FINAL REPORT

MBTA FISCAL YEAR 2006 BUDGET

Submitted by the

MBTA Advisory Board Finance Committee

June 7, 2005

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FINANCE COMMITTEE MEMBERS

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Newton

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Walpole

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Mr. George Bailey
Sharon

Ms. Marcia Crowley
Wayland

ADVISORY BOARD STAFF

Mr. Paul Regan
Executive Director

Ms. Ulla Hester
Budget and Policy Analyst

Ms. Deborah Gaul
Executive Assistant

PREFACE

The MBTA Advisory Board Finance Committee transmits the enclosed report for your consideration.

The committee wishes to thank the MBTA for their efforts in responding to requests for supporting documentation and attending committee meetings.

The committee also acknowledges the work of the Advisory Board staff who has provided invaluable budget analysis for the Committee.

Massachusetts Bay Transportation Authority
Statement of Revenue and Expense
FY2006 Budget Request

Recommended: That the MBTA Advisory Board approve the MBTA FY 2006 Budget submitted March 11, 2005 as is for Total Revenues of $1,256,567,231 and Total Expenses of $1,267,034,335 as detailed below.

REVENUE	FY2005 Approved Budget* Budget	FY2006 Budget Request	Advisory Board Suggested Changes	FY2006 Approved Budget
Operating Revenues				
Rapid Transit Revenue	136,368,610	139,127,405	-	139,127,405
Commuter Rail Transit Revenue	101,615,002	101,136,941	-	101,136,941
Surface Transit Revenue	85,999,559	84,936,453	-	84,936,453
School, Senior, and Paratransit Revenue	3,940,294	4,940,102	-	4,940,102
Advertising and Concession Revenue	21,607,338	15,063,500	-	15,063,500
Revenue from Real Estate Operations	28,022,394	33,475,675	-	33,475,675
Total Operating Revenues:	**377,553,197**	**378,680,077**	**0**	**378,680,077**
Non-Operating Revenues				
Interest Income	2,800,000	4,166,458	-	4,166,458
Non-Operating Income	6,299,450	16,308,089	-	16,308,089
Funds from the Federal Government	554,745	8,000,000	-	8,000,000
Utility Reimbursements	880,000	800,000	-	800,000
Total Non-Operating Revenues:	**10,534,195**	**29,274,547**	**0**	**29,274,547**
Revenue from Dedicated Sources				
Funds from Local Governments	137,732,242	136,026,868	-	136,026,868
Revenue Receipts from Sales Tax Trust	704,808,915	712,585,739	-	712,585,739
Total Dedicated Revenues:	**842,541,157**	**848,612,607**	**0**	**848,612,607**
Total Revenues:	**1,230,628,549**	**1,256,567,231**	**0**	**1,256,567,231**
EXPENSES				
Operating Expenses				
Wages	330,428,857	343,313,908	-	343,313,908
Fringe Benefits				
Pensions	27,787,331	38,874,525	-	38,874,525
Healthcare	84,729,001	94,024,588	-	94,024,588
Group Life	1,614,616	1,614,616	-	1,614,616
Disability Insurance	66,153	66,153	-	66,153
Workers' Comp	10,431,263	10,431,263	-	10,431,263
Other Fringe Benefits	290,414	290,414	-	290,414
Total Fringe Benefits	124,918,778	145,301,558	**0**	145,301,558
Payroll Taxes				
FICA	25,277,807	26,263,514	-	26,263,514
Unemployment	643,538	1,143,538	-	1,143,538
Total Payroll Taxes	25,921,344	27,407,052	**0**	27,407,052
Materials, Supplies, and Services	125,027,683	128,666,020	-	128,666,020
Casualty & Liability	14,913,614	14,713,614	-	14,713,614
Purchased Commuter Rail Expenses	216,449,131	211,770,719	-	211,770,719
Purchased Local Service Expenses	45,034,511	49,042,971	-	49,042,971
Financial Service Charges	1,801,000	1,801,000	-	1,801,000
Total Operating Expenses:	**884,494,918**	**922,016,842**	**0**	**922,016,842**
Debt Service Expenses				
Interest (All)	223,904,370	219,625,294	-	219,625,294
Principal Payments (All)	99,046,244	108,303,186	-	108,303,186
Lease Payments (All)	17,615,629	17,089,013	-	17,089,013
Total Debt Service Expenses:	**340,566,243**	**345,017,493**	**0**	**345,017,493**
Total Expenses:	**1,225,061,161**	**1,267,034,335**	**0**	**1,267,034,335**
NET REVENUE/(EXPENSE)	**5,567,388**	**(10,467,104)**	**0**	**(10,467,104)**

**IncludesFY2005 March Supplement and Transfer #1*

1. BUDGET OVERVIEW

The Request

On March 14th 2005, the MBTA presented its FY2006 Budget Request to the Full Advisory Board. CFO and Deputy General Manager Jonathan Davis outlined a budget that projected total revenues of $1,256,567,231.

