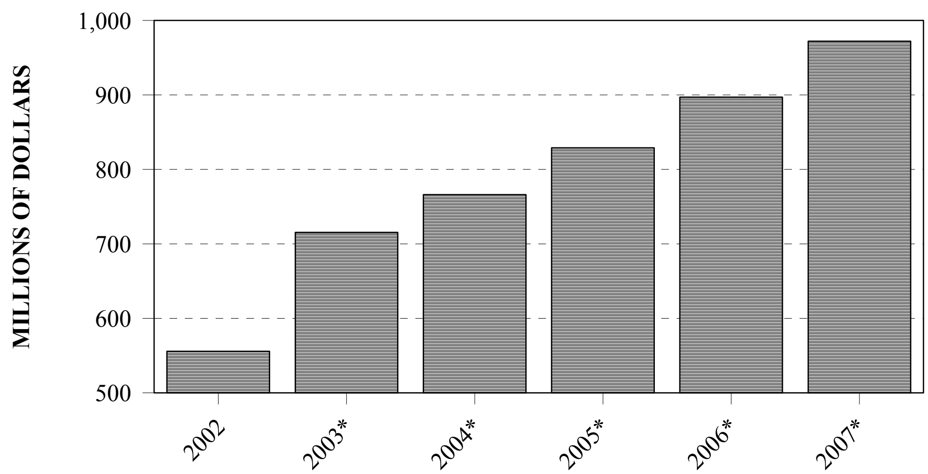
In the past, the MTA has been reluctant to publicly discuss its budget assumptions regarding future collective bargaining costs, even though these assumptions could significantly affect the projected budget gaps. To the MTA's credit, the October Plan includes a detailed description of these assumptions. The plan assumes that wages for those employees who have not yet reached new agreements with the MTA will increase during calendar years 2003 through 2005 at the same rate as the pattern set by the Transport Workers Union, and that in subsequent years wages will increase for all employees at the projected inflation rate. The October Plan does not anticipate any savings from changes in work rules or other collectively bargained productivity improvements.

B. Health and Welfare Contributions

Health insurance costs, which totaled $555.8 million in 2002, are projected to rise rapidly and reach $971.9 million by 2007 (see Graph 10). Health insurance costs are projected to increase by $159.7 million in 2003, an increase of 28.7 percent, and then increase by 7 percent in 2004 and by about 8.3 percent annually in subsequent years. The MTA agencies were instructed to use an inflation assumption of 8.2 percent for calendar years 2005 through 2007 when preparing health and welfare projections. These assumptions are generally consistent with forecasts by private consultants and the assumptions used by the City and State in preparing their budgets.

Graph 10

HEALTH AND WELFARE CONTRIBUTIONS



* MTA forecast

Source: Metropolitan Transportation Authority

C. Pension Contributions

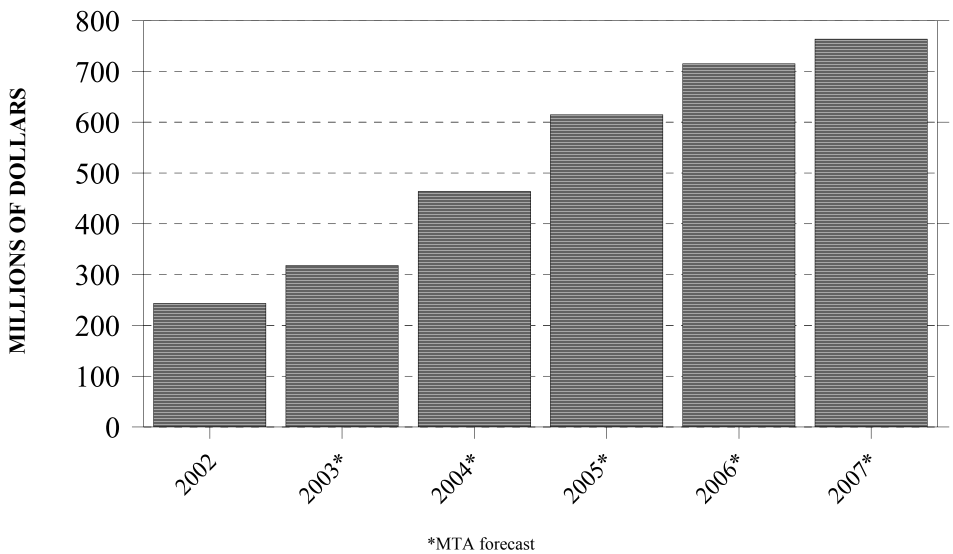
Pension contributions are projected to grow from $243.4 million in 2002 to $614.5 million in 2005 and then to $763.6 million by 2007 (see Graph 11), largely owing to pension fund investment losses in the past three years. The estimates assume that the actuarial pension funds will meet their investment targets during calendar years 2004 through 2007.

