

FY10

STAFF SUMMARY SHEET
(MBTA PROCEDURES NO. 1)

FROM:

Dept.: Budget

Author: Mary Runkel

Tel Ext.: [REDACTED]

Subject: FY2010 Operating Budget

Date: March 12, 2009

(The implications checked below are involved in this action, are discussed below or in a separate enclosure, and have been considered in the final recommendation.)

Operating Budget

Legal

Other

PURPOSE

To request approval of the Board of Directors to authorize the General Manager to submit to the Advisory Board, the Authority's budget of current operating expenses and debt service costs for the twelve-month period of fiscal year 2010: July 1, 2009 through June 30, 2010.

DISCUSSION

The FY 2010 budget contains a historically high deficit—\$160.4 million—which is impossible for the Authority to fund with its limited revenue sources and its largely depleted reserve funds. The dramatic deterioration of the Authority's financial stability began with last year's budget. The original FY 2009 budget, which contained a \$74.3 million structural deficit, required the Authority to restructure certain principal payments due in FY 2009 and draw \$19.3 million from its reserve funds.¹

At the time the FY 2009 budget was approved, the Authority was still in negotiations with its labor unions over contract terms for the new contract period July 1, 2006—June 30, 2010. The budget contained no provisions for wage increases because the matter had moved into interest arbitration and the Authority was already in a deficit status requiring a draw from reserves. The arbitrator's decision issued on July 7, 2008 awarded substantial retroactive raises of 3% per year for July 1st of 2006 through 2008, and 4% for July 1st of 2009. The two years of retroactivity and the wage adjustment for July 1, 2008 required the Authority to seek a supplemental budget on October 10, 2008. The \$57.8 million in additional operating expenses contained in the supplemental budget was largely used to cover the cost of the arbitration decision for Local 589 and pattern bargaining with the rest of the Authority's unions.²

¹ The Authority drew \$15 million from the Deficiency Fund and \$4.3 million from the Capital Maintenance Fund.

² \$53.3 million was attributable to the award and pattern bargaining, \$4.7 million for a contract extension with Massachusetts Bay Commuter Railroad Company (MBCR), and there was also a \$200,000 reduction in casualty and liability.

The Authority was able to fund \$35.0 million of the \$57.8 million increase through fare revenue growth, a parking rate increase, non-operating income, and funds from the federal government but the deficit caused by the supplemental budget grew by another \$22.8 million to a total of \$42.1 million. Hence, the Authority had no option but to withdraw the last million from its Deficiency Fund and take another \$21.8 million from its Capital Maintenance Fund.

The Authority began the FY 2010 budget process with largely depleted reserves and declining revenues. The Authority's current revenue sources in FY 2010 are not sufficient to cover a projected \$160 million deficit. Since Forward Funding took effect on July 1, 2000, the Authority has experienced a cumulative underperformance of sales tax—its primary revenue source—and now faces an upcoming fiscal year in which the sales tax guaranteed revenue amount will provide no revenue increase. While the Authority will receive \$3.7 million more in its other dedicated revenue source—local assessments—the Authority's own source revenues will actually decrease by \$7.7 million—primarily driven by lower anticipated property sales—for a net overall decrease in revenue of \$4.0 million.

With total revenues declining by \$4.0 million and total expenses increasing by \$114.3 million (\$36.8 million in operating expenses and \$77.5 million in debt service expenses), the Authority considered several options to achieve a balanced budget: new revenue sources from the Commonwealth, a fare increase, service reductions, debt restructuring, and the depletion of the Capital Maintenance Fund and Stabilization Fund. The use of further draws on the \$9 million remaining in the Capital Maintenance Fund to balance the operating budget will compromise desperately needed funds for state of good repair projects. The use of the Stabilization Fund, which currently has a balance of \$18.5 million, is not an option because the Authority is statutorily precluded from using these funds to meet operating needs in the budget.

