The Massachusetts Bay Transportation Authority

2008 Report to the Legislature

Massachusetts Bay Transportation Authority

Driven by Customer Service

The Massachusetts Bay Transportation Authority ("MBTA," or "Authority") owns and operates America's oldest subway system, having provided over a hundred years of subway service. Throughout its history, the Authority has played a vital role in the economic success of the region and has expanded dramatically to meet an ever-increasing demand for transit. This report highlights both the accomplishments and challenges the MBTA experienced during 2008 as it continues to reshape the nation's oldest subway system.

1. Inside the MBTA

The MBTA is the oldest and fifth largest transit system in the country; operating subway, trackless trolley, trolley, bus, water ferry, and commuter rail service throughout eastern Massachusetts. The Authority serves 175 communities and is responsible for an estimated 1.3 million passenger trips every business day. The MBTA effectively delivers service to a population of 4.7 million people dispersed over an area of 3,200 square miles by way of three heavy rail lines, a light rail line, one bus rapid transit line, and over 200 bus routes. The MBTA's commuter rail lines provide service as far south as Providence, Rhode Island, and as far north as Newburyport and as far west as Worcester. In addition, the MBTA provides a broad range of other passenger services including commuter boats, express buses, and "The Ride" which services the elderly and disabled.

A nine-member Board of Directors manages the Authority's affairs. The Secretary of the Executive Office of Transportation serves as the Chairman of the Board. Governor Patrick appointed James Aloisi Jr. as Secretary and Board Chairman in December 2008. The Board has the power to appoint and employ a General Manager and other officers. In May 2005, the Board of Directors appointed Daniel A. Grabauskas General Manager of the MBTA. An Advisory

Board, consisting of representatives from each of the cities and towns constituting the MBTA's service district approves the Authority's annual operating budget and reviews its Capital Investment Program (CIP). The Authority's organizational structure is presented in Appendix I.

2. Fiscal Year 2008 Financial Performance

On July 1, 2000, the Commonwealth created a new financing model for the MBTA, often referred to as "Forward Funding." Under the Authority's Enabling Act (chapter 161A of the General Laws of Massachusetts) the Authority develops and operates within a fixed budget. In this fiscally constrained environment, the MBTA must maximize its own revenue sources and place well-defined limits on operating costs and capital investments.

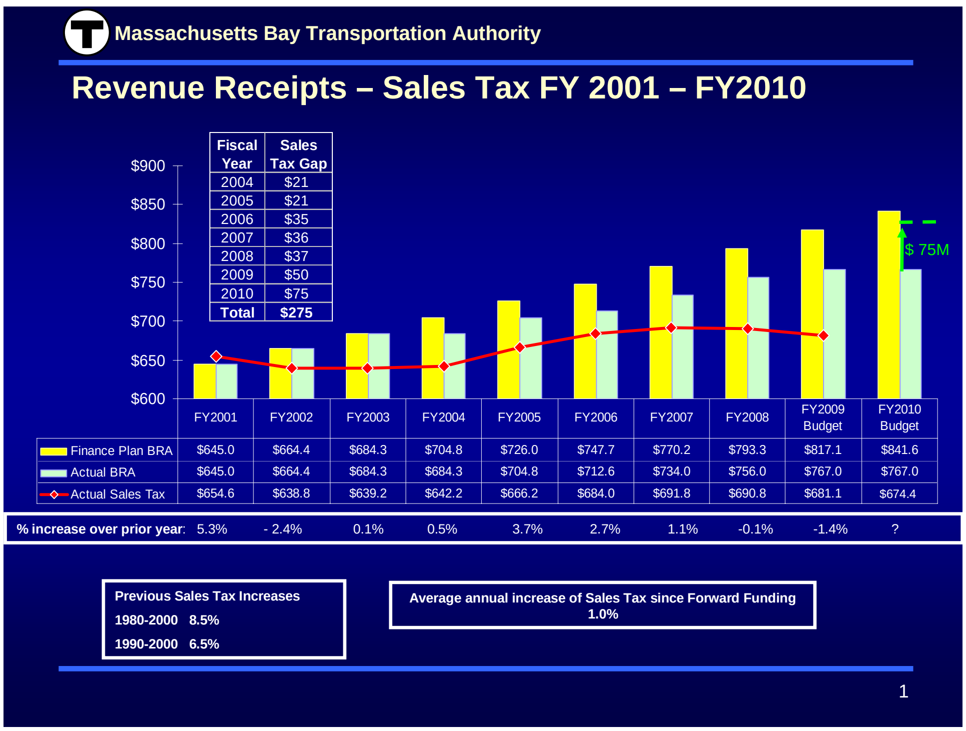
2.1 Revenues

The FY 2001- budget FY 2009 statements of revenues and expenses are presented in Appendix II. Total revenues for FY 2008 were $1.41 billion. The Authority collected $441 million in fare revenues in FY 2008, a $54.5 million increase over FY 2007.

