

Memorandum




Metropolitan Transportation Authority

State of New York

Date July 25, 2007

To Chairman Peter S. Kalikow and MTA Board Members

From Elliot G. Sander 

Re Preliminary 2008 Budget and July Financial Plan for 2008-2011

As the Executive Director and Chief Executive Officer of the MTA, I am indeed pleased to present to you for your consideration my first proposed Preliminary Budget for 2008 and proposed Four-Year Financial Plan for 2008-2011. These reflect developments that have occurred since the last Plan was issued in February 2007 and the policy and gap closing actions needed to address the MTA's structural and long-term financial challenges. We will continue over the months to come to discuss the MTA's financial outlook and proposed actions in great detail prior to the Board's adoption of the 2008 Budget in December.

In February, as you know, we projected an \$800 million deficit in 2008, growing to \$1.8 billion by 2010. You may recall that the 2008 problem would have approached \$1.1 billion if not for a 2006 surplus, largely a result of real estate tax windfalls that were rolled forward to get us through 2007 and to reduce 2008. The use of these prior year surpluses generated by extraordinary tax collections mask how poorly our annual revenues and subsidies match up against our annual expenses — i.e. they take our attention away from the need to address our structural deficit. If you were to look at the July baseline without the benefit of prior year surpluses, you would see that we have almost a \$1 billion deficit in 2008 growing to over \$2 billion in 2011. Beginning in 2009, even with the Financial Plan's assumption of the City's robust tax projections, the surpluses are expected to be depleted and there is a steep cliff that will need to be addressed that I believe should be dealt with sooner, not later.

This July baseline reflects overall net improvement since February, largely the result, not surprisingly, of real estate revenues that have exceeded our projections. Increased tax revenues will provide an additional \$502 million for 2007 and \$138 million for 2008 above what was projected in the February Financial Plan. Keep in mind, however, that while we have assumed that these receipts will remain robust over the financial plan period, if receipts drop, say to 2004 levels, we will be out over \$300 million next year and nearly \$1.2 billion during the plan period. Also, since the State assumes that the strong economy will continue in the out years, we have adjusted upward our state tax projections for the period 2008-2011 by \$994 million.

Other net improvements since February include fare and toll revenue, which have also benefited from the strong regional economy (up a projected \$53 million in 2007, \$64 million in 2008, \$71 million in 2009 and \$86 million in 2010). Health and welfare costs are projected to increase more slowly due to a lower-than-anticipated Empire Plan rate increase in 2007 and a reduction in inflation forecasts. These projections too are subject to risk if the economy falters.

These positive developments since February are offset to a great extent by increases in costs beyond our control, such as energy and pensions. In fact, over the 2007 to 2011 period, these “uncontrollable” expenses are projected to grow at 7.6% annually. In addition, the July Financial Plan baseline includes a significant increase in resources to address maintenance needs, reflecting MTA’s ongoing commitment to improve the reliability of its fleet and infrastructure. The Plan also demonstrates our uncompromising commitment to meeting continuing needs in the area of safety and security including the LIRR’s gap mitigation program, and MTA PD’s directed patrol initiative. I am proud to note that “controllable” expenses will grow at only 3.1% annually, slightly in excess of the anticipated inflation rate for the period, reflecting these additional resource commitments. MTA will have to maintain this spending discipline in order to avoid posing any additional risk to the Plan.

This July baseline is the strategic starting point for the set of actions proposed in this Financial Plan. These actions fall into 3 categories — Policy Actions, Gap Closing Measures and Cash Management Actions. Collectively, they are intended to address the needs of our customers, make strategic improvements and set us on stable fiscal footing.

Policy Actions describe spending initiatives that address important needs in the areas of service, customer satisfaction, safety and security. The Board is familiar with and has supported most of these items already, including additional service to Staten Island, funding for the Fulton Street Transit Center, the Bus Rapid Transit Initiative and the funding needed to operate and maintain our Integrated Electronic Security System.

