Financial Outlook for the Metropolitan Transportation Authority

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Highlights

- **Fares and tolls have been rising much faster than inflation over the past six years, and the MTA plans to raise them by 7.5 percent in 2015 and by another 7.5 percent in 2017 (more than twice the projected inflation rate).**
- **The MTA has successfully reduced the cost of the paratransit program (which serves the disabled), but cost-reduction efforts in other areas have been modest since 2010.**
- **Since February 2013, the MTA has identified $1.9 billion in new resources during the financial plan period. About half of the resources were used to fund discretionary actions; none of the resources were allocated to moderate future fare and toll hikes.**
- **The 2014 budget gap has been eliminated and the out-year gaps have been reduced to a cumulative total of $240 million (assuming the MTA achieves all of its cost-saving targets).**
- **The MTA estimates that it will need to invest $26.6 billion during the 2015-2019 period just to maintain and modernize the existing transportation system. Financing these investments will be difficult in the current economic and budgetary environment.**
- **The MTA plans to allocate a total of $2.7 billion in operating budget resources to fund capital projects on a pay-as-you-go basis through 2020, $675 million more than seven months ago.**
- **The MTA still faces budget risks, including the pace of the economic recovery and the impact of the next round of collective bargaining.**

On July 24, 2013, the Metropolitan Transportation Authority (MTA) released a preliminary budget for 2014 and an associated five-year financial plan ("the July Plan"). The July Plan, which covers the period from 2013 through 2017, reflects the MTA's commitment to reduce planned spending and to raise fares and tolls every other year.

While the MTA still faces budget risks, the July Plan reveals that the MTA's financial outlook is much improved compared to just seven months ago. The MTA has identified $1.9 billion in new resources over the course of the financial plan period, resulting mostly from improvements in the economy and smaller increases in the costs for employee fringe benefits, debt service and energy.

The MTA plans to use these new resources to: offset unplanned spending; reduce the projected budget gaps; help fund the next capital program; improve maintenance and service; and pay down some of its long-term liabilities. Although these are appropriate uses, none of the resources were used to moderate planned fare and toll increases.

In recent years, the MTA has placed less emphasis on new cost-reduction initiatives even as it continues to press for large fare and toll increases. Since 2007, the MTA has raised fares and tolls by 29 percent (twice the inflation rate). These increases occurred when riders were least able to afford them, as the recession took a heavy toll on family finances. Household income remains stagnant, yet the MTA plans to raise fares and tolls by 15 percent over a three-year period beginning in 2015.

The MTA has largely recovered from the recession and, although much work remains to be done, it quickly restored service after Superstorm Sandy. The MTA still faces challenges, perhaps none greater than funding its next capital program, but reducing the size of planned fare and toll increases should also be considered.

Background

In May 2009, New York State enacted new taxes (e.g., the payroll mobility tax) and fees, and dedicated the revenues to the MTA to help address its long-term structural imbalance. For its part, the MTA raised fare and toll revenues by 10 percent, and committed to raise fare and toll revenues by 7.5 percent in both 2011 and 2013 as well as to reduce future costs.

Shortly thereafter, the plan to put the MTA on sound financial footing began to unravel as the recession deepened. Collections from the new payroll tax fell far short of targets; real estate tax collections weakened; and the State cut funding to the MTA to help balance its own budget. In addition, labor costs rose because of an arbitration award. Given its precarious financial situation, the MTA issued Revenue Anticipation Notes in 2009 and 2010 to meet its financial obligations.

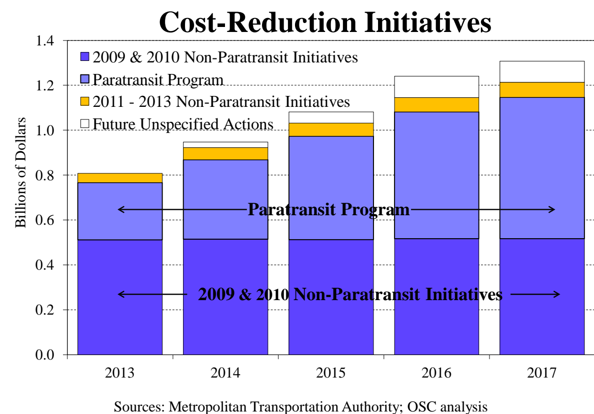
To stabilize its finances, the MTA embarked on a comprehensive gap-closing program in 2010. This program included service reductions, a three-year net-zero wage freeze and other cost-reduction actions. These actions have allowed the MTA to balance its budget without additional taxpayer assistance.