Advertising, real estate, and other non-transportation revenues were $67.9 million, an $11.4 million decrease attributable largely to a decline in the number of real estate sales, which often are unpredictably cyclical and have long transaction completion periods.

Under Forward Funding, the Authority receives a dedicated revenue stream consisting of assessments paid by the 175 cities and towns in its service district, and the greater of the amount raised by 20% of the existing statewide 5% sales tax (subject to certain exclusions such as meal tax), or the base revenue amount. In FY 2008, the Authority again received the base revenue amount in sales tax revenue ($756 million) as well as local assessment revenue of $143 million. Sales tax revenue for FY 2009 is again set at the minimum base revenue amount of $767 million, the third consecutive year of sub-3% increases. In FY 2010, the sales tax collections are projected to decrease, resulting in no increase to the base revenue amount. Since the advent of forward funding, sales tax revenue to the Authority has lagged over $275 million from even the most conservative revenue estimates envisioned by the forward funding finance plan (See Figure 1).

Figure 1: Sales Tax Receipts Compared to Forward Funding Finance Plan



2.2 Real Estate Operations, Advertising, and Parking

The Authority generated $47 million in revenue during FY 2008 from real estate operations, advertising, and parking. Non-transportation revenue generated by the use of MBTA-owned real estate includes: sale and grant of easements of surplus parcels; leasing of land and buildings such as concession/vendor space, advertising, abutter uses, and telecommunication facilities, curing of encroachments, and licensing for the use of land and buildings such as outdoor advertising (billboards) and underground utilities/fiber optics.

The Authority entered into new parking contracts in FY 2008, changing the fundamental structure of the agreements. Under the prior structure, the vast majority of the Authority's parking revenue was comprised of the annual fixed fee received from the parking vendor. Under the new structure, the Authority will pay the parking vendors a fixed management fee plus certain expenses and receive the parking revenue directly. The cumulative total cost of the six three-year contracts is $17.8 million, an annual expenditure of $5.9 million. Compensation is based on a fixed annual management fee and is paid from revenues generated by MBTA parking facilities.

In fiscal year 2008, parking facilities generated over $25.6 million in gross receipts (including both South Station bus terminal and North Station revenues). Revenues under the new agreement terms are projected to reach $40.5 million in FY 2009. Under the terms of the new parking management structure, the Authority will also be able to improve customer service by deploying technology advancements where appropriate across the parking system. An example of this is the pilot "park and pay by phone" program recently initiated on the Kingston commuter rail line.

2.3 Expenses

Total expenses for FY 2008 were $1.407 billion. Operating expenses of $1.047 billion accounted for 74% of total expenses. Debt service expenses were $369 million, or 26% of the total expenses. The FY 2009 and FY 2010 debt service budgets are $368 million and $445 million respectively. The FY 2009 budget includes a $42 million draw on reserve funds;

continuing an unsustainable pattern of escalating debt service and decreasing revenues, and cannot be covered by the Authority's modest reserve funds.

2.4 Financing

Since 2000 and the advent of forward funding, MBTA no longer issues bonds backed by a guarantee of the Commonwealth of Massachusetts. The Authority has established its own credit structure and now issues bonds under two separate and independently rated credits backed by dedicated revenue sources; Sales Tax receipts and Assessment funds collected from MBTA member communities. Sales Tax bonds are secured by the dedicated sales tax revenues received by the Authority from the Commonwealth of Massachusetts and Assessment bonds are secured by the assessments paid to the MBTA by the 175 cities and towns in the MBTA district. Debt issued by the Authority prior to forward funding remains an obligation of the MBTA and is defined as "Prior Obligations."

