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THE MBTA OPERATING BUDGET – "IT'S DÉJÀ VU ALL OVER AGAIN"[1]

Driven by operating costs that were already growing and the pandemic's deep impacts on revenues, a Massachusetts Bay Transit Authority (hereinafter the MBTA or the T) operating budget that was in balance in FY 19 is now moving backward toward a deficit of more than $400 million in FY 22. And the T's longer-term fiscal trajectory is unsustainable, heading to the same "severe imbalance between costs and revenue" identified in 2015 by Governor Baker's Special Panel to Review the MBTA, which led to the creation of the Fiscal and Management Control Board (FMCB).

With the FMCB near its end, the incoming MBTA board will face a financial outlook even bleaker than that of 2015, with limited capacity to act without impacting current or planned MBTA services.

When the FMCB ends its statutorily limited five-year oversight of the MBTA on June 30, 2020, it will leave behind a long list of substantial and important accomplishments. But the Board also leaves a transit authority with a financial outlook that is arguably even more dire than the one it inherited five years ago. When the current FMCB took command in 2015, the MBTA was in crisis. As it exits, the MBTA is lurching towards another financial crisis, one that this time could prove existential.

This is the first of three Massachusetts Taxpayers Foundation (MTF) reports on the current state of the MBTA and its looming fiscal crisis. The second report will review the MBTA's long-term sources of funding for its capital investment needs. The third report will analyze the financial implications for the MBTA from the pandemic and the resulting changes to work and commuting habits and the state's economy. Together, these reports will detail the challenges ahead for the successor entity to the FMCB.

[1] Attributed to Yogi Berra.

WHY THE FMCB WAS CREATED

The FMCB was created after the record-breaking amounts of snow that fell in the winter of 2015[2] laid bare the painful reality: the T was broken. On February 9, 2015 at 7:00 p.m., following one of these record-breaking snowstorms that dropped nearly two feet by mid-afternoon, the MBTA suspended all rail service. The commuter rail had halted all inbound service to Boston earlier in the day. Limited service reopened 36 hours later, but it would take days for the MBTA to return to regular service.

A few days after the shutdown, the new Baker administration asked MTF to present its findings from a soon-to-be-released report, *The T: The End of Its Line*. MTF's presentation and report focused principally on the challenges to the T's operating and capital budgets, but as the report's title implies, it indicated that the problems extended far beyond the MBTA's finances (see Appendix C).

Days later, on February 20, 2015, Governor Baker announced the appointment of the Special Panel to Review the MBTA and asked for an assessment within 45 days. The key findings of the Panel's April 8 report, *Back on Track: An Action Plan to Transform the MBTA,* were blunt (Appendix D), with the first finding reaffirming one of MTF's principal conclusions:

> **"Unsustainable Operating Budget:** The MBTA would be insolvent if not for continuing and increasing subsidies due to a severe imbalance between costs and revenue."

The Special Panel considered four options to reform the MBTA that included full receivership and abolition of the MBTA and the creation of a successor agency. It opted to recommend the creation of a Fiscal and Management Control Board for a period of three to five years, the estimated time it would take to make measurable progress toward established goals.[3]

From its inception on July 17, 2015, the FCMB has brought stability, transparency, improved efficiencies and better systems to the flailing agency. Substantial improvements include streamlined procurement, better project management, and the ability of the MBTA to attract new talent through more flexible hiring practices. This five-member, voluntary Board has been dedicated to their mission, with three of the members, including the chair, serving the full five years.

The FMCB provided much-needed continuity and managerial focus to an agency that has seen high turnover in its executive leadership. Notable among its accomplishments is the increased transparency reflected in the 195 open meetings held through June 1, 2020. The FMCB compelled the MBTA to think bigger and more openly about its vision for the future. It recognized the competing needs for immediate improvements while also engaging in longer-

[2] 68 inches in Boston over a 30-day period

[3] *Back on Track: An Action Plan to Transform the MBTA*, April 8, 2016, slide 34.

term planning. The FMCB met these challenges head-on, tackling all of the Special Panel's key findings with urgency and rigor while also developing a long-term strategic plan.

So five years later, we should be able to report a turnaround success story, a case study of how to reform a critical public authority. Yet the MBTA remains in a precarious state and few would agree that the FMCB's work is complete or that MBTA governance should return to monthly oversight meetings by the Massachusetts Department of Transportation (MassDOT) board. In fact, the challenges ahead pose a far greater threat to MBTA operations than anything experienced to date.

