Financial Outlook for the Metropolitan Transportation Authority

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Report 10-2015 **October 2014**

Highlights

- **The MTA is making progress toward its goal of generating recurring savings of $1.5 billion by 2017. It currently projects balanced operating budgets for 2014 through 2017, and a manageable budget gap of $262 million in 2018.**
- **Ridership on the New York City subway system is the highest since 1949. Metro-North ridership has doubled over the past 30 years, and could exceed LIRR ridership by 2018.**
- **Fares and tolls are expected to rise by 4 percent in 2015 and again in 2017 (nearly half the rate originally planned but still faster than inflation).**
- **New labor agreements will cost $1.5 billion more than originally budgeted by the MTA.**
- **In 2014, overtime costs are expected to set a new record of $801 million, $186 million (30 percent) more than four years earlier.**
- **The MTA's potential liability from claims for personal injury and property damage has nearly doubled over the past eight years, growing from $1.2 billion to $2.3 billion.**
- **Unfunded liabilities for postemployment benefits other than pensions were $19.9 billion as of 2012.**
- **The amount of debt outstanding for the current and prior capital programs will reach $39 billion by 2018, more than twice the 2003 level.**
- **Debt service and other operating budget resources that support the capital program will reach $3.3 billion by 2018 (nearly four times higher than the 2003 level).**
- **The MTA's $32.1 billion capital program for 2015-2019 has a funding gap of $15.2 billion (nearly half the program's value), even after factoring in the MTA's contribution of $8.5 billion.**
- **Closing the capital program's funding gap through borrowing would put added pressure on fares and tolls. Each $1 billion borrowed would increase debt service by an amount comparable to a 1 percent increase in fares and tolls.**

On July 28, 2014, the Metropolitan Transportation Authority (MTA) released a preliminary budget for 2015 and an associated financial plan (the "July Plan"). The July Plan, which covers 2014 through 2018, shows that the MTA's short-term financial outlook continues to improve with the economy.

A number of factors have led to the improved outlook. Tax revenues and subway ridership have recovered from the recession faster than the MTA had anticipated, while the costs of fringe benefits, debt service and energy have grown more slowly. Despite the improvement, challenges remain.

After protracted negotiations, the MTA is concluding the current round of collective bargaining, which is expected to cost $1.5 billion more than budgeted. The MTA covered the cost with some of the resources that it had planned to use to pay down long-term liabilities and fund its capital program. The agreements will begin to expire as soon as 2016, raising the level of uncertainty during the latter part of the financial plan.

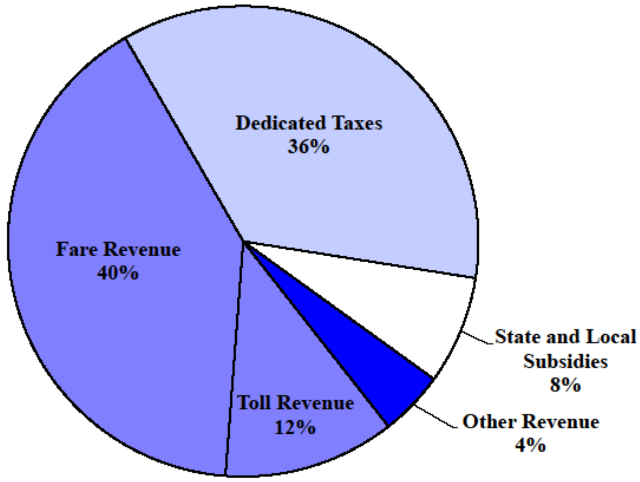
While the budget gaps for 2015 through 2017 have been eliminated, there remains a $262 million gap in 2018. Health insurance, debt service, overtime and liability claims are all growing faster than revenues, and some long-term obligations are not well funded.

The MTA's $32.1 billion capital program for 2015-2019 has a large funding gap ($15.2 billion) and was recently rejected by the State. In the absence of new resources, the MTA could be required to close the funding gap through a combination of program reductions and increased borrowing, which is how it closed most of the gap in the current capital program. Additional borrowing could increase pressure on fares and tolls, and while the MTA should explore opportunities for savings, deep cuts could affect the future reliability of the transit system and jeopardize expansion projects.

The MTA has made progress in closing the gaps in its operating budget, reached new labor agreements without raising fares and tolls any faster than already planned, and funded new services. Nevertheless, the MTA still faces challenges, perhaps none greater than adequately funding the next capital program without putting the financial burden on riders.