The MTA's financial outlook is much improved compared with just seven months ago. The MTA has reduced the size of its out-year budget gaps from $638 million to $240 million, including eliminating the 2014 budget gap. It also has set aside additional funding for the next capital program, as well as to improve maintenance and services. The MTA now projects a cash balance of $6 million in 2014 and budget gaps of $49 million in 2015, $91 million in 2016 and $100 million in 2017, assuming successful implementation of the MTA's cost-reduction efforts, additional fare and toll increases, and anticipated labor cost savings.

Status of Cost-Reduction Efforts

In 2009 and 2010, at the height of the MTA's fiscal crisis, the MTA proposed the largest cost-reduction program in its history. These initiatives are now expected to save $1.1 billion by 2017, 76 percent more than initially estimated because the MTA expanded successful cost-reduction initiatives in the paratransit program. Since 2010, the MTA has proposed additional savings initiatives, raising the total value of its cost-cutting efforts to $1.3 billion annually by 2017 (see Figure 1). Of this amount, $629 million is expected to come from the paratransit program and $517 million from other initiatives proposed in 2009 and 2010. Since then, cost-reduction initiatives outside of the paratransit program have been modest, generating only $67 million annually by 2017. The July Plan also anticipates savings of $95 million from future, still unspecified actions.

Figure 1

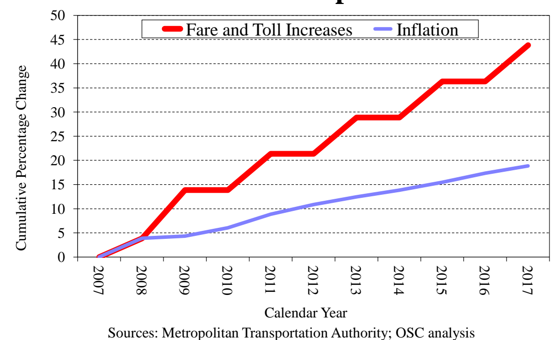


Sources: Metropolitan Transportation Authority; OSC analysis

Reliance on Fare and Toll Increases

Since 2007, the MTA has raised fares and tolls four times (see Figure 2), a cumulative increase of 29 percent (more than twice the inflation rate). Between 2007 and 2013, the cost of a 7-day MetroCard for use on the City's subways and buses rose by 25 percent, and the cost of a 30-day MetroCard rose by 47 percent (more than three times the inflation rate). The average fare per rider, including discounts and free transfers, rose by 36 percent. Fares on the commuter railroads increased by 32 percent, and E-ZPass tolls on the MTA's major bridges and tunnels rose by 33 percent.

Figure 2



Sources: Metropolitan Transportation Authority; OSC analysis

The MTA plans to raise fares and tolls in 2015 and again in 2017, in keeping with its policy of biennial increases. The July Plan assumes that each fare and toll increase would generate about $500 million annually, an increase of 7.5 percent (more than twice the projected inflation rate).[1] If fares and tolls rise as planned, they will have increased by 44 percent since 2007, much faster than the growth in inflation (less than 19 percent).

Unanticipated Resources

Since February 2013, a number of favorable developments have improved the MTA's financial outlook. These developments resulted in the MTA recognizing $1.9 billion in new resources during the financial plan period. Several factors are responsible for the additional resources, including higher tax revenues ($482 million), lower pension contributions ($404 million), lower energy costs ($372 million), lower debt service ($317 million), and lower health insurance costs for active employees and retirees ($218 million).