Back to the Operating Budget

In 2013, the MBTA released a projected five-year FY 15 – FY 19 operating pro forma as part of the Patrick administration's report entitled *The Way Forward: A 21st Century Transportation Plan*. In the plan, the MBTA projected that it would face an operating budget gap of $1.26 billion over that five-year period, bottoming out at a $358 million budget deficit in FY 19. The reason for the growing gap was simple: while expenses were increasing by 3.9 percent annually, revenues grew by just 1.2 percent. Rather than curtail costs, the T balanced its budgets in the five-year pro forma by including $1.32 billion in additional state contract assistance.

This pro forma informed MTF's 2015 report and the findings of the Special Panel, both of which concluded that the severe imbalance between costs and revenue, if left unaddressed, would bankrupt the MBTA.

Recognizing the imprudence of assuming persistent state bailouts, the newly installed FMCB made getting control of the budget a paramount priority. The T worked to increase revenues from non-fare sources (advertising, concessions, real estate, non-operating income, and utility reimbursements) by $57 million more than was projected in the FY 15 – FY 19 pro forma. In addition, dedicated sales tax revenues out-performed estimates by $29 million. These two sources, together totaling $86 million, accounted for 90 percent of the T's revenue growth in excess of projections over the five years. Table 1 contrasts what had been the MBTA's projected FY 19 budget gap of $358 million with the actual FY 19 budget that resulted from the FMCB's input.

Table 1 – FY 19 Projected Budget Gap vs. FY 19 Actual – How the T Closed the Shortfall

	FY 19 Projected	FY 19 Actual	$ Change
Revenues			
Fares	659	672	13
Local Assessments	173	170	-3
Dedicated Sales Tax Revenues	1,024	1,053	29
Other	91	147	57
Total	**1,947**	**2,042**	**96**
Expenses			
Wages and Payroll Taxes	656	528	-128
Fringe Benefits	223	225	2
Materials/Service/Energy	299	248	-51
Commuter Rail	438	409	-29
Purchased Local Services (The Ride +)	160	140	-19
Other	26	24	-2
Debt Service	504	487	-17
Total	**2,305**	**2,060**	**(244)**
Expenses - Revenues	(358)	(18)	340
State Contract Assistance	**366**	**127**	
Net Revenues	**8**	**109**	

With limited options and ability to increase revenues, the FMCB's primary focus was necessarily on restraining costs. The MBTA was able to reduce projected expenditures by $244 million over five years, lowering the annual rate of growth in operating expenses from the projected 4.83 percent to 0.94 percent through staff reductions, greater efficiencies in materials and services and innovative changes to services including The RIDE.

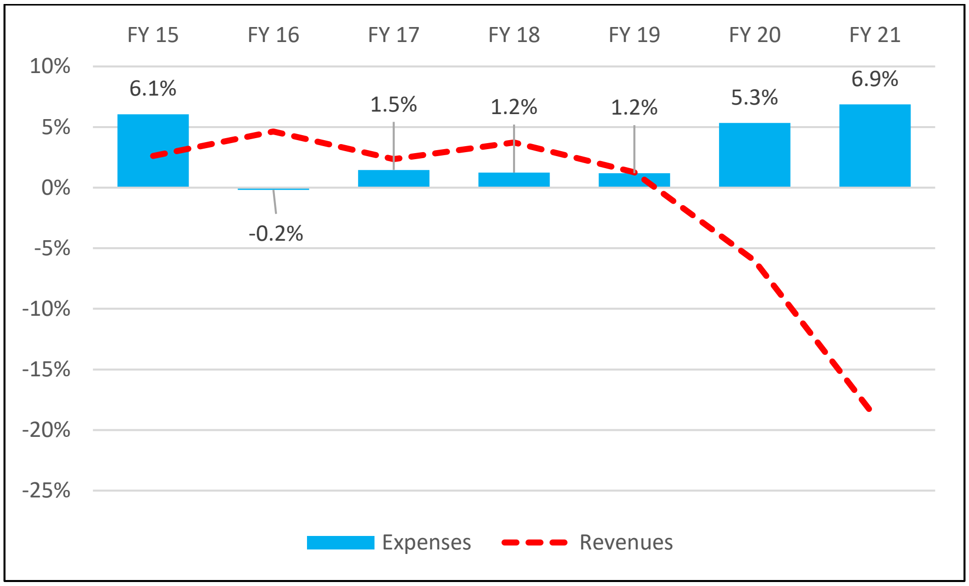
But now, as FY 20 ends, this fiscal progress has unraveled. Even before the pandemic hit, the MBTA's operating costs jumped by 5.3 percent in the FY 20 budget, a five-fold increase over previous years. Combine that steep rise in expenses with a $240 million loss in fare revenues due to the pandemic, and the T's balanced budget has gone off the rails.