While new revenue sources from the Commonwealth are by no means guaranteed as of this date, the Authority has elected this option to close the identified budget deficiency of \$160.4 million. The statement of revenue and expenses which appears in Tab B includes \$160.4 million of other dedicated revenue in order to achieve the statutory mandate of a balanced budget. However, the Authority has already begun making contingency plans for a combination of a fare increase and service cuts after July 1st if no new dedicated revenue source (or an amount less than the \$160.4 million used in this budget request) materializes. The size of the deficit would require fare increases in the range of 25% to 30%, with the difference made up of service cuts likely across all modes of transportation.

In addition, and pursuant to Section 11 of Chapter 161A of Massachusetts General Laws and the reporting requirements contained therein, the Authority has established a target net operating investment per passenger mile ratio that it expects to achieve in FY 2010: 34.1 cents, in conjunction with the preparation of this operating budget request. This is a target and not legislatively mandated.³ The legislation stipulates that beginning in FY 2006, the Authority shall seek to achieve and maintain a target ratio of not more than 20 cents for any

³ See tab C for a history of the net operating investment per passenger mile ratio since the advent of forward funding.

fiscal year. This target is not achievable in FY 2010 given the decline in non-operating revenues and significant cost escalation in operating expenses.

FY 2010 Revenue

Total revenue from all sources (including the proposed “other” dedicated revenue category) is projected to increase by \$156.4 million to a total of \$1.627 billion. Without the proposed new dedicated revenue source, total revenue would have decreased by \$4.0 million (0.4%) to a total of \$1.467 billion. The major categories follow:

Operating Revenue

Total Operating Revenue is projected to increase by \$9.8 million (1.9%) to a total \$526.3 million in FY 2010. The increase is due to \$4.5 million in additional fare revenue⁴ and \$5.3 million from the following other operating revenue categories:

	<u>Increase/ (Decrease)</u>
• Parking	\$5.6 million
• Other Real Estate Operations ⁵	\$1.0 million
• Advertising ⁶	<u>(\$1.3 million)</u>
Net Increase:	\$5.3 million

The Authority’s projected fare revenue budget of \$453.4 million creates a fare recovery ratio of 38.4%—just slightly under the FY 2009 fare recovery ratio of 39.2%.

Non-Operating Revenue

Non-operating Revenue will decrease by \$17.5 million to a total of \$23.3 million. The Authority anticipates continued lower property sales in FY 2010 (\$4.6 million vs. \$15.3 million in the FY 2009 budget that is also unlikely to be achieved), lower interest income (\$3.0 million vs. \$4.0 million in the FY 2009 budget) and fewer projected new non-operating income initiatives (\$2.4 million vs. \$8.4 million in the FY 2009 budget). Utility reimbursements offer the only offset to these declining revenue streams:

	<u>Increase/ (Decrease)</u>
• Utility Reimbursements	\$0.1 million
• Interest Income	(\$1.0 million)

⁴ Fare revenue assumes a 1% ridership growth.

⁵ Includes income from Transit Reality Associates real estate operations on behalf of the Authority, South Station Bus Terminal, Mass Mobility Compact, Commuter Rail Right-of-Way (B&M Access and Downeaster Service), North Station, and Massport Airport Shuttle/Silver Line Boardings

⁶ There will be no bonus checks paid to the Authority next year in the Authority’s systemwide advertising program run by Titan and the minimum annual guarantee could be in jeopardy. The advertising market has collapsed worldwide.

- Other Initiatives (\$6.0 million)
 - Property Sales (\$10.6 million)
- Net Decrease: (\$17.5 million)

The Authority’s projected total own source revenue, i.e. all revenue except dedicated revenue, creates a revenue recovery ratio of 46.5%—slightly under the FY 2009 revenue recovery ratio of 48.7%.

Revenue from Dedicated Sources

Revenue from existing dedicated sources is projected to increase by \$3.7 million (0.4%) to a total of \$917.2 million in FY 2010. Consistent with Forward Funding,⁷ assessments (funds from local government) will increase by \$3.7 million (2.5%) to a total of \$150.1 million. Revenue receipts from sales tax, however, will remain flat at \$767.0 million. Assuming the inclusion of the proposed other dedicated revenue source, revenue from dedicated sources will increase by \$164.1 million.

