Review of the Proposed Financial Plan and Capital Program for the Metropolitan Transportation Authority

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I. Executive Summary

The Metropolitan Transportation Authority (MTA) is the custodian of a regional mass transportation system that is critical to the economies of New York City and New York State. Some 25 years ago, the system was on the verge of collapse after decades of deferred maintenance and capital disinvestment. With assistance from the federal government, New York State, New York City, and other stakeholders, the MTA has invested $48 billion since 1982 to purchase new rolling stock, replace track, and perform upgrades. Consequently, service on the subway, buses, and commuter railroads improved dramatically and ridership soared.

The MTA now faces a new crisis, however; one that has been brought on by past decisions to borrow beyond its means. By failing to produce required five-year financial plans between September 1999 and October 2003, the public and its elected officials were prevented from seeing the ramifications of the MTA's decisions beyond 2004. If the MTA had prepared meaningful five-year financial plans during this period, it could have begun to address the problem sooner; thereby easing or possibly averting the crisis it faces today.

While the MTA has recently made progress toward greater transparency and accountability, this only came in response to an April 2003 report from the State Comptroller that found that the MTA had misled the public about its financial condition during the debate over the 2003 fare hike and from budget regulations promulgated by the State Comptroller in 2004.

Since October 2003, the MTA has released regularly scheduled four-year financial plans and has instituted other reforms. The Comptroller's regulations require the MTA to present, document, and report on its budget and financial plan in a manner that is consistent with well-established and prudent budgeting practices. The regulations also require each financial plan to be accompanied by a debt affordability statement showing the impact of planned borrowings on the operating budget and a certification from the Executive Director that the financial plan is based on reasonable assumptions and methods of estimation.

The MTA now projects very large gaps in its operating budget beginning in 2005 and extending forward indefinitely. One year after the largest fare increase in its history, the MTA's financial plan shows budget gaps of $745 million in 2005, $1.4 billion in 2006, $1.7 billion in 2007, and $2.1 billion in 2008. Gaps of this magnitude represent 18.9 percent of MTA revenues in 2006, 22.5 percent in 2007, and 27.1 percent in 2008, and are largely driven by past decisions to rely on debt to finance the MTA capital program in response to declining capital grants from New York State and a reduction in resources from extraordinary sources, such as proceeds from the sale of the New York Coliseum. The responsibility for this situation clearly resides with the MTA Board, which approved prior operating budgets and borrowing plans.

This office began warning the MTA in 1996 that it was borrowing more than it could afford for its capital program, but those warnings were ignored. Debt service costs are now projected to increase from $916 million in 2004 to $1.3 billion in 2005—an increase of 36.5 percent—as the up-front benefits of the MTA's 2002 debt restructuring initiative diminish, and the cost of borrowing to help fund the 2000-2004 capital program begins to mount. Debt service costs continue to increase, on average, at an annual rate of 10.2 percent during the balance of the financial plan period, and reach nearly $1.7 billion by 2008, which is almost twice the 2004 level. The debt service burden (i.e., debt service costs as a percent of total revenues) is projected to rise from 12 percent in 2004 to 21 percent in 2008, and then to 23 percent by 2015. These estimates include the cost of renovating 2 Broadway, which the MTA now estimates will cost $449 million ($845 million including interest), which is $300 million more than first estimated.

Pension costs are also projected to increase rapidly over the next few years, mostly because the MTA will have to increase its contributions to offset pension fund investment losses. The MTA's annual pension contribution, however, also includes the $162 million cost of converting the pension funds of the Long Island Rail Road and the Manhattan and Bronx Surface Transportation Operating Authority (a bus subsidiary of the Transit Authority), from pay-as-you-go systems to those funded on an actuarial basis. While pay-as-you-go systems provided short-term savings from 1962 through 1989, they only deferred payments that must be repaid with interest. If the New York City Transit and the MTA had begun funding these liabilities when they assumed these obligations, the liabilities would have been fully funded by now.

It is now clear that the MTA budget suffers from a serious structural imbalance. Revenues are projected to decline by 1.3 percent in 2005, the first decline since 1995—with the exception of 2001, which was affected by the attack on the World Trade Center—and expenses are projected to grow by 9.8 percent, or nearly five times the inflation rate. Revenues are projected to grow at an average annual rate of 1.5 percent in subsequent years—about half the inflation rate—while spending is projected to grow by 5.5 percent, or more than twice the regional inflation rate. If spending were held to the projected inflation rate, spending would be $4.3 billion less than projected by the MTA during calendar years 2005 through 2008.

This review of the MTA's most recent financial plan finds that the short-term outlook is stable, but that the long-term outlook is serious. The 2005 budget can be balanced exclusively through actions within the MTA's control. In addition, the 2004 surplus (i.e., cash balance) is running about $150 million higher than currently projected by the MTA. These resources could be used to moderate the fare increase, rescind the most onerous budget cuts, or narrow the 2006 budget gap. While the out-year budget gaps will probably narrow over time because of the MTA's conservative revenue forecasts, they are likely to remain too large for the MTA to close on its own without undesirable consequences.

The review also found that many of the actions proposed by the MTA to balance the 2005 budget and to narrow the 2006 budget gap are short-sighted or ill-advised. Those initiatives that would curtail bus, subway, and railroad service would result in 53.5 million fewer riders each year and could lead to increased road congestion and air pollution, and lost worker productivity. Other initiatives, many of which yield relatively small savings, would increase costs in the long run and could result in service disruptions. For example, the Long Island Rail Road plans to reduce track maintenance, which it acknowledges would result in "increased response time [and] potential train delays," and Metro-North plans to eliminate its new fence repair program, resulting in "decreasing the security and cleanliness of property and increasing the opportunity for theft and vandalism."

In addition, the Long Island Rail Road has proposed eliminating service to Belmont Park even though the lost revenues ($287,000) would be more than twice the projected savings ($136,000). Also, the Long Island Rail Road would abandon service on the West Hempstead and Oyster Bay lines, the Greenport-Ronkonkoma branch, and Montauk service west of Jamaica Station. Service could not be easily restored because the railroad intends to remove track and other infrastructure.

Despite the seriousness of the situation, the MTA has not done enough to reduce costs through internal management improvements. For example, this review found that the MTA employs 698 people in human resources, 443 in legal services (with another $10 million spent on outside law firms), and 166 in labor relations. In addition, the MTA employs 359 people in budget and accounting, and 444 in public relations and marketing. Agency actions identified by the MTA would reduce staffing levels in these areas by only 15 employees. In response to a draft of this report, the MTA stated that "task forces have already been organized to examine the areas cited by the Comptroller so that substantial savings can be achieved during the current Four-Year Financial Plan period." We also note that Bridges and Tunnels, with a budget of $356 million, identified savings of only $140,000, including the elimination of one vacant secretarial position for savings of $40,000. Long Island Bus identified no savings from management improvements. Moreover, the 2006 gap-closing program relies almost exclusively on service reductions and unspecified actions, and is notable for its absence of savings from management improvements.

Although the MTA could not have been expected at this time to balance all four years of its financial plan, it should have outlined a comprehensive multi-year strategy to restore budget balance. Such a strategy would have included annual targets for contributions made through internal management improvements, such as 25 percent of the value of the gap-closing program, and the amounts and sources of any outside assistance.

MTA Headquarters also must exert greater influence over the agencies. While Headquarters should not micromanage agency operations, it should reject agency proposals that defer maintenance, which will only increase future costs, and other proposals that are short-sighted or ill-advised, and insist on greater savings from management improvements.

Instead, the MTA has proposed balancing the budget almost exclusively at the expense of the riding public. The financial plan contemplates an endless cycle of fare and toll increases, as well as budget cuts that would reduce services and defer maintenance, which would lead invariably to higher future costs, lost ridership, and lost revenue. Pursuing this course would not close the projected budget gaps and would only reverse the gains of the past 20 years.

As the MTA wrestles with the consequences of borrowing beyond its means, it has simultaneously proposed a $27.8 billion five-year capital program with a $16.2 billion funding gap. Even though the operating budget assumes a contribution of $4 billion toward the capital program, these resources were not reflected in the capital program. While these and other resources excluded by the MTA would reduce the funding gap to $10 billion, the gap is still too large for the MTA to finance on its own, and the MTA will need help from its traditional funding partners.

The City has offered to fund the $2 billion estimated cost of extending the No. 7 subway line, but is insisting that the MTA take responsibility for any cost overruns. We note that large mass transportation projects in New York City have a history of costing more and taking longer than initially estimated. For example, the East Side Access project has fallen three years behind schedule and the cost has grown by $1.9 billion, from $4.4 billion in April 2001 to $6.3 billion in December 2003.

While the MTA anticipates $1 billion from the sale of assets to help fund the 2005-2009 capital program, it acknowledged during the course of this review that this estimate is "merely a placeholder at this time and there has not been an identification of specific assets." Although the State and City support economic development projects that would be built on platforms over the West Side and Atlantic Avenue rail yards, the MTA has yet to reach an agreement on the value of the air rights over the yards. The MTA had planned to sell buildings located at 341, 343, and 347 Madison Avenue and move the personnel in those buildings to 2 Broadway, but those plans were abandoned; however, they ought to now be reconsidered. The MTA should be more aggressive in identifying assets that can be sold to support the capital budget.

The regional mass transit system needs to expand to accommodate changing needs, but the MTA's first priority must be to restore and maintain the existing system. Despite the planned investment of $20 billion during calendar years 2000 through 2004, the MTA reports that it has fallen behind schedule in restoring a number of important capital assets. Four years ago, the MTA estimated that New York City Transit's power substations, shops, tunnel lighting, and fan plants would be restored by 2006, 2012, 2020, and 2022, respectively. The MTA now estimates that these assets will not be restored until 2015, 2019, 2022, and 2028, respectively. The restoration of subway stations and signals is also taking longer, and will not be completed until 2024 and 2027—some two to three years later than projected four years ago.

Although the MTA has not yet released a 20-year capital needs assessment that would indicate the amount of funding needed over the next 20 years to restore and maintain the existing system, the agencies have prepared their own estimates. The agencies identified capital funding needs of $26.1 billion for the 2005-2009 period. After trying three different funding levels, the MTA settled on an aggregate funding level of $17.2 billion, which is essentially the level of funding in the current capital program, adjusted for inflation. This aggregate funding level is $8.9 billion less than requested by the agencies, a shortfall of 34 percent, which could lead to further slippage in restoring the system. Moreover, funding was not allocated to the agencies based on need but on historical shares. Consequently, New York City Transit had 73 percent of its capital needs funded but the commuter railroads had only half of their capital needs funded.

Even so, New York City Transit received $4.4 billion less than requested, with most of the cut allocated to stations, signals and communications, elevated subways, shops, and yards. Long Island Rail Road received $2.3 billion less than it requested, with more than half of the cut allocated to track projects, rolling stock, signals and communications, bridges and viaducts, and stations and parking lots. Metro-North received $1.6 billion less than requested, with most of the cut allocated to rolling stock, shops and yards, and line structures (e.g., track rails and track ties). Bridges and Tunnels received $607 million less than requested, with most of the cuts allocated to restoring bridge roadways and decks.

