

# **I. Introduction**

# Memorandum



## Metropolitan Transportation Authority

State of New York

Date November 16, 2005

To Chairman Kalikow and MTA Board Members

From Katherine N. Lapp

A handwritten signature in blue ink, appearing to read "KNL", is written over the printed name "Katherine N. Lapp".

Re **MTA 2006 Final Proposed Budget November Financial Plan 2006-2009**

I am transmitting for your consideration the 2006 Final Proposed Budget and the four-year Financial Plan for 2006-2009, which reflects developments that have occurred since issuance of the July Financial Plan, including the passage of the State Bond Act last week which ensures that the 2005-2009 Capital Program is on track.

As described at the July meeting, the MTA's projected 2005 operating budget surplus, which at that time was estimated to be \$833 million, was generated by three major sources:

- The unexpected continuation of the regional real estate boom.
- Debt Service savings related to unprecedented low interest rates for MTA's fixed and variable rate debt.
- New taxes enacted by the State in May and effective in 2005 to support the 2005-2009 Capital Program.

Of the projected \$833 million surplus in July, \$481 million was generated from factors that would be non-recurring in future years; notably the real estate boom and low interest rates. As such, it was recommended that the non-recurring \$481 million be used in a prudent fashion to generate recurring benefits to the MTA and its riders without exacerbating the large budget gaps forecast in the later years of the financial plan. The balance of the surplus, together with other actions, would be used to help balance 2006 and 2007.

The 2005 surplus is now projected to be just over \$1 billion (\$1,044 million), which compares favorably with the July Plan's projected \$833 million – a \$211 million increase. The corresponding baseline changes for 2006 and 2007 also have improved since July by \$158 million and \$145 million, respectively; 2008 and 2009 have worsened by \$34 million and \$63 million, respectively.

\$50 million is recommended to fund a similar initiative in 2006 after an evaluation of the 2005 promotion.

The recent Katrina and Rita hurricanes have substantially affected energy prices. The July Plan had contained significant increases in fuel reflecting market trends occurring in the early part of 2005. The November Plan provides additional funding of \$21 million in 2005, \$49 million in 2006, and roughly \$30 million annually thereafter to offset increases to energy costs. Most of this increase is to provide for the effects of higher fuel costs on our electric power bills, which reflect a pass along of these higher costs. The energy price escalations are also anticipated to negatively affect consumer spending, thus resulting in a reduction in sales tax revenues. The extensive property damage caused by these hurricanes has also had a negative affect on insurance premiums. This proposed budget adds \$8 million in 2006 to maintain adequate insurance coverage throughout the MTA. Also, heightened terrorism alerts have increased overtime costs for MTA police and agency employees; in 2005, \$22 million was added to cover these costs.

In the July Plan, the MTA General Reserve was valued at \$40 million annually. This proposed budget assumes that the 2005 amount will not be needed. The November Plan redistributes this year's unspent reserve and allocates it evenly in 2006 through 2009, with \$10 million added to each year. This would bring the General Reserve to \$50 million annually. There are significant downside risks, however, that could materially impact MTA during the current financial plan period, including continued volatile energy and insurance costs, both of which have a commensurate impact on inflation and interest rates. Moreover, terrorism threats are expected to continue for the foreseeable future straining both the operating and capital budgets. To that end, I am recommending that the General Reserve be increased to \$75 million annually beginning in 2006 – this is roughly 0.75% of the MTA operating budget. Use of the unspent 2005 reserve reduces the impact on the financial plan to a net \$25 million annually. The level of the annual reserve will be reassessed in the next plan to ensure that we maintain the appropriate contingency reserve for MTA's \$10 billion budget.

