Maryland Department of Transportation
The Secretary's Office

Martin O'Malley
Governor

Anthony G. Brown
Lt. Governor

Beverley K. Swaim-Staley
Secretary

Harold M. Bartlett
Deputy Secretary

December 8, 2010

The Honorable Edward J. Kasemeyer
Chairman
Senate Budget and Taxation Committee
3 West Miller Senate Office Building
Annapolis MD 21401-1991

The Honorable Norman Conway
Chairman
House Appropriations Committee
121 House Office Building
Annapolis MD 21401-1991

Dear Chairman:

Please see the attached report prepared by the Maryland Transit Administration (MTA) concerning *MTA's Options for Meeting Farebox Recovery*. This report was prepared to meet the requirements set forth in the 2010 Joint Chairmen's Report, page 59, which directs:

> *"Operating costs for the Maryland Transit Administration (MTA) continue to increase; specifically, fuel, spare parts, labor and contracted service costs have outpaced the available revenues from fares despite a continued increase in ridership over that same period. The committees are interested in understanding the financial and ridership impacts of various revenue and expenditure options that MTA might pursue in order to meet the statutory farebox recovery level. By December 15, 2010, MTA should submit a report that outlines:*
>
> - *potential scenarios for increasing farebox in fiscal 2011 or 2012;*
> - *the ridership and revenue/expenditure impact of those scenarios;*
> - *the impact to MTA's budget and to the Transportation Trust Fund forecast of those scenarios; and*
> - *the efficiencies in service that could be undertaken to improve the farebox."*

Please feel free to contact Mr. Ralign Wells, Maryland Transit Administrator, at 410-767-3943 if you have questions regarding this report. Of course, please feel free to contact me directly.

Sincerely,

Beverley K. Swaim-Staley
Secretary

cc: Members of the Budget Committees
Mr. Ralign Wells, Administrator, Maryland Transit Administration

A Report to the Maryland General Assembly

Senate Budget and Taxation Committee,

House Appropriations Committee, and

House Ways & Means Committee

regarding

Maryland Transit Administration – Options for Meeting Farebox Recovery (2010 Joint Chairmen's Report, page 59)

December 2010

The Maryland Department of Transportation

MTA – Options for Meeting Farebox Recovery (2010 JCR, p. 59)

Introduction

This report was prepared to meet the requirements of the Joint Chairmen's Report on the State Operating Budget, April 2010 (p. 59). The language requiring this report is as follows:

> *"Operating costs for the Maryland Transit Administration (MTA) continue to increase; specifically, fuel, spare parts, labor and contracted service costs have outpaced the available revenues from fares despite a continued increase in ridership over that same period. The committees are interested in understanding the financial and ridership impacts of various revenue and expenditure options that MTA might pursue in order to meet the statutory farebox recovery level. By December 15, 2010, MTA should submit a report that outlines:*
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> - *potential scenarios for increasing farebox in fiscal 2011 or 2012;*
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> - *the impact to MTA's budget and to the Transportation Trust Fund forecast of those scenarios; and*
> - *the efficiencies in service that could be undertaken to improve the farebox."*

Background

Historically, the Maryland Transit Administration (MTA) has been subject to requirements that a certain percentage of operating expenses for its system be recovered from farebox revenue. In its 1999 report, the Maryland Commission on Transportation Investment recommended that the 50% farebox recovery requirement codified in law for MTA service be replaced with performance indicators and management audits in the interest of promoting operating efficiency at the MTA.

Chapter 210 and 211, Acts of 2000 (SB 811/HB 1248) set a 40% system-wide farebox recovery mandate for MTA while preserving the 50% requirement by means of a sunset provision that would have automatically repealed the lower ratio and reporting provisions on June 30, 2004, at which time the mandate would have reverted to 50%. However, Chapter 447, Acts of 2004 (SB 282) again reduced the minimum recovery ratio to 40%, but only for Baltimore Bus, Light Rail, and Metro subway combined. Chapter 447 also continued the performance report requirements originally established in Chapters 210 and 211, 2000 Laws of Maryland.

Chapter 684, Acts of 2008 (HB 1185), amended the farebox recovery requirement to 35% and explicitly added farebox recovery data to MTA's annual performance report, as well as repealing certain provisions of Chapters 210 and 211, Acts of 2000; and, Chapter 447, Acts of 2004.

