



## ***Blue-Ribbon Summit on Financing the MBTA and RTAs***

### ***Background on the Finances of the MBTA and Regional Transit Authorities***

***November 1, 2010***

Like many urban transit agencies across the U.S., the Massachusetts Bay Transportation Authority (MBTA or the T) and the fifteen Regional Transit Authorities (RTAs) that together serve 256 Massachusetts cities and towns are facing a stark financial crisis. While the existence of this financial crisis is well documented, its origins and its extent are not widely understood. This background paper has been prepared for the Blue-Ribbon Summit on Financing the MBTA and RTAs on Monday November 1, 2010, convened by the Conservation Law Foundation and the Dukakis Center for Urban and Regional Policy with the generous support of the Barr Foundation. The information presented is taken from the many reports on these topics published in recent years and from publicly available budgetary data from the MBTA, MBTA Advisory Board and RTAs. This background paper is designed to help stakeholders understand:

- The evolution of the financial structure of both the MBTA and the RTAs
- The current and projected size of the transit funding gap in Massachusetts

#### **How is transit provided in Massachusetts?**

Massachusetts has sixteen transit authorities, comprised of the MBTA and the fifteen regional transit authorities. The MBTA serves 175 communities with a combined population of almost 4.7 million people. It is the fifth largest transit system in the U.S. (measured by ridership), serving 1.25 million passengers daily with four rapid transit lines and fourteen commuter rail lines providing service to more than 250 transit stations as well as 182 bus routes.<sup>1</sup>

The Commonwealth's fifteen RTAs provide fixed route bus services and paratransit services for persons with disabilities and seniors to 256 cities and towns, providing more than 30 million passenger trips annually. (Seven of the RTAs overlap the MBTA's service district.) RTAs are locally controlled, governed by advisory boards comprised of chief elected officials from member communities which have the authority to hire and terminate appoint the RTA's administrator and to approve budgets. While RTAs manage their own operations, they are required (with one exception) to provide services through competitive procurement of private contractors.

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<sup>1</sup> MBTA. 2010. *Capital Investment Program FY2011-2015* [hereafter MBTA Capital Program].

## How is transit financed in Massachusetts?

Transit authorities require funding both for annual operations and for capital spending, in order to keep the transit system in a “state of good repair” and enhance and expand their systems. The MBTA’s fiscal year (FY) 2011 operating budget is \$1.6 billion.<sup>2</sup> The MBTA’s five year capital investment program for fiscal years 2011-2015 authorizes approximately \$3.84 billion in capital spending, which equates to an annual average of approximately \$768 million. The combined budget of the fifteen RTAs in FY2010 was \$265.3 million. The state and federally funded capital program for the 15 RTAs for FY2011 is \$76.5 million (including the RTAs’ use of the federal Transportation Development Credit financing tool).

The operations of the MBTA and the RTAs are financed with a combination of revenue sources. Operating revenues, sometimes called “own source revenues,” include fare revenue and other revenue (from advertising, parking and real estate leases). Dedicated revenues come from local and state sources that have been legislatively “dedicated” for the exclusive use of a transit authority, such as local assessments paid by cities and towns receiving transit service. Transit authorities also receive a small amount of miscellaneous income (from interest and federal funds, for example). But what happens when these revenue sources together fail to cover the authorities’ operating expenses? The answer to this question has changed in recent years and is different for the MBTA and the RTAs, as explained below.