Figure 1

MTA Sources of Revenue in 2015



Sources: Metropolitan Transportation Authority; OSC analysis

A. Revenue Trends

The MTA receives revenue from a variety of sources, including fares and tolls, dedicated taxes, and other sources including advertising, rentals and concessions. The July Plan assumes that revenues will grow at an annual rate of 2.6 percent (less than half the rate during the four prior years), increasing from $14.2 billion in 2014 to $15.8 billion in 2018. Growth reflects expected increases in tax collections, as well as two scheduled fare and toll hikes coupled with ridership increases. State and local subsidies to the MTA, however, are projected to increase by less than 1 percent annually during the financial plan period.

1. Fares and Tolls

More than half (52 percent in 2015) of the MTA's revenue comes from fares and tolls (see Figure 1). The MTA raised fares and tolls by 29 percent between 2007 and 2013, more than twice the rate of inflation during that period.

Fares and tolls are expected to rise by 4 percent in 2015 and by another 4 percent in 2017, which is faster than the cumulative inflation rate projected for the metropolitan region during this period (6.4 percent). Fare and toll revenue is expected to reach $7.6 billion in 2015, including $235 million from the increase scheduled for March 2015.

In 2013, subway ridership reached 1.7 billion, the highest level since 1949. The July Plan assumes that subway ridership will increase by more than 100 million riders by the end of 2018.

The recession took a heavy toll on the ridership of the MTA's commuter railroads. After setting a record in 2008, ridership on the Long Island Rail Road (LIRR) declined by 6.3 million riders (7.2 percent) through 2011. Although ridership has been growing slowly since then, the July Plan does not expect LIRR ridership to return to its prerecession peak until after 2018. In contrast, Metro-North Railroad did not experience a decline as sharp as the LIRR, and its ridership has been growing steadily in recent years. Metro-North ridership reached a new record in 2013 (81.8 million riders) and will set another record in 2014. Over the past 30 years Metro-North ridership has more than doubled, and according to MTA forecasts, it could exceed LIRR ridership by 2018.

Ridership on buses operated by the MTA (both New York City Transit and formerly private bus companies) declined by 7.5 percent between 2008 and 2013, in large part because the MTA shortened or eliminated a number of bus lines to help balance the budget during the recession. The MTA has since expanded services, and the July Plan assumes that bus ridership will grow each year, but will still be lower in 2018 than at its peak ten years earlier.

Bridge and tunnel crossings fell by 20 million vehicles (6.5 percent) between 2007 and 2013, largely as a result of the recession, higher gas prices and four toll increases. Crossings are expected to increase at an average annual rate of only 0.5 percent during the financial plan period to reach 288 million in 2018, which is 5 percent lower than the peak in 2007. These projections mirror a national trend of modest growth in traffic volume.

2. Dedicated Transit Taxes

Regional and statewide taxes and fees dedicated to mass transit account for about one-third (36 percent in 2015) of the MTA's revenue. These taxes include sales taxes, the payroll mobility tax (PMT), real estate–related taxes and a petroleum business tax. The July Plan assumes that tax revenues will grow from $5.1 billion in 2014 to $5.8 billion in 2018 (an average annual growth rate of 3.1 percent).

The PMT, established in 2009, is one of the MTA's largest sources of tax revenue. Revenues from this tax are expected to rise from $1.6 billion in 2014 to $1.8 billion by 2018 (an average annual growth rate of 3.6 percent). With all court challenges to the PMT resolved in its favor, the MTA now plans to issue debt backed by PMT revenue.

Revenue from taxes on commercial and residential real estate transactions in the MTA's 12-county region peaked at $1.6 billion in 2007, but then fell below $400 million in 2009 as the real estate market collapsed. Although revenue from real estate transactions has been improving (mostly due to the strong commercial market in Manhattan) and is projected to reach $1.2 billion by 2018, it will still be well below the peak level.

Metropolitan Mass Transportation Operating Assistance (MMTOA) comprises several taxes and is subject to State appropriation.[1] MMTOA revenue peaked at $1.7 billion in 2008, but declined to $1.3 billion in 2009 as a result of the recession. The July Plan assumes that collections will exceed the prerecession peak in 2017.

For the past two years, the State has diverted $50 million in MMTOA tax collections from the MTA. The State plans to divert a total of $390 million through 2031 to pay debt service on bonds that the State issued to fund MTA capital projects. These costs were previously funded by the State's general fund.