The New York City Employees' Retirement System, which includes most employees of New York City Transit and Bridges and Tunnels, operates on a fiscal year that begins in July. During 2003, the New York City Employees' Retirement System earned more on its investments than the amount assumed in the October Plan.

In addition, the MTA's actuarial pension funds, which operate on a calendar year basis, are on track to produce earnings that double the assumed rates of return. Together, these developments could reduce future pension contributions by $10 million in 2004, $19 million in 2005, $30 million in 2006, and $44 million in 2007.

Graph 11

PENSION CONTRIBUTIONS



Sources: Metropolitan Transportation Authority; OSDC analysis

During the past three years, however, the MTA's actuarial pension funds have lost, on average, 5 percent each year, compared with an expected gain of about 8.25 percent. Consequently, the pension funds fell short of their targets by more than 13 percent each year, and these shortfalls will have to be made up with additional pension fund contributions. For example, pension contributions on behalf of those employees of New York City Transit and Bridges and Tunnels who are members of the New York City Employees' Retirement System are projected to rise from $62 million in 2003 to $310 million in 2005, and then to $438 million by 2007.

A June 2003 report to the MTA Finance Committee advised the committee to review the current investment earnings assumptions that are used to calculate pension contributions, because there is a greater risk of an earnings shortfall over the short- to intermediate-term than in the past. Currently, the MTA's single-employer pension funds have investment earnings assumptions that range from 8 percent to 8.5 percent depending on the pension system. The Finance Committee report estimates that each

1 percent reduction in the investment earnings assumptions for these systems would increase annual contributions by about $35 million.

The Long Island Rail Road and the Manhattan and Bronx Surface Transit Operating Authority (MaBSTOA), a component agency of the Transit Authority, have large unfunded pension liabilities. As of December 31, 2001, MABSTOA had unfunded pension liabilities of $959 million that have been amortized over a 30-year period at the assumed actuarial interest rate of 8.25 percent for that system. The MaBSTOA liabilities are principally due to the conversion of the MaBSTOA pension fund in 1989 from a pay-as-you-go system to one funded on an actuarial basis. The annual cost of the MaBSTOA liabilities is projected to remain stable, at about $100 million between calendar years 2002 and 2010, and then decline to $80 million annually through 2025.

The Long Island Rail Road had unfunded liabilities of $631 million as of December 31, 2001, which have been amortized over a 40-year period at the assumed actuarial interest rate of 8.5 percent. The annual cost of these liabilities was projected to rise from $35 million in 2002 to $155 million by 2040. In April 2001, the Long Island Rail Road entered into a contract with a new actuarial consulting firm to review its defined benefit pension plans. The new firm determined that the unfunded pension liability had been understated and is now estimated at $865 million. The October Plan reported that: "…A number of factors contributed to several errors going undetected, but principally [the liability] resulted from a failure to reconcile the pension ledger and the failure of the actuary to perform an experience study…."[8] To rectify these errors, annual pension contributions have been increased by $30 million beginning in 2004. The increase is due, in part, to a reduction in amortization period (from 40 years to 30 years) and a change to a level-dollar method of amortization. The MTA will subsidize the Long Island Rail Road in 2004, but the subsidy will be gradually phased out by 2007.