The MTA plans to use some of these resources to offset unplanned costs and other budgetary needs ($523 million), and to reduce its projected budget gaps ($399 million). About half of the resources (nearly $1 billion) would be used to fund discretionary actions, including: funding capital projects on a pay-as-you-go basis ($435 million); new initiatives, such as improved maintenance and services ($441 million); and paying down long-term pension liabilities of the Long Island Rail Road ($80 million). Although these are appropriate uses, none of the resources were used to reduce the size of planned fare and toll hikes.

While the MTA used a portion of the resources to reduce projected budget gaps, it could have eliminated the gaps entirely and reduced the size of the next fare and toll increase.[2] The MTA instead chose to set aside additional operating funds for capital projects because of the uncertainties in funding the next five-year capital program.

Utilization Trends

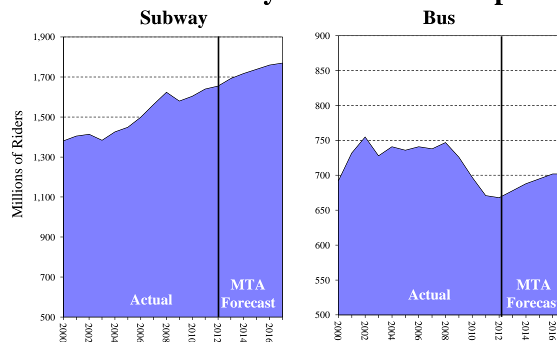
In 2013, the use of the MTA's mass transit services (i.e., subway, commuter railroads and bus) will likely exceed prerecession levels. The July Plan assumes that utilization will grow by 2 percent in 2013 and by about 1 percent annually thereafter. Recent trends are discussed below.

New York City Transit: Subway ridership fell by 44 million riders in 2009 (see Figure 3) as a result of job losses brought about by the recession. Since then ridership has recovered, reaching the highest level since 1950 even with service disruptions from Superstorm Sandy. The July Plan assumes subway ridership will reach nearly 1.7 billion riders in 2013 and then grow by 26 million riders (1.5 percent) in 2014 as the economy improves.

Ridership on buses operated by New York City Transit fell by 11 percent between 2008 and 2012 (to the lowest level since 1999), following service cuts that were implemented in response to revenue shortfalls brought about by the recession and the impact of Superstorm Sandy. The July Plan assumes bus ridership will resume growing and will reach 700 million riders by 2016, still lower than the prerecession level.

Figure 3

New York City Transit Ridership



Sources: Metropolitan Transportation Authority; OSC analysis

Long Island Rail Road (LIRR): The recession took a heavy toll on the commuter railroads. After reaching a historic peak in 2008, LIRR ridership fell by 6.3 million riders (7.2 percent) through 2011 (see Figure 4). In 2012, however, ridership increased by 1 percent, even with the disruptive impact of Superstorm Sandy. Although ridership is projected to increase by 1.7 million riders (2 percent) in 2013 and to grow in subsequent years, it is not expected to reach the prerecession level during the financial plan period.

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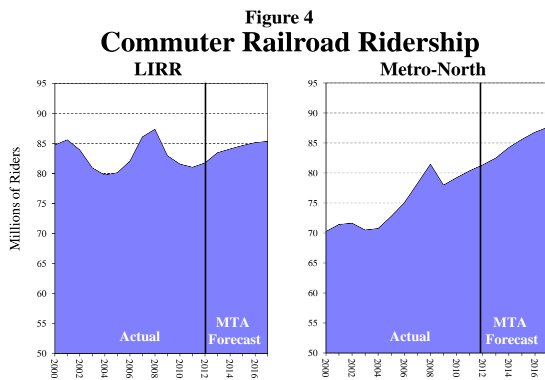
[1] Fares and tolls will rise by an average of more than 8 percent to meet the MTA's revenue target, because utilization typically declines when fares and tolls rise.

[2] OSC estimates that each percentage point reduction in the proposed fare and toll increase for 2015 would cost the MTA $56 million in 2015, and $69 million in each subsequent year.