The agencies also identified capital needs of $73 billion for the 2010-2024 period. Additionally, the MTA has either begun or has plans to initiate expansion projects valued at $33 billion. Thus, it is critically important that a long-term financing strategy be developed to maintain the existing system and to finance expansion projects to completion.

The MTA is now operating in an environment of constrained resources and could not realistically fund all of the capital needs identified by the agencies. The Capital Program Review Board and the public, however, should know the trade-offs and compromises that were made by MTA management in producing the proposed capital program for the 2005-2009 period. The Capital Program Review Board, which must unanimously approve the proposed capital program, should ask the MTA to withdraw the program until the MTA identifies sources of funding, releases its own capital needs assessment, explains the ramifications of not fully funding the agencies' budget requests, and articulates its funding priorities in the event that the capital program cannot be fully funded.

The regional mass transit system is too important to be allowed to deteriorate once again, and the Governor must get involved. Fortunately, the MTA can balance the 2005 operating budget without outside assistance, but it must move expeditiously to prepare a credible multi-year strategy to achieve fiscal stability. Those who use the system will undoubtedly be asked to make sacrifices, but the MTA must do its part as well.

The State also should approve legislation introduced by the State Comptroller that would provide for increased supervision and oversight of public authorities, of which the MTA is the largest. The legislation would impose strict new procurement, lobbying, and governance rules, and would strengthen oversight by giving the State Comptroller the authority to approve authority contracts before they are awarded, as is the case for State agencies.

Table 1
Metropolitan Transportation Authority
Financial Plan for Calendar Years 2004 Through 2008

(in millions)

	2004	2005	2006	2007	2008
REVENUES					
Fare Revenue	$ 3,428	$ 3,467	$ 3,518	$ 3,567	$ 3,610
Vehicle Toll Revenue	1,087	1,087	1,092	1,096	1,099
Tax Revenue	2,091	1,939	1,962	2,031	2,053
State and Local Subsidies	561	576	590	603	618
Capital and Other Reimbursements	1,121	1,078	1,104	1,126	1,157
Other Revenue	324	323	334	344	354
Total Revenues	**8,612**	**8,470**	**8,600**	**8,767**	**8,891**
EXPENSES[1]					
Payroll	3,716	3,792	3,886	3,983	4,092
Overtime	420	411	426	434	447
Health & Welfare	774	873	957	1,048	1,145
Pension Contributions	497	654	758	807	857
Other Fringe Benefits	462	475	490	503	517
Debt Service	916	1,250	1,445	1,570	1,672
General Reserve[2]	30	30	30	30	30
Other Expenses	1,924	1,961	2,032	2,124	2,233
Total Expenses	**8,739**	**9,446**	**10,024**	**10,499**	**10,993**
Accrual Surplus/(Gap)	**(127)**	**(976)**	**(1,424)**	**(1,732)**	**(2,102)**
Cash Adjustments	285	231	65	51	21
Prior-Year Cash Balance	151	- - -	- - -	- - -	- - -
Cash Balance	**$ 309**	**$ (745)**	**$ (1,359)**	**$ (1,681)**	**$ (2,081)**

Sources: Metropolitan Transportation Authority; OSDC analysis

[1] The financial plan has been adjusted to exclude depreciation, which does not affect the MTA's cash balance.

[2] The financial plan also has an annual reserve of $25 million to fund potential increases in pension contributions beyond the amounts budgeted.

II. Calendar Year 2004

The MTA's adopted budget for calendar year 2004 and the associated financial plan projected a closing cash balance of $36 million for 2004, and budget gaps ranging from $1 billion to $2.1 billion for calendar years 2005 through 2007. During the course of 2004, the tax revenue outlook has improved and projected spending has been reduced, thus increasing the size of the cash balance projected for 2004 and narrowing the out-year budget gaps. The MTA now projects that 2004 will end with a cash balance of $309 million, which is $272.5 million more than anticipated at the beginning of the year; and that the out-year budget gaps will be smaller by $260 million in 2005 and by more than $400 million in 2007 (see Table 2). These favorable developments reduced the 2005 budget gap from more than $1 billion to $745 million, and the MTA intends to use the 2004 cash surplus to further narrow the 2005 budget gap to $436 million. The out-year gaps have been reduced to $1.4 billion in 2006 and $1.7 billion in 2007.

Table 2
Cumulative Changes since Adopted Budget
(in millions)

Better/(Worse)

	FY 2004	FY 2005	FY 2006	FY 2007
Restated Closing Cash Balance Per December 2003 Plan	**$ 36.2**	**$ (1,004.9)**	**$ (1,674.6)**	**$ (2,082.7)**
Revenues				
Real Estate–Related Tax Revenue	203.1	35.2	34.6	57.8
Additional 2003 Cash Balance	32.1	- - -	- - -	- - -
Other Tax Revenue	33.1	105.2	125.0	135.3
State and Local Subsidies	(21.7)	(20.7)	(29.3)	(19.6)
Fare and Toll Revenue	(23.8)	(25.9)	(23.9)	(32.0)
Other Operating Revenue	21.9	24.9	32.6	44.7
Anticipated Governmental Aid	(121.3)	- - -	- - -	- - -
Subtotal	**123.4**	**118.7**	**139.0**	**186.2**
Expenses				
Debt Service	138.0	123.0	129.0	136.7
Savings from Corporate Restructuring	(5.0)	(25.0)	(25.0)	(25.0)
Agency Spending	16.1	43.3	72.3	104.1
Subtotal	**149.1**	**141.3**	**176.3**	**215.8**
Net Change Since December 2003 Plan	**272.5**	**260.0**	**315.3**	**402.0**
Closing Cash Balance per July 2004 Plan	**$ 308.7**	**$ (744.9)**	**$ (1,359.3)**	**$ (1,680.7)**

Sources: Metropolitan Transportation Authority; OSDC analysis

A. Revenue Changes

Revenues are now projected by the MTA to be $123.4 million higher in 2004 than projected at the beginning of the year, and higher by even larger amounts in subsequent years. Most of the improvement reflects an increase in projected tax revenues. Real estate–related tax revenues are now expected to exceed the MTA's initial estimates by $203.1 million in 2004, but this benefit is partly offset because an increase in additional governmental assistance never materialized. Real estate–related tax collections through October 2004 are running $156 million higher than assumed in the July financial plan, but some portion may be due to timing.

Revenues from other tax sources are expected to exceed planned levels by only $33.1 million in 2004, but by more than $100 million annually in subsequent years. The improved outlook for 2004 largely reflects unanticipated revenues from taxes on petroleum-related businesses and products. In subsequent years, the additional tax revenue is expected to come from the sales tax and the corporate franchise surcharge as the economy improves.

Fare and toll revenue is now projected to be about $25 million less each year than the amounts projected in December 2003, even though ridership is higher than expected because riders are making greater use of MetroCard discounts. This use has reduced subway and bus fare box revenues by $35 million, and reduced the average fare from a budgeted level of $1.30 to $1.26. Toll revenue from bridge and tunnel crossings is expected to be higher by $11.2 million in 2004.

B. Expenditure Changes

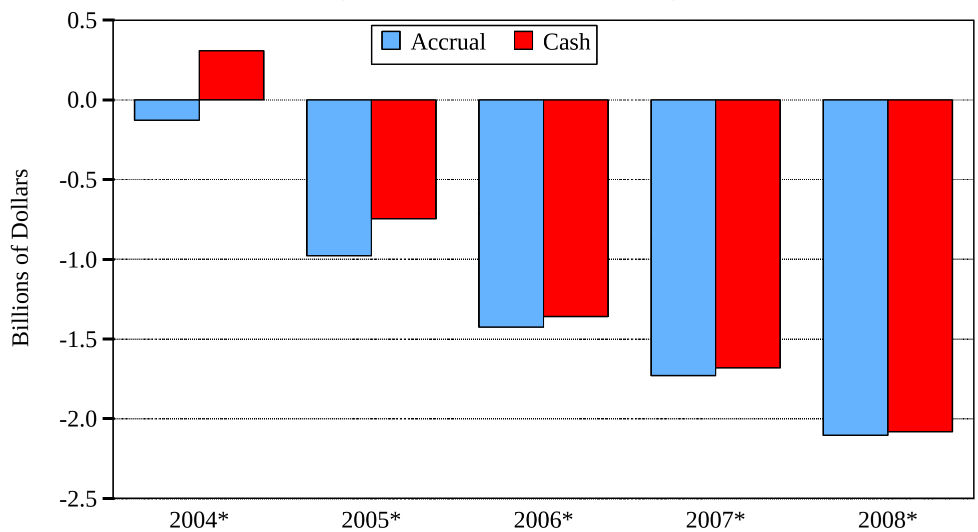
During 2004 the MTA revised its debt service projections to more accurately reflect spending patterns and cash needs, and lower-than-anticipated interest rates. By doing so, debt service costs were reduced by $138 million in 2004 and by $527 million during calendar years 2004 through 2007, compared with estimates in the December 2003 plan. Agency spending is now expected to be lower because the July Plan assumes wages will rise with the current projected inflation rates, which are lower than they were in December 2003. Also, the revised plan no longer assumes savings from the MTA's proposed corporate restructuring, which would create new divisions for rail, subway, and bus. The Transport Workers Union and the Assembly Speaker oppose the restructuring in its current form because the new bus division would have unlimited authority to reduce service, and new hires would not have civil service protections.

III. Structural Imbalance

The MTA's budget for 2004 and the associated four-year financial plan show large and growing budget gaps on both a cash and accrual basis[3] (see Graph 1). On a cash basis, the MTA projects a positive closing cash balance of $309 million for 2004, but on an accrual basis—which presents a clearer picture of an entity's financial condition—the MTA projects a budget gap of $127.5 million for 2004. The structural imbalance was masked on a cash basis in 2004 because that year's budget was balanced, in part, with resources from prior years and from cash receipts from the settlement of claims stemming from the attack on the World Trade Center, which had been booked on an accrual basis in prior years.

Graph 1

Growing Out-Year Budget Gaps



* MTA Forecast

Sources: Metropolitan Transportation Authority; OSDC analysis

The year-end cash balance is projected to turn from a surplus of $309 million in 2004 to a deficit of $745 million in 2005, mostly as a result of: a 36.5 percent increase in debt service costs ($334 million), which reflects the declining up-front benefit of a debt restructuring initiative begun in 2002; a decline in nonrecurring resources used to finance the operating budget ($258 million; see Appendix for more

[3] We have adjusted the MTA financial projections to exclude depreciation, which is a balance sheet item and which does not reflect results from operations.

information); and higher pension and health insurance costs ($148 million and $96 million, respectively). The budget gaps, on both a cash and accrual basis, widen in subsequent years primarily as a result of continued rapid growth in debt service and pension costs, and stagnant revenue growth (see Table 3). In addition, the cost of the paratransit program is projected to nearly double between 2004 and 2008. The budget gaps are projected by the MTA to reach $1.4 billion in 2006, $1.7 billion in 2007, and $2.1 billion in 2008. Gaps of this magnitude represent 18.9 percent of MTA revenues in 2006, 22.5 percent in 2007, and 27.1 percent in 2008.