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Measurement

The farebox recovery ratio is the ratio of gross revenue to adjusted expenses, and measures only the subsidy level of transit service operated, not efficiency or cost-effectiveness. The numerator of the ratio is gross revenue, which are the sum of fare revenue and an allocated share of certain non-passenger operating revenue. The denominator is adjusted expense, which is the sum of gross expense less certain capital, and allocated administrative costs. Tables 1 and 2 summarize the revenue and expense components of the measure.

Table 1: Expense inclusions & exclusions, MTA farebox recovery

Include	Exclude
Insurance	Paratransit and commuter rail service expenses
Changes in inventory levels	Past pension service liabilities
Pro-rated share of administrative costs	New services for the first 36 months of service
	Capital costs, including 20 percent of revenue vehicle maintenance costs

Table 2: Revenue inclusions & exclusions, MTA farebox recovery

Include	Exclude
Passenger fare revenues	Paratransit and commuter rail revenues
Advertising revenues	New services revenues for the first 36 months
Lease and rental income	

Factors in Revenue and Expenditure Growth

MTA's operating revenue is entirely a function of ridership, which itself is a function of the level of service provided. Revenue is also impacted by economic factors such as employment levels and gas prices. In terms of influences on expense, MTA relies heavily on three factors to operate and maintain transit service:

1) *Union labor*: The majority (77%) of MTA's workforce is represented by unions and works under the terms of collective bargaining agreements which set wages, hours, conditions of employment, and fringe benefit arrangements. MTA recently completed interest arbitration with its largest union, Amalgamated Transit Union (ATU) Local 1300, representing approximately 2,500 MTA operations employees, including all operators and mechanics. The arbitration board awarded Local 1300 employees an hourly wage increase totaling 11.5% from FY 2009-12, and increased pension benefits by 40% in the same period. Table 3 illustrates the increasing share of MTA's budget taken by union wage and benefit costs.

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Table 3: MTA Union Labor as Share of Operating Expense

	FY08	FY09	FY10[1]	Projected FY11	Projected FY12
Union Labor Cost	$203,499,806	$203,405,809	$214,980,650	$221,207,178	$254,992,077
Annual Growth		*0.0%*	*5.7%*	*2.9%*	*15.3%*
Total Operating Expense	$556,602,216	$591,720,288	$610,286,666	$624,105,533	$640,506,533
Annual Growth		*6.3%*	*3.1%*	*2.3%*	*2.6%*
Union % Of Total	36.6%	34.4%	35.2%	35.4%	39.8%

2) *Diesel fuel*: MTA is the largest purchaser of diesel fuel in State government, and the second largest purchaser in the State. In FY 2010, MTA purchased 7.4 million gallons of diesel fuel, costing a total of $16.9 million. MTA has begun to move its fleets to hybrid-electric buses and increase the use of biodiesel to improve fuel efficiency, but fluctuations in service levels and per gallon prices still present a large cost to MTA. While diesel prices were historically low for much of FY 2009, MTA's price per gallon for diesel fuel increased 15% from June of 2009 to June of 2010. Table 4 below shows diesel fuel price fluctuations in recent years.

Table 4: MTA Diesel Fuel, Average Price Per Gallon, FY 2008-10

	FY 2008	FY 2009	FY 2010
Jul	$2.261	$3.961	$1.811
Aug	2.226	3.416	2.005
Sep	2.385	3.320	1.920
Oct	2.483	2.931	2.050
Nov	2.779	2.173	2.139
Dec	2.781	1.658	2.095
Jan	2.786	1.580	2.227
Feb	2.794	1.477	2.162
Mar	3.280	1.365	2.277
Apr	3.523	1.575	2.367
May	3.796	1.597	2.321
Jun	3.996	1.899	2.188
Annual	$2.924	$2.246	$2.130

[1] Substantial increase in labor costs for FY2010 and subsequent years reflect the 2010 arbitration board award.

3) *Repair parts:* MTA's bus fleet has an average age of 7.7 years and average annual mileage in excess of 32,000 miles. The most-used buses in the fleet cover over 36,000 miles per year on average. MTA's Light Rail fleet is over 20 years old, and the Metro subway fleet was purchased and put in service nearly 30 years ago. Both rail fleets increase total mileage annually, and all MTA fleets operate in the full spectrum of weather conditions. The annual mileage accumulated by MTA's aging fleets requires a regular maintenance regimen and a significant inventory of spare parts, many of which have to be re-engineered since manufacturers have gone out of business. The cost of these parts escalates each year, and newer, more sophisticated buses and trains often require more expensive parts.