As of December 31, 2001, the actuarial assets of the MaBSTOA pension fund were sufficient to cover only 40.6 percent of the fund's liabilities, and the assets of the Long Island Rail Road pension funds were sufficient to cover only 56.6 percent of their liabilities. In contrast, the MTA's other two actuarial pension funds had assets to cover more than 80 percent of their liabilities and the New York City Employees' Retirement System was nearly fully funded.

The MTA proposed legislation in June 2003 that would authorize it to issue pension obligation bonds to fund the MaBSTOA and Long Island Rail Road liabilities and to generate budget relief. According to an analysis performed by one of the

[8] Metropolitan Transportation Authority, MTA-Wide Financial Plan for 2004-2007 and Final Proposed Budget for 2004, October 28, 2003, page 190.

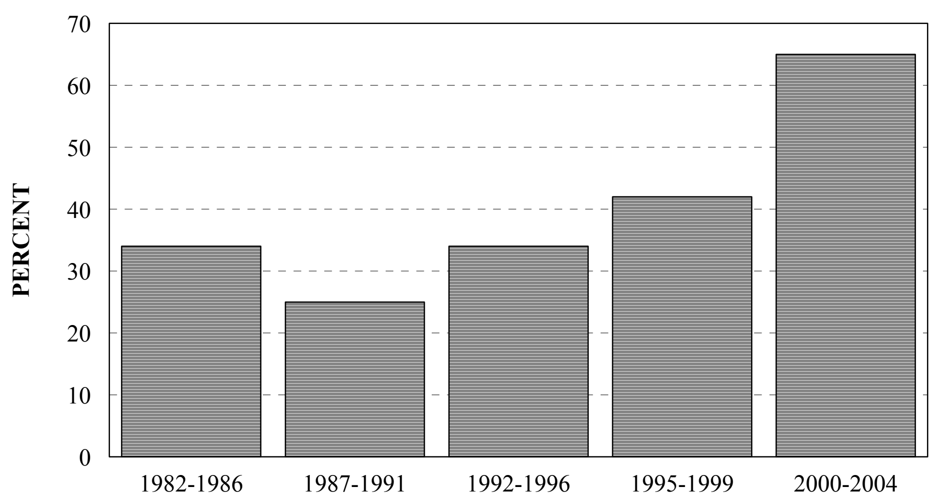
MTA's financial advisors in December 2002, pension obligation bonds would have saved $137 million in the first year, due exclusively to a one-year lag in debt service payments, and an annual average of about $47 million during the next three years. The savings would come chiefly from taking advantage of the difference between the interest rates charged by the pension funds and the public marketplace.

D. Financing the Capital Program

The MTA has increasingly relied on debt to finance its capital programs as contributions from the State have declined (see Graph 12). The amount contributed by the State toward MTA capital programs—both direct contributions and proceeds from bonds supported by State-authorized dedicated taxes—has declined, from an average of 18.4 percent of total resources in the MTA's first two capital programs to 6.8 percent of total resources in the 1995-1999 program. The State, however, is not making any direct contribution to the 2000-2004 capital program, although its participation in the MTA debt restructuring initiative freed up $650 million.

Graph 12

PERCENT OF CAPITAL PROGRAMS FUNDED WITH DEBT



Sources: Metropolitan Transportation Authority; OSDC analysis

Moreover, the City's contribution has been minimal, about $106 million annually, and has recently been reduced by 30 percent. The federal government is expected to fund nearly $4.9 billion, or 25.8 percent, of the current capital program. As a result, the current $18.9 billion five-year capital program is funded with

$12.3 billion in bond proceeds[9]—more than twice the level in the prior program. In total, nearly two thirds of the funding for the current capital program is expected to come from debt, far more than prior capital programs.