Even more concerning is the fact that the budget gap in FY 21 will be several times that of FY 20. The FY21 budget recently approved by the FMCB projects operating costs to increase by $115 million (6.9 percent) over FY 20, while estimated fare and other operating revenues plummet by $532 million or 70 percent from their FY 19 peak (Figure 1 and Appendix A).

In another blow to its long-term finances, the $126 million that the MBTA had anticipated in additional state funds beginning in FY 21 ($53 million from higher dedicated sales tax revenues and $73 million from a $1.00 fee increase on TNC rides) has evaporated due to the economic fallout from the pandemic and the state's precarious budget predicament.

The solutions to closing the FY 21 budget shortfall could grow more challenging still should lawmakers decide the state cannot afford the $127 million contract assistance appropriation or disagree with the MBTA using $66 million of capital sources to pay personnel costs.

Figure 1 – Year-over-Year Changes in MBTA Expenses and Revenues



In the short term, $960 million in one-time funds, largely from federal relief, should bridge the FY 20 and FY 21 budget gaps, but this assistance merely delays the impending crisis. Without it, the MBTA would already be facing financial catastrophe, or as MTF put it back in 2015, the T would be at the end of its line.

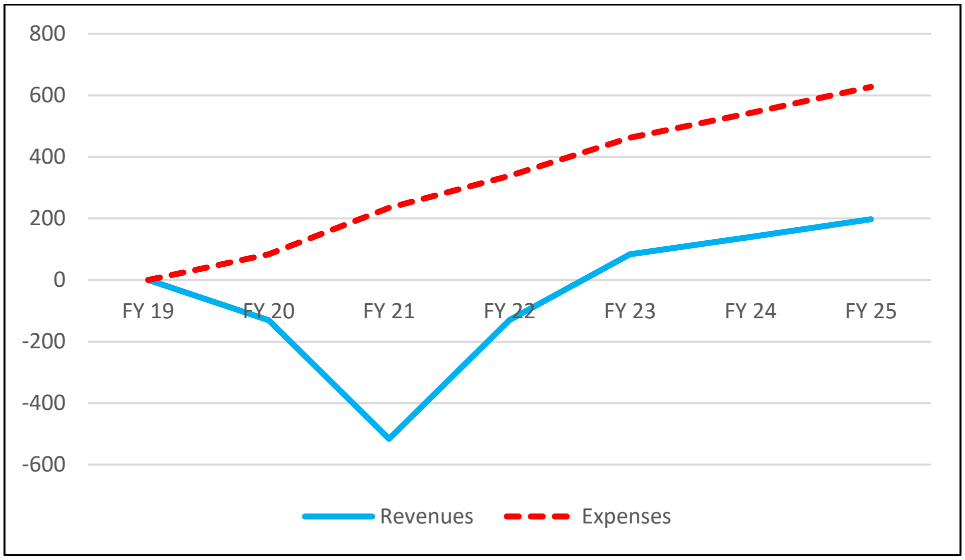
The Next Crisis Is Already Here. The New Board Must Confront Budget Problems Immediately

Alarming as the FY 20 and FY 21 shortfalls are, the T's longer-term budget outlook is even more startling, with the gap between expenses and revenues once again projected to grow wider with each passing year, necessitating the need for annual financial bailouts.

Based on the assumptions outlined in Appendix B that were reviewed by several people familiar with MBTA finances, operating costs are expected to increase by another 4.6 percent or nearly $100 million in FY 22. On the revenue side, fare and other operating revenues could partially rebound to $500 million, if an economic recovery can be sustained, and the MBTA's pandemic policies, such as spacing and use of masks, prove sufficient to overcome most riders' health and safety concerns. Based on these assumptions, the MBTA is projected to have an operating gap of $400 million in FY 22.

On its current trajectory, budget gaps increase year-over-year and MBTA finances continue to deteriorate because expenses again significantly outpace revenues but this time the T has few options to avoid insolvency.