Sources of revenue for capital spending include federal grants, state infrastructure funds and issuance of debt in the form of bonds or grant anticipation notes. A portion of capital spending may also be funded on a “pay as you go” basis when revenues exceed operating costs, but such funding is not available when transit authorities cannot cover operating expenses out of available revenues. All but three of the RTAs serve designated urbanized areas and therefore receive federal capital funding from Federal Transit Administration grant programs (although a twenty percent local match from a non-federal source is required, which historically has come out of the transportation portion of the Commonwealth’s bond cap). The RTAs in Franklin County, Martha’s Vineyard and Nantucket serve rural areas and therefore receive FTA grant money that can be used for either operating or capital expenses; in practice such funds are generally dedicated to operating expenses so all capital funds for these RTAs must come from the Commonwealth.<sup>3</sup>

*MBTA Finances Before Forward Funding:* Prior to 2000, the MBTA received an unlimited “net cost of service” payment from the Commonwealth to offset costs incurred in the previous fiscal year for providing bus and rail service within the metropolitan Boston region. The MBTA would conduct operations for a fiscal year and then, in essence, submit a bill to the Commonwealth to cover its financial deficit. This system was referred to as “backward funding” in the November 2009 D’Alessandro report, which explained that “[b]ackward funding created no expectations or incentives for the MBTA to control spending or grow its revenues because the State was required to cover its deficits. As the size of the deficits grew larger, the annual bill presented to the State was aptly deemed a ‘budget buster.’”<sup>4</sup>

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<sup>2</sup> *Staff Summary for MBTA 2011 Operating Budget Board Action* [hereafter MBTA 2011 Budget] available at [www.mbta.com](http://www.mbta.com).

<sup>3</sup> MassDOT Office of Transportation Planning. 2010. *Draft FFY2011-2015 Highway Capital Investment Plan*.

<sup>4</sup> D’Alessandro, D., Romary, P., Scannell, L.J. & Woliner, B. 2009. *MBTA Review* [hereafter D’Alessandro Report] at 5.

Prior to 2000, the MBTA had limited responsibility for funding its capital program. As the MBTA Advisory Board has explained, before forward funding “the MBTA did not issue debt for major projects. Instead, the Commonwealth borrowed for transit projects on the T’s behalf and paid back these debts over time.”<sup>5</sup>

*Forward Funding the MBTA:* The so-called Forward Funding legislation was enacted in 1999 and took effect at the beginning of FY2001, on July 1, 2000. The goal of the Forward Funding legislation was to “transform the MBTA from an agency that bills the State for its operating deficits to a system that sustains itself from an identifiable revenue stream. In terms of the MBTA’s operations, this would require greater cost efficiency and revenue enhancement.”<sup>6</sup>

The legislation tied the MBTA’s funding to the Commonwealth’s sales tax revenues, setting aside twenty percent of those revenues – one cent from the then-five cent sales tax (excluding meals taxes) as a dedicated revenue stream for the T. In addition, the forward funding legislation restructured revenue from local assessments paid by cities and towns served by the MBTA, expanding the number of communities required to pay local assessments but also setting the total amount of such assessments and providing for a decrease in total local assessments through FY2006 (after which assessments grow by the lesser of the rate of inflation or two and one-half percent). The plan was for the MBTA to have the dedicated sales tax as its sole state subsidy and balance its budget by internally managing its costs and other revenue sources.

Another major change made by the Forward Funding legislation involved the MBTA’s capital budget and how projects were to be financed. Under forward funding, “the MBTA gained the authority to issue debt and the responsibility to pay it back.”<sup>7</sup> Forward Funding also transferred \$3.2 billion in debt from the Commonwealth to the MBTA.<sup>8</sup> Ten years later, the MBTA calculates that \$1.68 billion of its current outstanding debt of \$5.5 billion remains prior obligation debt. Additional prior obligation debt is included in the \$1.47 billion in debt that the MBTA classifies as “legal commitments” debt incurred to fulfill the Central Artery transit requirements (with the \$1.47 billion including a mix of prior obligation debt and new revenue bonds issued since 2000).<sup>9</sup>