B. Expenditure Trends

MTA expenditures grew rapidly during 2003 through 2008 (see Figure 2), driven by rising debt service and higher costs for fringe benefits (e.g., health insurance and pensions), but then slowed in 2009 and 2010 as the MTA froze wages and imposed budget cuts to offset revenue losses from the recession. More rapid expenditure growth resumed in 2011 as a result of higher costs for health insurance, debt service and energy. The July Plan assumes that continued growth in these three areas will drive spending from $13.9 billion in 2014 to $15.8 billion in 2018 (an annual average growth rate of 3.3 percent).

1. Personal Service Costs

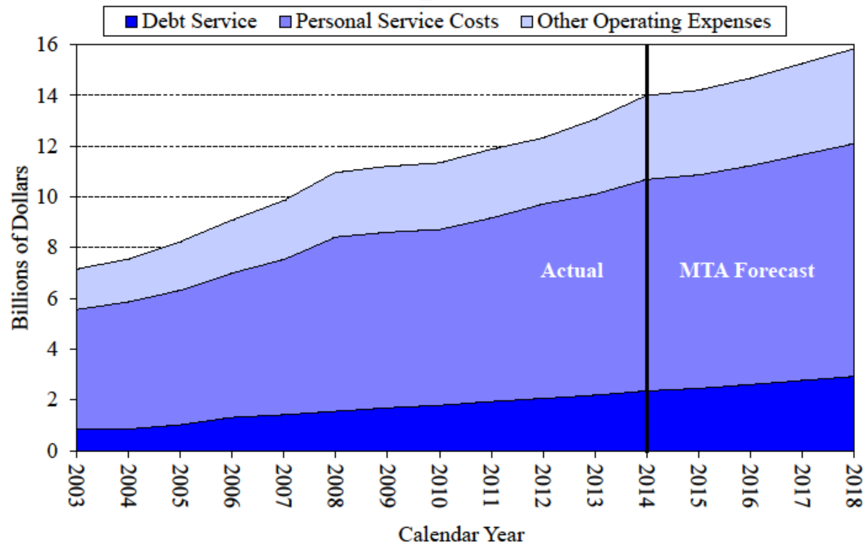
Personal service costs (e.g., salaries and wages, plus fringe benefits) account for 60 percent of non-reimbursable expenses. These costs are projected to grow from $8.3 billion in 2014 to $9.2 billion by 2018, a slower annual rate of growth (2.4 percent) than in recent years because pension contributions are projected to remain level.

The MTA has hired 2,456 employees over the past three years, and plans to hire another 1,564 by the end of 2015. These additions will increase the workforce to 68,543 employees, just short of the peak level in 2008. Two-thirds of the planned hires will be maintenance and operations personnel.

Collective Bargaining: In May 2014, after protracted negotiations, the MTA and the Transport Workers Union (TWU), which represents about half of the MTA's work force, reached agreement on a new contract. The MTA's financial plan had assumed three years of net-zero wage growth (i.e., any wage increases would be offset by savings), followed by annual increases at the projected inflation rate. The TWU, in comparison, sought higher wage increases without concessions.

The new TWU contract calls for wage increases of 8 percent over five years, as well as improved optical and dental benefits, and new maternity and paternity leave benefits. The cost of these provisions will be partly offset by requiring new employees to work longer to reach the top salary in their job titles, and by increasing employee contributions to health insurance from 1.5 percent to 2 percent of salary.

Figure 2
MTA Expenditures



Sources: Metropolitan Transportation Authority; OSC analysis

After two unsuccessful attempts at federal mediation over the past year, the MTA reached new agreements with a coalition of unions that represent most of the LIRR's workforce. As was the case with the TWU, the MTA's financial plan assumed three years of net-zero wage growth followed by annual increases at the projected inflation rate. Under the new agreement, LIRR workers will receive wage increases totaling 17 percent over six and a half years.

The cost of these wage increases will be partly offset by requiring new LIRR employees to work longer to reach the top salary in their job titles, and by increasing employee contributions for health insurance and pensions. Workers will continue to contribute between 3 percent and 4 percent of their salaries toward their pensions, but new employees will be required to contribute for 15 years (instead of 10 years for current employees). For the first time, LIRR employees will be required to contribute toward the cost of their health insurance, paying 2 percent of their annual salaries.