Figure 2 – Estimated Changes in Expenses and Revenues from FY 2019



Using FY 19 as a base year, expenses are expected to increase by an average of 4.7 percent annually through FY 25 while revenues flatten out to 2 percent growth from FY 23 – FY 25, triggering an ever-widening budget shortfall (Figure 2). Costs drivers include:

- **Personnel**: If the MBTA plans to maintain its commitments to address safety concerns, provide Board approved additional operating services and capital delivery increases, it will need to increase staffing by approximately 500 positions. In addition, Collective Bargaining Agreements cause labor costs to increase an average of 2 percent yearly.
- **Pensions**: The MBTA must address its large unfunded pension obligation by increasing its annual contributions as a growing number of retirees puts greater stress on the system. These contributions will continue to increase by 14.7 percent annually (the average rate from FY 15 – FY 21), adding greatly to the agency's cost structure.
- **Debt service**: The MBTA plans to borrow between $1.5 - $2 billion to fund its capital program that would add approximately $15 - $20 million in annual debt service costs
- **Operating losses from GLX and South Coast Rail**: The expansion of services through the green line extension and the south coast commuter rail line add $49 million to the MBTA's annual operating losses beginning in FY 23.[4]

[4] MBTA *Five-Year Operating Budget Pro Forma (FY20-FY24)*, February 10, 2020, slide 24.

This imbalance between costs and revenues is untenable. With the Commonwealth facing its own multi-year budget deficit (see MTF report, *Massachusetts Fiscal Challenges Could Last Years*), it would be folly for the MBTA to plan on a state bailout to balance its recurring budget shortfalls.

The FMCB was able to find and implement a myriad of cost-saving and other efficiencies during its five-year term while maintaining or improving the level of MBTA services provided. The new Board will find it much more difficult, if not impossible, to realize savings without affecting current or planned service levels.

Members of the new Board face a daunting task. Nothing less than the future of the MBTA hangs in the balance.

Appendix A – FY 22 MBTA Budget Gap

Massachusetts Bay Transportation Authority				
Revenue	**FY19**	**FY20**	**FMCB Approved FY 21**	**MTF Projected FY 22**
Operating Revenues				
Revenue from Transportation	671,700,000	531,700,000	187,800,000	503,775,000
Other Operating Revenues	90,200,000	73,800,000	41,400,000	67,650,000
Total Operating Revenues:	**761,900,000**	**605,500,000**	**229,200,000**	**571,425,000**
Non-Operating Revenues				
Dedicated Sales Tax Revenue	1,053,200,000	1,088,000,000	1,083,300,000	1,107,674,250
Dedicated Local Assessments	170,100,000	174,400,000	177,900,000	181,180,257
Other Income	57,200,000	43,600,000	35,700,000	52,871,744
Additional State Assistance	127,000,000	127,000,000	127,000,000	127,000,000
Total Non-Operating Revenues:	**1,407,500,000**	**1,433,000,000**	**1,423,900,000**	**1,468,726,251**
Total Revenues:	**2,169,400,000**	**2,038,500,000**	**1,653,100,000**	**2,040,151,251**
Expenses				
Operating Expenses				
Regular Wages	438,100,000	461,300,000	489,600,000	541,092,000
Overtime	49,400,000	47,100,000	34,300,000	40,700,000
Wages Subtotal	**487,500,000**	**508,400,000**	**523,900,000**	**581,792,000**
Fringe Benefits				
Pensions	101,600,000	119,400,000	134,500,000	155,753,761
Health	99,700,000	97,200,000	102,000,000	99,956,623
Health & Welfare Fund	11,700,000	16,000,000	12,000,000	11,613,372
Workers Compensation	11,700,000	11,700,000	12,400,000	11,674,440
Fringe Benefits Subtotal	**224,700,000**	**244,300,000**	**260,900,000**	**278,998,195**
Payroll Taxes	**40,200,000**	**43,100,000**	**46,400,000**	**51,272,000**
Materials, Supplies and Services	247,600,000	260,100,000	317,100,000	335,100,493
Casualty & Liability Subtotal	**16,200,000**	**33,100,000**	**17,700,000**	17,700,000
Purchased Commuter Rail Expenses				
Fixed Price	327,300,000	335,100,000	341,900,000	
Extra Work and Services	43,200,000	50,100,000	66,800,000	
Fuel	29,700,000	25,200,000	29,100,000	
PRIIA	9,000,000	10,100,000	11,100,000	
Commuter Rail Subtotal	**409,200,000**	**420,500,000**	**448,900,000**	**464,535,678**
Purchased Local Service Expenses				
THE RIDE	121,600,000	122,000,000	128,700,000	135,473,746
Ferry	15,500,000	16,500,000	17,500,000	18,995,931
LSS Other	3,200,000	2,900,000	3,200,000	3,442,568
LSS Subtotal	**140,300,000**	**141,400,000**	**149,400,000**	**157,912,245**
Financial Service Charges	7,800,000	6,600,000	7,000,000	6,916,173
Total Operating Expenses:	**1,573,500,000**	**1,657,500,000**	**1,771,300,000**	**1,894,226,785**
Debt Service				
Interest	266,600,000	211,400,000	303,400,000	
Principal Payments	220,300,000	276,900,000	220,100,000	
Lease Payments				
Total Debt Service Expenses:	**486,900,000**	**488,300,000**	**523,500,000**	**546,458,667**
Total Expenses:	**2,060,400,000**	**2,145,800,000**	**2,294,800,000**	**2,440,685,451**
Net Revenue	**109,000,000**	**(107,300,000)**	**(641,700,000)**	**(400,534,200)**

