CENTER FOR
Co$t Effective
GOVERNMENT

HOW A FINANCIAL CONTROL BOARD CAN SAVE THE MTA AND NEW YORK TAXPAYERS

SEPTEMBER 2024

Declaring the MTA Insolvent

Key Points:

- The MTA faces a budget gap of $2.5 billion in 2025 and 2026.
- Subway service delays tripled between 2012 and 2017.
- The MTA has a lower percentage of trains that arrive on time compared to other major subway systems.
- New York State law prevents the MTA from filing bankruptcy, but the state can impose a financial control board.
- Control boards have been implemented in cities and municipalities including New York City, Nassau and Erie Counties in New York; Detroit, Michigan; San Bernardino, California; Vallejo, Californian and Stockton, California.
- Detroit shed $7 billion in debt and restructured an additional $3 billion while eliminating $7.8 billion in payments to retired workers and $4.3 billion in unfunded healthcare obligations.
- Police and Fire retirees had a cost-of-living adjustment reduced from 2.5 percent to 1 percent.
- Unfortunately, state and agency leaders continue to claim that the MTA has a revenue problem, when the reality is the agency has a spending problem.

- It is the recommendation of this white paper that in lieu of state leaders and the MTA seeking more borrowing, higher taxes, and fare hikes, an effort be initiated by the state legislature and the Governor to impose a financial control board upon the MTA. Such a control board would authorize a restructuring of onerous work rules, overtime policies, and other wasteful components of the MTA that have been the driving force behind its near insolvency.

Only a financial control board can save the MTA and New York Taxpayers

Governor Kathy Hochul of New York recently announced that she was shelving the long-awaited tolling plan known as congestion pricing, just weeks before it was to go into effect. With this last-minute decision, the MTA must now contend with a $15 billion gap in its capital plans, underscoring the severe financial mismanagement plaguing the organization. Forecasts indicate budget gaps of $2.5 billion in 2025 and 2026, potentially soaring to $4.6 billion if the MTA's unspecified gap-closing measures fail and economic conditions worsen.

A 2019 audit by the New York State Comptroller's Office revealed that MTA transit capital projects are rife with cost overruns and delays. Even with these bloated budgets, the MTA's service quality has not increased. The New York City subway service has steadily declined, with delays tripling between 2012 and 2017 and average train speeds falling to 1950s levels. Furthermore, a lower percentage of trains arrive on time compared to other major subway systems.

An investigation by the New York City Comptroller found that the MTA knowingly misled the public by reporting inaccurate information, masking the subways' deterioration and misrepresenting the causes of delays. Despite internal warnings about data deficiencies, MTA officials continued to disseminate misleading information. Meanwhile, the MTA is pushing the financial burden onto consumers. In August 2023, fare hikes raised the base fare for a subway or bus ride from $2.75 to $2.90, the first increase in eight years, and hiked Long Island Railroad and Metro-North tickets by up to 4.5%.

Given the MTA's dire financial situation and its impact on service quality, New York State must act. *Although state law prevents the MTA from filing a bankruptcy petition under Chapter 9 of the U.S. Federal Bankruptcy Code, New York State can declare the MTA insolvent and impose a state control board to address these pervasive issues effectively.*

Historical Context of Financial Control Boards in the United States

New York State has previously implemented financial control boards to address severe fiscal challenges in its municipalities.

New York City

New York City's near-bankruptcy during the 1975 fiscal crisis stands as a stark reminder of the consequences of fiscal mismanagement. At that time, the city faced a dire financial emergency, rooted in a combination of declining tax revenues, escalating expenditures, and unsustainable borrowing practices. A shrinking population and deindustrialization eroded the city's tax base, while the municipal government continued to expand its budget, particularly in social services and public employee wages. This fiscal mismanagement, compounded by a loss of investor confidence, nearly led to the city's financial collapse. The situation deteriorated to the point where New York was effectively locked out of credit markets, unable to secure the loans needed to meet its obligations.

