U.S. Department of Transportation
Office of the Secretary of Transportation

The Inspector General

Office of Inspector General
Washington, D.C. 20590

July 16, 1998

The Honorable Frank R. Wolf
Chairman, House Subcommittee on
Transportation and Related Agencies
Committee on Appropriations
U.S. House of Representatives
Washington, DC 20515-6027

Report Number: TR-1998-176

Dear Mr. Chairman:

This report provides the results of our analysis of the Los Angeles County Metropolitan Transportation Authority's (MTA) Restructuring (Recovery) Plan. The analysis was required by the Conference Report of the Department of Transportation and Related Agencies Appropriations Act for Fiscal Year (FY) 1998. The Conference Report states:

> "None of the funds provided to the Los Angeles MOS-3 [Minimum Operable Segment 3] project shall be available until ... (2) the FTA [Federal Transit Administration] conducts a final review and accepts the [recovery] plans; (3) the General Accounting Office and the Department of Transportation's Inspector General conduct an independent analysis of the plans and provide such analysis to the House and Senate Committees on Appropriations; ..."

On May 15, 1998, MTA submitted its final Recovery Plan for review by the FTA, the General Accounting Office, and the Office of Inspector General (OIG). FTA completed its review and formally accepted the Plan on July 2, 1998. Our analysis, made concurrently with FTA's review, was completed on July 10, 1998.

We concluded that the Recovery Plan's 7-year projections of revenues and costs are supportable and reasonable. Therefore, we concur with FTA's decision to accept the Recovery Plan. However, as the Recovery Plan itself notes, MTA is facing a shortfall of $1.1 billion over the 7-year period ending in 2004. Further, as a result of our analysis, we concluded that risks remain regarding the Plan's implementation. Accordingly, we recommend that, contingent upon release of the

FY 1998 funds, the Committee confirm with MTA that the Recovery Plan commits as a first priority the funding required to complete the Red Line's MOS 3 North Hollywood extension and compliance with the Bus Consent Decree.[1]

The $1.1 billion shortfall in MTA's Recovery Plan assumes that the Congress would appropriate, over the life of the Plan, the cumulative amount of funds shown in the Full Funding Agreement. Our recommendation means that MTA would assure, as future years' budgets are prepared, that funding in the amounts identified in the Plan for the North Hollywood extension and the Bus Consent Decree are sufficient, before any other commitments for capital funds are made in those years. This in effect assures that, if financial shortfalls occur, those shortfalls will be addressed in the context of other MTA capital projects. It is not the intent of our recommendation to require an advance escrow sufficient to cover all future North Hollywood extension and bus capital costs, but to ensure that MTA provides the levels of funding identified in the Recovery Plan.

We also recommend that FTA (1) closely monitor MTA's financial performance throughout FY 1999 and (2) require MTA to describe what actions it plans to take to eliminate the funding shortfalls in FY 2000, before releasing that year's appropriated funds.

RESULTS

MTA has made significant progress during the past year to address its management and financial problems. The positive steps include: the hiring of a new Chief Executive Officer in August 1997 to put the agency's financial affairs in order; the decisive action taken in January 1998 to suspend work on three of its five rail construction projects to improve MTA's financial position; and the adoption of a balanced FY 1999 budget in June 1998 for both its capital and operating programs.

As a result of our analysis of MTA's documentation and our discussions with MTA officials, we concluded that the Recovery Plan's 7-year projections of $9.9 billion in revenues and $11.1 billion in costs (see table on next page) are supportable and reasonable. However, major risks remain, and MTA needs revenues, funding, or cost efficiencies to cover the $1.1 billion shortfall identified in the Recovery Plan.

[1] In 1996, a Bus Consent Decree, ordered by the U.S. District Court, directed MTA to establish a plan to reduce overcrowding and expand bus service. The Decree settled litigation filed by several citizen advocacy groups (including the NAACP Legal Defense Fund and the LA Bus Riders Union) in response to a planned fare increase. The Decree also provided for the appointment of a Special Master to facilitate the resolution of any disputes regarding Decree requirements.