Because these three cost elements increase annually due to inflation and market factors, the cost to provide the same level of service in the Baltimore area from year to year increases automatically.

The revenue side of the farebox recovery equation is dependent on ridership and fare prices. Ridership is a function of service provision and quality, employment, population, and economic factors including gas and parking costs. Research has established that ridership increases are driven first by service availability and quality, and second by economic factors such as the relative cost of transit compared to other modes of travel.

Maintaining a *constant* farebox recovery ratio means that ridership (and thus fare revenues) must *increase at the same rate as expenses* each year. To *improve* farebox recovery, ridership and revenue growth must *exceed* the rate of growth in spending, or spending growth must be lower than ridership and revenue growth. Because of the spending factors cited above, MTA would typically need a 4% to 6% annual increase in Baltimore-area ridership to keep farebox recovery *constant at current levels*. This growth in costs is typical of the transit industry, and properties nation-wide face the same issues in providing consistent, quality service while trying to attain sufficient revenues.

Historical farebox recovery expense and revenue totals for Baltimore local service and MARC are shown in Table 5. Note that in FY 2009, thanks to low diesel prices, effective overtime management, and record growth in ridership, MTA decreased expenses and increased revenue, increasing the farebox recovery ratio for Baltimore local service.

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Table 5: MTA Farebox Recovery Expense and Revenue, FY 2006-10

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Baltimore-area local service					
Total farebox expense	$238,170,038	$263,838,585	$285,426,204	**$277,953,055**	$282,798,224
Annual increase	*3%*	*11%*	*8%*	*-3%*	*2%*
Total farebox revenue	79,126,826	83,740,871	84,123,558	**85,162,843**	80,059,893[2]
Annual increase	*1%*	*6%*	*0%*	*1%*	*-6%*
Farebox recovery ratio	33%	32%	29%	**31%**	28%
MARC service					
Total farebox expense	$54,265,351	$57,697,294	$65,271,107	$84,415,429	$91,556,511
Annual increase	*11%*	*6%*	*13%*	*29%*	*8%*
Total farebox revenue	31,968,173	32,436,266	34,438,315	37,181,293	43,839,805
Annual increase	*8%*	*1%*	*6%*	*8%*	*18%*
Farebox recovery ratio	59%	56%	53%	44%	48%

Current Projections

MTA's latest estimate of farebox recovery is shown in Table 6. Farebox recovery ratios for Baltimore-area service has declined for the last several years until FY 2009. In FY 2010, MTA's recovery ratio decreased due to the award of retroactive pay increases for union employees awarded in the arbitration mentioned on page 2 of this report, as well as higher than usual number of liability claims and historically high snow removal expenses. MTA does not expect to carry these one-time costs in FY2011 or FY2012. MARC farebox recovery has also declined but is projected to remain well above the 35% requirement specified in the Transportation Article (Section 7-208) through FY 2012.

Table 6: Farebox recovery ratios, FY 2009 - 2012 (Est.)

	Actual FY 2009	Actual FY 2010	Estimated FY 2011	Estimated FY 2012
Baltimore area service	31%	28%	29%	29%
MARC	44%	48%	46%	45%

MARC expense is driven by the level of service and the contracts MTA holds with Amtrak and CSX, who operate MARC service using MTA-owned rail equipment. Amtrak and CSX are responsible for the operations of trains and stations, as well as maintenance of rail equipment and

[2] The decrease in revenue from FY09 to FY10 is attributable to lower ridership during the snow events of December 2009 and February 2010, lower overall ridership and lower non-fare revenue..

track. Additionally, the fees for track access in each contract have escalated in recent years, adding expense without increasing service. Because of this imbalance in expense and revenue growth, farebox recovery on MARC service is projected to decline through FY 2011, though it will remain well above the statutory requirement of 35%.

Attaining Required Farebox Recovery Ratios

Tables 7, 8, and 9 outline the actions required to meet the 35% Baltimore-area ratio through either fare increases or cuts to existing service levels, beginning in FY 2012 and continuing through FY 2016. Because of the requirements for public hearings and input for both fare increases and service adjustments, implementing either solution in FY 2011 is not feasible. Reaching the prescribed ratio would require either an initial fare increase from $1.60 to $2.00 (+25%); or an initial expense reduction of roughly $53 million (18% of service based on cost per mile).