*Implementation of MBTA Forward Funding:* In order to implement forward funding, the MBTA developed a Finance Plan which set benchmarks for revenue and operating costs for fiscal years 2001 through 2008. The recent D’Alessandro report compared actual outcomes to those benchmarks and projections; the report’s findings are summarized in the table on the following page. Expectations about how forward funding would play out proved untrue on both the revenue and expense sides of the ledger. With respect to revenue, sales tax revenues grew more slowly than projected, resulting in a cumulative sales tax shortfall of \$460 million (from FY01-08). (However, because the legislation provided for a minimum level of funding, the actual sales revenue shortfall has been closer to \$150 million.) With respect to expenses, the D’Alessandro

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<sup>5</sup> Kane, B. 2009. *Born Broke: How the MBTA Found Itself with Too Much Debt, the Corrosive Effects of this Debt, and a Comparison of the T’s Deficit to Its Peers*. MBTA Advisory Board [hereafter *Born Broke*] at 2.

<sup>6</sup> D’Alessandro Report at 5.

<sup>7</sup> *Ibid.*

<sup>8</sup> *Ibid.*

<sup>9</sup> MBTA 2011 Budget.

report concluded that the “main driver . . . of why Forward Funding failed was unavoidable cost explosions”<sup>10</sup>, with the four major expense categories being fuel and utilities, payroll and fringe benefits, The Ride (required paratransit services) and commuter rail expenses.

**D’Alessandro Report Key Findings:  
Comparison of MBTA Finance Plan for FY01-08 to Actual Outcomes**

	<u>Finance Plan</u>	<u>Actual Outcome</u>
State Sales Tax Revenue	3% growth per year	1% growth per year
Operating Costs	2% decrease per year	4-5% increase per year
Overall Budget	Balanced	Net Deficits
Cash Flow	Fewer short-term fixes	Multiple debt restructurings and one-time cash infusions
Cash Surpluses	5-10% of gross revenues	0%

*Transportation Reform:* In June 2009, Chapter 25 of the Acts of 2009, or “An Act Modernizing the Transportation Systems of the Commonwealth of Massachusetts,” was signed into law. This transportation reform legislation created a single state transportation department, the Massachusetts Department of Transportation (MassDOT), as of November 1, 2009.

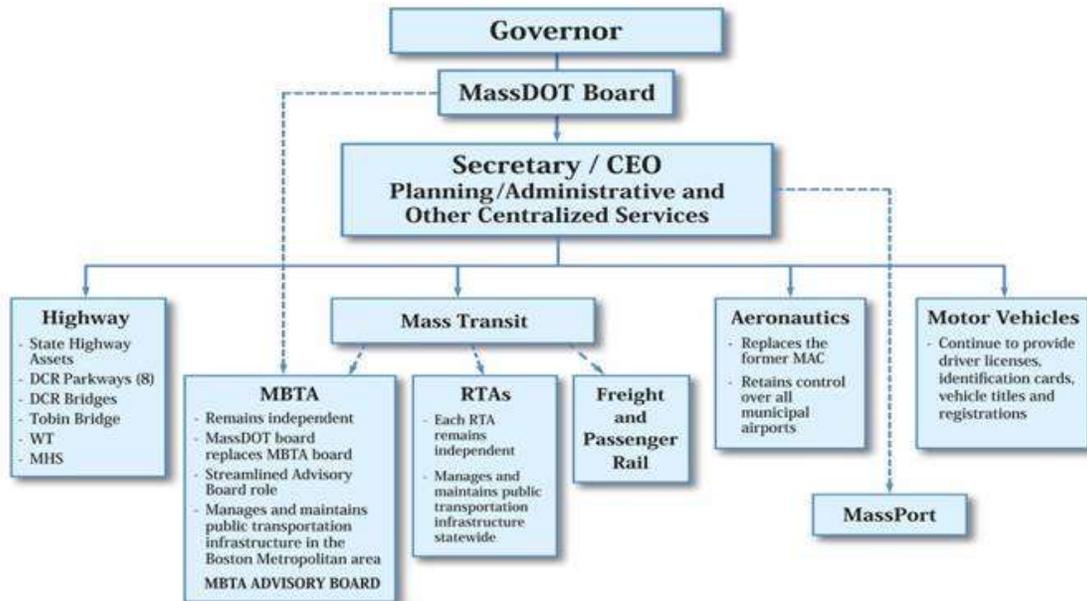
Under transportation reform, the MBTA remains a separate legal entity, but is subject to greater levels of oversight by and coordination with MassDOT. The MassDOT and MBTA Boards of Directors have the same five members to allow for improved communication, coordination and planning among the MBTA, MassDOT and the Commonwealth. But, as a separate entity, the MBTA maintains its own financial systems, reporting and debt service. Both the MBTA and the RTAs are subject to oversight by the Rail and Transit Division of MassDOT. (See organization chart on the following page.)