MTA RECOVERY PLAN
REVENUES AND COSTS
For the period FYs 1998 – 2004
(In millions)

REVENUES & FUNDING		COSTS		SHORT FALLS
		CAPITAL:		
FEDERAL	$1,002	Rail	$1,388	
STATE	567	Bus	1,128	
LOCAL	877	Other (Includes Alameda Corridor)	427	
Subtotal	$2,446	Subtotal	$2,941	($ 495)
		OPERATING:		
FEDERAL	$ 197	Rail	$ 905	
STATE	164	Bus	4,902	
LOCAL	7,137	Debt Service	2,334	
Subtotal	$7,498	Subtotal	$8,141	($ 643)
TOTAL	$ 9,944	TOTAL	$ 11,082	($1,138)

The Recovery Plan reflects sales tax and fare revenue forecasts that exceed actual growth levels during the last several years (i.e., 4.6 percent vs. 3.0 percent, and 5.5 percent vs. 2.0 percent, respectively). Failure to achieve these revenue estimates would increase the projected shortfall. While MTA has a $495 million capital shortfall in the Recovery Plan, MTA has also made commitments to fund capital projects other than the Red Line to North Hollywood and the items required by the Bus Consent Decree. Because of these conditions, we made recommendations to ensure that MTA adheres to the Recovery Plan's funding levels for the Red Line to North Hollywood and the Bus Consent Decree.

Discussion

Recovery Plan Leaves Funding Shortfalls for Operating Expenses and Capital Improvement Costs

While the Recovery Plan demonstrates the availability of sufficient funding to complete the Red Line's MOS 2 and the North Hollywood extension and to comply with the Bus Consent Decree, it does so only by leaving a $1.1 billion funding shortfall in the agency's capital ($495 million) and operating ($643 million) budgets over the 7-year period ending in 2004. The distribution of the funding shortfall by component, as shown in the Recovery Plan, is provided in the table on the next page.

MTA RECOVERY PLAN
CAPITAL AND OPERATING SHORTFALLS
For the period FYs 1998 – 2004
(in millions)

COMPONENT		CAPITAL SHORTFALL	OPERATING SHORTFALL
RAIL:	Red Line – MOS 2	$ 0	
	Red Line – No. Hollywood	0	
	Other Rail Capital	(71)	
Rail Subtotal:		($ 71)	($ 104)
BUS:	Acquisitions	(0)	
	Other Bus Capital	(377)	
Bus Subtotal:		($ 377)	($ 539)
ALAMEDA CORRIDOR		($ 0)	N/A
OTHER/ADMIN. PROJECTS		($ 47)	N/A
TOTAL SHORTFALLS		($ 495)	($ 643)

Realistically, operating expenses – such as wages, fuel, debt service costs, and utilities – must be paid, otherwise, parts of the system would have to be shut down. Similarly, actions to fulfill the Bus Consent Decree requirements cannot be deferred.

Without additional revenues, MTA will likely be forced to defer maintenance (budgeted at approximately $125 million per year); reduce its reinvestment in capital equipment, such as refurbishing rail cars and facilities; and/or borrow funds. MTA's ability to defer maintenance and reinvestments in buses is somewhat limited by requirements of the Bus Consent Decree. MTA does have additional borrowing capacity that it could access. Paying principal and interest on any new debt, however, will consume additional funds in later years.

Subsequent to submission of its Recovery Plan, MTA developed a balanced budget for FY 1999. By reducing administrative and maintenance costs and increasing revenues through additional borrowing, MTA eliminated the $75 million operating deficit and the $128 million capital deficit identified in the Recovery Plan for FY 1999. MTA has not yet balanced the future years' budgets. To be successful, MTA must now operate within the constraints of its FY 1999 balanced budget. Throughout FY 1999, FTA should monitor how well MTA's actual performance compares to its approved budget. If MTA is successful in FY 1999, FTA should require a similar approach in FY 2000 and require MTA to

show how it plans to close the funding gap of approximately $220 million reflected in the Recovery Plan for that year.