MBTA FY2006 Revenues

Operating Revenues	$ 378,680,077
Non-Operating Revenues	29,274,547
Assessments	136,026,868
Sales Tax Revenues	712,585,739
Total	**$1,256,567,231**

Projected revenues increase by $21.5 million over FY2005 and reflect a decrease in advertising revenue of about $6.5 million from FY05. While the operating and non-operating revenue figures are projections, both the Assessments and the Sales Tax Revenue figures have been certified by the State.

The Authority is seeking a net increase of $41,973,173 over last year's total expense budget. While Debt Service Expenses are decreasing by $6,902,735 the Operating Budget is increasing by $48,875,908 over FY2005. The FY2006 Operating Budget changes are in the following areas:

MBTA FY2006 Operating Budget Increase Request

Wages and Payroll Taxes	$14,370,759	38.3% of the increase
Pensions	11,087,194	29.6%
Healthcare	9,295,587	24.8%
Local Service Expense	4,008,460	10.7%
Materials, Supplies, Services	3,638,337	9.7%
Casualty and Liability	(200,000)	-0.5%
Commuter Rail Expense	(4,678,412)	-12.5%
Total	37,521,925	

The Debt Service Budget shows an increase in principal payments offset by a drop in interest payments and a slight decrease in lease payments.

MBTA FY2006 Debt Service Budget Request

	FY2005	**FY2006**	**Inc/(Dec)**
Interest	$223,904,370	$219,625,294	$(4,279,076)
Principal	99,046,244	108,303,186	9,256,942
Leases	17,615,629	17,089,013	(526,616)
Total	**$340,566,243**	**$345,017,493**	**4,451,250**

FY 2006 is the first year since forward funding in which the Authority is experiencing a budget shortfall, which the Authority proposes to cover by moving $10.5 million from the Deficiency Fund. The budget request includes the funding for Silver Line Phase II and cuts Night Owl service, two Inner Harbor Ferry routes and the Inter-district Bus Program. The Authority is continuing its commitment to cost containment by reducing departmental spending and increasing workforce efficiency. Finally, the request supports the Authority's ongoing contractual and statutory obligations and funds debt service in support of the Capital Investment Program.

Note:

The review period for this request coincided with consideration of the FY2005 Transfer/Supplement Request #1, which was approved by the Full Advisory Board on March 17, 2005. For purposes of this report, all noted variances are based on the FY2005 Approved Transfer/Supplement Budget, not the FY2005 Approved Budget included in the March 14th, 2005 Request. Pertinent line-item data is included by section to illustrate and clarify the FY2005 budget changes and how those changes affect the variances for FY2006.

The Review Process

The Finance Committee met four times to consider the Authority's budget request. Staff of the MBTA, including the CFO, Budget Director and Chief Operating Officer met with the Committee to present their departmental needs and answer questions. As in past years, the Finance Committee was provided all of the requested budget review materials and additional information, and would like to thank the Authority for the timeliness and quality of those items.

2. DISCUSSION

Revenue

FY 2006 Revenues are projected to exceed FY 2005 Revenues by $25.9 million, or 2.1%. Operating Revenues are expected to be flat with static fare revenues and a decrease in advertising revenue offset by an increase in revenue from Real Estate Operations. Dedicated Revenues will increase by $6 million, which includes a $1.7 million decrease in Local Assessments offset by a 1.1% increase in Sales Tax Revenue, which amounts to $7.7 million. Non-operating income is increasing by $18.7 million, mainly due to a $10 million Commuter Rail Coach lease and the programming of $8 million in federal operating assistance.

The reduced income from the new advertising contract is of concern, as it is $6 million lower in FY 2006 than requested in this year's budget submission. Although advertising income can conceivably be higher -- the MBTA receives 65% of net advertising revenue or a minimum of $9 million -- and extra revenue might be generated from additional smaller advertising contracts, the total advertising income will likely be lower than originally proposed in the budget request received by the Advisory Board. The MBTA expects to issue RFPs in June of this year for advertising in the Airport, World Trade Center and Courthouse stations as well as an advertising contract for video advertising on subway trains.