The strategies for closing the out-year gaps remain consistent with the plan outlined in July. First the \$200 million set aside from the 2004 surplus will be added to the plan in 2006. Agencies have proposed "PEGs" (2006 Agency Programs to Eliminate the Gap), which are now valued to save \$18 million in 2005 and \$42 million in 2006; associated headcount savings are estimated to be 143 positions in 2006. These figures are virtually identical to those proposed in the July Plan with the exception of the LIRR, which eliminated one PEG that would have reduced train crew staff by 14 positions and saved approximately \$2 million per year. Instead, it will achieve savings through reductions in consulting services, adjustments to inspection schedules for the new M7 cars and staff scheduling efficiencies. These actions will more than offset the cost of restoring the 14 positions proposed for elimination in the July Plan. The net cash balances

As I reported to you in my memorandum dated October 18<sup>th</sup> and at last month's Board meeting, recent monthly real estate tax receipts and lower rates for debt service have exceeded the expectations in the July Plan. The 2005 closing balance now reflects an additional \$224 million from these sources, bringing the total non-recurring portion of the \$1 billion closing cash balance to \$705 million.

This Budget Proposal reflects the recommendations outlined last month, which proposed that \$700 million of the non-recurring surplus be spent as follows:

- ✓ Reduce Unfunded Pension Liabilities (\$450 million) by paying down \$450 million of the \$2.2 billion of unfunded accrued liabilities, thus generating \$42 million in annual savings;
- ✓ Address needs in Capital Security (\$100 million) to ensure existing projects remain on schedule and fund immediate capital needs, such as CCTV cameras in 60 subway stations and on buses as a pilot program, installing Emergency Exit release devices on gates in subway stations and subway car seat locks. After the World Trade Center attack, MTA established \$591 million in the Capital Budget to fund security enhancements at critical infrastructure and facilities. As the design process has progressed, total project costs have been revised to reflect the best available information. To address projected increases in costs from the original project estimates made in 2002, the MTA will be utilizing security experts to re-evaluate capital security priorities and a value-engineering process to determine whether these projects should be modified or re-ordered. It is proposed that these funds will be dedicated to mitigating necessary cost increases;
- ✓ Provide Agency Service Enhancements (\$50 million in 2006, \$35 million annually thereafter) to cover intensive cleaning programs in NYCT as well as the commuter railroads; increased commuter railroad train service (to address overcrowding, reduce the time of gaps between trains and to provide additional weekend and off-peak service) and additional K-9 teams and patrol presence by MTA Police. These funds would also be used to delay implementation of NYCT's revised off-peak seated load bus guidelines until 2007;
- ✓ Customer (Holiday) Fare Initiatives (\$50 million in 2005 and \$50 million in 2006). The 2005 initiative will offer half-fare on subways and local buses on weekends from Thanksgiving through New Year's Day; holiday bonuses for time-based MetroCards; and bonus trips for commuter railroad customers. This initiative was endorsed by the Board at its meeting last month. An additional

after Gap closing and Policy actions for 2005 and 2006 are now forecast to be \$462 million and \$220 million, respectively.

The 2006 Agency PEGs will also reduce the 2007 through 2009 gaps by \$44 million, \$47 million and \$50 million, respectively. In addition, agencies have also proposed cost reduction measures that will commence after 2006, which will further improve the out-year gaps by \$3 million in 2007, \$16 million in 2008 and \$24 million in 2009. These programs were included in the July Plan. The November Plan also continues to assume that MTA will implement modest fare and toll increases bi-annually; for this plan period, these will take place in 2007 and 2009. The estimated yield from these increases is virtually the same as the July Plan. After taking into account these gap closing measures, the November Plan's net cash balance includes deficits of \$152 million in 2007, \$797 million in 2008 and \$934 million in 2009.

As was the case in July, our short-term fiscal position has improved with additional taxes and debt savings generated by the continuation of the real estate market's boom and slower increases in interest rates. If the market falls at a slower pace than the plan projects, our position could be better next year. This would certainly assist in the solutions that must be developed to deal with the structural deficits that are looming just two years from now. These gaps have not improved since the July Plan largely because of the effect of the current energy price escalations on the economy and inflation. In addition in accordance with past practices, the agencies are in the process of completing their year-end reviews of their capital needs in the context of the approved 2005-2009 Capital Plan. Those amendments together with any funding changes will be brought to the Board early next year.

I look forward to public and Board input on this plan over the coming weeks culminating with the adoption of the 2006 Budget by the Board in December.