During FY 2008, the MBTA's Sales Tax Bonds and Assessment Bonds maintained their high ratings. Standard and Poor's continued to rate both MBTA's Sales Tax bonds and Assessment bonds AAA. Moody's rates Sales Tax bonds and Assessment bonds Aa2 and Aa1, respectively. During fiscal year 2008 the Authority issued two series of Sales Tax bonds: the 2008 Series A Sales Tax bonds in the amount of $256,375,000 and the 2008 Series B in the principal amount of $49,770,000. Both of these bond issues were used to refinance higher interest debt, pay interest at a variable rate, and are hedged by swap agreements. The Authority also issued $105,775,000 in commercial paper to refund the Series 2003 B Auction rate bonds in the amount of $93,375,000 and to fund $12.4 million in capital projects.

3. MBTA's Capital Investment Program

The Capital Investment Program (CIP) is a guide to the MBTA's five-year capital budget. The CIP is a strategic planning document that programs funds over a five-year horizon to meet the MBTA's operational objectives within its financial capacity. The document describes the MBTA's infrastructure and the capital needs to maintain the system, outlines ongoing and programmed capital projects, and details planned projects to expand the transportation network. Unlike the Program for Mass Transportation (PMT) and other planning documents, the CIP is financially constrained – only capital projects with identified funding are included. Given the Authority's financial limitations and its vast array of infrastructure, the capital needs identified each year usually exceed the MBTA's capacity to provide funding.

Therefore, the MBTA engages in an annual prioritization process to select the highest priority needs for funding and inclusion in the CIP. Prioritization of projects to be included in the CIP is based on the following criteria as defined in the MBTA's enabling legislation; the impact of the project on the effectiveness of the Commonwealth's transportation system, service quality, the environment, health and safety, the state of good repair of MBTA infrastructure, and the Authority's operating costs and debt service.

Overall, the Authority funds the CIP prioritizing reinvestment in the existing system in compliance with the MBTA's legal commitments for expansion and other projects, and Americans with Disability Act (ADA) requirements.

In light of the significant financial challenges the MBTA is currently facing, specifically its tremendous debt burden, current and anticipated wage and benefit costs, and the precipitous decline in the receipt of projected and dedicated revenues since the inception of Forward Funding, the MBTA's financial condition is precarious and not sustainable at current levels of operating and capital commitments. As a result, the Capital Investment Program is at a crossroads. Without legislation providing new revenue or debt relief the Authority may not be able to afford to invest funds in many of the projects described in the CIP.

Although the Massachusetts legislature is considering transportation reform and a variety of options to raise revenue, the source and amount of net new revenue dedicated to the MBTA, if any, is highly uncertain at this time. Without net new revenue or substantial debt relief the Authority may not be able to fund the projects in this CIP. Borrowing the $1.0 billion required to fund many of this 2010-2014 CIP is not affordable within the constraints of existing available revenue, and would not be prudent in the face of projected increasing deficits. The following charts present the proposed capital funding sources and allocation for the FY2010 – FY 2014 CIP.

Massachusetts Bay Transportation Authority
Capital Investment Program FY10 - FY14