APPENDIX B: MTF ASSUMPTIONS FOR THE FY 22 OPERATING BUDGET

Revenues

1. Revenue from transportation -- The FY 21 budget assumes a slow recovery in fare revenues from 10% in December 2020 to 60% by June 2021.

   Commuter rail represents about$250 million. Fewer commuter rail riders from a long, slow recovery and alternative work and commuting options means slower recovery than buses and subway lines. Bus and subway likely to recover more quickly if the MBTA can provide confidence in health and safety issues. Fare hikes are off the table for now, reduced enforcement of payment (such as entry through back bus doors), and factors such as means-tested fares will further restrain fare revenue growth. Best case - 90% fare recovery of FY 19 for the month of June 2022 or $500 million for FY 22.
2. Assume that other operating revenues – parking, advertising, and real estate - recover at the same percentage as fares – 75 percent.
3. Dedicated sales tax revenues – at inflation (2.25%).
4. Dedicated local assessment – inflation adjusted at five-year inflation average (1.84%).

Expenses

1. Regular wages – 2% inflation/collective bargaining agreement increase on FY 21 base <u>PLUS</u> costs from budget priorities and policy choices approved by the FMCB of $41.7 million (table below). This does not include $7.1 million for policy choices not yet approved, such as bus transformation, service enhancements, bus network design, and weekend pilots.

FY 22 Includes	FY 21 Prelim	FY 21 Approved	FY 22
Budget priorities			
safety panel recommendations	44.3	22.2	22.1
other operating initiatives	4		4
PFML	4.2		4.2
Subtotal	52.5		30.3
Policy choices			
peak bus expansion	6.5		6.5
light/heavy rail	4.9		4.9
Subtotal	11.4		11.4
FY 22 Additional Wages			**41.7**
FY 22 Does Not Include			
bus transformation	0.6		0.6
service enhancements	4.5		4.5
bus network redesign	1.4		1.4
weekend pilots	0.6		0.6
Subtotal	**7.1**		**7.1**

2. Overtime: average of FY19 and FY 20 - $40.7 million – COVID-19 related leave, PFL, PFML (starts 1/1/2021), increase in retirements, challenges in hiring. – Overtime is likely higher than FY 21 estimate of $34.3 million.
3. Pensions -- average annual increase for past six years (FY15 - FY21) – 14.65%, (FY 21 payment represents 27% of wages, up from 16.6% in FY 16).
4. Health -- assumes average cost of past five years.
5. Wellness fund -- average cost of past five years.
6. Other fringe – average cost of past five years.
7. Payroll taxes – same percentage growth as wages (10.5%)
8. Materials – average annual increase in materials for past five years (5.68%). This may be understated given that the $57 million increase in FY 20 over FY 19 represented a 22% increase in year-over-year costs.
9. Insurance – same as FY 21.
10. Commuter Rail – average annual growth rate for past five years (3.48%).
11. The RIDE - average annual growth rate for past five years (5.26%).
12. Ferry - average annual growth rate for past five years (8.55%).
13. LSS - average annual growth rate for past five years (7.58%).
14. Debt service – $20 million increase based on sale of $450 million revenue bonds at 3%, with a 30 year term.
    a. Capital Improvement Plan (CIP) includes $440 million in revenue bonds in FY 23 and $500 million in FY 24, which would add a combined $45 million in debt service costs.