Even if MTA is successful in eliminating the FY 1999 capital deficit of $128 million, the Recovery Plan still reflects a cumulative capital shortfall of over $375 million for the remaining years (FYs 2000 – 2004) of the Plan.[2] MTA's current efforts are aimed at balancing revenues and expenditures in the short term and have not focused on eliminating the longer term funding shortfalls. Saving money in the short term by deferring or postponing vehicle and facility maintenance, over time, could significantly reduce service quality and reliability. Ultimately, these actions would reduce ridership and related revenues. In light of the considerable investment and progress already made in constructing the North Hollywood extension, we agree that completing the extension is the prudent course of action. However, if funds planned for maintenance and replacement of equipment are used for this work, significant problems may occur in future years.

Other Capital Projects Also Require Funding

After funding the Red Line to North Hollywood and complying with the Bus Consent Decree requirements, MTA's Recovery Plan indicates there are not sufficient funds for other planned capital projects. If MTA is unable to reduce future years' operating deficits, revenues allocated to capital items in the Recovery Plan will have to be shifted to cover operating expenses. This could increase the deficit for capital projects. One major project identified in the Recovery Plan for MTA capital investment is the Alameda Corridor.[3] The Recovery Plan indicates that $294 million of MTA's revenues will be provided to this project. To meet this commitment, MTA plans to spend $245 million in State pass-through funds and $49 million of local funds generated by sales tax revenues. Considering the shortage of funds in MTA's capital budget, fulfilling its commitment to the Alameda Corridor project could be a potential problem.

Sales Tax & Fare Revenue Forecasts

MTA finances the major portion of its local share of capital projects and operating expenses through the sale of revenue bonds, which are backed by the proceeds from sales taxes. In 1980, Proposition A provided funding for a

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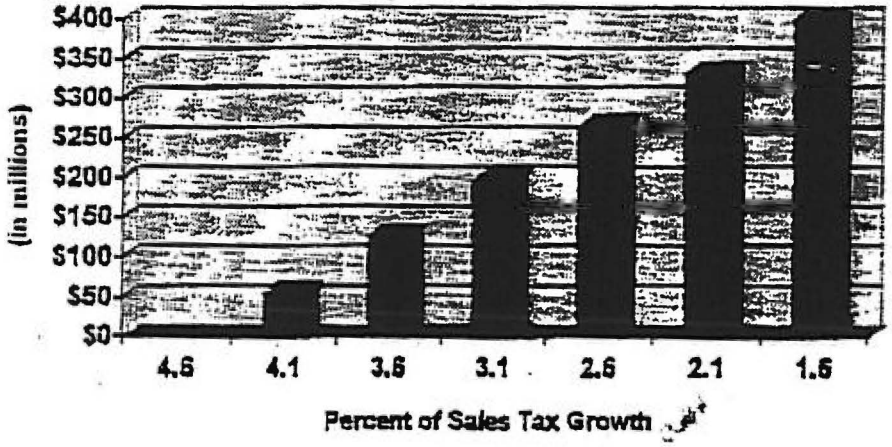
[2] Per the Recovery Plan, the capital budget had a $10 million surplus in FY 1998, a $128 million deficit in FY 1999, and a $377 million deficit in FYs 2000 – 2004. These figures net to the cumulative deficit of $495 million over the 7-year Recovery Plan period.

[3] The $2 billion Alameda Corridor project, upon completion, will be a 20-mile railroad freight corridor connecting the Ports of Los Angeles and Long Beach with the transcontinental railyards in downtown Los Angeles.

regional rail transit system and other transportation improvements from a half-cent sales tax increase. In 1990, Proposition C provided funding for expansion and improvements to the transit system from another half-cent sales tax increase.