Chart 1 - MBTA Capital Funding Sources

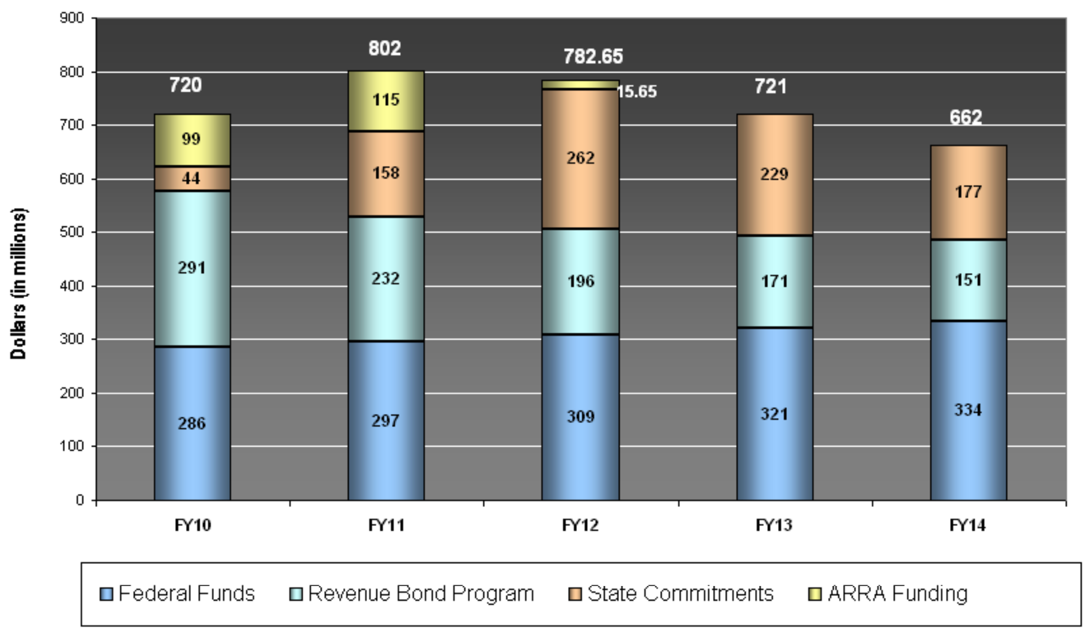
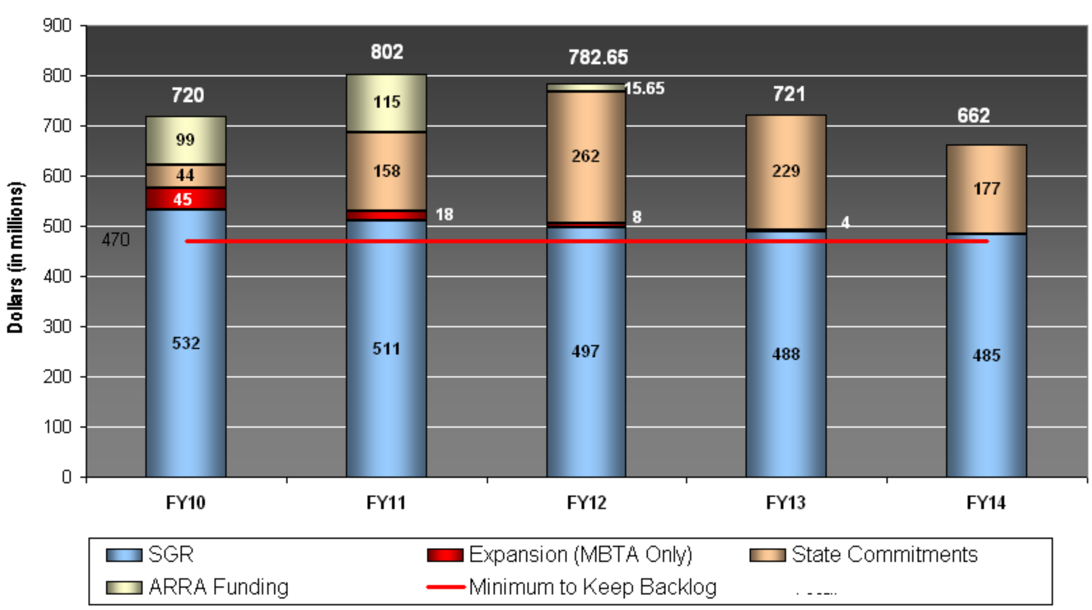


Chart 2 - Funding Allocation



3.1 State of Good Repair Spending

One of the highest priorities for the MBTA is the pursuit of a “State of Good Repair.” To measure the need for capital expenditures devoted to maintaining and replacing existing infrastructure, transit systems use the State of Good Repair standard, wherein all capital assets are functioning at their ideal capacity within their useful design life.

While few transit systems are likely to achieve this ideal, the standard does identify a level of ongoing capital needs that must be addressed over the long-term for the existing infrastructure to continue to provide reliable service.

To assist in this, the MBTA employs a State of Good Repair database to help guide its capital decisions. Based on an inventory of all existing MBTA capital assets, the model allows the MBTA to track the capital investment needs for the Authority’s existing infrastructure, and to develop a capital investment program to maintain the system in a state of good repair. Based upon this model, the Authority must invest $470 million annually in order to maintain the current $2.7 billion backlog in state of good repair projects and $570 million annually to eliminate the backlog over 20 years.

The Authority is in the process of updating the State of Good Repair Database, including a new module to measure the impact of State of Good Repair investments (or disinvestments) on the operating budget.

3.2 Sources of Funding

The MBTA’s capital program is funded by revenue bonds, pay-as-you-go capital, federal grants, project financing, state infrastructure funds, and other sources. Given the constraints on the Authority's finances, the MBTA's goal is to transition from a high reliance on debt financing to greater use of pay-as-you-go financing of capital projects. The transition from debt financing to pay-as-you-go capital funding will take time and discipline, and depends, to a large extent, on factors beyond the MBTA's control, such as ridership trends and the growth in sales tax collections. As previously described, the MBTA has been dramatically affected by the anemic growth in sales tax revenues over the last several years and is therefore still dependent on revenue bonds to finance its share of Capital Investment Program spending.