A draft of the MTA's next five-year capital plan is scheduled to be released in July 2004, along with an updated needs assessment for the next 20 years. The October Plan includes debt service projections for the next five-year capital program based on broad assumptions about the size, composition, and sources of funding for the 2005-2009 capital program.

As shown in Table 10, the October Plan assumes that the 2005-2009 capital program would total nearly $26.6 billion—40.3 percent more than the 2000-2004 capital program—with more than a threefold increase in spending on network expansion projects. The October Plan assumes that the next capital program would include $9.3 billion for East Side Access and the Second Avenue Subway, but also assumes that the City of New York will finance the extension of the No. 7 subway line.

Table 10
Five-Year Capital Programs

(in millions)

	2000-2004 Capital Program	2005-2009 Capital Program
State of Good Repair		
New York City Transit	$ 10,488	$ 11,730
Long Island Rail Road	2,313	2,606
Metro-North Railroad	1,466	1,667
Bridges & Tunnels	1,111	1,268
Subtotal	**15,378**	**17,271**
Network Expansion		
Second Avenue Subway	1,050	5,684
East Side Access	1,500	3,607
LaGuardia Access	645	- - -
Repair Nos. 1 & 9 Lines	162	- - -
Other	201	- - -
Subtotal	**3,558**	**9,291**
Total	**$ 18,936**	**$ 26,562**

Sources: Metropolitan Transportation Authority; OSDC analysis

To fund the next capital program, the October Plan assumes a funding profile similar to the one that funded the 2000-2004 capital program (see Table 11). The October Plan assumes that the MTA will finance 38 percent of the 2005-2009 capital

[9] This estimate includes $4.5 billion in bond proceeds that were freed up by the MTA's debt restructuring initiative.

program (excluding network expansion projects) with bond proceeds, which is consistent with the percentage that funded the 2000-2004 capital program, excluding proceeds from the debt restructuring initiative.

Table 11
Sources of Capital Funding
(in millions)

	2000-2004 Program	2005-2009 Program
State of Good Repair		
Federal Grants	$ 4,282	$ 4,815
City Grants	535	558
Bonds	6,331	7,168
MTA-Generated Funds	4,232	4,729
Subtotal	**15,380**	**17,270**
Expansion Projects		
Federal Grants	600	4,646
Bonds	1,522	2,628
MTA-Generated Funds	1,434	2,017
Subtotal	**3,556**	**9,291**
Total	**$ 18,936**	**$ 26,561**

Sources: Metropolitan Transportation Authority; OSDC analysis

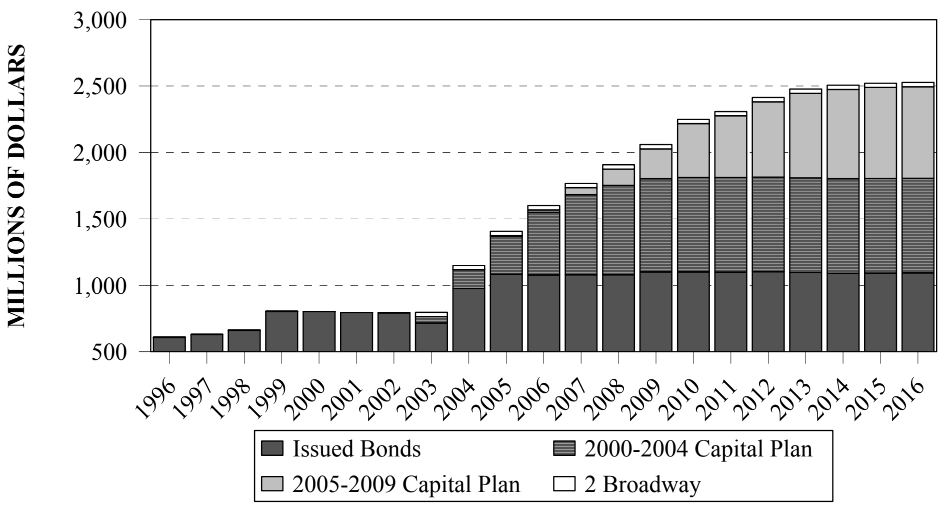
The October Plan, however, makes optimistic assumptions about the contributions from the City of New York and the availability of federal transportation aid. The October Plan assumes that the City of New York will restore its contribution to the MTA capital program to historical levels and will fund the extension of the No. 7 subway line. In addition, the federal government's relatively generous commitment to the current capital program derives from the Transportation Equity Act for the 21st Century (TEA 21). The Act expired on September 30, 2003, and although it was extended for five months, even the MTA's current capital program presupposes a level of federal funding in 2004 that may not materialize.