The Recovery Plan relies on sustained growth in MTA's sales tax revenues to finance completion of the Red Line to North Hollywood, new bus purchases, bus and rail operations, and debt service on bonds issued. MTA forecasts growth in tax revenues averaging 4.6 percent annually through 2004 (resulting primarily from projected inflation in retail prices). This rate is above the recent growth rate of about 3.0 percent. If sales tax revenues grow at a slower rate than projected, MTA would then face deeper budget shortfalls for the 7-year period. The following chart depicts the shortfalls that would result from various growth rate scenarios.

Impact of Various Sales Tax Growth Rates on Projected Revenue Shortfalls
Over 7-Year Period (FYs 1998 - 2004)



MTA advised us that the FY 1998 sales tax growth rate has actually been about 5.8 percent. If this trend continues, MTA's financial position will actually improve.

Furthermore, the Recovery Plan forecasts rely on an annual growth rate in fare revenues of 5.5 percent. That projected growth rate is well above recent growth (since 1993) of less than 2.0 percent. If fare revenues increase at a lower rate than anticipated, the deficit would increase. For example, if the increase is only one-half the anticipated rate (i.e., 2.75 percent vs. 5.5 percent), MTA would experience a potential revenue shortfall of an additional $205 million over the 7-year period.

Compliance with Bus Consent Decree Carries Risk

The Bus Consent Decree requires that MTA reduce its bus load factor from 1.45 (equates to 19 standing passengers) in October 1996 to 1.35 (15 standing passengers) in December 1997 and to 1.20 (9 standing passengers) by June 2002. MTA states it is in compliance with the December 1997 load factor goal. We analyzed 1,171 bus time segments using MTA's methodology and confirmed that MTA met the goal of 1.35 in 97 percent of these segments. Of the 1,171 bus time segments analyzed, 773 occurred during morning and afternoon peak periods (i.e., 6:00 AM – 9:00 AM and 3:00 PM – 6:00 PM). Of these 773 peak time segments, MTA met the goal of 1.35 in all but 26 (or 3.4 percent) of the time periods. Of the 410 non-peak segments, MTA met the goal in all but 7 (or 1.7 percent) of the time periods. However, the methodology MTA uses to calculate the bus load factor is disputed by citizen advocacy groups, which are being collectively represented by the Bus Riders Union.

MTA calculates the bus load factor based on average ridership levels for each bus line. The Bus Riders Union contends each bus line should be monitored for 100 percent compliance, meaning that a one-time failure on a bus line would violate the Bus Consent Decree. Under the methodology used by the Bus Riders Union, only 63 percent of the lines in our sample were in compliance with the December 1997 goal. MTA and the Bus Riders Union also disagree on the number of new bus purchases necessary to ensure compliance with the load factor goals. In our opinion, both of these issues will ultimately be referred to the Bus Consent Decree's Special Master for interpretation and/or resolution. If the Special Master rules in favor of the Bus Riders Union, MTA's cost to meet the requirements of the Bus Consent Decree will increase, and the Recovery Plan's cost estimates will be understated.

Actual Benefits of "Work-Out" Proposals May Not Materialize

In an effort to address the operating shortfalls in the Recovery Plan, MTA formed "work-out" teams. The teams made 66 recommendations to achieve additional cost savings or additional revenue sources. The teams articulated expected benefits, probability of success, and the amount of risk. We analyzed 37 of the 66 recommendations and found they were reasonable and based on objective analysis. We agree that some savings/revenues can be reasonably expected to occur if identified recommendations are implemented. Some, however, are not likely to achieve the projected level of savings or revenues. For example:

Bus Service Delivery. MTA is proposing a major restructuring of its entire system of bus routes. To implement this restructuring, MTA plans

to consolidate inefficient lines and return the savings to other routes in order to improve service. Further, MTA is proposing 18 other changes, ranging from closure of certain bus divisions to cutting specific lines and transferring routes. MTA estimates these proposals, in total, will provide an estimated $325 million in cumulative savings through FY 2004. However, we note that, prior to implementation, these changes need the approval of both the MTA Board and the employees' union. In addition, MTA must consult with the Bus Riders Union and hold public hearings. If this process results in significant adjustments to the work-out team's recommendations or long delays in their implementation, the realization of the entire $325 million in savings will not occur.