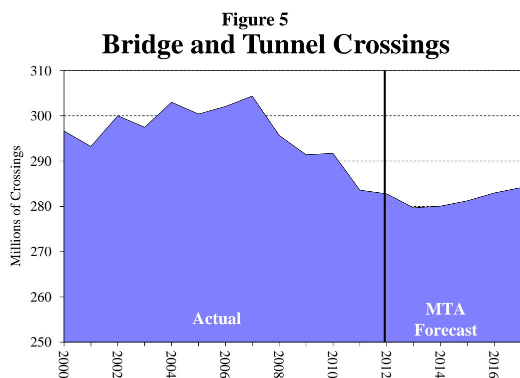
Figure 4
Commuter Railroad Ridership



Sources: Metropolitan Transportation Authority; OSC analysis

Metro-North Railroad: After peaking in 2008, ridership on Metro-North fell by 4.3 percent in 2009, but most of the losses were regained by the end of 2012. The level in 2012 would have reached a new record if not for Superstorm Sandy. Ridership is expected to rise by 1.4 percent in 2013, setting a new record, and to continue to grow at a slightly slower rate thereafter.

Figure 5
Bridge and Tunnel Crossings



Sources: Metropolitan Transportation Authority; OSC analysis

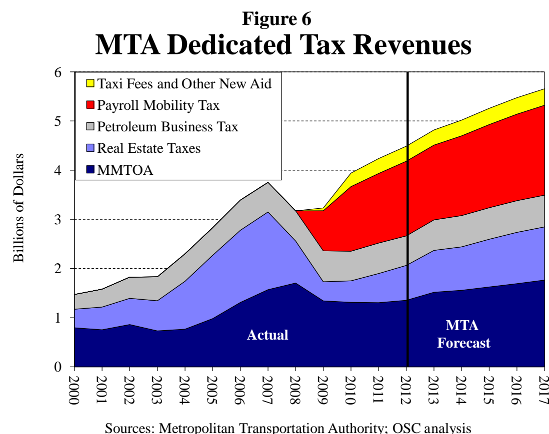
Bridge and Tunnel Crossings: Crossings declined by 22 million vehicles (7.1 percent) between 2007 and 2012, as a result of rising gas prices and three toll increases (see Figure 5). Crossings through May 2013 were down 1.4 percent, mostly as the result of another toll increase in March 2013. The July Plan assumes that crossings will decline by 1 percent in 2013 and then increase slightly in subsequent years.

Trends in Dedicated Transit Taxes

Since 1980, New York State has imposed taxes and fees on both a regional and a statewide basis to benefit mass transit. These taxes include sales taxes, the payroll mobility tax, real estate-related taxes, a petroleum business tax and motor vehicle fees. The July Plan assumes that the MTA will receive nearly $5 billion from these sources in 2014, rising to $5.6 billion by 2017 (see Figure 6).

The payroll mobility tax (PMT) is one of the MTA's largest sources of tax revenue. Revenues are projected to rise from $1.5 billion in 2013 to $1.8 billion by 2017. A State appellate court recently overturned a lower court ruling that the PMT was unconstitutional. The plaintiffs, led by Nassau County, have appealed. While the MTA continues to collect revenues from the PMT, it is unable to borrow against these resources to help fund its capital program.

Figure 6
MTA Dedicated Tax Revenues



Sources: Metropolitan Transportation Authority; OSC analysis

Metropolitan Mass Transportation Operating Assistance (MMTOA), which is subject to State appropriation, consists of revenue from a number of taxes imposed within the MTA region.[3] MMTOA revenue peaked at $1.7 billion in 2008, but then declined to $1.3 billion in 2009 and remained at that level through 2012. The MTA expects revenue from this source to grow to $1.5 billion in 2013, an increase of 12 percent, and then reach $1.8 billion by 2017.