Table 3
Cumulative Change
Revenues and Expense Trends
(in millions)

(Increase)/Decrease

	2004 Budget	Annual Change 2005	2006	2007	2008	2008 Plan	Percent Change
Revenue							
Fares & Tolls	$ 4,514	$ 41	55	53	46	$ 4,709	4.3 %
Tax Revenue	2,091	(152)	33	59	22	2,053	(1.8) %
Subsidies	561	15	4	23	15	618	10.2 %
Other	350	(1)	14	13	10	386	10.3 %
Total	**7,516**	**(97)**	**106**	**148**	**93**	**7,766**	**3.3 %**
Expenses							
Salaries & Wages	3,261	(102)	(83)	(91)	(97)	3,634	(11.4) %
Overtime	353	12	(14)	(5)	(12)	372	(5.4) %
Health & Welfare	741	(96)	(80)	(87)	(95)	1,099	(48.3) %
Pensions	478	(148)	(100)	(46)	(47)	819	(71.3) %
Other Fringes	352	(16)	(13)	(11)	(11)	403	(14.5) %
Debt Service	916	(334)	(195)	(125)	(102)	1,672	(82.5) %
Paratransit Program	146	(27)	(31)	(37)	(43)	284	(94.5) %
Fuel and Power	290	(7)	(2)	(2)	(2)	303	(4.5) %
Other	1,349	(23)	(40)	(53)	(64)	1,529	(13.3) %
Capital	(242)	(10)	2	5	6	(245)	1.2 %
Total	**7,644**	**(751)**	**(556)**	**(452)**	**(467)**	**9,870**	**(29.1) %**
Accrual Gap	**$ (128)**	**$ (848)**	**$ (450)**	**$ (304)**	**$ (374)**	**$ (2,102)**	**(1,542) %**

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

IV. Revenue and Expenditure Trends

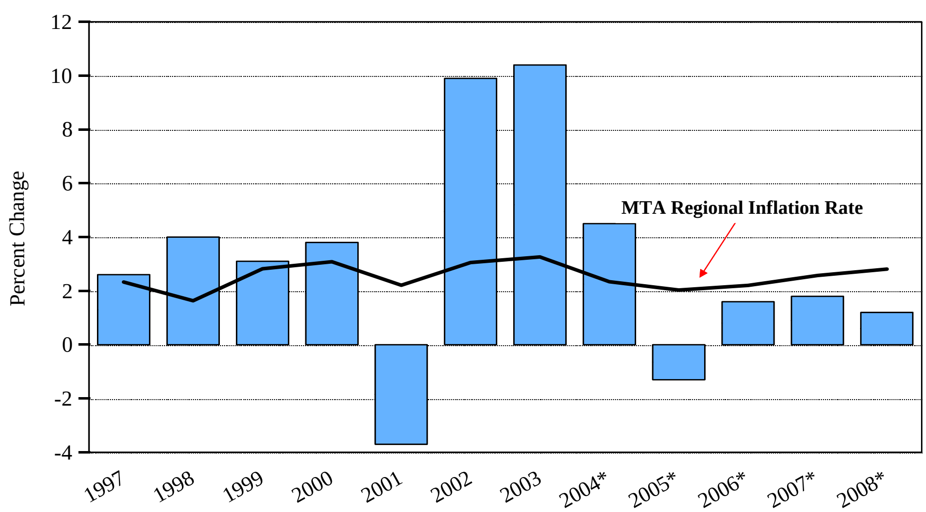
The projected budget gaps are due to disparate projected rates of growth in revenues and expenditures. Even though revenues are expected to grow by 4.5 percent in 2004, reflecting the full-year value of last year's fare and toll increases as well as strong tax collections, expenditures are projected to grow at an even faster rate of 6.9 percent. In 2005, revenues are projected to decline by 1.3 percent (see Graph 2), the first decline since 1995—with the exception of 2001, which was affected by bridge, tunnel, and subway disruptions caused by the attack on the World Trade Center—and expenses are projected to rise by 9.8 percent. In subsequent years revenues grow at an average annual rate of 1.5 percent, and spending is projected to grow at an annual rate of 5.5 percent—more than twice the projected inflation rate.

A. Revenue Trends

More than 60 percent of the MTA's revenues come from fare collections on its subways, buses, and commuter trains, and from toll collections at its bridges and tunnels. Another 28 percent comes from tax revenues. These revenue sources are largely dependent on the economy, and rise and fall with the business cycle. The remaining 12 percent of revenues comes from governmental subsidies and reimbursements, which, with few exceptions, have not been adjusted over the years for inflation.

Graph 2

Annual Change In Revenues



* MTA Forecast

Sources: Metropolitan Transportation Authority; OSDC analysis

The MTA projects that total revenues will decline in 2005 by $97 million, or 1.3 percent (see Table 4). The decline is driven by the financial plan assumption that real estate–related tax revenue will fall off by $251 million, or 33 percent, because rising interest rates will dramatically reduce the number of mortgage refinancings. Based on the assumptions of slow growth in regional employment and modest increases in other economically sensitive tax revenues, MTA revenues are projected to increase at only 1.5 percent, on average (about 60 percent of the projected inflation rate), during calendar years 2006 through 2008.

Table 4
Sources of Revenue
(in millions)

(Increase/Decrease)

	2004	2005	Percent Change	2006	2007	2008	Three-Year Growth Rate
Fare Revenue	$ 3,428	$ 3,467	1.1 %	$ 3,518	$ 3,567	$ 3,610	1.3 %
Toll Revenue	1,087	1,088	0.1 %	1,092	1,096	1,099	0.3 %
Tax Revenue	2,091	1,939	(7.3) %	1,972	2,031	2,053	1.9 %
Government Subsidies[4]	561	576	2.7 %	580	603	618	2.4 %
Other	350	349	(0.3) %	363	376	386	3.4 %
Total	**$ 7,516**	**$ 7,419**	**(1.3) %**	**$ 7,525**	**$ 7,673**	**$ 7,766**	**1.5 %**

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

1. Fare and Toll Revenue

Fare revenue is projected to increase by 1.1 percent in 2005 and by 1.3 percent, on average, during calendar years 2006 through 2008. These rates of growth reflect the financial plan assumptions that regional employment will increase slowly during the plan period and that market share of the 30-day MetroCard will continue to grow. The plan also assumes that toll revenue will increase by 6.3 percent in 2004, but by only 0.1 percent in 2005 and by 0.3 percent, on average, during calendar years 2006 through 2008. While these estimates are appropriately conservative, we note that Bridges and Tunnels has a history of slightly underestimating toll revenue.

2. Tax Revenue

The MTA benefits from a number of different tax sources that are dedicated to funding transportation. As shown in Table 5, the financial plan anticipates about $1.9 billion in tax revenues in 2005—a reduction of $152 million, or 7.3 percent, from

4 Estimates exclude MTA cross-subsidies to Long Island Bus and Staten Island Railway.

the level forecast for 2004. Proceeds from the largest source of tax revenue, the State Metropolitan Mass Transportation Operating Assistance account (MMTOA),[5] are projected to increase in 2005 by $100 million or 12.8 percent, to $867.2 million. These gains, however, are expected to be more than offset by a decline of $217 million, or nearly 38 percent, in revenue from the mortgage-recording tax. Collections from this source, however, are exceeding the MTA's revised estimate for 2004 and are likely to exceed the estimate for 2005 as well.

The growth in tax revenues will be held down to only 1.9 percent on average during the balance of the plan period because revenue from the petroleum business tax,[6] which generates more than $550 million annually for the MTA, is projected to increase by only 0.5 percent each year; and because real estate–related tax revenue is projected to decline slightly during this period. Continuing declines in revenue from real estate–related transactions reflect the expectation that mortgage refinancings will drop off dramatically in response to rising interest rates.

Table 5
Dedicated Taxes
(in millions)

	2004	2005	Percent Change	2006	2007	2008	Three-Year Growth Rate
MMTOA	$ 768.7	$ 867.2	12.8 %	$ 905.3	$ 937.6	$ 972.5	3.9 %
Petroleum Business Tax	554.6	551.6	(0.5) %	552.8	556.5	559.3	0.5 %
Mortgage-Recording Tax	573.5	356.4	(37.9) %	340.2	345.4	329.5	(2.6) %
Urban Tax	189.8	155.7	(18.0) %	164.0	180.6	177.9	4.5 %
Investment Income	4.0	8.0	100.0 %	10.2	10.8	13.9	20.2 %
Total	**$ 2,090.6**	**$ 1,938.9**	**(7.3) %**	**$ 1,972.5**	**$ 2,030.9**	**$ 2,053.1**	**1.9 %**

Sources: Metropolitan Transportation Authority; OSDC analysis

3. Government Subsidies

The MTA expects to receive $576.4 million in subsidies and reimbursements in 2005 based on legislative formulas and memorandums of understanding with New York State, the State of Connecticut, New York City, and counties in the MTA transportation district. Of this amount, the MTA expects to receive $378.8 million in unrestricted aid under the State's 18-b program (see Table 6), which is funded equally by the State and the counties in the MTA region. For example, New York City pays

5 The MMTOA benefits from a number of taxes, including a sales tax on certain tangible products and services, and surcharges on businesses operating within the MTA region. Most of these surcharges, which generate about $500 million annually, were recently extended for another four years.

6 The tax rate for the petroleum business tax rises and falls with the Producer Price Index for refined petroleum products. The rate cannot rise or fall by more than 5 percent each year.

$188 million each year to New York City Transit and the Staten Island Railway, an amount that is matched by New York State. The subsidy under the 18-b program, however, has remained unchanged for 15 years and its purchasing power has been greatly eroded by inflation. If adjusted for inflation, the MTA could expect another $225 million of governmental assistance in 2005 under the 18-b program.

The State and the City contribute equally ($45 million each) toward the cost of the reduced fare program for schoolchildren and the City contributes $14 million to the reduced fare program for the elderly (though neither of these are considered subsidies by the MTA). In 1995, the City reduced its contribution to the reduced fare program for schoolchildren. While the State agreed to contribute $45 million toward this program, the MTA experienced a net loss of $39 million.