Net Operating Investment Per Passenger Mile (NOIPPM)

Massachusetts General Law set the net operating investment per passenger mile ratio as a measure of the efficiency of Authority operations by evaluating the proportion of operating expenses covered by system revenues. The goal set by the legislation is a ratio of not more than $.20 for any fiscal year beginning in FY2006 without reducing service levels or raising fares. Since FY2002 however, NOIPPM has been increasing instead of decreasing:

FY2002	$0.239
FY2003	$0.250
FY2004	$0.256
FY2005 (Estimated)	$0.257
FY2006 (Estimated)	$0.279
FY2007 (Estimated)	$0.258[1]

The increase is primarily due to ridership and fare revenue declines that began in the Fall of 2001, minimal growth in dedicated revenues due to the weak economy and large increases in employee compensation, particularly fringe benefits, and fuel costs. Ridership decreases have leveled off, but ridership is expected to remain flat for FY 2006.

[1] *Source: MBTA Estimates based on National Transit Database Report/Methodology*

Operating Expense

Headcount, Wages, Fringe Benefits, Pensions

The Authority is requesting an additional $38 million over the post-transfer FY2005 budget to cover increases in wage and fringe benefits costs and contractual and statutory obligations. Healthcare costs are rising by 11% over the FY 2005 post-transfer budget, an increase of $9.3 million. Current union contracts dictate that wages will increase by 4%, requiring $12.9 million in additional funds. Since the authority cut 32 positions from its operating budget the effective increase in wages over FY 2005 is 3.9%.

	FY2005	**FY2006**	**Variance**	**% Variance**
Pre-Transfer Wages	330,428,856	343,313,908	12,885,052	3.9%
FY2005 Approved Transfer	-	-	-	
Post-Transfer Wages	330,428,856	343,313,908	12,885,052	3.9%
Pre-Supplement Healthcare Expense	79,545,180	94,024,588	14,479,408	18.2%
FY2005 Approved Supplement	5,183,821	-	(5,183,821)	
Post-Supplement Healthcare Expense	84,729,001	94,024,588	9,295,587	11.0%

Pension obligations will grow by $11.1 million and are expected to rise in future years. The increase is due to a rising number of retirees eligible to receive pension (from 5360 in FY 2003 to 5731 in FY 2004) and relatively poor stock market performance of the pension plan's assets. The MBTA's pension liability is determined through actuarial valuation, which calculates the pension fund's market value based on a 5-year moving average. The difference between total pension liability and the asset's actuarial valuation determines the MBTA's contribution rate for the coming year. In FY2006, the employer contribution rate will be 9.8261% of payroll compared to 5.9161% in FY2005. Employee contributions will remain at 4% as negotiated as part of the collectively bargained pension agreement. Because the pension fund's valuation is based on a 5-year average, the MBTA's pension liabilities are likely to continue to grow in the future (see below).

31-Dec	**Market Value**
2003	$1,595,166,573
2002	$1,431,483,029
2001	$1,781,792,722
2000	$1,978,324,284
1999	$1,974,110,279

An additional $1.5 million will be required for payroll taxes for statutory Social Security and unemployment costs and $3.4 million to fund contractual increases in The Ride.

The MBTA's headcount request for FY 2006 shows an overall decrease of 50 position, 32 in operating (of those 3 part-time) and 18 in capital. The decrease in capital includes a reduction of 20 positions in Bus Operations attributable to decreased maintenance needs due to the new bus fleet and a reduction of 10 positions in the Construction group which is offset by an increase of 10 positions in SMI. Bus operations saw an increase of 10 positions to staff the full Silverline Phase 2 service and Revenue's headcount increased by 46 positions related to automated fare collection implementation and operation.

The subway headcount budget reflects a reduction of 25 part-time operators, which is expected to go into effect mid-year when the green line switches to single-driver per train operations. It is possible that union efforts to resist this manpower change will delay the implementation of single driver trains. Finally, 26 of the headcount reductions have not been allocated to a specific department and are currently carried in Financial Planning.

Absenteeism

The MBTA has made measurable progress in reducing absenteeism during calendar year 2004 compared to recent years. Average days absent (for any reason, paid & unpaid) decreased from 21.62 in CY2003 to 17.23 in CY2004. Despite this progress, in CY 2004, 16.7% of the workforce has been absent for more than 25 days and 35.4% of the workforce falls into the category of excessive absenteeism, defined as absent for more than 10 days a year by the MBTA. The Authority continues to address this issue in order to increase operating efficiencies and cut down on over-time costs. In April of 2005, a new attendance policy was presented to MBTA employees. Although it contains few major changes, it signals a renewed commitment to enforcing existing policies. One change reduces the maximum personal leave period from 1 year to 6 months, at which point health insurance coverage terminates. Plans for monitoring and enforcing the policy include education of managers and work force, implementing hand scanners for attendance tracking, and introducing incentives for good attendance.