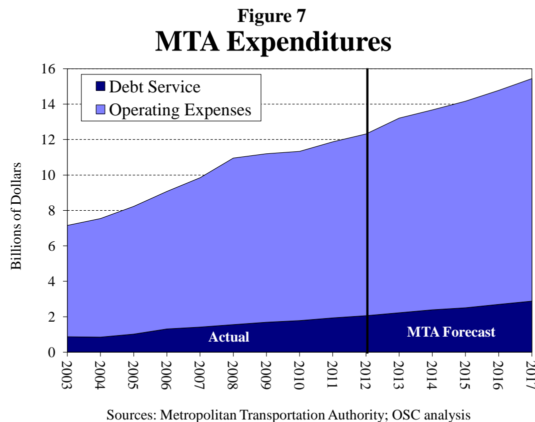
The MTA also receives revenue from taxes on commercial and residential real estate transactions in the MTA region. Revenues from this source peaked at $1.6 billion in 2007, but then fell below $400 million in 2009 as the real estate market collapsed. The MTA expects revenue from real estate transactions to total $852 million in 2013, more than twice the amount collected four years earlier, and then increase by 27 percent over the next four years, to almost $1.1 billion by 2017.

[3] These taxes include sales taxes, corporate franchise taxes on certain transportation and transmission companies, and a small portion of the statewide tax on petroleum businesses.

Expenditure Trends

MTA expenditures grew rapidly during the 2003-2008 period (see Figure 7), but then slowed as a result of budget cuts and a wage freeze. The July Plan assumes spending will grow at an average annual rate of 4 percent through 2017, driven by higher debt service and fringe benefit costs.

Figure 7
MTA Expenditures



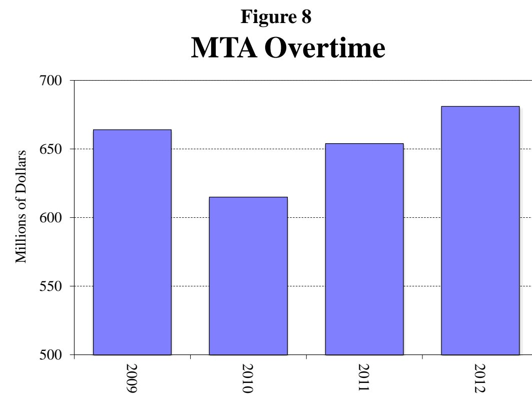
Sources: Metropolitan Transportation Authority; OSC analysis

Salaries and Wages: Salaries and wages account for 37 percent of the MTA's budget. All of the MTA's labor agreements with its unionized employees have expired, some as long as four years ago. The labor contract between the MTA and the Transport Workers Union (TWU), which represents about half of the MTA's workforce, expired in January 2012.

The MTA has imposed a four-year wage freeze for all management employees, and assumes three years of net-zero wage growth for unionized workers. (To achieve this objective, the MTA assumes that any wage increases would be funded through productivity improvements or other concessions.) While the MTA has set aside resources to fund wage increases at the inflation rate after the end of the three-year period, it has not set aside funds for retroactive wage increases.

Overtime: In 2009, overtime hit an all-time high of $664 million. In 2010, the MTA began a concerted effort to reduce overtime. While those efforts reduced costs by $49 million in 2010 (see Figure 8), since then the MTA has experienced setbacks as overtime has exceeded initial forecasts. While bad weather has been a factor, it accounts for only a portion of the variance. For example, overtime reached a new record of $681 million in 2012, which was $128 million more than anticipated in that year's adopted budget, but just $42 million of the variance was attributable to weather-related events (including Superstorm Sandy). Overtime was $70 million more than budgeted during the first half of 2013 and could exceed last year's record level.

Figure 8
MTA Overtime



Sources: Metropolitan Transportation Authority; OSC analysis

Health and Welfare: These costs cover active employee health insurance and other benefits, such as dental and vision coverage, and disability and life insurance. Though health insurance premiums are projected to grow more slowly than previously forecast, these costs are still projected to grow by 41 percent during the financial plan period, reaching $1.3 billion by 2017.

Pension Contributions: The July Plan assumes that pension contributions, after growing relatively rapidly for more than a decade, will rise by 1.1 percent annually during the financial plan period, reflecting changes implemented by the City Actuary in the assumptions and methodologies used to calculate contributions to the New York City Employees' Retirement System. These changes include using a new methodology for calculating employer contributions, lowering the investment earnings assumption from 8 percent to 7 percent, updating demographic trends, and stretching out the amortization period for unfunded liabilities. The July Plan, however, does not reflect last year's investment performance, which was better than expected. As a result, future contributions could be lower by about $20 million beginning in 2015.