Table 6
Government Subsidies
(in millions)

	2004	**2005**	**2006**	**2007**	**2008**
NYS Operating Assistance (18-b)	$ 190.9	$ 190.9	$ 190.9	$ 190.9	$ 190.9
Local Operating Assistance (18-b)	187.9	187.9	187.9	187.9	187.9
Subtotal	**378.8**	**378.8**	**378.8**	**378.8**	**378.8**
Station Maintenance	126.5	129.2	132.4	136.0	140.4
Nassau County Subsidy for LI Bus	7.4	15.6	17.2	20.6	24.6
Connecticut Subsidy for MNRR	48.3	52.8	61.4	67.5	73.9
Subtotal	**182.2**	**197.6**	**211.0**	**224.1**	**238.9**
Total	**$ 560.9**	**$ 576.4**	**$ 589.8**	**$ 603.0**	**$ 617.6**

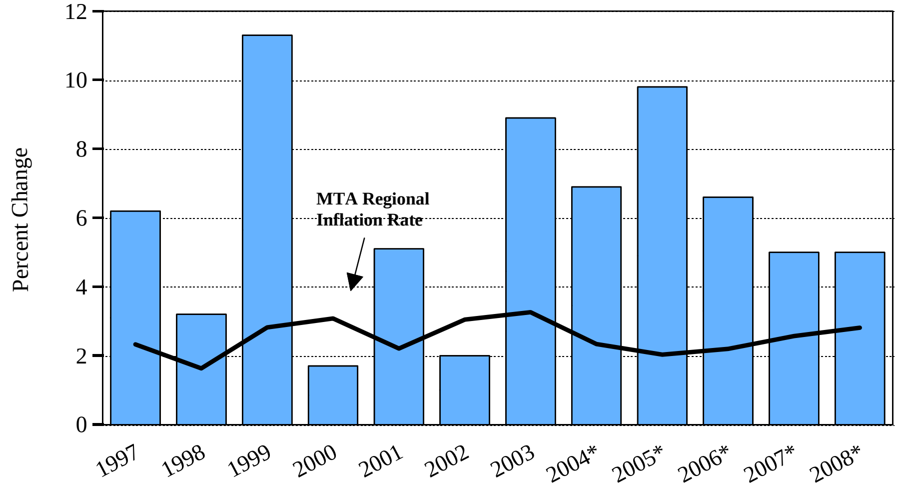
Note: Columns may not add due to rounding.
Sources: Metropolitan Transportation Authority; OSDC analysis

B. Expenditure Trends

Expenses, excluding depreciation but including debt service, grew at an average annual rate of 5.4 percent during calendar years 1997 and 2003—twice the rate of inflation during that period (see Graph 3). The financial plan assumes that spending will grow by 6.9 percent in 2004, 9.8 percent in 2005, and by 5.5 percent, on average, during calendar years 2006 through 2008. These rates of growth are far higher than the projected inflation rate, which is expected to average 2.4 percent during these years. It is illustrative to note that if spending were held to the projected inflation rate during calendar years 2005 through 2008, spending would be $4.3 billion less than forecast by the MTA.

Graph 3

Growth in MTA Expenditures



* MTA Forecast

Note: Excludes depreciation.

Sources: Metropolitan Transportation Authority; OSDC analysis

The rapid growth in spending is largely due to decisions made by the MTA in past years to finance an increasing portion of its capital program with debt. The growth in spending is also driven by an increase in pension contributions to make up for pension fund investment shortfalls attributable to the stock market downturn. The contribution, however, also includes about $162 million to fund, on an actuarial basis, $1.8 billion in accrued liabilities that have gone unfunded over the years by the Long Island Rail Road and the Manhattan and Bronx Surface Transit Operating Authority.

As shown in Table 7, debt service costs are projected to increase by 36.5 percent in 2005 as the up-front benefits of the 2002 debt restructuring initiative diminish, and the cost of borrowing to help fund the 2000-2004 capital program begins to mount. Pension contributions are projected to increase by 31 percent, and health and welfare costs are projected to rise by 13 percent. Spending is expected to exceed the projected inflation rate during calendar years 2006 through 2008 because debt service costs are expected to increase at an average rate of 10.2 percent, pension contributions are expected to increase by 9.4 percent each year, and health and welfare costs are expected to rise at an annual rate of 9.5 percent. Excluding these costs, spending is expected to increase by 3.1 percent in 2005 and by 3.4 percent, on average, during calendar years 2006 through 2008—only slightly faster than the projected inflation rate. The MTA was recently notified by its power providers, however, that costs for electricity may grow faster than assumed in the July Plan.

Table 7
Projected Growth in Expenditures
(in millions)

	2004	2005	Percent Change	2006	2007	2008	Three-Year Growth Rate
Salaries & Wages	$3,261	$3,363	3.1 %	$ 3,446	$ 3,537	$ 3,634	2.6 %
Overtime	353	341	(3.4) %	355	360	372	2.9 %
Health & Welfare	741	837	13.0 %	917	1,004	1,099	9.5 %
Pension Contributions	478	626	31.0 %	726	772	819	9.4 %
Other Fringe Benefits	352	368	4.5 %	381	392	403	3.1 %
Debt Service	916	1,250	36.5 %	1,445	1,570	1,672	10.2 %
Paratransit Program	146	173	18.5 %	204	241	284	18.0 %
Fuel and Power	290	297	2.4 %	299	301	303	0.7 %
Other	1,349	1,372	1.7 %	1,411	1,465	1,529	3.7 %
Capital Reimbursement	(242)	(232)	(4.1) %	(234)	(239)	(245)	1.8 %
Total	**$ 7,644**	**$ 8,395**	**9.8 %**	**$ 8,950**	**$ 9,403**	**$ 9,870**	**5.5 %**

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

1. Salaries and Wages

The MTA has 62 collective bargaining agreements that cover about 55,000 full-time employees, including those reimbursed by the capital budget. The financial plan assumes that wages will increase at the projected inflation rate after the expiration of current labor agreements, the largest of which expires in December 2005.

Unlike the City of New York, the MTA does not anticipate any savings from productivity and management improvements to help fund these agreements.[7] For years, the Transport Workers Union (TWU) has contended that its workers could perform the same work that the MTA contracts out for less cost. In fact, an October 1998 report submitted to the federal government by New York City Transit acknowledges that its in-house workforce performed station rehabilitations faster and at less cost than private contractors. As part of the negotiations for the 2002-2005 labor agreement, the parties signed a memorandum of understanding that gives the TWU the opportunity to present proposals to management to bring work in-house.

[7] The City of New York reached a three-year agreement with District Council 37 that calls for a 2 percent wage increase in the third year of the agreement to be funded from productivity or other operational savings. The agreement also presents the opportunity for another 1 percent wage increase if funded with productivity improvements.

2. Health and Welfare

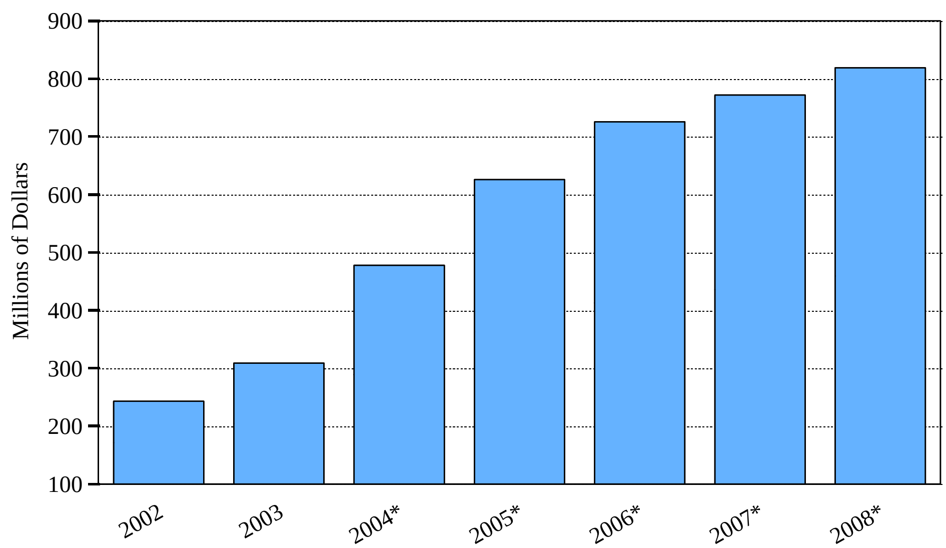
Health insurance costs totaled $556 million in 2002 and rose to $703 million in 2003 (a 26 percent increase), largely because the MTA agreed to assume the obligations of the TWU's health insurance benefits trust, which had unfunded liabilities accruing to 2001 and 2002, as part of the 2002-2005 labor agreement. Under the agreement, the MTA eliminated a projected deficit in the fund and agreed to maintain current benefit levels. Health insurance costs are projected to rise to $741 million in 2004, and then increase by 13 percent in 2005 and by 9.5 percent annually thereafter based on projected increases in the premiums charged by the New York State Empire Plan, which provides insurance for most New York State and local government employees.

3. Pension Contributions

Pension contributions are projected to increase from $243 million in 2002 to $626 million in 2005, an increase of 158 percent, and then grow by another 31 percent to $819 million by 2008 (see Graph 4), largely owing to pension fund investment losses during calendar years 2000 through 2002.

Graph 4

Pension Contributions



* MTA Forecast
Sources: Metropolitan Transportation Aothority; OSDC analaysis

About 64 percent of the MTA's employees are members of the New York City Employees' Retirement System (NYCERS). Last year, NYCERS earned about 16.3 percent on its investments, or twice the expected gain of 8 percent. These unexpected gains have not been reflected in the July Plan, which could reduce planned contributions by $6 million in 2005, $12 million in 2006, $20 million in 2007, and $30 million in 2008. In addition, the City's Actuary is contemplating changes in actuarial assumptions and methodologies that could slow the projected growth in pension costs. Key changes under consideration include the implementation of a one-year lag in calculating pension contributions, and the funding of the full cost of cost-of-living adjustments for retirees, rather than phasing in the costs. The Actuary's office has not released the net impact of the proposals, but we estimate that these changes could save the MTA about $100 million in 2005, $60 million in 2006, $25 million in 2007, and $35 million in 2008.

The Long Island Rail Road and the Manhattan and Bronx Surface Transit Operating Authority (MaBSTOA), a component agency of the Transit Authority, have unfunded pension liabilities of $1.8 billion. The MaBSTOA, which was taken over by New York City Transit in 1962, had unfunded liabilities of $935 million as of December 31, 2002. These liabilities, which are being amortized over a 30-year period, are principally due to the conversion of the MaBSTOA pension fund in 1989 (as mandated by State law) from a pay-as-you-go system to one funded on an actuarial basis. The MTA is contributing an additional $80 million each year to the MaBSTOA pension fund to make up for past decisions not to fund the cost of the liability on an actuarial basis. These liabilities would have been fully funded by now if New York City Transit had begun funding them when it took over MaBSTOA.

The Long Island Rail Road, which became part of the MTA in 1968, had an unfunded pension liability of $363 million as of January 2000. These liabilities are principally due to the conversion of the pension fund in 1987 from a pay-as-you-go system to one funded on an actuarial basis. In April 2001, the railroad entered into a contract with a new firm to perform actuarial services. In October 2001, the new firm found "pension ledger" inaccuracies and inconsistent information that were valued at $184 million. It was not until September 2003 that staff informed the MTA Chairman and Executive Director of the $184 million error, and another month later that the MTA's Finance and Audit committees were informed. The unfunded liability has since risen to $865 million as a result of the cost of early retirements and investment losses. The Long Island Rail Road is contributing $94 million each year to pay off, over 27 years, its unfunded liabilities, including $82 million for the conversion. In June 2004, the MTA Inspector General briefed the Audit Committee in executive session on the results of his investigation of the pension errors.