The MTA estimates that these labor agreements and the pattern they set for the other unions will cost $1.5 billion more than originally budgeted for 2014 through 2018. Rather than offsetting any of these unplanned costs with savings from new efficiencies, the MTA intends to reallocate $1.2 billion that had been set aside to reduce long-term liabilities and to help fund the capital program.

The sources of the $1.2 billion are listed below.

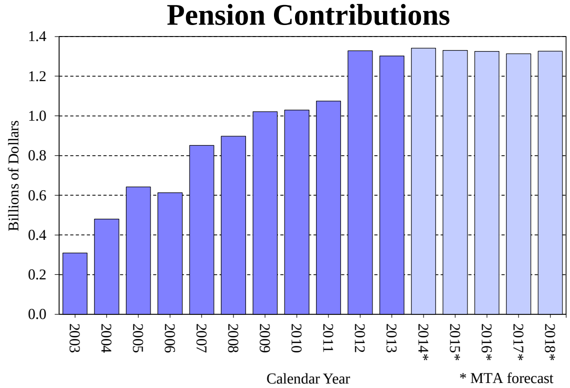
- The MTA reallocated $786 million that it had set aside to reduce its unfunded liability for postemployment benefits other than pensions.[2] This includes $254 million from a reserve that was established to reduce unfunded liability and $532 million from suspending future contributions to the reserve. This is the first time that the MTA has withdrawn funds from this reserve without making plans to reimburse it.
- The MTA redirected $100 million (over four years) that it had earmarked to make supplemental contributions to the LIRR pension system to reduce its $1.3 billion unfunded liability.[3] Only 24 percent of the liabilities of the LIRR pension plan are currently funded because the plan had been funded on a pay-as-you-go (PAYGO) basis for many years.
- The MTA redirected $320 million (over four years) in operating budget resources that it had previously earmarked to help fund the 2015-2019 capital program, leaving $290 million annually beginning in 2015.

The remaining $313 million in unplanned labor costs was funded from unanticipated resources, including higher-than-expected tax revenues and slower-than-planned growth in debt service and fringe benefits.

Pension Contributions: The July Plan assumes that pension contributions (after growing relatively rapidly for more than a decade) will remain level during the financial plan period at about $1.3 billion (see Figure 3). This is the result of better-than-expected returns on investments in recent years, as well as changes in methodologies and assumptions adopted by the New York City Employees' Retirement System (NYCERS).[4] In addition, employees hired after April 1, 2012, at Bridges and Tunnels, MTA Headquarters and New York City Transit (NYCT) are members of a less costly pension plan.

Figure 3

Pension Contributions



Sources: Metropolitan Transportation Authority; OSC analysis

Health and Welfare: The cost of providing health insurance and welfare benefits (e.g., dental benefits) for both active employees and retirees has been growing rapidly. The July Plan assumes that these costs will total $1.5 billion in 2014 and then grow by 34 percent to nearly $2 billion in 2018.

Health and welfare costs for active employees will rise from $995 million in 2014 to $1.3 billion in 2018. These estimates reflect the impact of recent labor agreements that require higher employee contributions, which reduced the MTA's costs by about $100 million annually.

Most public sector entities fund postemployment benefits other than pensions on a pay-as-you-go basis. The MTA estimates that these payments will grow by 38 percent to $644 million between 2014 and 2018. The amount paid by the MTA represents less than one-quarter of the contribution that would be required if these costs were funded on an actuarial basis.[5] As a result, costs are deferred to future years. The MTA estimates that the unfunded liability for retiree benefits grew by 49 percent to $19.9 billion between 2007 and 2012 (the most recent year for which data are available).

Overtime: A series of audits by the Office of the State Comptroller (OSC) found a culture of acceptance regarding excessive overtime at the MTA. In 2010, the MTA made a concerted effort to reduce overtime after setting a record of $664 million in the prior year. Although those efforts reduced overtime to $615 million in 2010, overtime has risen every year since, and the MTA estimates that overtime will set a new record of $801 million in 2014. This would represent an increase of $186 million (30 percent) in four years.

The MTA cites weather (such as Superstorm Sandy in 2012 and heavy snow in 2013 and 2014) and employee availability as two factors that contribute most to unplanned overtime. The July Plan assumes a 10 percent reduction in overtime in 2015.