OPEBs: The MTA funds other post-employment benefits (OPEBs), such as retiree health insurance costs, on a pay-as-you-go (PAYGO) basis. Such costs are projected to rise from $464 million in 2013 to $664 million in 2017, an increase of 43 percent due to higher health premiums. The

actuarial cost of accrued liabilities for OPEBs was estimated at $17.8 billion in 2011. If funded on an actuarial basis, the required OPEB contribution would have totaled $2.4 billion in 2011.

Energy: While energy costs have been lower than budgeted in 2012 and 2013 as a result of lower fuel and electricity prices, these costs are projected to rise from $724 million in 2012 to $913 million in 2017, an increase of 26 percent, mostly as a result of projected increases in electricity rates.

Paratransit Services: Since 2010, the MTA has taken steps to slow the growth of the paratransit program, which provides services to the disabled. The MTA is expanding the use of less expensive taxis and livery cars, has tightened eligibility standards, and will offer free MetroCards to encourage program participants to use subways and buses instead of more costly paratransit services. Although the cost of the program is still projected to rise by 41 percent to $695 million by 2017, this forecast is half of the amount projected in November 2009.

Insurance: The majority of the MTA's insurance coverage is provided by its self-insured insurance subsidiary, the First Mutual Transportation Assurance Company (FMTAC). The MTA agencies pay premiums to FMTAC (for its coverage and reinsurance in the commercial marketplace) as well as to commercial insurers for costs that FMTAC does not cover.

In the aftermath of Superstorm Sandy, the MTA is paying higher commercial insurance premiums for less coverage. While the MTA obtained $500 million in property coverage, that is $300 million less than under the prior policy. Premiums are expected to grow from $8 million in 2012 to $33 million in 2013, rising to $105 million in 2017, reflecting unfavorable insurance market conditions.

In July 2013, the MTA obtained $200 million in additional insurance to protect against storm surge damage through an arrangement with a third-party insurer, MetroCat Re. MetroCat Re sold notes to investors willing to assume the risk of traditional insurers. The insurance premiums paid by the MTA to MetroCat Re will fund the debt service on the notes. The arrangement is the first of its kind specifically to protect against storm surges.

Financing the Capital Program

The transportation system operated by the MTA has improved significantly since 1982 (when the system was on the verge of collapse) as the result of a capital investment of nearly $90 billion through 2012. Despite this progress, many parts of the system are still in need of repair and modernization.

In July 2011, the MTA faced a $9.9 billion funding gap in the last three years of its $26.3 billion capital program for 2010-2014. With few funding options available, the MTA released a preliminary financing strategy that called for record borrowing and $2 billion in savings from efficiencies.

With less than 18 months remaining in the 2010-2014 capital program, the MTA reports that efficiencies have saved $825 million. According to the MTA, the savings have come from lower-than-expected bids, revised project cost estimates and updated project scopes. The MTA has indicated, however, that it will not meet its $2 billion savings target from efficiencies alone, and intends to defer some capital projects to the next capital program. The Office of the State Comptroller (OSC) estimates that the total value of deferred projects could exceed $700 million.

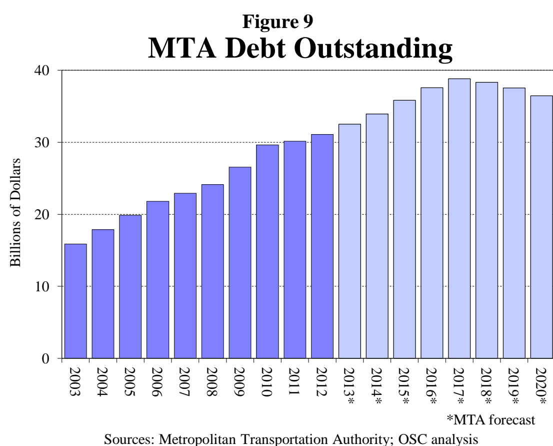
The financing strategy for the 2010-2014 capital program also calls for the MTA to borrow $14.8 billion, which is the largest borrowing program in MTA history. As a result, borrowing accounts for 60 percent of the total resources needed to fund the program, which is twice the share that borrowing accounted for during the first ten years of the MTA's capital program.