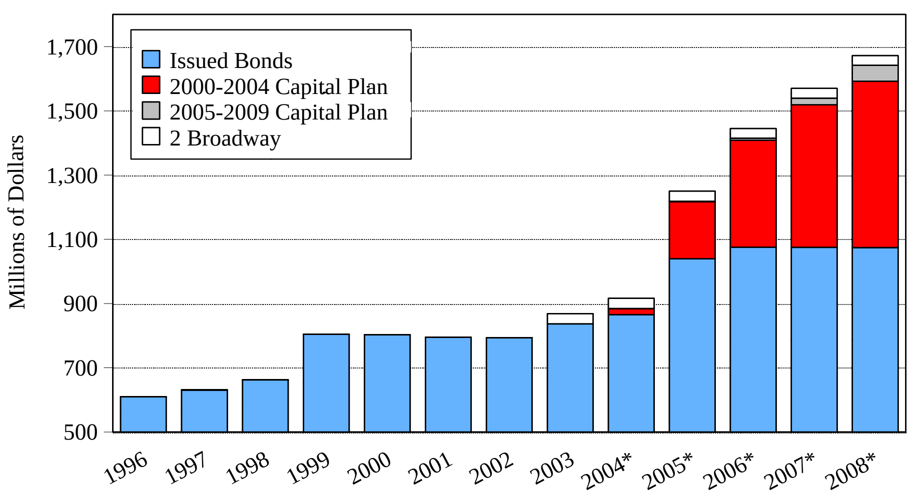
In addition, the MTA intends to assume operational responsibility for the seven private bus companies subsidized by the City. Among the issues yet to be finalized include financial responsibility for unfunded pension liabilities.

4. Debt Service

Debt service costs are projected to reach $1.3 billion in 2005, an increase of $334 million, or 36.5 percent, over the 2004 level. These costs will continue to increase rapidly during the plan period to nearly $1.7 billion by 2008 (see Graph 5). These increases are attributable to the loss of the up-front benefits from the MTA's 2002 debt restructuring initiative and planned borrowing in support of the 2000-2004 capital program. The MTA has acknowledged that "…debt service expenses for our existing and prior capital programs are a primary contributor to our operating budget deficits." The MTA currently has $19.7 billion in debt outstanding and plans to issue another $7 billion just to finance the balance of the 2000-2004 capital program, which will increase debt service by $565 million annually. (The MTA will need State approval to raise its debt ceiling by $1.2 billion to complete the current program.) These estimates also include the cost of renovating 2 Broadway, which has grown from $135 million in 1998 to $449 million. Including interest on borrowing, the total cost of renovating 2 Broadway is estimated by the MTA to total $845 million, after a recent debt refunding.

Graph 5

Debt Service Projections



* MTA Forecast

Sources: Metropolitan Transportation Authority; OSDC analysis

V. Closing the Gap

The MTA did not release a five-year strategic operations plan between September 1999 and October 2003 as required by Section 1269-d of the Public Authorities law,[8] and this prevented the public and its elected officials from seeing the financial impact of the MTA Board's policy decisions beyond 2004. Since October 2003, it has become clear that the MTA faces large and growing budget gaps, despite the largest fare hike in its history in May 2003.

The MTA projects a budget gap of $745 million for 2005 and gaps of $1.4 billion, $1.7 billion, and $2.1 billion for calendar years 2006 through 2008, respectively. To narrow the 2005 budget gap, the MTA intends to use the entire 2004 cash balance projected for that year. While using the 2004 cash balance in 2005 will make the MTA's job of balancing the 2005 budget easier, it will provide no recurring benefit and will only delay difficult decisions.

Table 8
MTA Gap-Closing Program
(in millions)

	Better/(Worse)			
	2005	**2006**	**2007**	**2008**
Projected Gaps per July Plan	**$ (744.9)**	**$ (1,359.3)**	**$ (1,680.7)**	**$ (2,081.5)**
2004 Cash Balance	**308.7**	**- - -**	**- - -**	**- - -**
FY 2005 Gap-Closing Program				
2005 Agency Actions	228.4	286.9	261.6	306.4
Increased Fare and Toll Yields	219.2	221.8	224.0	226.3
Increase in Express Bus Fare	19.5	20.0	20.0	20.0
Contingency Reserve	(20.0)	(30.0)	- - -	- - -
Cash Savings from Prior-Year Actions	19.7	- - -	- - -	- - -
Subtotal	**466.8**	**498.7**	**505.6**	**552.7**
Remaining (Gap)/Surplus	**$ 30.6**	**$ (860.6)**	**$ (1,175.1)**	**$ (1,528.8)**
FY 2006 Gap-Closing Program				
2006 Agency Actions	- - -	135.1	138.0	139.5
2005 Cash Balance	(30.6)	30.6	- - -	- - -
Subtotal	**(30.6)**	**165.7**	**138.0**	**139.5**
Remaining (Gap)/Surplus	**$ - - -**	**$ (694.9)**	**$ (1,037.1)**	**$ (1,389.3)**
FY 2007 Gap-Closing Program				
Increased Fare and Toll Yields	- - -	- - -	236.0	238.7
Remaining (Gap)/Surplus	**$ - - -**	**$ (694.9)**	**$ (801.1)**	**$ (1,150.6)**

Sources: Metropolitan Transportation Authority; OSDC analysis

[8] The MTA released a strategic operations plan on February 28, 2003, but that plan was released only in response to the State Comptroller's demand that the MTA comply with the Public Authorities Law. In our view, the plan was defective because it showed balanced budgets through 2008 and concealed the true size of the projected budget gaps.

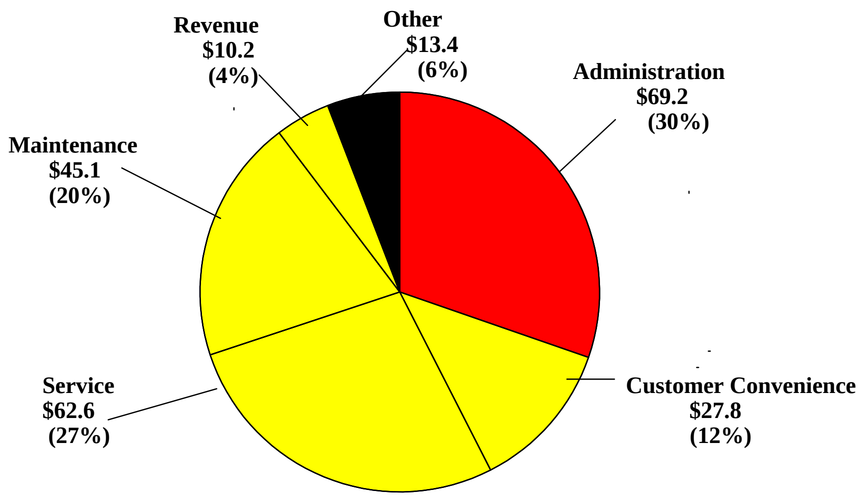
The MTA has presented a gap-closing program for 2005 that is exclusively within its control to implement, but it has not outlined a comprehensive multi-year strategy to achieve recurring budget balance. To close the remaining gap for 2005 and to narrow the out-year gaps, the MTA has proposed a 2005 gap-closing program (see Table 8) that includes agency actions ($228 million), a 5 percent increase in fare and toll revenue ($219 million), and higher express bus fares ($19.5 million).

As shown in Graph 6, nearly two thirds of resources from agency actions are expected to come from reducing services, maintenance, and customer convenience and from increasing fees ($145.7 million in 2005 and $224.6 million by 2008).

Graph 6

2005 Agency Actions

(in millions)



Sources: Metropolitan Transportation Authority; OSDC analysis

The following are the largest initiatives proposed by the MTA that would reduce services or maintenance, or would affect customers in other ways in 2005. The items here account for half of the total amount in this category.

- Reduce bus service during off-peak hours, which the MTA acknowledges would result in 215,000 fewer riders per week in 2005 and 400,000 fewer riders per week in 2006 ($38.4 million in savings in 2005).
- Replace 49 full-time subway station booths and all 115 remaining part-time booths with automated MetroCard vending machines ($8.3 million).
- Reduce commuter railroad station and car cleaning ($4.7 million from the Long Island Rail Road and $2.4 million from Metro-North).

- Impose a $1.00 monthly administrative fee on E-ZPass users ($6.6 million).
- Reduce subway dispatch and platform employees ($6 million).
- Eliminate conductors on the Canarsie (L) subway line through the installation of automated speed controls ($3.2 million).
- Reduce Long Island Rail Road track maintenance ($1.9 million), which would result in "increased response time [and] potential train delays."
- Close all outlying station restroom facilities maintained by Metro-North ($1.7 million).

The MTA has also proposed a number of actions, listed below, that would yield a relatively small amount of savings, but could increase costs in the long run, inconvenience riders, or result in lost ridership.

- Extend the inspection interval for Long Island Rail Road diesel equipment for savings of about $1 million, which would "likely result in service disruptions and train delays."
- Close the Grand Central North passageway and stationmaster's office in Grand Central Terminal on weekends, affecting 6,000 weekend riders and adding up to 20 minutes to the trip in each direction ($731,000).
- Defer service improvements on Metro-North's Harlem Line that were anticipated from the construction of a third track. Savings of $1.9 million would be partly offset by lost revenues of $1.2 million. Also, the expected savings is about half of the $3.7 million annual debt service.
- Eliminate two out of four air-conditioning repair crews for Long Island Rail Road trains ($652,000), resulting in longer crew response time.
- Defer maintenance at Grand Central Terminal ($510,000), "which may pose a risk of deterioration over time."
- Cancel the filling of water tanks for bathroom sinks on the new M7 Long Island Rail Road trains ($300,000).
- Reduce Long Island Rail Road funding for emergency busing during adverse weather conditions or other emergencies by 25 percent ($250,000).
- Eliminate Metro-North's new fence repair program ($162,000), resulting in "decreasing the security and cleanliness of property and increasing the opportunity for theft and vandalism."
- Defer the painting of Long Island Rail Road bridges and other railroad structures for the fourth straight year even though "structures [are] now taking on rust and deterioration" ($153,000).

- Close the Long Island Rail Road customer service office in Pennsylvania Station during the morning rush hour ($90,000).

Cuts to areas categorized by the MTA as “administration” total $69.2 million, but two thirds would come from savings on materials and supplies ($20 million), postponing new initiatives ($11 million), and from an audit of the employee health benefit trust fund that identified 4,040 ineligibles ($11.8 million). Agency actions are expected to reduce planned staffing levels by 2,738 employees in 2005, and 1,664 would come through layoffs. Of this amount, the MTA plans to eliminate 396 administrative positions (14 percent of the total planned) and 20 percent of these positions are currently unfilled.

The MTA has yet to comply with the provision of the Comptroller’s regulations that requires a breakdown of actual and projected staffing levels by functional category (e.g., maintenance, operations, and administration). The MTA has indicated it needs additional time to implement a new MTA-wide accounting system that would allow it to collect such information. A temporary waiver was granted to the MTA, but with the requirement that the MTA provide a timetable for implementation before January 1, 2005.