In response, the state of New York and the federal government intervened, establishing the Municipal Assistance Corporation (MAC) and imposing a Financial Control Board (FCB) to oversee the city's financial operations. The FCB wielded broad powers, including the authority to approve or reject the city's budget and borrowing plans, ultimately restoring fiscal discipline and rebuilding investor confidence. The 1975 crisis serves as a cautionary tale of the dangers of unchecked borrowing and fiscal mismanagement. The potential imposition of a financial control board on the MTA reflects a similar need for oversight to ensure financial stability and to prevent history from repeating itself.

Other New York Control Boards

In the 1990s, Nassau County faced significant fiscal peril that necessitated intervention. The Nassau County Interim Finance Authority (NIFA) was established to shore up the fiscal health of the county.

Similarly, in 2003, Buffalo, the largest city in Erie County, faced a severe fiscal crisis characterized by a massive budget shortfall, compounded by an expensive new labor contract with city police and other budgetary strains. In response, then-Mayor Anthony Masiello appealed to the state for assistance. The state's intervention led to the creation of a control board with significant oversight powers. This board had the authority to approve or disapprove budget proposals, borrowing plans, and labor contracts, and reviewed every expense over $50,000.

Rockland County, New York

In the 2010s, Rockland County, New York, faced significant financial difficulties. By 2014, the county had amassed a debt of $240 million and a budget deficit of $138 million, earning the status of the most fiscally stressed county in New York State. The county's credit rating was downgraded to near junk status by Moody's, reflecting the severity of the crisis. Several factors contributed to Rockland County's financial troubles, including overestimation of sales and mortgage tax projections, the danger of relying on one-shot revenues, and increasing healthcare subsidies. The impact of mandated programs further strained the budget, while poor financial management exacerbated these issues. These financial difficulties severely impacted the county's ability to provide essential services and maintain its infrastructure, necessitating immediate and robust fiscal intervention to avoid further economic decline.

In response to this crisis, the New York State government and Rockland County implemented several measures to stabilize its finances, greatly improving its long-term financial outlook. Key initiatives included debt authorization, allowing Rockland County to issue debt up to $96 million to liquidate the accumulated deficit, and the Fiscal Stabilization Act of 2013, which mandated the creation of a fund balance account for contingencies.

The state also imposed stricter financial oversight, requiring the county to submit its proposed budget to the State Comptroller for review to ensure fiscal responsibility. Structural reforms included renegotiating labor contracts, cutting non-essential services, and improving efficiencies in county operations. Increased oversight of nonprofit organizations receiving public funds ensured greater accountability through annual audits and spending verification. As a result of these combined efforts, Rockland County's financial stability has gradually improved, culminating in the 2024 budget, which includes a 2% property tax cut, maintains programs and services without layoffs, and increases funding for social services, nonprofit organizations, and additional positions in various departments. Despite ongoing challenges, such as housing affordability, these measures have set Rockland County on a positive trajectory for sustainable financial health.

In May of 2024, Kenneth Zebrowski, a member of the New York State Assembly, introduced legislation aimed at stopping a cash-strapped Rockland County school district from closing its doors to students this fall. This state bill would create a fiscal control board that will control the finances of the district, including setting tax rates and capital bonds to keep the school open.

]

Control boards outside of New York

Jefferson County, Alabama

Jefferson County, Alabama, filed for the largest municipal bankruptcy in U.S. history in 2011, driven by a disastrous sewer project that pushed its debt to over $4 billion. The financial crisis of 2008 further exacerbated the situation by causing interest rates on the county's debt to soar, making it unmanageable. In response, the county restructured its debt by issuing $1.8 billion in new debt to refinance the existing $3.2 billion sewer debt, with creditors like J.P. Morgan Chase conceding significant reductions. Additionally, the county agreed to annual sewer rate increases of 7.9% for the first four years, followed by a 3.5% increase in subsequent years, to generate sufficient revenue for servicing the restructured debt.

San Bernardino, CA

The third-largest municipal bankruptcy at the time, San Bernardino, serves as a major example of state-led financial restructuring. When the city entered bankruptcy in

2012, it had a cash deficit of $18.2 million and a projected $45.8 million budget deficit. Declining revenues from property taxes, vehicle license fees, and redevelopment funds had severely impacted the city's finances. Notably, property taxes accounted for about 30% of total revenue in the years leading up to the crisis.