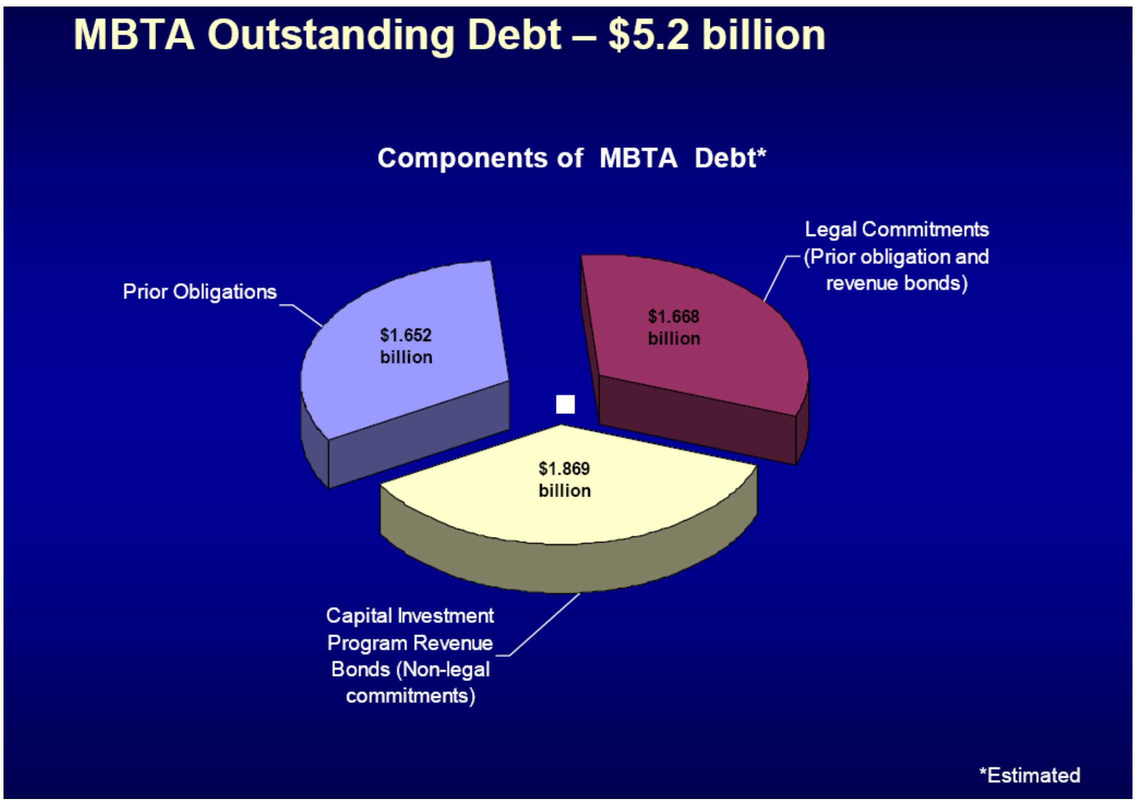
The MBTA would need to issue $1.0 billion in revenue bonds and utilize an additional $1.5 billion in federal grants to fund much of the $3.7 billion in total spending envisioned in the 20010-2014 Capital Investment Program, with the balance of funds coming from pay-as-you-go capital, state funds, and project financing.

Federal funding is a major component in determining the level of capital investment the Authority is able to program. Federal aid for transit programs has historically been provided pursuant to multi-year authorizations. The current authorization, the Safe Accountable, Flexible, Efficient Transportation Equity Act (SAFETEA-LU), provides funding through the 2009 federal fiscal year.