Despite recent improvements, the MBTA has an opportunity to realize significant savings by aggressively enforcing the attendance policy and reducing absenteeism. A study by Watson Wyatt conducted in 2001 suggested that the Authority could incur direct and indirect cost savings of $2.5 million by implementing an absence management program at a time when average days absent ranged from 15.24 in 1998 to 16.47 in 2000, significantly lower than current levels (see year-by-year averages below).

Year	**Average days absent**
1997	15.95
1998	15.24
1999	15.42
2000	16.47
2001	20.50
2002	21.44
2003	21.62
2004	17.35

While the Advisory Board acknowledges the MBTA's recent successes in addressing absenteeism, the numbers above suggest that additional savings are not only possible, but necessary. It is difficult to quantify the savings without a more in-depth study, but in times of budget shortfalls a reduction in absenteeism and the related costs should be a priority for the Authority.

Materials, Supplies, and Services

More than half of the total $8 million increase in Materials, Supplies and Services over the approved FY 2005 budget is the result of the FY 2005 transfer request approved by the Advisory Board in April 2005. The transfer was requested to cover large increases in fuel costs, both to fuel revenue vehicles and in power purchases. The remaining $3.6 million increase for FY2006 is also attributable largely to an increase in fuel costs for bus operations.

	FY2005	FY2006	Variance	% Variance
Pre-Transfer Materials, Supplies, Services	120,618,440	128,666,020	8,047,580	6.7%
FY2005 Approved Supplement	4,409,243	-	(4,409,243)	-
Post-Supplement Materials, Supplies, Services	125,027,683	128,666,020	3,638,337	2.9%

Purchased Commuter Rail Expenses

Despite significant increases in fuel expenses, which were also the reason for the FY 2005 supplement approved in April 2005, the overall commuter rail expense budget for FY 2006 is slightly lower than last year's due to fixed price savings of $9.6 million. Ridership and revenues are expected to remain flat from FY 2005 at $102,136,941 leading to a net expense of $112,128,348.

	FY2005	FY2006	Variance	% Variance
Pre-Transfer Purchased Commuter Rail Expenses	212,598,112	211,770,719	-$827,393	-0.4%
FY2005 Approved Supplement	3,851,019	0	-$3,851,019	-
Post-Supplement Purchased Commuter Rail Expenses	216,449,131	211,770,719	-$4,678,412	-2.2%

MCBR's on-time performance has been 1% to 2% better than Amtrak's performance in the past. The majority of problems occur on lines with mixed freight and passenger traffic controlled by CSX. Ridership has been slightly down due to overall economic conditions, however, complaints about revenue collection are down as well. MCBR has finished its annual passenger count and is expected to start conducting counts on a quarterly basis in order to collect accurate ridership information. The Authority is not yet satisfied with MBCR's overall maintenance efforts and is putting in place a quality control program to monitor the condition of the coaches, particularly to address the rebuilding of broken air conditioning systems.

Purchased Local Service Expenses

Purchased Local Service Expenses are increasing by $4 millions from the post-transfer FY2005 budget, but less than $2 million from the original FY 2005 approved budget. The increase is largely due to increases in The RIDE, offset by savings from eliminating $1.5 million in subsidies for Inter-district Bus Service and cutting two harbor ferry routes for savings of $.7 million.

	FY2005	FY2006	Variance	% Variance
Pre-Transfer Purchased Local Service Expenses	47,124,609	49,042,971	$1,918,362	4.1%
FY2005 Approved Supplement	(2,090,098)	0	$2,090,098	-
Post-Supplement Purchased Local Service Expenses	45,034,511	49,042,971	$4,008,460	8.9%

The FY 2006 budget request of $45,473,333 for The RIDE is 9.5% higher than the projected FY 2005 actuals, but $1.5 million lower than originally anticipated for FY 2006. The contract was reduced by that amount based on a revised ridership increase of 2.94% versus the originally projected 5%.

The current contract with The RIDE operators includes incentives to direct riders to regular service and the MBTA is considering alternative measures to contain paratransit costs, such as providing monthly transit passes free of charge to those who might qualify for The RIDE, but choose to use regular service instead. The Authority has initiated an in-depth study measuring performance.