Fare Increase. MTA plans to implement a 10-cent fare increase for its bus and rail lines in FY 2000. MTA estimates an additional $30 million in revenues (over the 5-year period FYs 2000 – 2004) due to these fare increases. These increases (commensurate with increases in the Consumer Price Index) are allowed under the terms of the Bus Consent Decree. For fare increases on buses, MTA must consult with the Bus Riders Union and hold public hearings. Rail fare increases can be undertaken by a vote of the MTA Board along with a public hearing. With the fare increase, some loss of riders to carpools or personal vehicles can be expected, and some riders may take fewer trips. MTA officials acknowledged its calculations may underestimate the actual ridership losses. Furthermore, MTA's method of fare collection on its rail lines (including the Red Line) is dependent on an honor system, rather than a typical fare and turnstile system. MTA's system makes it even more problematic to rely on expected fare increases.

Recommendations

We recommend the Committee release the FY 1998 appropriated funds to the MTA for the explicit use on the Red Line's North Hollywood extension. We also recommend that, contingent upon release of funds, the Committee confirm with MTA that the Recovery Plan commits as a first priority the funding required to complete the Red Line's North Hollywood extension and compliance with the Bus Consent Decree.

Our recommendation means that MTA would assure, as future years' budgets are prepared, that funding in the amounts identified in the Recovery Plan for the North Hollywood extension and the Bus Consent Decree are sufficient, before any other commitments for capital funds are made in those years. This in effect assures that, if financial shortfalls occur, those shortfalls will be addressed in the context of other MTA capital projects. It is not the intent of our recommendation

to require an advance escrow sufficient to cover all future North Hollywood extension and bus capital costs, but to ensure that MTA provides the levels of funding identified in the Recovery Plan.

We also recommend that FTA (1) closely monitor MTA's FY 1999 budget execution and (2) require MTA to submit a formal plan reflecting actions it plans to take to eliminate the funding shortfalls in FY 2000, before releasing that year's appropriated funds.

If you have any questions or need further information, please contact me on 366-1959 or Raymond J. DeCarli, Deputy Inspector General, on 366-6767. We are sending identical letters to Senator Shelby, Senator Lautenberg, and Congressman Sabo.

Sincerely,

Kenneth M. Mead
Inspector General

cc: The Secretary of Transportation
The Deputy Secretary of Transportation
Federal Transit Administrator

Federal Agency Backs MTA's Recovery Plan

By RICHARD SIMON
TIMES STAFF WRITER

The Metropolitan Transportation Authority's recovery plan for putting its fiscal house in order received the backing of another federal agency Friday.

But, like a parent worried about a child continuing to improve on *his grades*, the U.S. Department of Transportation inspector general recommended that Washington closely monitor the MTA's progress in working out its financial problems.

"We couldn't be happier," said MTA Chief Executive Officer Julian Burke, noting that the inspector general praised the agency's "significant progress."

But citing "major risks" from financial uncertainties still facing the county transit agency, Inspector General Kenneth M. Mead also recommended that Congress ensure that the MTA allocates sufficient funds to complete the subway to North Hollywood and to implement court-ordered bus improvements.

"Considering the shortage of funds in MTA's capital budget, fulfilling its commitment to the Alameda Corridor project could be a potential problem," Mead said.

Burke expressed confidence that the MTA would keep its funding commitment to the Alameda Corridor, a railway designed to speed the flow of cargo between the ports and rail yards in Los Angeles.

The MTA chief said that although the agency still faces a projected $660-million shortfall over the next several years, he expects to reduce it by a "substantial amount" thanks to a new multiyear federal transportation funding bill.

The inspector general's office becomes the third federal agency—after the Federal Transit Administration and the GAO—to complete its review of the MTA's recovery plan.

The reviews were required before the federal government would release $61.5 million from this year's federal budget for the Metro Rail subway project.