San Bernardino's financial troubles were further exacerbated by wasteful capital projects and questionable use of redevelopment funds. The city invested in projects such as a minor league baseball stadium and a renovated historic theater, but also diverted redevelopment revenue to less relevant items such as a public access television station. Additionally, these funds were used to cover operating expenses, including salaries for city officials. This misuse of funds mirrors the MTA's own challenges with mismanagement and wasteful spending. To address its financial crisis, San Bernardino undertook comprehensive restructuring, renegotiating labor contracts and cutting operational costs, illustrating the effectiveness of state intervention in restoring fiscal stability.

San Bernardino's resurgence following its 2012 bankruptcy declaration highlights the transformative power of municipal bankruptcy restructuring. Exiting bankruptcy in 2017 marked the end of a prolonged financial crisis characterized by a severe cash deficit and high unemployment. The city now boasts over $40 million in cash reserves—25% of its general fund budget—and projects a $2.5 million budget surplus for the current fiscal year, a stark contrast to the $45.8 million deficit at the time of bankruptcy. Substantial investments in infrastructure, including repaving 53 streets and enhancing key avenues, along with improvements to parks, senior centers, and tree trimming services, underscore the city's commitment to revitalization. Enhanced public safety and community services are evident in the increased workforce, including more police and code enforcement officers, and the introduction of specialized teams addressing housing and homelessness. Although the city's unemployment rate was 16% during the bankruptcy, double the national average, efforts to stabilize the economy have shown positive outcomes. San Bernardino's recovery is a testament to the resilience of its community and leadership, demonstrating that strategic fiscal and structural reforms can effectively overcome financial adversity.

In 2017, San Bernardino began paying creditors again under a bankruptcy exit plan approved by the judge. At that time, there were over 1,000 claims against the city. Now, with the case officially closed, San Bernardino can focus on its continued recovery and growth.

Fast forward to 2022, and the city’s financial outlook has significantly improved. U.S. Bankruptcy Judge Scott Clarkson recently closed the bankruptcy case because the city resolved claims and demonstrated its ability to pay outstanding long-term obligations.

San Bernardino, with a population of 220,000 people, is now in a much better position. They've been tackling street paving and tree trimming projects and hiring much-needed staff. For the current fiscal year, the city even forecasts a $2.5 million budget surplus, a remarkable turnaround from the projected $45 million budget shortfall during the bankruptcy period. Mayor John Valdivia aptly stated, "the grueling and deep cuts we all experienced are in the rearview mirror" of San Bernardino's history.

Detroit, Michigan

As the largest municipal bankruptcy filing in U.S. history, the city of Detroit set the mark for large-scale financial restructuring. In 2013, Detroit filed for bankruptcy, citing over $18 billion in debt. While a New York law bars an MTA bankruptcy that would impose losses on bond holders, no such legislation exists in Michigan. However, Detroit's restructuring included more than just giving bond holders a haircut. A key aspect of Detroit's restructuring also involved renegotiating labor contracts, which were a significant burden on the city's finances. The city managed to reduce pension liabilities and healthcare costs by reaching agreements with unions, resulting in significant savings. Additionally, the city privatized certain services and streamlined operations to reduce expenses. These measures, combined with the reallocation of resources and improved financial oversight, allowed Detroit to emerge from bankruptcy with a more sustainable fiscal framework. All of these measures can also be applied to the MTA through a financial control board.

These measures, combined with resource reallocation and enhanced financial oversight, allowed Detroit to emerge from bankruptcy with a more sustainable fiscal framework.

Detroit's bankruptcy, filed in July 2013 and concluded in December 2014, was the largest and most consequential municipal bankruptcy in U.S. history. The bankruptcy adjustment plan, officially known as the Plan of Adjustment, laid out how the city would restructure its debts and obligations to regain financial stability. Here are the key details:

Approval of the Plan and Path to Recovery

- **Approval and Purpose**:

  The "Plan of Adjustment" was approved by Judge Steven Rhodes and served as the blueprint for Detroit's recovery. It outlined the total amount of debt, mechanisms for paying off some of it, and key steps to improve city services, all aiming to balance the budget, reduce debt, and enhance public services.