Debt Service

Total debt service is projected to amount to $345 million, $6.9 million less than originally budgeted in FY 2005 and $4.45 million more than the post-supplement budget. The decrease reflected in the FY 2005 Approved Transfer Request resulted from refunding of General Transportation System bonds, assessments bonds and sales tax bonds in times of lower interest rates in both FY 2004 and 2005. Lease payments will increase by $637,000 due to additional vehicle leases for The RIDE, the Revenue department and the Systemwide Maintenance Improvements department.

	FY2005	**FY2006**	**Variance**	**% Variance**
Pre-Transfer Interest (All)	230,942,122	219,625,294	-$11,316,828	-4.9%
FY2005 Approved Supplement	(7,037,752)	-	$7,037,752	-
Post-Supplement Interest (All)	223,904,370	219,625,294	-$4,279,076	-1.9%
Pre-Transfer Principal Payments (All)	104,525,964	108,303,186	$3,777,222	3.6%
FY2005 Approved Supplement	(5,479,720)	-	$5,479,720	-
Post-Supplement Principal Payments (All)	99,046,244	108,303,186	$9,256,942	9.3%
Pre-Transfer Lease Payments (All)	16,452,142	17,089,013	$636,871	3.9%
FY2005 Approved Supplement	1,163,487	-	-$1,163,487	-
Post-Supplement Lease Payments (All)	17,615,629	17,089,013	-$526,616	-3.0%
Pre-Transfer Total Debt Service Expenses	351,920,228	345,017,493	(6,902,735)	-2.0%
FY2005 Approved Supplement	(11,353,985)	-	11,353,985	-
Post-Supplement Total Debt Service Expenses	340,566,243	345,017,493	4,451,250	1.3%

In FY 2006 the Authority will continue to fund capital projects by using its $200 million Commercial Paper Program and retire the notes when another series of revenue bonds is being issued late FY 2006. The MBTA constantly re-evaluates its debt portfolio in search of ways to decrease overall debt services costs. The Authority has not been able to execute its plan to contribute a percentage of net revenue to the Capital Maintenance Fund due to slower than expected revenue growth under forward funding. Consequently, it has not been able to decrease its debt burden and continues to carry debt service expenses of 27% of its operating budget.

3. RECOMMENDATIONS

After thoroughly reviewing the requested budget and accompanying materials as well as discussing budget details with MBTA staff, the Advisory Board proposes a list of recommendations outlined below. Fully recognizing the difficult financial situation the Authority faces during the coming year, the MBTA Advisory Board takes an unprecedented action by refraining from imposing budget cuts for FY 2006 and relying instead solely on strategic recommendations.

Recommendations

- Continue to focus on State of Good Repair and enact a moratorium on any capital projects that do not fall under SGR or the American Disability Act. In the current fiscal situation capital expansion projects, even if financed with state and federal funds, are not sustainable and will have adverse effects on the health of the system by spreading operating expenses over a larger system once the expanded lines go into operation.

- Continue to address Absenteeism. The Authority's absenteeism numbers are still high and further reductions will positively impact overtime and general wages and related costs. Recent changes to the attendance policy and the introduction of technology, such as hand scanners to verify attendance, demonstrate the Authority's commitment to this issue. However, improvements can only be sustained through continuous management and enforcement of the attendance policy at all levels. This requires extensive training of managers and thorough monitoring of compliance with the attendance policy. The Advisory Board believes that the current fiscal situation forces the MBTA to reduce the high costs of excessive absenteeism and will continue to closely monitor the MBTA's progress in the future.

- Pursue the timely introduction of Automated Fare Collection, which is expected to lead to increased revenues by reducing fare evasion and producing a bump in revenue due to the switch to stored value cards. The MBTA should aggressively distribute smart cards once the system can accommodate them since they promise operational and financial advantages over other fare media.

- Continue to pursue elimination of two-driver cars on the green line, despite expected pushback from the union. Draft a plan for Proof of Payment fare collection on the Green Line to prevent revenue loss when this switch occurs.

- Continue to consider creative advertising venues and pursue timely award of contracts for the RFPs issued in June (Aquarium, Courthouse, WTC stations and television advertising) to maximize advertising revenue in FY 2006.

Finally, the Finance Committee is very concerned that the MBTA's financial difficulties in FY2006 are not the result of isolated circumstances, but rather continuing problems with larger revenue trends. Five years after its inception, Forward Funding has not resulted in a larger Pay-Go Capital Fund and greater stability in the operating budget. The Finance Committee recommends that the Advisory Board staff examine the impact of the redesigned revenue stream and the effect the law has on MBTA Operating and Capital spending and report to the full Advisory Board, with recommendations, in Fall 2005.