The MTA plans to issue $12.6 billion of its own debt, and is seeking approval from the federal government for a $2.2 billion low-interest loan under the Railroad Rehabilitation and Improvement Financing (RRIF) program to complete the East Side Access project. (The MTA has also applied for RRIF funding to refinance $800 million in outstanding debt.) The application is still under review by an independent financial advisor, but if it is approved the MTA would realize significant debt service savings, which it intends to use to fund its next capital program.

Based on the MTA's latest estimates, outstanding debt is expected to rise from more than $32 billion at the end of 2013 to nearly $39 billion by 2017, an increase of 19 percent even as $4.2 billion in existing debt is retired (see Figure 9). Such a heavy reliance on debt would burden the operating budget, just as heavy borrowing in the past has contributed to the MTA's current problems. While the amount of outstanding debt is expected to decline in subsequent years, the MTA's estimates do not reflect potential borrowing associated with the next capital program, which is scheduled to begin in 2015.

Figure 9

MTA Debt Outstanding



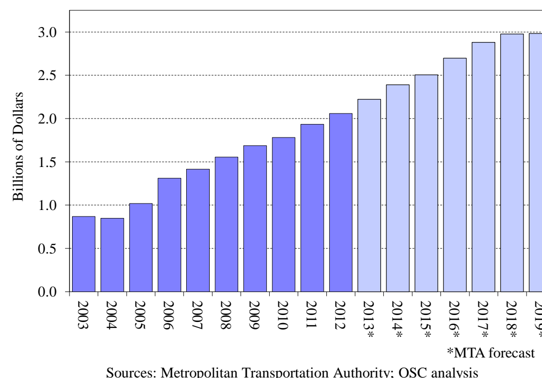
Sources: Metropolitan Transportation Authority; OSC analysis

Debt service, which is driven by the amount of debt issued to fund the capital program, is expected to grow during the financial plan period and level off at $3 billion by 2018, 45 percent higher than in 2012 and nearly double the amount from ten years earlier (see Figure 10). Without fare and toll increases, debt service as a percentage of total revenue could rise from 16.2 percent in 2013 to nearly 20 percent in 2018. (Even with biennial fare and toll increases at the projected inflation rate, the burden could reach 19 percent by 2018.) These estimates also exclude the potential impact of the next capital program.

In an effort to reduce the impact of borrowing on the operating budget, the MTA has been taking steps to partly fund its capital needs with non-bond proceeds. The MTA had initially dedicated $2.3 billion from the payroll mobility tax to the 2010-2014 capital program for PAYGO financing, but, when other sources of capital funding did not materialize, the MTA redirected most of those resources to fund debt service on additional borrowing.

Figure 10

MTA Debt Service

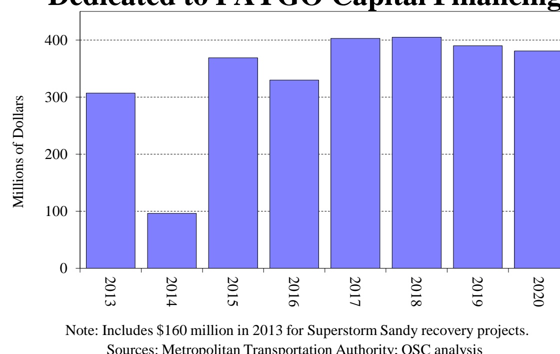


Sources: Metropolitan Transportation Authority; OSC analysis

In recent years, the MTA has been setting aside savings from debt refinancings and low interest rates to help fund the capital program. In total, the MTA plans to set aside $2.7 billion to finance capital projects on a PAYGO basis through 2020 (see Figure 11). Of this amount, $666 million would be devoted to the 2010-2014 capital program and $2 billion to the 2015-2019 capital program.