Financial Restructuring and Debt Reduction

- **Debt Reduction**:

  Detroit successfully restructured or eliminated approximately $7 billion of its $18 billion debt and liabilities, including cuts in unsecured liabilities and settlements with creditors. Complex negotiations led to reduced payouts for unsecured creditors, who often received only a fraction of what they were owed, and some were issued new financial instruments like bonds.

Pension and Retiree Health Benefits (potentially redundant)

- **Pension Cuts**:

  Pensions for general city employees were reduced by 4.5%, with the elimination of cost-of-living adjustments (COLAs). Police and fire retirees faced smaller cuts but retained reduced COLAs.

- **Health Benefits**:

  Retiree health benefits were significantly scaled back, with many retirees transitioning to Medicare or private insurance exchanges supplemented by stipends.

Asset Management

- **Detroit Institute of Arts (DIA) Preservation**:

  The "Grand Bargain," a collaborative effort involving foundations, the state of Michigan, and the DIA, was key in preserving the DIA's art collection, valued in billions, from being sold off during bankruptcy proceedings. This initiative also helped fund pension obligations.

Governance and Financial Oversight

- **Financial Oversight Commission**:

  A financial review commission was established to oversee the city's finances and ensure compliance with the Plan of Adjustment. This oversight was expected to last for at least 13 years or until specific financial milestones were met.

How has it worked?

The bankruptcy process allowed the emergency manager to negotiate modifications to the debt without having to pay creditors during the negotiations. In the years after Detroit declared bankruptcy, the city has experienced a significant resurgence. As noted above, Detroit ultimately shed $7 billion in debt and restructured an additional $3 billion, allocating about $1.7 billion toward city improvements. The bankruptcy proceedings eliminated $7.8 billion in payments to retired workers and relieved the city of $4.3 billion in unfunded healthcare obligations and future costs. This financial reset allowed Detroit to emerge from state financial oversight and control by December 2014.

This financial stabilization was pivotal in attracting private investments, particularly in the downtown area, leading to a revitalization marked by new businesses, trendy restaurants, and upscale housing. Notably, Detroit has maintained a budget surplus in recent years, with no need to use federal pandemic relief funds to cover deficits. Wall Street responded positively to these developments, upgrading Detroit's credit rating, which, although still below investment grade, is a significant improvement from its post-bankruptcy lows.

The bankruptcy allowed for the addressing of the significant underfunding in its pension funds. The gap in the city's two pension funds, the General Retirement System (GRS) and the Police and Fire Retirement System (PFRS), amounted to $3.5 billion. Pension liabilities represented 19 percent of the $18.3 billion in total liabilities accrued by July 18, 2013, the day the city filed for bankruptcy. GRS benefits were cut by 4.5 percent, and 2.25 percent cost-of-living adjustments (COLAs) were eliminated. PFRS beneficiaries had their COLAs reduced from 2.25 percent to 1 percent, avoiding steeper cuts because police and fire employees do not participate in Social Security.

By renegotiating contracts with unions and cutting expenses through privatization and streamlined operations, Detroit achieved substantial savings. These measures, combined with resource reallocation and enhanced financial oversight, allowed Detroit to emerge from bankruptcy with a more sustainable fiscal framework.

The MTA

While many municipal entities such as the city of Detroit were allowed to file bankruptcy, that option is not available for New York's Metropolitan Transit Authority. According to an article in Yahoo Finance: "No Bankruptcy. State law specifically prohibits MTA, its Transit System affiliates, its Commuter System subsidiaries or MTA Bus from filing a bankruptcy petition under Chapter 9 of the U.S. Federal Bankruptcy Code. As long as any Transportation Revenue Bonds are outstanding, the State has covenanted not to change the law to permit MTA or its affiliates or subsidiaries to file such a petition. Chapter 9 does not provide authority for creditors to file involuntary bankruptcy proceedings against MTA or other Related Entities."

Nevertheless, there are numerous options available for New York's leaders to entertain to help restructure the MTA without more tax raising schemes.