Under transportation reform, the Commonwealth’s transportation system is funded from five sources (state taxes, motor vehicle fees, federal funds, toll revenue and bond proceeds) and administered through two separate funds, the Commonwealth Transportation Fund (CTF) and Massachusetts Transportation Trust Fund (MTTF). The Commonwealth Transportation Fund replaces the former Highway Fund as the principal source of transportation-related revenues and expenditures for the Commonwealth. CTF retains revenue from the \$0.21 per gallon excise tax on gasoline and diesel fuel and from motor vehicle fees (vehicle license, registration and driver’s license fees). In addition, as part of the Commonwealth’s fiscal year 2010 budget, the Massachusetts sales and use tax was increased from five percent to six and one-quarter percent and 0.385 percent of the state sales tax was directed to the CTF. (Outside section 138(b) (i) of the FY10 budget legislation provides that \$160 million annually from this sales tax revenue must go to the MBTA and \$15 million to the RTAs.)

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<sup>10</sup> D’Alessandro Report at 7.

## MassDOT Organizational Chart



The revenues that go into the CTF are used to cover the state’s obligations with respect to debt service, contract assistance and other state transportation programs. Remaining funds from the CTF are transferred into the second fund, the Massachusetts Transportation Trust Fund. The MTF funds the operation of MassDOT and also supplemental assistance to the MBTA and RTAs. It receives tolls and other fee-based revenue collected by MassDOT as well as the funds from the CTF transferred each year through the state budget.

*Regional Transit Authorities:* The fifteen RTAs rely on a combination of fares, local assessments levied on cities and towns within their respective service districts, operating subsidies provided by the Commonwealth and federal grants. In FY2010, the RTAs had a combined \$265 million in operating costs, of which \$136 million was covered by fares and other system revenue, \$36 million by federal grants, \$26 million by local assistance and \$59 million by state assistance. In 2007 the Transportation Finance Commission identified problems with the RTAs’ revenue structure (some of which have been addressed by the transportation reform legislation) which resulted in the need for RTAs “to cut services significantly in recent years,”<sup>11</sup> including

- Local assessments are capped by Proposition 2½ to growth of no more than 2.5 percent annually;
- State contract assistance has increased only minimally since FY 2002; and
- RTAs are funded in arrears by legislative appropriation, forcing them to borrow funds and incur additional interest expenses.

The 2000 forward funding legislation applied to the MBTA but not to the RTAs, which continue to be reimbursed through the state budget for a portion of their “net cost of service.” Each year,

<sup>11</sup> Massachusetts Transportation Finance Commission. 2007. *Volume 2: Building a Sustainable Transportation Financing System* [hereafter TFC Volume 2] at 18-19.

revenues are deducted from expenses to calculate an RTA's net cost of service. RTA member communities are then assessed at least twenty-five percent and not more than 50 percent of this net cost of service; the assessment is deducted from local aid payments. The Commonwealth provides at least fifty percent and not more than seventy percent of the net cost of service to the RTA.<sup>12</sup> This contract assistance to the RTAs was, for example, budgeted at \$44 million in FY 2010 (supplemented by an additional \$15 million from the sales tax increase). Pending receipt of contract assistance and local assessments, many RTAs have to borrow funds using Revenue Anticipation Notes (RANs) to cover the interim funding gap. The Transportation Finance Commission estimated that "about half of the RANs are attributable to state contract assistance with the other half issued to cover local assessments," with the RTAs incurring about \$2.4 million in interest expense on RANs in FY2009.<sup>13</sup>