At the onset of Forward Funding, the estimate⁸ of sales tax for FY 2010 was \$842 million and was predicated on a growth assumption of a minimum of 3% per year. In fact, sales tax has increased an average of only 1.0% per year through FY 2009—leaving a gap in expected funding of \$75 million in FY 2010 and a cumulative gap in funding of \$275 million since FY 2001 (see Tab D).

FY 2010 Operating Expenses

The need for \$36.8 million in additional resources in FY 2010 falls into two categories: (1) ongoing operations and quality of service and (2) contractual and statutory obligations. The Authority has generated cost reductions, which have helped minimize the overall operating expense increase.

Ongoing Operations and Quality of Service

The Authority will require \$8.9 million in additional funds in FY 2010 for the following, largely non-controllable, costs:

- \$5.3 million for providing commuter rail service including on-time performance and equipment availability incentives (\$3.5 million), commuter rail contract service enhancement scope changes (\$0.9 million), penalties (\$0.5 million), revenue incentive/service improvement account (\$0.2 million), and Massachusetts Bay Commuter Railroad (MBCR) FELA/third party claims (\$0.2 million)

⁷ Legislation passed in 1999 changing the funding structure of the Authority, including the dedication of a percentage of the state-wide sales tax, excluding meals

⁸ Guaranteed revenue amount assumed in the Authority’s Finance Plan

- \$2.5 million for power and utilities
- \$0.8 million for financial service charges for the growth in debit/credit card processing fees associated with the use of automated fare collection vending machines
- \$0.3 million for contract cleaning of stations, facilities, and vehicles

Contractual and Statutory Obligations

The Authority will require \$61.5 million in additional funds in FY 2010 as a result of fringe benefits and payroll costs and existing contractual and statutory obligations as follows:

- \$19.6 million for contract rate increases, fuel costs, and higher ridership for the Authority's paratransit service THE RIDE⁹
- \$14.7 million for the 4% wage increase in the fourth and final year of the arbitration award for the unionized workforce
- \$10.8 million for the contractual fixed price contract increase with MBCR
- \$8.6 million for increased healthcare expenses¹⁰
- \$6.3 million in pensions which includes \$3.0 million for an anticipated Authority contribution rate increase for the MBTA Retirement Fund
- \$0.9 million for FICA and unemployment insurance
- \$0.6 million for scheduled contractual subsidy increases for the Authority's commuter boat services (Hingham, Hull/Quincy, and Inner Harbor)

Cost Reductions

Offsetting the requested budget increases associated with ongoing operations and quality of service and contractual and statutory obligations are cost reductions which total \$33.6 million:

- \$20.6 million in non-recurring costs associated with the arbitrator's back pay awards for FY 2007 and FY 2008¹¹
- \$4.6 million in wage savings from the elimination of 70 operating budget positions

⁹ The cost of THE RIDE has grown from \$21.4 million in FY 2000 to \$75.2 million in the FY 2010 budget.

¹⁰ The \$115.7 million healthcare budget includes savings from the arbitrated plan design changes (\$5.9 million) and retiree contributions (\$0.7 million). Without these savings, the healthcare budget would have been \$122.3 million in FY 2010.

¹¹ The back pay costs were included in the FY 2009 supplemental budget and are non-recurring.