The Impact of Congestion Pricing

The structural imbalance within the MTA has prompted lawmakers to conjure up various revenue raising schemes to keep the ever-strained agency afloat. Insolvency has been avoided in large part due to massive borrowings by the state, which are ultimately unsustainable. Moreover, fares continue to rise to feed the expenditure beast, and as noted above, schemes such as congestion pricing seek to tax motorists for the mere privilege of driving into certain parts of Manhattan during designated hours.

Unfortunately, state and agency leaders continue to claim that the MTA has a revenue problem, when the reality is the agency has a spending problem.

The MTA's history of inefficiencies

The following are prime examples of the MTA's irresponsible and wasteful spending:

1. **$20M Employee Lounge at Grand Central Station in 2009** (Source: NYS Senate)
2. **$7M Doghouse in Duchess County in 2009** (Source: NYS Senate)
3. **At $2.5 billion per mile**, construction costs of the Second Avenue Subway were **8 to 12 times more expensive** than similar subway projects in Italy, Istanbul, Sweden, Paris, Berlin and Spain. (Source: Bloomberg).
4. **Engineers and Conductors Earning $283K Plus $10K/Month Pension** (Source: NYS Senate)
5. **10,482 MTA workers were paid at least $100,000 annually in 2013.** (Source: Empire Research Group)
6. **More than 700 MTA workers earned $100,000 or more in overtime** in 2023, contributing to a 9% increase in payroll costs, according to a new report by the Empire Center for Public Policy. (Source: Newsday)
7. **$10,000 for shoes for Desk Workers**. (Source: Newsday)
8. **Underreported $500M While Seeking 2002 Fare Increase** (Source: New York Times)
9. **More than 1,100 employees doubled their salaries** in 2023 as the agency's overtime bill skyrocketed to nearly $1.3 billion. (Source: CBS News)
10. **Excessive Staff Levels and Outsourcing**:
    - 698 in Human Resources,
    - 443 in Legal,
    - $10M in Outside Legal Services,

    - 444 in Public Relations,
    - 359 in Accounting,
    - 166 in Labor Relations.

    (Source: NYS Comptroller, 2005)

These examples are only a fraction of the mismanagement within the agency. Additional abuses include:

- **Overtime Abuse**: Despite pledges to clean up these abuses, overtime payments remain rampant, with some employees earning six-figure overtime bonuses. In one notable case, an employee earned $344,000 in overtime alone. Subway workers, including administrative personnel, average $155,000 annually, with some earning as much as $240,000—double the industry norm. (Source: Newsday, 2024)
- **Disability Abuse at LIRR**: Nearly 97% of Long Island Railroad retirees took advantage of the disability system at the height of the scandal, a situation that remains largely unresolved. (Source: New York Times)
- **Exorbitant Construction Costs**: Railroad construction costs in New York reached an astronomical $2.6 billion per mile, compared to $170 million per mile in Atlanta. (Source: High Speed Rail Alliance)
- **Mismanagement and Inefficiency**: Tunnel-boring in New York employs 25 people, whereas Spain performs the same work with just nine. Seniority-based

overtime practices led to inflated salaries in the latter years of employment and pension padding. (Source: NYPost, High Speed Rail Alliance)

- **Misuse of Funds for Employee Salaries**: In 2015, the MTA spent $9.85 billion on employee salaries, retirement, and post-employment benefits, which exceeded total revenue collections by $1 billion. (Foundation for Economic Education)
- **Job Duty Restrictions**: Subway cleaning workers, for example, were not even permitted to replace light bulbs in 2012, a clear illustration of inefficiencies and poor resource management. (Source: NYPost).
- **Inefficient fare collection:** The MTA lost an estimated $690 million in unpaid fares and tolls in 2022. (Source: Blue-Ribbon Panel Investigation)

CONCLUSION

Although the MTA cannot declare bankruptcy under current law, state leaders have another option: placing the MTA under the oversight of a financial control board. A financial control board would allow for the restructuring of the MTA's contracts, its outdated work rules, and its costly spending practices. Like actions taken in other fiscally distressed municipalities, such as Detroit, financial control boards restore fiscal stability by enforcing oversight and reforming budgetary practices.