Until the current fiscal year, a line item in the state budget (6005-0015) provided contract assistance to the RTAs. In the fiscal year 2011 budget, the first adopted under the new transportation reform legislation, the budget provided the same \$44 million in state assistance to the RTAs from the Commonwealth Transportation Fund. The 2009 transportation reform legislation will further change the funding system for the RTAs beginning in fiscal year 2012. Section 152 of the legislation provides that "all regional transit authorities . . . shall move to a forward funded budgeting system not later than July 1, 2011" and requires the Secretary of Administration and Finance to seek the necessary appropriations to fund the changeover.

### **How large is the transit funding gap in Massachusetts?**

To answer this very complicated question, we will first review the findings of the Transportation Finance Commission and then examine separately the MBTA's unmet needs with respect to transit operations (including debt service), maintenance and capital expansion. The Commission noted that it was unable to incorporate a gap analysis for the RTAs "[d]ue to the complexities in evaluating the operations and capital needs of the fifteen separate Regional Transit Authorities" although it emphasized that these agencies serve a valuable transportation function, and will undoubtedly need additional resources."<sup>14</sup>

*Transportation Finance Commission:* In 2007 the Transportation Finance Commission released its oft-cited "gap analysis" of the difference between the Commonwealth's projected transportation revenues and its needs for operating and capital funds. The Commission concluded that to "simply bring the *existing* surface transportation system to a state of good repair and maintain it at that level, Massachusetts will need to close at least a \$15 to \$19 billion funding gap over the next 20 years."<sup>15</sup> The MBTA system itself accounted for between \$4 and 8 billion of this gap.<sup>16</sup> The \$4-8 billion shortfall for the MBTA did not include any planned capital expansions or enhancements except for the Central Artery transit commitments. The Commission nonetheless noted that

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<sup>12</sup> MBTA and Regional Transit Authorities. 2005. *Coordination and Efficiencies Report*.

<sup>13</sup> Massachusetts Transportation Finance Commission. 2007. *Transportation Finance in Massachusetts: An Unsustainable System* [hereafter TFC Volume 1] at 10.

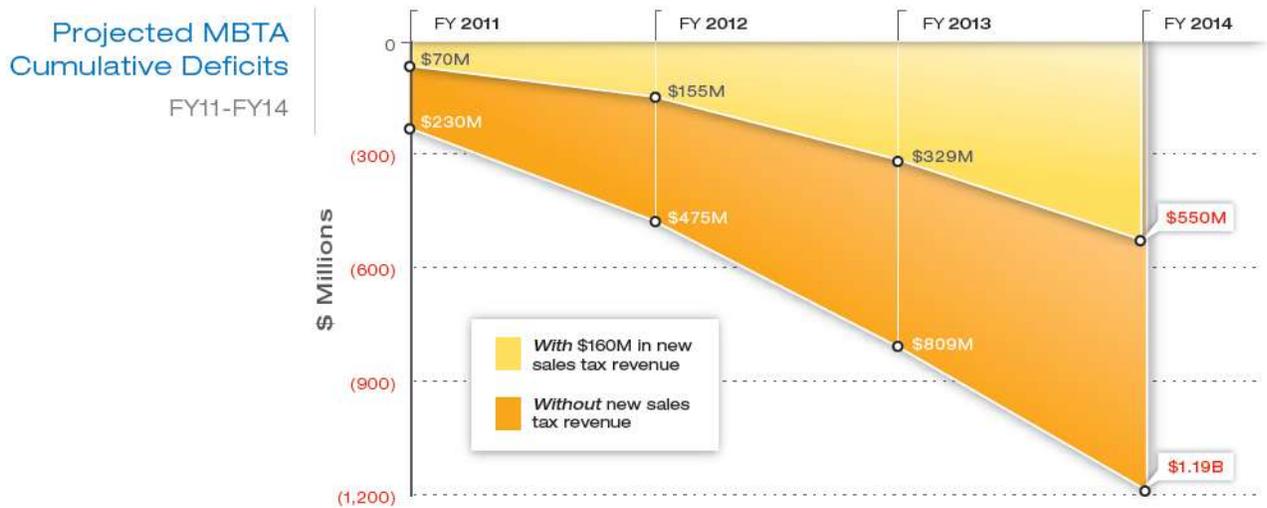
<sup>14</sup> *Ibid* at 50.