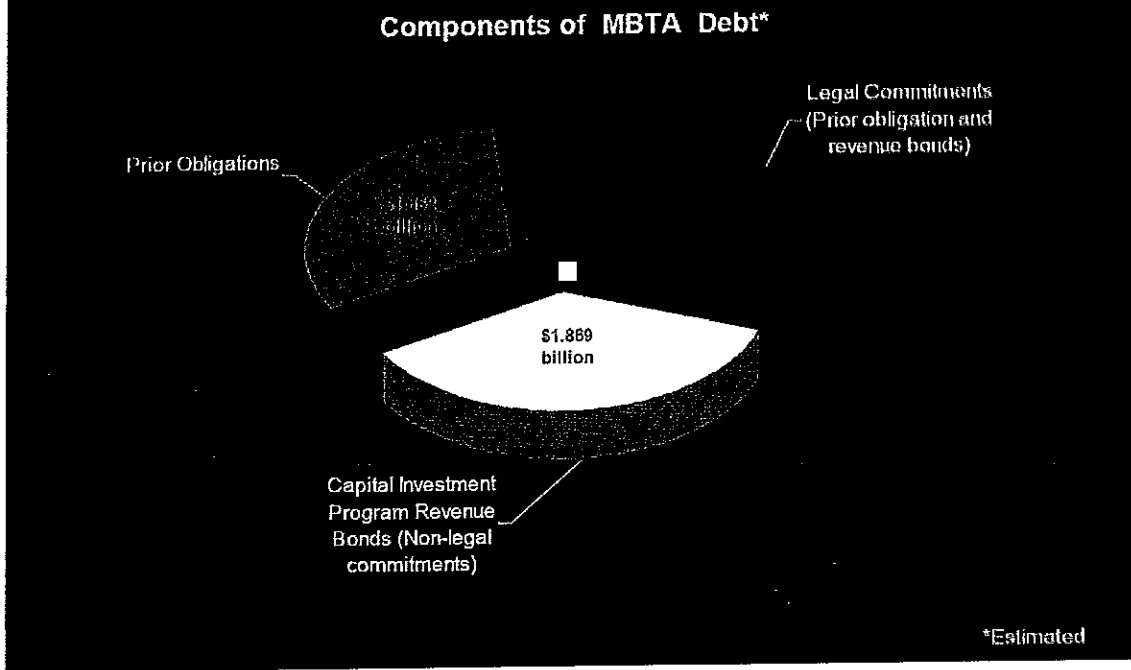
- \$2.7 million in lower train fuel costs
- \$2.5 million reduction in commuter rail state of good repair PAY GO spending
- \$1.7 million in lower diesel and gasoline costs
- \$0.6 million in savings from reducing miscellaneous authority-wide materials and supplies purchases
- \$0.4 million reduction in commuter rail amortization for mobilization
- \$0.3 million in group life insurance and workers' compensation savings
- \$0.2 million savings from the elimination of three towns which are no longer part of the Suburban Bus Program

FY 2010 Debt Service

Interest and Principal Expenses

The FY 2010 budget contains a dramatic jump in principal and interest payments as the bill on the Authority's \$5.2 billion in outstanding debt comes due. This \$5.2 billion in outstanding MBTA debt originates directly from three sources: "prior obligation debt" inherited by the MBTA at the onset of Forward Funding in 2000, projects required to be built and funded by MBTA as legal commitments associated with the Central Artery project permitting process, and the Authority's commitment to act as a good steward of the system and fund at least \$470 million per year in capital investment necessary to maintain the current \$2.7 billion dollar backlog in much needed State of Good Repair projects. The Authority's share of this capital investment continues to be drawn from bond funds due to the persistent lack of growth in sales tax revenues and the corresponding scarcity of available pay-as-you-go capital. The following chart summarizes the components comprising the MBTA's overall outstanding debt.