<u>Other operating risks</u>

1. $127 million appropriation from state – given recent history and a $6 billion state tax revenue gap, state funding could be at risk.
2. $66 million for about 500 additional personnel from the capital budget need legislative approval for FY 20 and FY 21, or the shortfalls are larger. Use of capital funds for ongoing operational costs would be a temporary solution. If these costs are not permanently shifted to capital, the MBTA will have an even bigger gap in FY22.
3. Expanded service in order to maintain social distancing adds to operating costs.
4. Pensions – about $100 million annual cash burn; increased number of retirees, fewer employees; portfolio returns below 6% - all would increase current risks.
5. Green Line Extension (GLX) and South Coast Rail services result in an annual operating loss of $49 million in FY 23.
6. The current commuter rail contract with Keolis expires June 2020 but can be extended for two two-year extensions. How the relationship is managed during a steep decline and potentially slow recovery in ridership could prove challenging.

APPENDIX C: MTF REPORT FROM 2015 - *THE T: THE END OF ITS LINE* – CONCLUSION

While the focus of this report is the MBTA's finances, the problems confronting the MBTA encompass all aspects of its operations. Management processes, lack of oversight, and political considerations, while improved in some areas, have contributed to the MBTA's persistent problems and any viable solution must include changes to each if the MBTA is to be sustainable. The MBTA faces significant challenges on all fronts, as this report demonstrates. They include:

- Revenue sources are insufficient and are statutorily capped at rates that all but ensure that the operating deficit will increase over time.
- Expenses are significantly higher than *Forward Funding*[5] assumed and far outpace inflation and growth in projected revenue. While some reforms have been made to health insurance coverage, retirement eligibility, and other benefits, much more must be done to bring the MBTA's costs in line with its revenues.
- Due to the high amount of debt the MBTA carries, and the growing costs of paying for that debt, the MBTA is incapable of making the capital investments necessary to maintain the system at adequate levels. Eliminating the State of Good Repair (SGR) backlog has become increasingly difficult and make investment in expansions simply unaffordable and imprudent given the additional burdens it will place on the operating budget in future years.
- The MBTA lacks the management tools (functional asset management system, updated comprehensive SGR backlog list, etc.) to quantify the extent of its capital needs properly.
- Interested stakeholders need to take a more realistic, long-term and holistic approach to what future MBTA service looks like if we want the MBTA to be able to deliver reliable, safe service to its ridership for years to come.

[5] *Taking The T … To the Next Level of Progress*, MBTA Blue Ribbon Committee, Report on Forward Funding, April 2000.

APPENDIX D – SPECIAL PANEL TO REVIEW THE MBTA: KEY FINDINGS

From a press conference at the State House on April 8, 2015, the Baker Administration and members of the panel announced a summary of key findings and proposed recommendations for short- and long-term reforms.

"Massachusetts deserves a reliable, well-managed, cost-effective transportation system, and this in-depth report offers a plan of action to responsibly pursue organizational and operational reforms to reach this goal," said Governor Baker. "Thanks to the hard work of the panel members, we have action items to improve service reliability, correct the failures that would bankrupt the MBTA if left unchecked, and rescue the transportation system our economy relies upon."

- **Unsustainable Operating Budget:** The MBTA would be insolvent if not for continuing and increasing subsidies due to a severe imbalance between costs and revenue.
- **Chronic Capital Underinvestment:** The MBTA has not spent the capital funds already available to it, resulting in chronic underinvestment in its aging fleet and infrastructure.
- **Bottleneck Project Delivery:** The MBTA struggles to get projects completed.
- **Ineffective Workplace Practices:** The MBTA is ineffective at managing work due to weak workplace practices and chronic absenteeism.
- **Shortsighted Expansion Program:** MassDOT and the MBTA lack a long-range expansion strategy shaped around the physical and financial capacity of the MBTA and future needs for regional transit.
- **Organizational Instability:** The MBTA is hampered by frequent leadership changes, vacancies, and looming attrition.
- **Lack of Customer Focus:** The MBTA is not organized to operate as a customer-oriented business.
- **Flawed Contracting Process:** The MBTA's procurement and contract management is inefficient.
- **Lack of Accountability:** The Commonwealth provides more than half of the MBTA operating budget and additional funding for capital projects, but the MBTA is not accountable to the Governor or the Legislature.