Table 9
Staffing Levels in Selected Central Offices

	NYCT	LIRR	MNR	HQ	TBTA	Total
Human Resources	462	99	86	NA	51	698
Budget/Accounting	36	107	16	105	95	359
Public Relations/Marketing	298	63	26	57	NA	444
Legal Services	307	32	17	77	10	443
Labor Relations	105	10	14	32	5	166
Total	**1,208**	**311**	**159**	**271**	**161**	**2,110**

Sources: Metropolitan Transportation Authority; OSDC analysis

In the absence of this information, we made a cursory examination of administrative staffing levels at selected offices (see Table 9). We found that the MTA employs 698 people in human resources, including 462 in New York City Transit; 443 in legal, including 307 in New York City Transit ($10 million is spent on outside law firms); and 166 in labor relations. In addition, the MTA employs 359 people in budget and accounting, and 444 in public relations and marketing, including 298 in New York City Transit. The agency actions identified by the MTA would reduce staffing levels in these areas by only 15 employees. We also note that Bridges and Tunnels, with a budget of $356 million, identified savings of only $140,000, including the elimination of one vacant secretarial position for savings of $40,000. Long Island Bus identified no savings from management improvements.

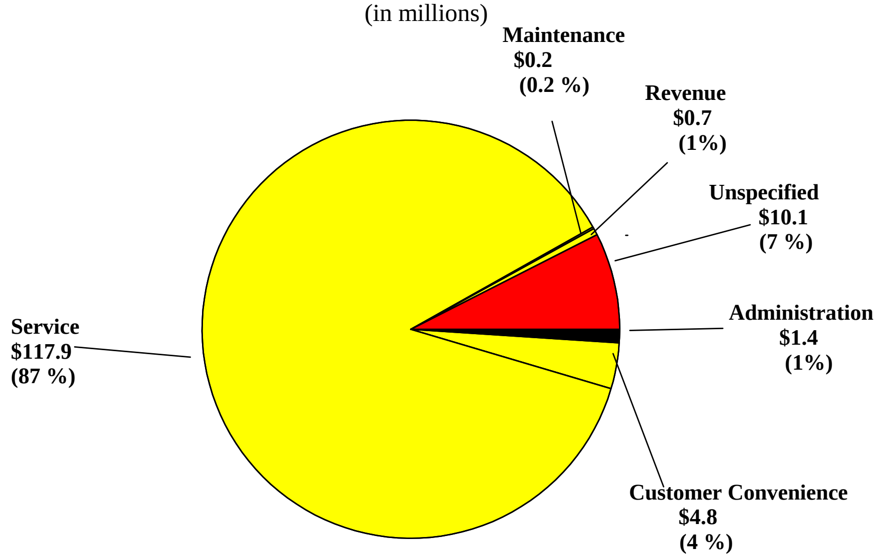
In response to a draft of this report, the MTA stated that the positions in the categories in Table 9 are shown by reporting unit within the agencies and not by function. Therefore, the MTA believes that the classifications shown in the table do not necessarily reflect the number of positions that perform a particular function. For example, the MTA pointed out that the "Public Relations/Marketing" category includes 262 customer telephone center employees. The MTA also stated that "task forces have already been organized to examine the areas cited by the Comptroller so that substantial savings can be achieved during the current Four-Year Financial Plan period." An October 20, 2004 report to the Audit Committee found that many finance, human resource, procurement, and technology functions at the agency level are duplicative. The MTA budgeted $708.9 million for these functions in 2004, but the financial plan does not anticipate any savings from consolidating these services.

Even if the 2005 gap-closing program is implemented as proposed by the MTA, the structural imbalance would not be corrected and the MTA would still face a budget gap of $860.6 million in 2006. To narrow the 2006 budget gap, the MTA has proposed a $135.1 million gap-closing program that relies almost exclusively on service reductions and unspecified actions, and is notable for its absence of savings from management improvements (see Graph 7).

Graph 7

2006 Agency Actions

(in millions)



Sources: Metropolitan Transportation Authority; OSDC analysis

The following are initiatives proposed by the MTA for 2006 that would reduce services or maintenance, affect customers in other ways, or could lead to increased road congestion and air pollution.

- New York City Transit would discontinue most bus routes with less than two thirds cost recovery ($47.5 million), affecting 276,000 riders per week.
- New York City Transit would eliminate all bus service between 1 a.m. and 5 a.m. ($8.7 million), affecting 60,000 riders per week.
- New York City Transit would reduce subway service by 10 percent on most subway lines ($19.5 million), affecting 164,000 riders per week.
- New York City Transit would reduce evening and weekend subway service on all lines ($6.1 million), affecting 37,000 riders per week.
- The Long Island Rail Road would eliminate service to Belmont Park even though the lost revenues ($287,000) would be more than twice the projected savings ($136,000). The MTA cited station maintenance as the reason for terminating service, but the City Comptroller characterized the problems as minor in an April 2003 audit.
- The Long Island Rail Road would abandon service on the West Hempstead and Oyster Bay lines ($9.5 million), which would affect 9,000 commuters, and on the Greenport-Ronkonkoma Branch ($1.7 million) and Montauk service west of Jamaica Station ($1.1 million). Service could not be easily restored because the MTA intends to remove track and other infrastructure.
- Metro-North would reduce peak-period train service by 10 percent ($3.1 million), increasing commutation time by 20 minutes each day and affecting 34,000 riders per day.
- Metro-North would close all but five of its ticket offices and reduce hours at Grand Central Terminal ($2.5 million), which it believes “will have a major customer impact.”
- The Staten Island Railway has proposed eliminating weekend service, which would inconvenience 5,000 riders per week ($400,000).

These proposals would narrow the 2006 budget gap by 16 percent, which still leaves gaps that range from $694.9 million in 2006 to $1.4 billion in 2008. The MTA has not articulated a plan to close these gaps other than to suggest that fares and tolls would rise another 5 percent in 2007. Even with this cycle of service cuts and fare and toll hikes, the MTA would be left with budget gaps of $801.1 million in 2007 and almost $1.2 billion in 2008. While the out-year gaps are likely to narrow given the MTA’s conservative revenue forecasts, the remaining gaps will probably remain too large for the MTA to close on its own without undesirable consequences.

VI. Proposed Capital Program

On September 29, 2004, the MTA Board approved a proposed five-year $27.8 billion capital program for calendar years 2005 through 2009 even though the program showed a $16.2 billion funding gap. Moreover, the MTA expects the Capital Program Review Board to approve the capital program without knowing the sources of funding, the impact of the capital program on the operating budget, or the MTA's funding priorities in the event that this ambitious program cannot be fully funded.

Table 10
Proposed 2005-2009 Capital Program
(in billions)

Core Program	
New York City Transit	$ 12.1
Long Island Rail Road	2.4
Metro-North Railroad	1.4
Bridges and Tunnels	1.3
Subtotal	**17.2**
Expansion Projects	
East Side Access	4.6
Second Avenue Subway	2.8
No. 7 Line Extension	2.0
JFK Rail Link to Lower Manhattan	0.4
Expansion Project Management	0.1
Subtotal	**9.9**
Security	**0.5**
Other	**0.2**
Total	**$ 27.8**

Sources: Metropolitan Transportation Authority; OSDC analysis

The proposed capital program allocates $17.2 billion to a core capital program that is designed to restore the regional mass transit system to a state of good repair, maintain capital assets by preserving appropriate replacement cycles, and fund system improvements (see Table 10). The MTA has proposed spending another $9.9 billion on expansion projects such as East Side Access, the Second Avenue Subway, the extension of the No. 7 subway line, and a rail link between Lower Manhattan and Jamaica, Queens, and $700 million more on security and other projects.

In recent years the MTA has increasingly relied on debt to fund its capital programs in the face of declining capital grants from New York State and resources from extraordinary sources, such as the sale of the New York Coliseum. The decision to rely on borrowing to fund past capital programs is largely responsible for the operating budget gaps the MTA must now confront.

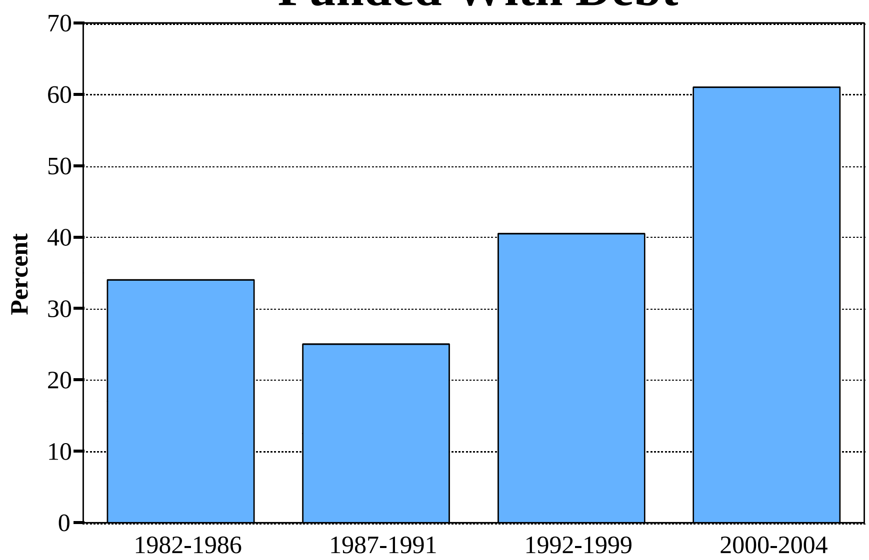
The Capital Program Review Board, which includes representatives of the Governor, the Mayor of New York City, the Speaker of the State Assembly, and the Majority Leader of the State Senate, should ask the MTA to withdraw the proposed capital program until the MTA identifies sources of funding and its programmatic priorities, and releases an updated capital needs assessment so that the Board and the public can have a meaningful opportunity to evaluate the proposed capital program.

A. Reliance on Debt

In recent years, the MTA has increasingly relied on debt to finance its capital programs. The current $20.3 billion five-year capital program for calendar years 2000 through 2004 is funded with $12.4 billion in bond proceeds—more than twice the amount in the prior five-year period. In total, more than 60 percent of the funding for the current capital program is expected to come from debt, 50 percent more than the amount funded with debt during calendar years 1992 through 1999 (see Graph 8).

Graph 8

Percent of Capital Programs Funded With Debt



Sources: Metropolitan Transportation Authority; OSDC analysis

Even though the federal government has increased its capital grants to the MTA capital program over the years, the MTA increased borrowing to fund its capital programs to offset reductions in State capital grants and revenues from extraordinary sources, such as proceeds from the sale of the New York Coliseum, in order to achieve its programmatic objectives, which grew dramatically during the 2000-2004 capital program. The amount of capital grants from the State declined from 19.6 percent of total resources in the MTA's first capital program, to 10.8 percent in the second, to 0.6 percent during calendar years 1992 through 1999, and then to nothing in the 2000-2004 capital program.

The City's contribution averaged $138 million during calendar years 1982 through 1986, or 9 percent of the resources for the first five-year capital program. Pursuant to a 1986 agreement between the Governor, Mayor, and the Chairman of the Municipal Assistance Corporation, which allocated a portion of the surplus funds from refinancing outstanding bonds of the Municipal Assistance Corporation to New York City Transit's capital program, the City was required to provide $105 million each year through 1995 to support New York City Transit's capital program. While the City continued to fund New York City Transit's capital program at this level through 2000, the City has reduced its annual contribution to $71 million, on average, for the 2000-2004 capital program, and plans to provide about $74 million annually through 2013.