MBTA Outstanding Debt – \$5.2 billion

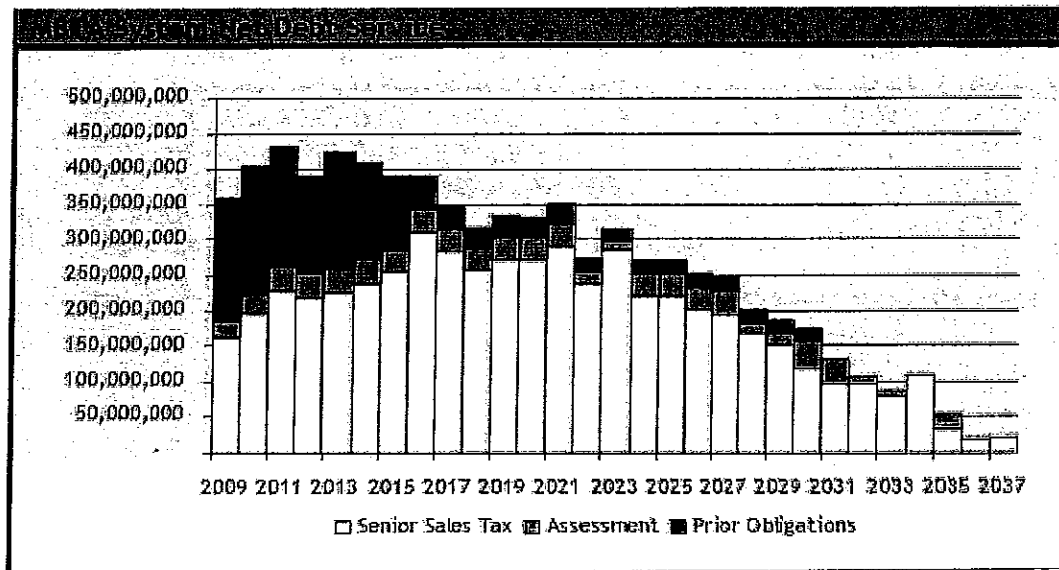


Currently, no dedicated funding source exists to pay for the Authority's portion of the Capital Investment Program. As a result, sales tax, assessment, and the Authority's own source revenues must cover both operating and capital expenses. The Authority's five-year Capital Investment Program is funded by five sources: revenue bonds, federal grants, state infrastructure funds, grant anticipation notes, and pay-as-you-go capital. In FY 2010, as in past years, the MBTA's non-federal portion of the capital program will be funded primarily by the issuance of new revenue bonds which will only further contribute to the unsustainable pattern of escalating principal and interest costs.

Since FY 2001, the MBTA has attempted to implement a "pay-as-you-go" capital funding structure, but that has been made impossible due to the limited growth in sales tax revenues. It is unlikely that the Authority will be able to increase "pay-as-you-go" funding in the future given the bleak economic outlook for both the overall economy and sales tax revenues. The Authority is committed to a minimum investment of \$470 million per year to the State of Good Repair program and to allocate at least 90% of the Capital Investment Program toward State of Good Repair investments in the core system even in light of the organization's financial condition. Failure to invest at least this amount would result in degradation of the core transit system and a deterioration of service. Such an outcome would likely result in lower ridership and other real economic costs given the importance of transit to the overall local economy.

Total principal and interest expenses are projected to increase by \$76.0 million (21.8%) in FY 2010. Principal and interest costs will consume almost 30% of the Authority's

FY 2010 projected operating revenues leaving fewer funds available to provide vital transit services. Principal and interest will continue to increase and remain high over the next several years – see chart below which reflects only existing principal and interest without any new borrowing. Continued reliance on bonds to finance the Authority’s portion of the Capital Investment Program will only further exacerbate this situation. Much of the current debt has been refinanced at a lower cost over the past ten years, but those savings opportunities no longer exist.



The following table summarizes the FY 2010 principal payments and interest expense:

Bond Issue	Principal Payment	Interest Expense
Prior Obligations	\$113.2 million	\$52.3 million
Revenue Bonds	44.1 million	198.8 million
New Revenue Bonds/CIP* Funding		12.6 million
Commercial Paper		0.5 million
Liquidity and Remarketing Fees		3.7 million
Derivative Income		(1.0) million
Total	\$157.3 million	\$266.9 million
* Capital Investment Program		

Lease Payments

Lease payments for revenue and non-revenue vehicles will increase by \$1.5 million to \$21.0 million. This is a result of arranging additional tax-exempt vehicle leases for THE

RIDE program, police vehicles, and system wide maintenance vehicles.