Figure 4 shows that most of the growth in overtime has been concentrated in NYCT, but it has also grown at the LIRR, Metro-North and MTA Headquarters where the MTA Police are based. Between 2010 and 2014, overtime will have increased by $111 million (30 percent) at NYCT; $41 million (44 percent) at the LIRR; $31 million (44 percent) at Metro-North; and by nearly double at MTA Headquarters.

Figure 4

Overtime

(in millions)

	2010	**2011**	**2012**	**2013**	**2014***
NYCT	$365.0	$388.9	$420.6	$493.5	$475.7
LIRR	92.9	97.3	103.5	111.3	133.6
Metro-North	70.5	78.6	73.2	84.6	101.6
MTA Bus	48.1	45.5	48.0	49.1	50.1
B&T	18.8	18.8	20.9	19.2	23.3
LI Bus	11.4	10.0	- - -	- - -	- - -
MTA HQ	7.0	14.2	12.8	19.2	13.4
SIRTOA	1.2	1.4	1.9	2.9	3.0
Total	**$615.0**	**$654.6**	**$680.9**	**$779.8**	**$800.6**

*MTA forecast

Note: B&T=Bridges and Tunnels; SIRTOA=Staten Island Railway. Beginning in 2012, a private entity took over operations of LI Bus.

Sources: Metropolitan Transportation Authority; OSC analysis

2. Energy

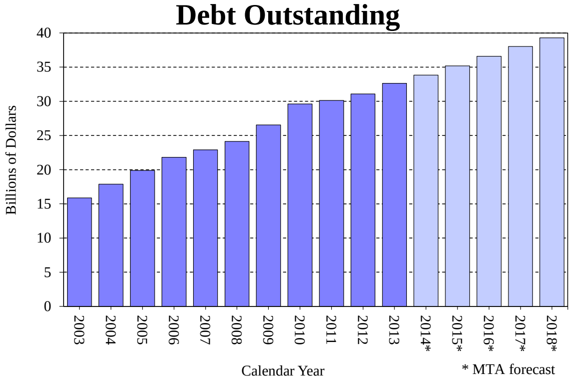
The July Plan assumes that energy costs will grow more slowly than previously projected because fuel prices and electricity rates have not grown as quickly as had been anticipated. Nevertheless, energy costs are expected to grow from $819 million in 2014 to $924 million in 2018.

3. Debt Service

The MTA has relied heavily on debt to finance capital improvements because the level of resources provided by its funding partners fell short of its needs. As a result, the amount of MTA debt outstanding is expected to exceed $39 billion by 2018, more than twice the 2003 level. This estimate, moreover, excludes any new borrowing in support of the 2015-2019 capital program (see Figure 5).

Figure 5

Debt Outstanding



Sources: Metropolitan Transportation Authority; OSC analysis

On September 24, 2014, the MTA proposed a nearly $32.1 billion capital program for 2015-2019. Of this amount, $23.5 billion (nearly three-quarters) would be allocated to maintain and modernize the existing subway, bus and commuter rail systems. Another $3.1 billion would be allocated to maintain the bridges and vehicular tunnels operated by the MTA. System expansion projects would be allocated $5.5 billion, including $2.8 billion to complete East Side Access, $1.5 billion to begin Phase 2 of the Second Avenue Subway, and $743 million for Metro-North Penn Station Access.

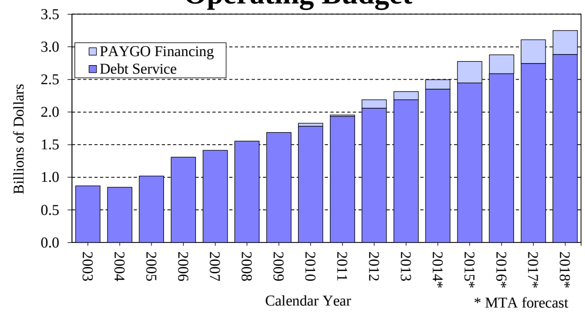
So far the MTA has identified potential sources of funding of $16.9 billion, leaving a funding gap of $15.2 billion (nearly half of the program's value). The largest source of outside funding is expected to come from the federal government ($6.8 billion), but federal authorization is scheduled to expire in May 2015 and will need to be renewed.

The MTA anticipates a 25 percent increase in the contribution from New York City, but no funding from New York State has been currently identified. The MTA would contribute $8.5 billion, mostly by issuing additional debt ($6.2 billion) and providing PAYGO financing ($1.7 billion).