Figure 11

Operating Budget Resources Dedicated to PAYGO Capital Financing



Note: Includes $160 million in 2013 for Superstorm Sandy recovery projects.
Sources: Metropolitan Transportation Authority; OSC analysis

The MTA estimates that it will need to invest $26.6 billion during the 2015-2019 period just to fund its core capital needs (i.e., maintenance and modernization). Additional resources would be needed to complete the East Side Access project, and to begin the next phase of the Second Avenue Subway and other expansion projects.

Maintaining and modernizing the regional mass transit system is critically important, but funding the next MTA capital program will be difficult. Although the federal government is expected to fund about one-third of the core program in the current five-year capital program, federal budget

authorization for transportation expires in September 2014, and concerns over the size of the federal deficit are likely to result in lower levels of federal support in the future.

In addition, the PAYGO resources set aside by the MTA for the 2015-2019 capital program would fund only 7.5 percent ($2 billion) of the MTA's estimated capital needs. Even if the MTA redirected these resources to fund debt service on additional borrowing, as it did for the 2010-2014 capital program, it would still fund only a small portion of its capital needs ($4.5 billion). As a result, the MTA can be expected to look to the State and the City for additional sources of capital funding, either direct capital grants or new revenues against which the MTA could borrow.

Superstorm Sandy

Superstorm Sandy disrupted operations and caused serious damage to the MTA's infrastructure. The MTA estimates that the storm caused $5.1 billion in losses, including $4.8 billion in damages to its infrastructure and $350 million in operating losses related to emergency expenses and lost revenue. It is expected that federal funding and insurance proceeds will offset all but $500 million of the losses.

The MTA also plans to spend $5.8 billion on mitigation projects to help protect its assets against future storms. The federal relief act for Sandy, however, appropriated $5.4 billion for mitigation projects in all affected states, and in the wake of federal sequestration the amount was effectively reduced to less than $5 billion. The MTA will have to compete for these funds with other transit agencies affected by Superstorm Sandy.

Reserves and Other Resources

The July Plan includes a general reserve of $130 million in 2013, which is expected to grow to $155 million by 2017. These resources are available to mitigate any adverse budget developments. The MTA plans to use any unneeded funds in the general reserve to pay down unfunded liabilities, retire outstanding debt, or fund capital projects on a PAYGO basis.

The July Plan also allocates operating resources of about $1 billion annually for purposes other than balancing the budget. While these purposes are fiscally prudent and will help the MTA's long-term financial position, the resources could be redirected by the MTA Board for other purposes.

In the past, the MTA has borrowed funds that were set aside to meet future obligations for other post-employment benefits (OPEBs) and used the funds to help balance the operating budget and meet cash flow needs. The amount in the OPEB reserve is expected to grow from $399 million in 2013 to $882 million by 2017, assuming the borrowed funds are fully repaid.

In past years, the MTA has also borrowed from its capital fund to help meet its cash flow needs. In 2012, the MTA used $100 million in operating resources to increase its cash reserves, and it plans to set aside an additional $100 million each year between 2013 and 2016 for this purpose. As discussed earlier in this report, the MTA also plans to use $2.7 billion in operating resources through 2020 to fund capital projects on a PAYGO basis.

Risk Assessment

The greatest risk to the MTA's operating budget is the pace of the economic recovery. Any setbacks would affect not only the MTA, but also other levels of government upon which the MTA is dependent.

In addition, all of the contracts with the MTA's unionized workers have expired. The contract with the TWU, which represents more than half of the MTA workforce, expired in January 2012. The July Plan anticipates annual savings of about $300 million from a no-net-cost wage agreement covering three years for unionized employees, followed by wage increases at the inflation rate. The agreement between the MTA and the TWU is subject to binding arbitration, though neither side has publicly indicated any intent to take that route.

Legal challenges to the payroll mobility tax, which is one of the MTA's largest sources of tax revenue, are also still ongoing. A State appellate court recently overturned a lower court ruling that the PMT was unconstitutional, but the plaintiffs have appealed.

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