There are two additional items that I am particularly proud of and want to draw to your attention. The first is a set-aside of \$30 million in 2008 that will grow to \$60 million a year thereafter to supplement service across the MTA family. These funds are proposed to be expended after holding a competition where we seek the very best ideas from our agency heads. The second initiative will provide a total of \$34.6 million during the remainder of 2007 — \$25.4 million for the bus and subway system, and another \$9.2 million for our railroads — to establish pilot programs that will demonstrably improve and enhance the experience of both our internal and external customers. These pilots will be developed, after consultation with you, and are designed to test programs that will make a meaningful difference for our passengers and employees. My expectation is that these programs will only be continued or expanded if the agency is able to generate the recurring savings required to offset the cost of the new initiatives in 2008 and beyond.

The gap-closing measures that we are asking you to consider over the next several months are more difficult than asking for your support for our proposed new policy initiatives. We have strived to propose an equitable sharing of the burden by all our key stakeholders that use and benefit from our system including our transit riders and Bridge and Tunnel drivers, our agencies, our governmental partners, and our employees.

- **Transit Riders and Bridge and Tunnel Drivers:** The proposal includes a 6.5% increase in yield from fare and tolls in 2008. We have not increased our fares since 2005 and the 6.5% represents an increase designed to keep pace with inflation. The plan also includes fare and toll increases that will be indexed to inflation and implemented every other year thereafter. This approach spares the public from large periodic increases and allows MTA to better plan budget stability. Before proposing this action, we considered a “wait and see” scenario, which proved to have major adverse consequences to the riding public. Assuming that we spend down fully the surplus and implement every cost-reduction initiative possible — including agency efficiencies, the use of additional State tax collections, the assumption of legislative tax code changes, and a contribution from our workforce — we cannot make it through 2009. Implementing a fare and toll increase of about 20% in mid-2009 — which is the same level as 2003 and the largest increase in ten years — would still require service cuts to balance the budget. And it is too soon to count on revenues from congestion pricing, given that the legislation was just agreed upon in Albany, a Commission needs to be formed to look at alternative approaches and, after the Commission acts, the Legislature has to consider its recommendations.
- **MTA Agencies:** The proposal includes annual agency budget reductions of 1.5%. This is a departure from the past where each year we gave agencies varying targets. While this will surely be difficult to meet it will allow agencies the ability to plan ahead for efficiencies. These reductions will not include service cuts. I have heard many times from you and other advocates of mass transit that service cuts are not the answer and they are not being proposed today as any part of the solution.
- **Governmental Partners:** The proposal includes new State revenues. These funds are from State tax re-estimates, pay out of all dedicated fund tax balances, and legislative proposals to tighten up the tax codes. Beginning in 2010 we have identified the need for additional governmental aid that will grow annually with inflation.
- **Employees:** We have assumed that our employees will make a modest contribution to the plan through negotiation of new contracts. In addition, we expect efficiency measures, including shared services, will require downsizing the workforce. This plan, as previous plans, provides funds to cover the expected cost of downsizing, which we now anticipate will be needed in 2009 and 2010.

The remaining category of financial plan actions fall under the heading of cash management. These actions are fiscally prudent measures proposed to make our surplus work harder for us and minimize areas of cost where we are most at risk. In total these measures will save \$55 million. These proposed actions, which we are seeking Board authorization to begin implementing in 2007, fall into 3 areas:

- Retire early approximately \$300 million in bonds that come due in 2009 to reduce debt service costs.
- Enter into pre-purchase agreements for fuel. Given our high dependence on this commodity and the high risk in the area of price volatility, we are proposing to lock in more than 30% of our fuel purchases for 2008 and 2009.
- Prepay \$200 million in pension payments for the MTA Defined Benefit Plan and the MaBSTOA Plan. This approach will enable early investment of the payments yielding a slight cost reduction in 2008.

Based on these three categories — policy actions, gap closing measures and cash management — MTA projects ending 2008 with a \$323 million cash balance and with small, manageable deficits in 2009 and beyond.

Clearly, fiscal challenges confront the MTA in the years to come; however, Board action requiring multi-year financial planning has been a critical asset in helping the Board address these challenges with as much public input and comment as possible. As we move forward toward the looming multi-year billion dollar gaps, the Board's continued fiscal discipline and leadership will be needed to ensure that the MTA operates efficiently, effectively and safely for our customers and workers.

I look forward to public and Board input on this plan over the coming months, culminating with the adoption of the 2008 Budget by the Board in December.