Debt Management

The MBTA refunded over \$2.0 billion in debt during FY 2005, FY 2006, FY 2007, and FY2008 in order to achieve economic savings and reduce principal and interest costs. Debt management also includes defeasance of debt and hedge agreements in order to manage financing costs and volatility in an uncertain economic environment. The day of reckoning is here. In today's capital markets, further restructuring of debt will come at an unaffordable cost and delay the inevitable.

With the continuing slow growth in sales tax revenue, principal and interest costs will consume an ever increasing amount of revenue each year. Unless corrected or mitigated, this will compromise the Authority's ability to continue to provide the anticipated service levels included in the FY 2010 budget and in future years. The Authority could decide to curtail the Capital Investment Program, with the aforementioned negative impact on the system's State of Good Repair. However, since the majority of the debt has been issued this would provide very little relief in the short term.

This year the MBTA Board of Directors created a Board Finance Committee. The board has been instrumental in evaluating and assessing capital spending needs. They have also set policy for prioritizing and maximizing capital projects that are eligible for federal funds thus reducing the amount of debt the Authority will have to issue.

SUMMARY

The FY 2010 budget request of \$1.627 billion reflects a 7.6% overall increase over the FY 2009 budget and was achieved with an assumption of uncertain new dedicated revenues from the Commonwealth. It is difficult to predict what future budgets will look like without growing dedicated revenues and significant debt relief. The FY 2010 budget as proposed with new dedicated revenues will maintain current service but leaves open the extent to which fare increases and service cuts may become necessary in the future should the Authority fail to receive stable revenue streams.

That total debt service expenses will account for 68% of the budget increase next year (\$77.5 million of the \$114.3 million overall increase) highlights the fact that the Authority can no longer dig its way out of its future deficits by cutting operating costs. The Authority will proceed over the next several months with planning for a contingency of fare increases and service cuts should the proposed new dedicated revenue source be insufficient to produce a balanced budget.

RECOMMENDATION

It is recommended that the Board of Directors approve the proposed FY 2010 annual

operating budget and authorize the General Manager to submit the budget to the MBTA Advisory Board for their approval.

ATTACHMENTS

- Tab A Recommended Vote
- Tab B Statement of Revenue and Expenses
- Tab C Net Operating Investment per Passenger Mile: FY 2000—FY 2010
- Tab D Revenue Receipts—Sales Tax FY 2001—FY 2010

COORDINATION

Wesley G. Wallace, Jr., Treasurer/Controller

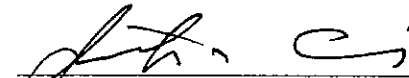
RECOMMEND APPROVAL



Mary E. Runkel
Director of Budget

Date: March 9, 2009

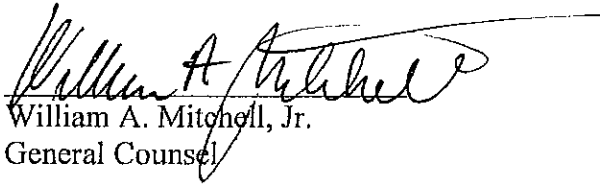
RECOMMEND APPROVAL



Jonathan R. Davis
Deputy General Manager and
Chief Financial Officer

Date: 3/10/2009


RECOMMEND APPROVAL



William A. Mitchell, Jr.
General Counsel

Date: _____

APPROVAL



Daniel A. Grabauskas
General Manager

Date: _____

RECOMMENDED VOTE

That the Board of Directors approve the Authority's budget of current operating expenses and debt service costs for a one year period—July 1, 2009 through June 30, 2010—in the amount of \$1,627,144,895 in the form submitted to this Meeting; and that the General Manager is hereby authorized and directed to submit the same, in the name and on behalf of the Authority, to the MBTA Advisory Board for its approval, in accordance with Section 20 of Chapter 161A of the Massachusetts General Laws.