<sup>15</sup> TFC Volume 1 at 31.

<sup>16</sup> *Ibid.* at 50.

“[t]here is an enormous pool of potentially worthy projects” and that “the Commonwealth obviously must invest in transit and highway enhancements and expansions over the next two decades to support a growing population and an expanding economy. This will cost billions of dollars not included in the gap analysis.”<sup>17</sup>

*Projected Operating Deficits:* The Transportation Finance Commission admonished the MBTA for failing to control its operating expenses, finding that “[o]ne of the key cost drivers facing the MBTA is the very generous package of retirement benefits – both pensions and health care.”<sup>18</sup> More than two years later, in late 2009, the MBTA Review organized by David D’Alessandro at the request of Governor Patrick conducted a “frank assessment” of the MBTA’s operating deficit and projected operating deficits through FY 2014. The projections were made both with and without the \$160 million in additional sales tax revenue appropriated in the FY 2010 budget (since that amount must be appropriated annually and the state is under no obligation to continue that funding). The projections show that the MBTA’s cumulative deficit from FY2011-2014 could total \$550 million even if this additional revenue continues to be provided annually.<sup>19</sup> Even if the MBTA retains the additional \$160 million appropriated from the sales tax increase, annual shortfalls of \$70 – 220 million will have to be addressed.



The D’Alessandro report identifies several cost categories that are driving the MBTA’s rising costs and operating deficits:

- Fuel and Utilities: The MBTA has massive needs for fuel and electricity and is therefore vulnerable to rising energy costs; fuel and utility costs rose by more than 120% between FY01 and FY08.<sup>20</sup>

<sup>17</sup> Ibid at 56.

<sup>18</sup> Ibid at 4.

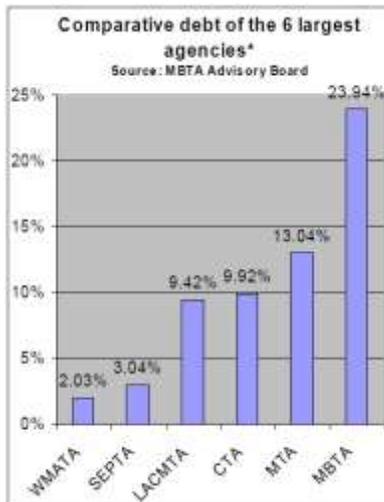
<sup>19</sup> D’Alessandro Report at 3.

<sup>20</sup> D’Alessandro Report at 8.

- **Wages and Fringe Benefits:** The majority of the MBTA's 6,000+ workers are represented by one of twenty-eight unions and so changes in wages and benefits are subject to collective bargaining. The transportation reform legislation began to address health care and pension costs, providing that MBTA employees would move to the state health insurance plan and limiting early retirement. In terms of wages alone, the D'Alessandro Report found that the MBTA's rates are similar to those of other large U.S. transit systems.<sup>21</sup>
- **The RIDE:** The MBTA is required by the Americans with Disabilities Act to offer complementary door-to-door transport service for certain eligible individuals. Costs for this service, called the RIDE, have increased due to vendor fees, fuel costs, and increased ridership.<sup>22</sup> The costs of this service have grown from \$21.4 million in FY2000 to \$85.9 million in the FY2011 budget.<sup>23</sup>