The current capital program also had a large initial funding gap, which was mostly closed by reducing the size of the program and increasing borrowing, which slowed capital improvements and increased pressure on the operating budget.[6] Borrowing for the 2010-2014 capital program is projected to reach a record $14.8 billion (not including costs related to Superstorm Sandy), which represents 61 percent of the program's value. As a result, debt service and other operating budget resources devoted to the capital program will reach $3.3 billion in 2018, nearly four times the 2003 level (see Figure 6).

Figure 6

Impact of the Capital Program on the Operating Budget



Note: Does not include costs related to Superstorm Sandy.
Sources: Metropolitan Transportation Authority; OSC analysis

New York's Capital Program Review Board recently rejected the 2015-2019 capital program. The MTA will have to work closely with its funding partners to ensure that its capital needs are adequately funded without putting the financial burden on riders. In the absence of new resources, the MTA may close the $15.2 billion funding gap through a combination of program reductions and increased borrowing, which is how it closed most of the gap for the current capital program.[7] OSC estimates that each $1 billion borrowed would increase debt service by about $70 million annually, which is comparable to a 1 percent increase in fares and tolls.

4. New Initiatives

In December 2013, a Metro-North train derailed just north of the Spuyten Duyvil station in the Bronx. Excessive speed around a tight curve was the primary cause of the accident, which resulted in the death of four passengers and the injury of dozens more. In response to this event and other incidents on the subways and commuter railroads, the MTA plans to implement an agency-wide safety program with a cost of $365 million over five years.

The MTA safety program includes customer and employee safety initiatives (such as cameras both inside and outside commuter train engineer cabins), and more frequent track inspections and repairs. In addition, the MTA is moving forward with the installation of positive train control (PTC), an initiative designed to prevent train-to-train collisions and derailments by guiding train movements. The MTA plans to invest $914 million in capital funds to install PTC on all Metro-North and LIRR trains by December 2018, three years later than the deadline set by Congress in 2008.

The July Plan also allocates funds to increase maintenance on existing LIRR railcars because of delays in the delivery of new railcars. In addition, there are plans for increased maintenance on aging buses and, in an effort to reduce overtime, the hiring of additional station cleaners.

As the MTA's financial outlook has improved, the MTA has restored many of the services that were cut during the recession and has added new services. The July Plan allocates another $20 million annually for this purpose. For example, NYCT has proposed increasing and restoring service on a number of bus routes throughout the City and on the J subway line. The LIRR has also proposed extending and restoring service on a number of different rail lines.

5. Judgments and Claims

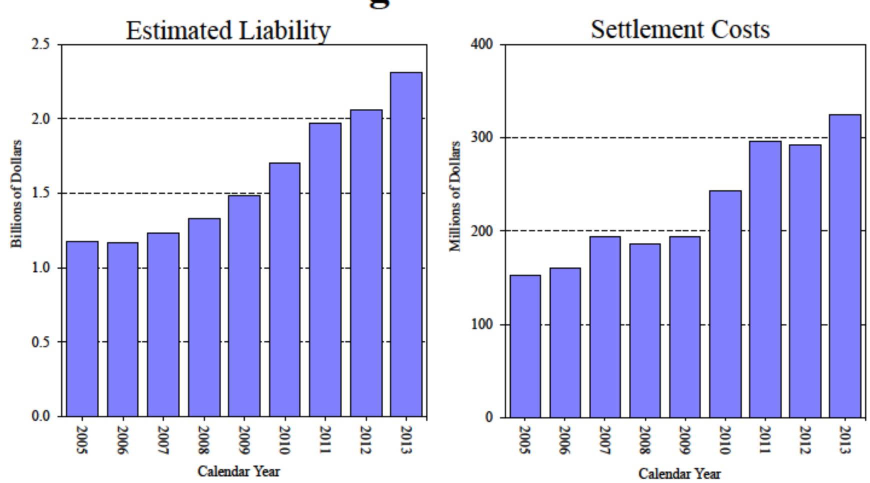
Each year the MTA estimates its potential liability for claims arising from injuries to customers and employees, and from property damage. As shown in Figure 7, estimated liability has nearly doubled from 2005 to 2013, growing from $1.2 billion to $2.3 billion. According to the MTA, the growth is driven by workers' compensation payments to its employees, which reflects increases in the maximum benefit. Other factors include an increase in the cost of claims filed by the public, and the takeover of certain private bus companies in 2006.