3.3 FY 2010 Debt Service

Interest and Principal Expenses

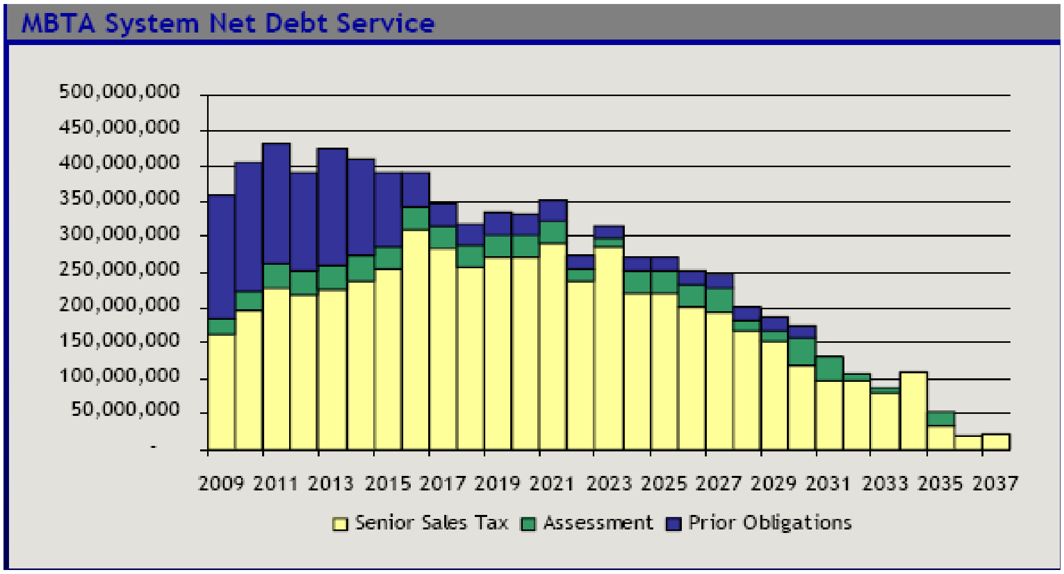
The FY 2010 budget contains a dramatic jump in principal and interest payments as the bill on the Authority's $5.2 billion in outstanding debt comes due. This $5.2 billion in outstanding MBTA debt originates directly from three sources: "prior obligation debt" inherited by the MBTA at the onset of Forward 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.



Currently, no dedicated funding source exists to pay for the Authority's portion of the Capital Investment Program. 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 <u>30%</u> 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 <u>existing</u> 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*		

4. 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.

Appendices I and II include an organizational chart of the MBTA and a Statement of Revenues and Expenses from Fiscal Year 2001 through Budget Fiscal Year 2009. In addition, the following attachments included with this report provide further detail on the operations of the Authority over the past fiscal year.