Although the City contributed additional amounts to the MTA's capital program over the years, these contributions were frequently designed to help balance the City's operating budget. For example, the City provided the MTA with $500 million in bond proceeds in calendar years 1996 and 1997 in exchange for $250 million in cash. Similarly, the City issued $345 million in bonds to support the 1995-1999 and 2000-2004 capital programs in exchange for $345 million in cash from the sale of the New York Coliseum. Also, pursuant to agreements with the State, the City agreed to allocate to mass transit $690 million in federal funds from the cancelled West Side Highway (Westway) project and surplus funds from refinancing outstanding bonds of the Municipal Assistance Corporation.

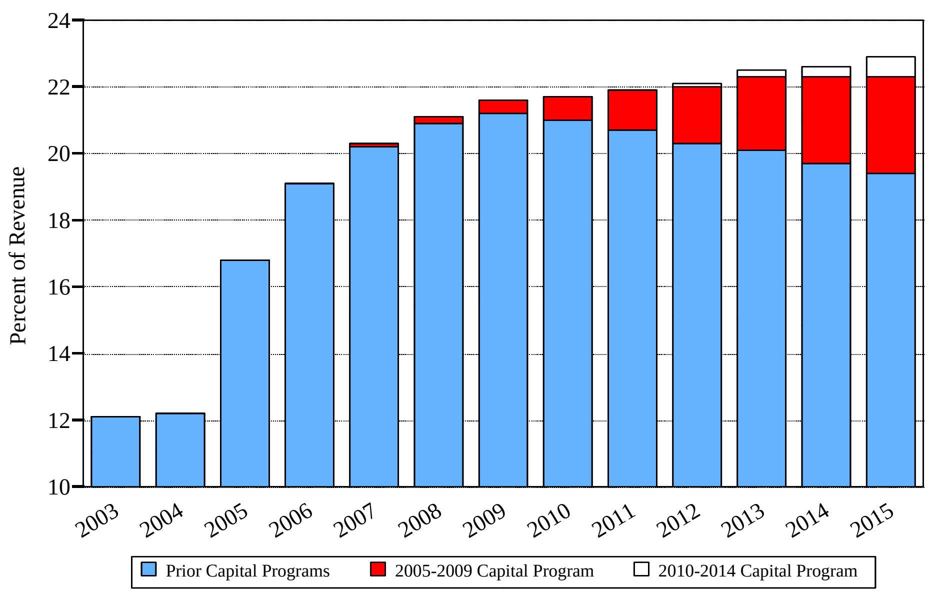
The State has authorized the MTA to borrow additional amounts in support of the capital program and has authorized additional tax revenues to flow to the MTA to help fund the debt service on these bonds or support the operating budget, in general. This State contribution, however, is markedly different from a capital grant, because the MTA and not the State is responsible for the cost of the borrowing. Moreover, the burden that these bonds place on the MTA operating budget is not fixed, but rises and falls with economically sensitive tax revenues, which are subject to business cycles.

Even when these bond resources are taken into account, State contributions—both capital grants and proceeds from bonds supported by State-authorized dedicated taxes—declined, from 18.4 percent of total resources in the first two capital programs to 10.4 percent of total resources in the 1992-1999 program. Although the State did not contribute directly to the 2000-2004 capital program, it did agree to restructure outstanding State service contracts under the MTA's 2002 debt restructuring initiative, which will free up $777 million. In addition, the MTA expects to issue nearly $2.5 billion in tax-backed bonds in support of the 2000-2004 capital program. Thus, in total, the State is expected to fund $3.3 billion, or 16.3 percent, of the 2000-2004 capital program.

The decision to rely on debt has placed a heavy burden on the MTA's operating budget. The debt service burden, which averaged 12 percent during calendar years 2003 and 2004 (see Graph 9), will rise to almost 21 percent by 2008 and then 23 percent by 2015, assuming the MTA is able to limit its contribution to the next two capital programs to $4 billion (as assumed in the MTA financial plan for the 2005-2009 capital program). This assumption, however, may be overly optimistic given that the MTA is expected to contribute $12.4 billion to the 2000-2004 capital program. To maintain the same debt service burden in 2015 as in 2004, fare, toll, tax, and other revenue would have to increase by an average of 8.9 percent annually.

Graph 9

Debt Service Burden



Sources: Metropolitan Transportation Authority; OSDC analysis

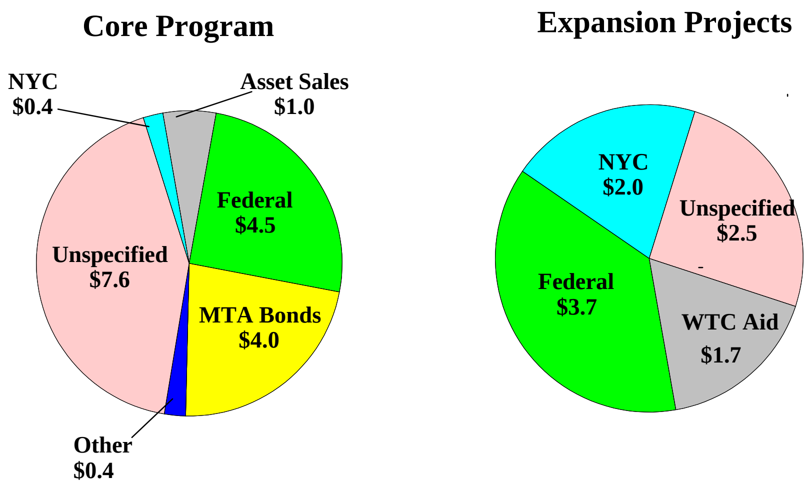
B. Funding the 2005-2009 Capital Program

The 2005-2009 capital program shows a funding gap of $16.2 billion—$12 billion for the core program and $4.2 billion for the expansion program. The capital program, however, does not include a $4 billion contribution from the MTA to its core program that is assumed in its own financial plan. In addition, the capital program excludes a $371 million contribution that is shown in the City's capital program. Taken together, these resources would reduce the funding gap for the core program to $7.6 billion (see Graph 10).

Graph 10

Sources of Funding for Proposed 2005 - 2009 Capital Program

(in billions)



Sources: Metropolitan Transportation Authority; OSDC analysis

Moreover, the MTA has not taken into account the availability of $1.7 billion in unused transportation funding from the $21 billion assistance package to New York City following the attack on the World Trade Center. These resources, which are intended to benefit Lower Manhattan, could be applied to the expansion program, leaving a funding gap of $2.5 billion (see Graph 10). Some $322.5 million in unused City funds from the cancelled LaGuardia Airport subway project could also be available, but the City has not indicated how these resources would be reallocated.[9]

[9] New York City had dedicated $645 million toward the LaGuardia Airport subway link project, but allowed the MTA to reallocate half of this amount to purchase new buses in anticipation of the MTA's assumption of operational control over seven private bus companies that are currently subsidized by the City.

Finally, Senators Schumer and Clinton are urging Congress to make available for mass transportation $2 billion in unused Liberty Zone tax benefits.

1. Federal Funding

The largest amount of funding identified by the MTA for its core program would come from the federal government ($4.5 billion). While the federal government has not authorized the successor funding bill to the Transportation Equity Act for the 21st Century, the amounts anticipated by the MTA are not inconsistent with recent allocations and amounts contemplated in reauthorization bills currently under consideration by the House and Senate.

The MTA is counting on an additional $3.7 billion from the federal government over the next five years to fund expansion projects, including $2.3 billion for East Side Access and $1.4 billion for the Second Avenue Subway. These amounts are based on the assumption that the federal government will fund 50 percent of the cost of these projects. Although the federal government has recommended that both projects receive funding, no funding levels have been agreed to. While the MTA assumes that the federal government will fund half the cost of these projects, Congress has appropriated far less. For example, the federal government authorized $353 million for East Side Access for federal fiscal years 1998 through 2003, but Congress appropriated only $155 million. Moreover, the total cost of the East Side Access project has grown by $1.9 billion, or 43 percent, from $4.4 billion in April 2001 to $6.3 billion in December 2003, and its completion date has been delayed by three years to 2012. Thus, the MTA's assumption that it will be responsible for only half of the cost of these expansion projects may prove overly optimistic.

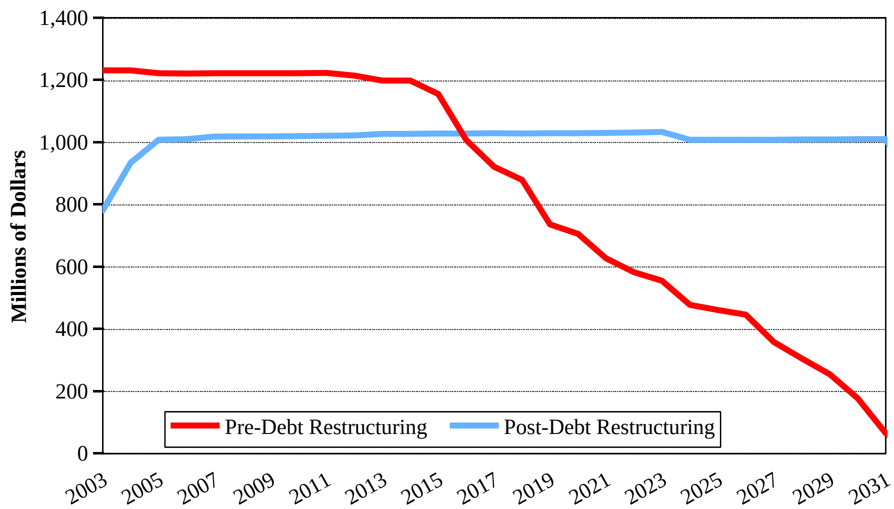
2. MTA Debt

The MTA assumes that it will fund $4 billion, or 23 percent, of the core program. While the MTA was unable to provide any documentation illustrating how it arrived at that figure, MTA budget officials stated that, "the $4 billion MTA funding assumption for the 2005-2009 capital program is not based on a specific calculation, but rather a series of discussions with MTA staff and our financial advisors. The $4 billion amount recognizes a need for the MTA to continue to contribute to future capital programs, but also takes into consideration the impact of current debt service projections on our operating budget." We note that the size of the proposed MTA contribution is about one third the size of the MTA's $12.4 billion contribution to the current 2000-2004 capital program, which included $4.5 billion in proceeds from the 2002 debt restructuring initiative.

The restructuring initiative freed up resources to help fund the 2000-2004 capital program by taking advantage of lower interest rates and by freeing reserves, but it also pushed debt into the future. Although annual debt service costs will now be, on average, $220 million lower than previously scheduled through 2015, debt service costs will be much higher in subsequent years. In total, debt service costs will be lower by $2.8 billion between 2003 and 2015, but higher by $8.6 billion between 2016 and 2032, a net increase of $5.8 billion. While debt service costs were previously scheduled to decline sharply over a 15-year period beginning in 2015, they will now remain level through 2031, at about $1 billion just for the bonds currently outstanding (see Graph 11). Consequently, the MTA has locked itself into a relatively high level of debt through 2031, which will make funding future capital programs more difficult, and will continue to put pressure on the MTA's operating budget.