*Debt Service:* A major factor in the MBTA's operating deficit is its debt burden. The MBTA Advisory Board has found that "[t]he MBTA is unique among its peers in that it lacks a dedicated revenue source for debt service or capital maintenance. Among its peers, the MBTA spends the most on debt service as a percentage of funds also available for operating costs."<sup>24</sup>

As noted above, the debt problem began when Forward Funding was implemented and the MBTA inherited \$3.3 billion in debt obligations from the state.<sup>25</sup> This amount consists of approximately equal halves of "prior obligation debts" – borrowings by the Commonwealth to finance public transportation prior to 2000 – and "legal commitment debts" – borrowings corresponding to



public transportation projects the state was legally obligated to build as part of the Big Dig. In 2000, responsibility for the completion of legal obligation projects was transferred to the MBTA and the MBTA borrowed additional funds from 2000 through 2007 to fund construction of these

<sup>21</sup> Ibid at 9.

<sup>22</sup> Ibid at 10.

<sup>23</sup> MBTA 2011 Budget at 4.

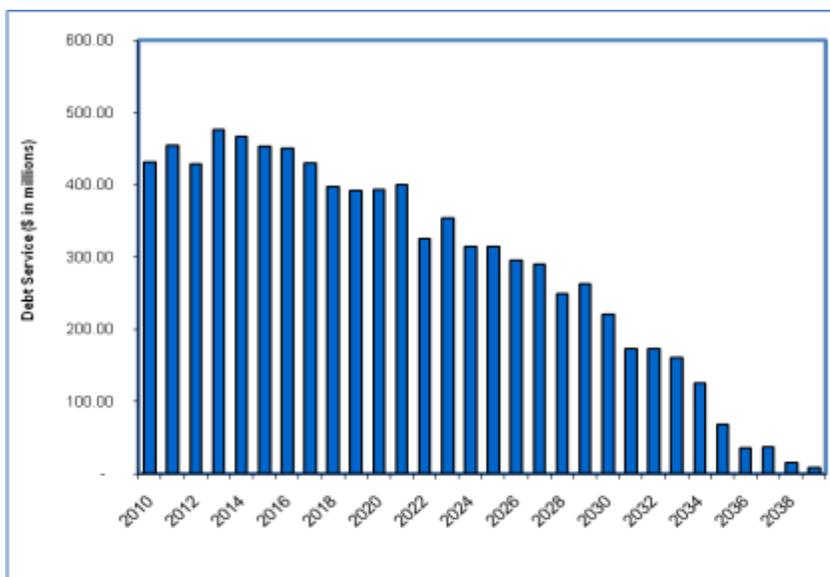
<sup>24</sup> Born Broke at 15-16.

<sup>25</sup> Ibid at 2.

projects. In 2007 the state re-assumed responsibility for the projects, but the debt borrowed in the intervening years remains the MBTA’s responsibility.<sup>26</sup>

As of the FY09 close, the MBTA had a total of \$8.6 billion of debt outstanding, comprised of \$5.3 billion in principal and \$3.3 billion in interest.<sup>27</sup> Because the MBTA has not been able to generate any cash surpluses, it has been forced to take on additional debt and to restructure existing debt in order to fund its operating and capital needs. The MBTA has an additional \$2.2 billion in principal it has borrowed since 2000 to fund its capital improvement program.<sup>28</sup> The T also restructured over \$2 billion in debt during fiscal years 2005-2008 to reduce principal and interest costs and has continued to restructure debt to lower short-term debt service payments. As a result, payments on the MBTA’s debt, including principal and interest, extend through 2039 and will be more than \$400 million annually until 2022, even if no additional debt is issued.<sup>29</sup> The D’Alessandro report characterized the MBTA’s “extreme debt restructuring in recent years” as a “Faustian Bargain” that repeatedly shifts the problem of paying down debt to another year’s budget.<sup>30</sup>