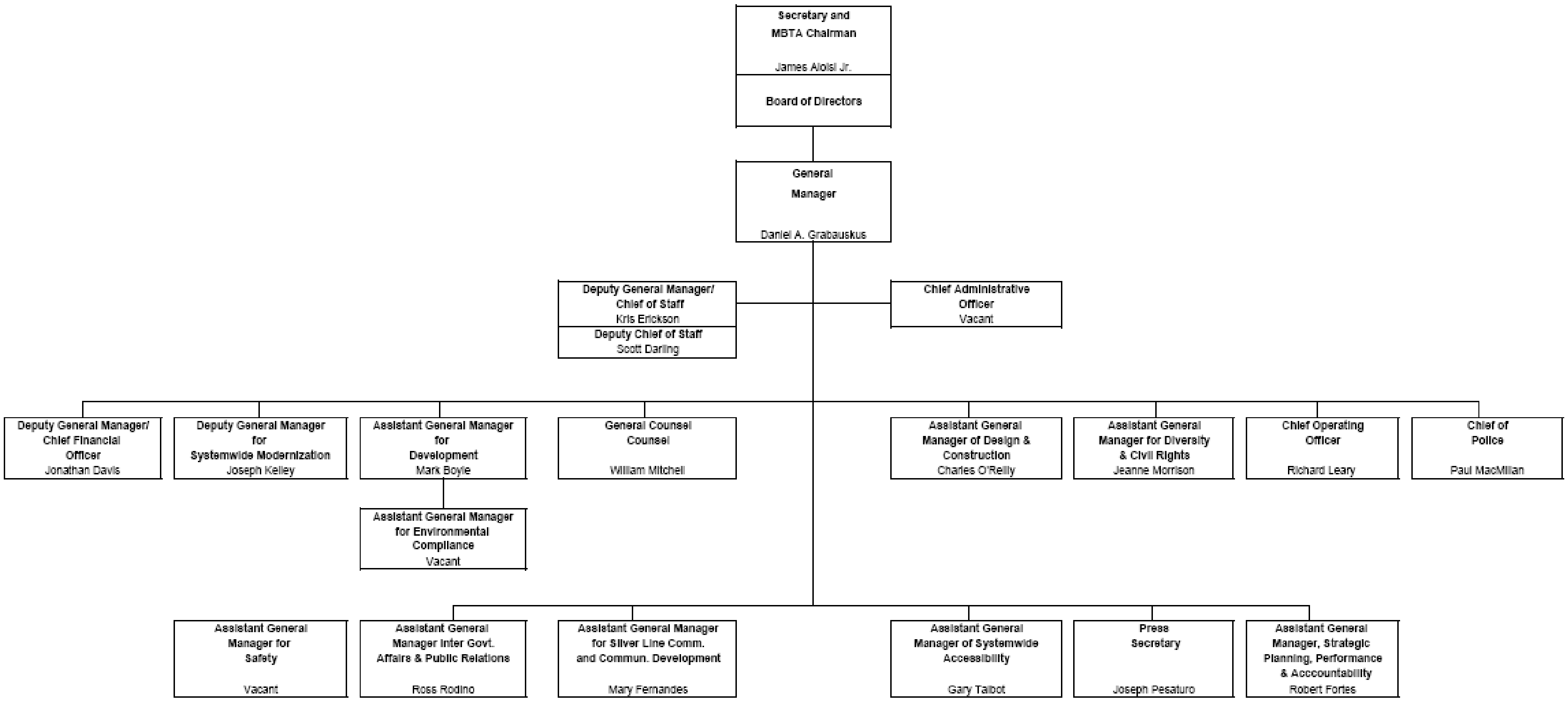
<u>List of Attachments</u>

1. MBTA 2008 ANNUAL REPORT
2. MBTA FISCAL YEAR 2009 BUDGET
3. MBTA CAPITAL INVESTMENT PROGRAM – FY 2009 – FY 2013 (CD)
4. PRELIMINARY SERVICE PLAN (CD)
5. PROGRAM FOR MASS TRANSPORTATION (CD)
6. 2009 SALES TAX BONDS SERIES A AND SERIES B OFFICIAL STATEMENT
7. AUDITED FINANCIAL STATEMENTS AS OF JUNE 30, 2008 AND 2007
8. PRESENTATION OF THE MBTA BOARD OF DIRECTORS FINANCIAL SUBCOMMITTEE
9. PRESENTATION OF MBTA COST CONTAINMENT AND REVENUE INITIATIVES
10. FY 2008 ANNUAL REPORT ON MAXIMIZING NON-TRANSPORTATION REVENUE

6. Appendices

Appendix I: Organizational Chart

MASSACHUSETTS BAY TRANSPORTATION AUTHORITY



Appendix II: Statement of Revenues and Expenses FY 2001 thru Budget FY 2008

Massachusetts Bay Transportation Authority
Statement of Revenue and Expenses
FY 2001 to Budget 2009