Graph 11

Comparison of Debt Service Costs Pre- and Post-Debt Restructuring



Sources: Metropolitan Transportation Authority; OSDC analysis

3. Asset Sales

The MTA anticipates $1 billion from the sale of assets, which it would appropriately dedicate to the capital program rather than to the operating budget. The MTA stated in response to our inquiry that the $1 billion estimate is "merely a placeholder at this time and there has not been an identification of specific assets," and that it was "currently exploring all options and expect[ing] to seek the advice of our financial advisors and other consultants to catalogue our numerous assets to aid in the selection process. Among the ideas looking forward are the sale or other disposition of air rights over the Hudson Yards now used by the Long Island Rail Road and seeking corporate or commercial sponsorships for rolling stock and/or facilities."

The MTA has steadfastly maintained that it will receive "fair market value" for the air rights over the Hudson Yards and Atlantic Avenue rail yards, but has yet to reach agreements with the New York Jets or Brooklyn Nets, who would like to construct facilities over the yards; or with the City and the State, which are promoting economic development projects for these sites. The MTA recently hired Jerome Haims Realty Inc., to conduct an appraisal of the western rail yard, and the New York Jets have retained Cushman and Wakefield. The MTA has not identified any other properties but told us that it intended to issue in late September a "request for proposals" for a consultant to catalogue its assets, and that a copy would be provided to us. To date, we have not received a copy. We do note that the MTA had planned to move personnel to 2 Broadway after selling buildings at 341, 343, and 347 Madison Avenue, which are all connected to Grand Central Station, but those plans were abandoned. However, given the size of the capital funding gap those plans should be reconsidered.

4. City of New York

The City is urging the MTA to construct an extension of the No. 7 Subway Line from 42nd Street and Broadway to 34th Street and 11th Avenue, to stimulate investment and development on the far West Side of Manhattan and to support a multi-use facility that would house a football stadium for the New York Jets and possibly the 2012 Olympics. The City has agreed to fund the estimated $2 billion cost of extending the No. 7 subway line, but the funding is contingent on a speculative financing mechanism that has not yet been approved. In addition, the City is insisting that the MTA be responsible for any cost overruns.

C. Progress Toward A State of Good Repair

The MTA has invested more than $48 billion over the past 20 years and has made impressive progress toward restoring the regional mass transit system to a state of good repair. However, certain elements have yet to be restored and in some cases the target dates for achieving a state of good repair have been pushed back. Even after a state of good repair is achieved, capital investments are still needed on an ongoing basis to maintain normal replacement cycles.

While New York City Transit has achieved a state of good repair for many of its assets, such as rolling stock and tracks, it has yet to restore elements such as stations, bus depots, car maintenance shops, and power substations. The MTA estimated four years ago in its 2000-2019 needs assessment that New York City Transit's power substations, shops, tunnel lighting, and fan plants (which provide ventilation in subway tunnels to draw smoke and fumes away from passengers during emergencies) would achieve a state of good repair by 2006, 2012, 2020, and 2022, respectively. The MTA currently estimates, however, that these assets will not reach a state of good repair until 2015, 2019, 2022, and 2028, respectively. The restoration of New York City Transit depots, subway stations, and signals is also taking longer than expected and will not achieve a state of good repair until 2010, 2024 and 2027, respectively—some two to three years later than previously forecast.

The MTA reports that all of Long Island Rail Road's assets have achieved a state of good repair with the sole exception of its bridges and viaducts, which are expected to be fully restored by 2014.

Metro-North Railroad reports that its rolling stock, track, and signals have achieved a state of good repair, and that its shops and yards, stations, and structures will achieve a state of good repair by 2014, 2019, and 2024 respectively, or ten years later than projected four years ago. Bridges and Tunnels reports that all of its assets have achieved a state of good repair.

D. Capital Needs for 2005-2009

In response to our request for an updated MTA capital needs assessment, which includes estimates of the amount of capital needed over the next 20 years, the MTA responded that the assessment is "a work in progress that does not contain the final conclusions of MTA Headquarters in consultation with the transit and commuter agency presidents. Rather than prejudice the progress of individual or groups of projects, we do not think it advisable to release an incomplete study. The completed study will not be available until sometime after the submission of the transit and commuter capital programs to the Review Board by October 1, 2004." As of this writing, the MTA has not released an updated capital needs assessment.

The agencies, however, have prepared their own 20-year needs assessments and based their requests for funding on these analyses. For calendar years 2005 through 2009, the agencies identified capital funding needs of $26.1 billion for their core programs,[10] adjusted for inflation, but the core program proposed by the MTA allocates $17.2 billion for this purpose, a difference of $8.9 billion, or 34 percent. In the aggregate, the MTA funded 66 percent of the agencies' requests and while New York City Transit had 73 percent of its budget request funded, the commuter railroads had less than half of their combined budget request fully funded (see Table 11).

Table 11
Difference in Requested Capital Funding
Calendar Years 2005 Through 2009
(in billions)

	Agency Request	MTA Allocation	Funding Shortfall	Percent Funded
Core Program				
NYC Transit	$ 16.5	$ 12.1	$ (4.4)	73 %
Long Island Rail Road	4.7	2.4	(2.3)	52 %
Metro-North Railroad	3.0	1.4	(1.6)	47 %
Bridges & Tunnels	1.9	1.3	(0.6)	67 %
MTA Police & Other	NA	0.1	.1	NA
Total	**$ 26.1**	**$ 17.2**	**$ (8.9)**	**66 %**

Sources: Metropolitan Transportation Authority; OSDC analysis

Even so, New York City Transit received $4.4 billion less than requested. Station rehabilitation projects are funded at 72 percent of the level recommended by New York City Transit, or $831 million less than requested; signals and communications are funded at 75 percent of the recommended level, or $614 million less than requested; line structures (e.g., elevated subways) are funded at 57 percent of the recommended level, or $471 million less than requested; and shops and yards are each funded at about half the amounts requested, or about $450 million less than requested for each category. Tunnel lighting is funded at 75 percent of the requested amount, or $101 million less than requested, and at the proposed funding level, one third of tunnel lighting will still need to be modernized to current standards after 2009.

Long Island Rail Road received $2.3 billion less than requested. Track projects are funded at 69 percent of the recommended level, or $330 million less than requested; rolling stock (i.e., trains) is funded at 57 percent of the recommended level, or $298 million less than requested; stations and parking lots are funded at 41 percent of the amount requested, or $203 million less than requested; and line structures,

[10] We have adjusted both the total agency request for capital funding for the 2005-2009 capital program and Metro-North's individual request to reflect the acceleration of the planned purchase of M-7 rail cars from the 2005-2009 capital program to 2004.

signals and communications, and shops and yards are each funded at about half the recommended levels, or about $250 million less than requested for each category. In addition, the Long Island Rail Road requested $308 million for Pennsylvania Station, but only $32 million was allocated for this purpose.

Metro-North received $1.6 billion less than requested. Rolling stock is funded at 42 percent of the recommended level, or $499 million less than requested; shops and yards are funded at 46 percent of the recommended level, or $307 million less than requested; line structures (e.g., track rails and track ties) are funded at 51 percent of the recommended level, or $250 million less than requested; and stations are funded at 51 percent of the recommended level, or $240 million less than requested.

Bridges and Tunnels received $607 million less than requested. Roadways and decks are funded at 63 percent of the recommended level, or $426 million less than requested, and utilities are funded at 28 percent of the recommended level, or $108 million less than requested. The difference between the amounts requested by Bridges and Tunnels and those allocated by the MTA takes on even greater importance because Bridges and Tunnels notes in its capital needs assessment that its estimates already "reflect a significant reduction from the original internal estimates for the 2005-2009 period."

MTA budget officials told us that "the agencies' individual submissions reflect a 'best case' scenario for what each would like to do over the twenty years," and that some of the projects recommended for the 2005-2009 capital program, in their view, could not be initiated during this period for technical reasons. In a response to a draft of this report, the MTA stated that after trying three different aggregate funding levels it settled on $17.2 billion, which "approximately represents the current approved program plus inflation," and that it was the "most prudent aggregate funding level we could put forward."

In addition, the split between New York City Transit and the commuter railroads also was not based on need. Instead, New York City Transit was allocated 75 percent of the resources, which is consistent with the allocation in the originally approved 2000-2004 capital program, in accordance with the expressed desire of the MTA Board. Similarly, the Long Island Rail Road was allocated 60 percent of the resources allocated to the commuter railroads, which is also consistent with past practice.[11]

[11] The percent allocated in the 2005-2009 capital program to Metro-North includes $234 million for the accelerated purchase of M-7 rail cars in 2004.

The agencies, however, expressed concerns about the reduced levels of funding proposed by MTA Headquarters. Bridges and Tunnels stated in a memo to the MTA Executive Director dated May 19, 2004, that reduced capital funding would result in "the ill-advised practice of deferring and phasing large-scale deck projects, thereby adding to the risk of emergency repairs and revenue loss, greatly inconveniencing customers beyond what is necessary, disrupting facility master plans and significantly increasing both the long-term capital and short-term operating expenses of the agency."

Long Island Rail Road noted in a memo to the MTA Executive Director dated March 31, 2004, that deferring planned rolling stock purchases will result in a "fleet size that does not accommodate M-7 seat loss and the presence of additional standees beyond the 1,000 currently projected….By deferring a known good product at an extremely advantageous price, the LIRR must plan to purchase additional MU fleet in the 2010-2014 program at significantly higher cost."

Metro-North noted in a memo to the MTA Executive Director dated April 2, 2004, that the proposed funding levels "are inadequate to continue to bring the Metro-North system to a state of good repair, protect past investments and accommodate projected growth."

The agencies also identified unfunded capital needs of $73 billion for the 2010-2024 period. Additionally, the MTA has either begun or has plans to initiate expansion projects valued at $33 billion. Thus, it is critically important that a long-term financing strategy be developed to maintain the existing system and to finance expansion projects to completion.

In light of these concerns, the Capital Program Review Board should ask the MTA to explain the ramifications of not fully funding the agencies' budget requests. While we understand that the MTA is operating in an environment of constrained resources, the Capital Program Review Board and the public should know the trade-offs and compromises that were made by MTA management in producing the proposed capital program for the 2005-2009 period.

Appendix

Nonrecurring Resources

The July Plan includes $420.6 million in nonrecurring resources in 2004 and $162.3 million in 2005. While these resources will help the MTA balance the 2004 and 2005 budgets, they provide no recurring benefit.

Table 12
Non-Recurring Resources
(in millions)

	2004	2005
World Trade Center Insurance Proceeds	$ 146.8	$ - - -
MRT Corporate Account	111.2	8.7
2003 Debt Service Prepayment	79.7	32.0
2000 Pension Prepayment	42.5	- - -
2003 Pension Prepayment	- - -	118.1
Stabilization Fund Interest Income	10.8	- - -
Other Insurance Settlements	10.1	- - -
All other	19.5	3.5
Total	**$ 420.6**	**$ 162.3**

Sources: Metropolitan Transportation Authority; OSDC analysis

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