Liabilities impact the operating budget when claims are settled and paid. The cost to settle claims has more than doubled from 2005 to 2013, growing from $153 million to $325 million (see Figure 7). More than three-quarters of the increase has occurred since 2009. These costs are likely to continue to grow (at least in the short term) as a result of the increase in estimated liabilities in recent years.

6. Reserves and Other Resources

The July Plan includes a general reserve of $135 million in 2014, which increases by $5 million each year to $155 million in 2018. These resources are available to mitigate adverse budget developments, but any unneeded funds would be used to pay down unfunded liabilities, retire debt or fund capital projects on a PAYGO basis.

Figure 7
MTA Judgments & Claims



Sources: Metropolitan Transportation Authority; OSC analysis

C. Status of Cost-Reduction Program

In 2009 and 2010, at the height of its fiscal crisis, the MTA proposed the largest cost-reduction program in its history. By July 2013, it had set a goal of generating $1.3 billion in recurring savings by 2017. In November 2013, following a report by the Comptroller that encouraged the MTA to raise its target, the MTA increased its goal to $1.5 billion.[8] These additional savings, combined with previously unanticipated resources, permitted the MTA to reduce planned fare and toll increases from 7.5 percent to 4 percent in 2015 and 2017, and to increase contributions to its capital program. The MTA is making progress toward its goal, although the source of the remaining $137 million in recurring savings has not yet been identified.

D. Risk Assessment

The MTA's operating budget is subject to a variety of risks. For example, MTA revenues are very sensitive to changes in the economy, as evidenced by the sharp falloff in tax revenues and in fare and toll revenues during the recent recession. While the MTA budget has mostly recovered from the impact of the recession, the national recovery has already lasted longer than the average length of all post–World War II recoveries. Thus, the possibility of an economic setback increases with each year.

In addition, after protracted and sometimes difficult negotiations, the MTA is concluding the current round of collective bargaining, resulting in agreements that are expected to cost $1.5 billion more during the financial plan period than budgeted by the MTA. Since these agreements begin to expire in 2016, the MTA will have to reach new agreements that cover the balance of the financial plan period.[9] The July Plan includes funding to increase wages by 2 percent in those years, but the actual cost will be determined through negotiations.

Despite these risks, there is also the potential for unanticipated resources. For example, debt service could be lower because interest rates may not increase as fast as anticipated by the MTA. The Federal Reserve is committed to keeping interest rates low until there is further improvement in labor market conditions consistent with stable inflation. In recent years, the MTA has realized substantial savings from refinancing outstanding debt at lower interest rates and from lower-than-anticipated interest rates for new issuances.

Real estate transaction tax collections could be higher by $50 million in 2014 and by $75 million in 2015, based on current levels of activity in the commercial real estate market in New York City.

Pension contributions for MTA employees who are members of NYCERS could be lower by as much as $75 million by 2018 as the benefit of higher-than-expected investment earnings are phased in. NYCERS earned 14.4 percent on its investments (twice the expected return) during the fiscal year that ended June 30, 2014.

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

2 In 2008, the MTA established a trust to help fund the future liability of postemployment benefits other than pensions, such as health insurance for retirees. Until 2012, when the MTA contributed $300 million, the trust itself was unfunded. Instead of funding the trust directly, the MTA held contributions in a reserve before shifting them to the trust, thus making those funds available for cash flow needs.

3 In recent years, the MTA has taken steps to reduce unfunded LIRR pension liabilities. Last year, the MTA allocated $130 million from the unused balance of its general reserve and $80 million of unanticipated real estate taxes to make a supplemental contribution to the LIRR pension fund.

4 All employees of Bridges and Tunnels (TBTA) and most employees of New York City Transit (NYCT) are members of NYCERS.

5 If funded on an actuarial basis, the required contribution for postemployment benefits other than pensions would have totaled $2.8 billion in 2013.

6 The current capital program also benefited from a $770 million contribution from New York State, a $295 million federal grant and an additional $250 million from New York City generated from the sale of real estate assets.

7 Closing the funding gap exclusively through borrowing would increase debt service by $1 billion annually.

8 Cost-reduction initiatives in the paratransit program account for 44 percent of the total expected savings.

9 The LIRR labor agreements expire on December 16, 2016, while the TWU labor agreement expires on January 15, 2017.

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