REVENUE	FY2001*	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009 Supplemental Budget
Operating Revenues									
Revenue from Transportation	280,982,907	283,287,567	274,205,790	295,496,104	319,271,166	333,095,971	386,487,953	440,961,963	448,957,752
Other Operating Revenue	37,721,851	37,831,187	43,361,074	49,440,154	47,751,508	47,213,995	45,133,618	48,835,439	67,560,758
Total Operating Revenues:	318,704,758	321,118,754	317,566,864	344,936,258	367,022,674	380,309,966	431,621,571	489,797,402	516,518,510
Non-Operating Revenues									
Revenue from Dedicated Sources									
Dedicated Local Assessment Revenue	144,553,734	142,872,642	141,142,768	139,437,832	137,732,280	136,026,829	139,427,540	142,913,229	146,486,059
Dedicated Sales Tax Revenue	590,772,447	664,350,000	682,094,554	686,976,316	704,620,528	711,086,005	733,963,311	755,962,210	767,019,551
Other Dedicated Revenue									
Other Income	27,739,969	15,007,513	12,686,250	12,813,202	16,705,530	39,615,533	34,166,997	19,081,077	40,713,344
Total Non-Operating Revenues:	763,066,150	822,230,155	835,923,572	839,227,349	859,058,339	886,728,367	907,557,848	917,956,516	954,218,955
Total Revenues:	1,081,770,908	1,143,348,909	1,153,490,436	1,184,163,607	1,226,081,013	1,267,038,333	1,339,179,419	1,407,753,918	1,470,737,465
EXPENSES									
Operating Expenses									
Wages	291,092,991	307,843,432	311,714,068	319,328,460	337,189,978	347,845,647	353,664,245	361,508,444	411,542,418
Fringe Benefits									
Pensions	27,192,984	25,873,867	24,739,165	25,434,823	27,540,881	41,857,263	52,005,454	44,609,385	47,665,008
Health	60,578,664	60,323,763	67,674,053	77,001,451	86,781,407	93,753,992	95,930,047	104,869,299	107,084,278
Life Insurance	1,165,569	1,449,418	1,559,360	1,545,094	1,553,709	1,440,961	1,504,695	1,543,583	1,714,381
Disability	112,429	83,977	49,488	93,127	62,747	50,427	57,374	59,370	63,819
Workers Compensation	10,007,115	9,551,837	9,715,188	9,977,686	10,141,536	9,052,116	8,703,779	8,764,567	10,829,027
Other Fringes	344,430	237,440	260,500	416,524	256,262	231,396	138,491	194,365	290,414
Subtotal Fringes	99,401,191	97,520,302	103,997,754	114,468,705	125,336,543	146,386,155	158,339,840	160,040,569	167,646,928
Payroll Taxes									
FICA	22,086,654	22,622,521	22,696,017	23,625,249	26,013,957	26,490,013	26,630,379	26,467,343	29,767,181
Unemployment	300,580	568,412	856,692	781,663	886,056	965,961	849,024	869,093	908,214
Subtotal Payroll Taxes	22,387,234	23,190,933	23,552,709	24,406,912	26,900,012	27,455,974	27,479,403	27,336,436	30,675,394
Materials, Supplies and Services	110,677,687	111,318,591	118,917,517	108,786,619	121,716,973	134,304,402	145,356,389	162,826,552	182,943,232
Casualty & Liability									
Risk Insurance	1,439,198	2,092,547	4,536,073	6,210,857	6,972,111	6,497,308	6,445,066	6,267,586	6,322,079
Injuries & Damages	8,799,958	11,269,261	8,745,682	9,200,585	7,700,129	7,694,353	9,160,851	9,963,614	9,213,614
Subtotal Casualty & Liability	10,239,156	13,361,808	13,281,755	15,411,442	14,672,240	14,191,661	15,605,917	16,231,200	15,535,693
Purchased Commuter Rail Expenses	172,540,460	185,824,276	192,605,170	213,691,186	216,403,861	216,249,789	223,729,831	247,434,243	270,838,408
Purchased Local Service Expenses	28,996,629	32,131,530	35,172,502	38,327,589	43,985,446	49,520,600	54,572,067	60,614,114	61,531,256
Financial Service Charges	1,504,828	1,544,492	1,546,016	1,834,522	1,801,021	1,623,857	1,728,409	1,728,946	4,328,960
Total Operating Expenses:	736,840,166	772,735,364	800,787,491	836,256,438	888,006,076	937,578,085	980,475,100	1,037,720,504	1,145,042,290
Debt Service Expenses									
Interest	164,976,429	193,845,930	216,966,041	204,783,748	223,291,802	205,292,656	229,571,436	234,235,624	245,716,876
Principal Payments	111,645,667	131,959,750	110,349,327	117,798,529	95,651,923	113,104,925	112,722,401	116,476,024	102,567,312
Lease Payments	14,918,033	15,261,176	15,908,155	16,423,708	17,577,942	18,270,012	21,110,882	18,621,977	19,500,000
Total Debt Service Expenses:	291,540,129	341,066,856	343,223,523	339,005,985	336,521,666	336,667,593	363,404,719	369,333,625	367,784,188
Total Expenses:	1,028,380,295	1,113,802,220	1,144,011,014	1,175,261,423	1,224,527,742	1,274,245,678	1,343,879,819	1,407,054,129	1,512,826,478
Surplus	53,390,613	29,546,689	9,479,422	8,902,184	1,553,271	(7,207,345)	(4,700,400)	699,789	(42,089,013)
Deficiency Fund	(13,130,183)	(1,075,047)	(5,363,232)	(4,770,114)	(1,553,271)	7,207,345	4,700,400	0	16,000,000
Capital Maintenance Fund	(36,583,800)	(24,116,436)						0	26,089,013
Net Surplus/(Deficit)	3,676,630	4,355,206	4,116,190	4,132,070	0	0	0	699,789	0

* beginning of forward funding