Moreover, the October Plan is silent on the source of $6.7 billion of MTA-generated resources that would be needed to fully fund a capital program of the size contemplated by the MTA. During the 2000-2004 capital program, the MTA funded $4.5 billion with proceeds from the debt restructuring initiative, but these resources will not be available to help fund the 2005-2009 capital program. Leasing arrangements and the sale of air rights could generate some resources, but would represent only a small portion of the resources needed to fill the funding gap. Since the October Plan already makes optimistic assumptions about federal and City contributions, the MTA would most likely look to the State, either in the form of a direct contribution or a tax dedicated to fund debt service on bonds, to help fund the

2005-2009 capital program. Unless the MTA obtains additional outside assistance, it would have to rely more heavily on its own bonds, which would further strain the operating budget, or cut the size of the proposed capital program. The October Plan already assumes that the MTA will issue $9.8 billion in bonds to help fund the 2005-2009 capital program, nearly 25 percent more than the amount that funds the current capital program.

Graph 13

DEBT SERVICE PROJECTIONS



Sources: Metropolitan Transportation Authority; OSDC analysis

The October Plan assumes that debt service costs will grow from $797.2 million in 2003 to nearly $1.2 billion in 2004—an increase of 44 percent (see Graph 13). The increase is mostly attributable to the loss of the benefits of the MTA's debt restructuring initiative, but also to the cost of bonds to be issued in support of the 2000-2004 capital program. Debt service costs are projected to reach $1.7 billion by 2007—more than twice the 2003 level—reflecting the issuance of new debt to finance the balance of the 2000-2004 capital program. Consequently, debt service costs as a percent of revenue would grow from 11.5 percent in 2003 to 23.7 percent in 2007.[12] In subsequent years, the growth in debt service is primarily driven by the MTA's preliminary assumptions about the sources of funding for the 2005-2009 capital

[12] These estimates exclude resources from additional fare and toll yields.

program. Even using optimistic assumptions that would reduce the amount of debt the MTA would need to issue, debt service costs would grow from $1.7 billion in 2007 to $2.5 billion by 2014—more than three times the 2003 level.[13]

Our analysis indicates that debt service costs could be even higher than projected by MTA—by $24 million in 2006 and $55 million in 2007. The debt service projections for the commuter railroads in the October Plan have been held constant beyond 2005 because the supporting documentation to the October Plan shows that the MTA will reach its State-authorized debt ceiling of $16.5 billion during that year. Our debt service estimates assume that the State will increase the MTA's bonding authority so that it will be able to complete the 2000-2004 capital program. Alternatively, the MTA may have to curtail the 2000-2004 capital program by $1.7 billion—about 9 percent of the program's value.

The MTA response to our draft report stated that it believes the statutory debt ceiling would be reached in 2006 and not in 2005. The MTA, however, was unable to reconcile this position with the documentation included in the October Plan, which shows that the debt ceiling would be reached in 2005. The MTA also stated in its response that debt service costs would not exceed the amounts set forth in the October Plan as we suggest—but again, the MTA was unable to reconcile this conclusion with the documentation in the October Plan. The MTA stated that it would seek State authorization to increase the debt ceiling to complete the 2000-2004 capital program in conjunction with the implementation of the 2005-2009 capital program.

[13] These estimates include debt service costs on $409.6 million in bond proceeds that were used to renovate 2 Broadway.