The MBTA’s debt service obligations constitute nearly one-quarter of the T’s FY2011 budget. The more than \$400 million in principal and interest payments budgeted for FY2011 nearly consumes all \$450 million in projected fare revenue.<sup>31</sup>



*Maintenance/State of Good Repair:* The MBTA, along with the Federal Transit Administration and other transit systems, has adopted the State of Good Repair (SGR) standard to determine how much capital spending is required for proper maintenance. The MBTA defines SGR as “a standard wherein all capital assets are functioning at their ideal capacity within their design life.”<sup>32</sup>

<sup>26</sup> Ibid. at 3.

<sup>27</sup> KPMG. 2009. Massachusetts Bay Transportation Authority FY09 Audited Financial Statements at 21.

<sup>28</sup> MBTA 2011 Budget at 7.

<sup>29</sup> Ibid at 8-9.

<sup>30</sup> D’Alessandro Report at 20-21.

<sup>31</sup> Ibid.

<sup>32</sup> D’Alessandro Report at 22.

Each year, the MBTA compiles a list of projects that are necessary to achieve SGR. The MBTA continues to state that it needs to spend \$470 million annually “to maintain the current \$2.7 billion backlog in much needed state of good repair projects.”<sup>33</sup> The Transportation Finance Commission, however, noted that achieving SGR within twenty years would actually require spending \$570 million annually, meaning that even if the T achieves this spending target it is falling behind by \$100 million annually.<sup>34</sup> This warning was confirmed by the D’Alessandro Report in 2009, which found that the backlog is getting worse, stating “the SGR backlog exceeds \$3 billion and the annual allocation needed to prevent it from growing larger will be \$694 million, \$224 million more than the annual level of recent years.”<sup>35</sup>

Given this higher estimate for needed SGR funding, it is troubling that the MBTA’s recently-issued five year Capital Investment Program states that the T’s “long-standing commitment to fully fund state of good repair projects (at least \$470 million annually) is in jeopardy.”<sup>36</sup> The vast majority of the approximately \$3.84 billion authorized to be spent over the next five years is for SGR. (The plan also projects spending to complete legally required Artery transit commitments but includes equal amounts of state funding, reflecting the Commonwealth’s decision to shift the cost of those commitments off of the MBTA.) But the preface to the Capital Investment Program notes that “[w]ithout debt relief or a more extensive pay-as-you-go capital program the Authority may not be able to afford to invest funds in many of the projects described in this document.”<sup>37</sup>

*Capital for Expansion:* Neither the Transportation Finance Commission’s “gap analysis”<sup>38</sup> nor the MBTA’s Capital Investment Program<sup>39</sup> includes the cost of expanding or enhancing the MBTA transit system (beyond completing legally-required projects such as the Green Line extension through Somerville to Medford Hillside). Transit advocates, however, argue that transit capacity and ridership need to expand to support economic growth and the reduction of greenhouse gas emissions in Massachusetts and to provide service to communities that have been shortchanged in the past.<sup>40</sup> Transit expansions will further increase the amount of resources needed by the MBTA, both for capital to build the projects and funds to operate them.

At this time, no comprehensive estimate exists for the capital and operating costs of the myriad of potentially desirable MBTA and RTA enhancement and expansion projects.

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<sup>33</sup> MBTA Capital Program at 8.

<sup>34</sup> TFC Volume 1 at 17.

<sup>35</sup> D’Alessandro Report at 23.

<sup>36</sup> MBTA Capital Program at 7.

<sup>37</sup> Ibid.

<sup>38</sup> TFC Volume 1 at 56.

<sup>39</sup> MBTA Capital Program.

<sup>40</sup> Pollack. S. 2009. “To Derail Economy, Put the T On Hold” *Boston Globe* (op ed).