Table 7 shows the fare price required to meet the 35% recovery mandate in FY 2012. Subsequent fare increases or expense reductions would be required to maintain the 35% farebox recovery level. Fare amounts shown below are rounded to the nearest dime.

Table 7: Fare increases required to meet the 35% farebox recovery ratio (Baltimore)

	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Core riders (proj.)	93,644,911	94,325,221	95,135,229	95,953,692	96,618,561
	0.64%	*0.73%*	*0.86%*	*0.86%*	*0.69%*
Core expense (proj.)	$288,666,488	$295,591,531	$302,849,433	$314,668,642	$323,901,059
	3.61%	*2.40%*	*2.46%*	*3.90%*	*2.93%*
Fares @ 35% FBR	$99,842,965	$102,083,175	$104,595,964	$108,704,660	$111,907,419
New fare required	**$2.00**	**$2.00**	**$2.00**	**$2.10**	**$2.10**
Required annual increase	25.0%	0.0%	0.0%	5.0%	0.0%

Estimated service cuts to meet the 35% farebox recovery level are shown in Table 8. MTA spent fully 90% ($549.7 million) of its FY2010 budget on statewide transit service, 92% ($562.1 million) if insurance costs are included, leaving only $48.2 million in non-service related spending.

The size of the required service cut shown in Table 8, $53.3 million, is greater than MTA's entire administrative budget. A spending reduction of that magnitude would require service cuts, and necessitate layoffs of both union and management employees. Additionally, it would require the sale or retirement of large portions of MTA's bus fleet in advance of their useful life cycle, requiring repayment of federal funds to the Federal Transit Administration.

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Table 8: Service cuts required to meet the 35% farebox ratio (Baltimore)

	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Core riders (proj.)	93,644,911	94,325,221	95,135,229	95,953,692	96,618,561
Fare revenue (proj.)[3]	$82,358,812	$83,427,200	$84,244,336	$84,980,257	$85,626,814
Projected expense	$288,666,488	$295,591,531	$302,849,433	$314,668,642	$323,901,059
Expense @ 35% FBR	$235,310,891	$238,363,429	$240,698,103	$242,800,734	$244,648,040
Required annual service cuts to meet FBR	**-18%**	**-1%**	**-1%**	**-3%**	**-2%**

It is an understatement to say that an 18% reduction in service would affect MTA's customer base and the future success of Baltimore-area transit operations. Fully 55% of MTA's Baltimore-area riders are dependent on transit as their primary mode of transportation. Reducing service and reliability so extensively would virtually guarantee that riders would be driven away from transit options, reducing revenue and requiring further cuts to meet the farebox recovery ratio. This "vicious cycle" of declining service and declining ridership should be avoided at all costs.

Table 9, below, shows the impact on the Transportation Trust Fund of both the fare increase and service reduction options.

Table 9: Impacts to the Transportation Trust Fund, FY 2012-16

	FY2012	FY 2013	FY 2014	FY2015	FY2016
MTA fare increase					
Revenue to TTF	$17,469,368	$18,642,489	$20,339,663	$23,703,689	$26,257,623
MTA service reduction					
Savings to TTF	($53,313,352)	($57,189,570)	($62,117,146)	($71,808,724)	($79,187,356)

MTA has made great strides in increasing the efficiency, cost-effectiveness, and productivity of its operations in the last four years. In FY 2010, 90% of MTA's operating budget went directly to operating statewide transit service. Recent efforts to make MTA more cost-effective include reducing overtime use, enforcing the absenteeism policy implemented in January 2009, and developing internal systems to track MTA's efficiency and productivity with regular reviews of data and results.

Additionally, MTA has reduced its management workforce by 13%, deferred system-wide service expansions, and reduced administrative costs by $8 million since April 2008. Because of the large fixed cost of operations as well as MTA's commitment to maximizing ridership and

[3] A reduction in service will most likely result in a reduction in ridership, which will in turn reduce fare revenue.

available service, gains from efficiency are not significant enough to make a difference in the farebox recovery ratio.

As an example, MTA reduced annual overtime spending for Baltimore local service by $3.7M from FY 2009 through FY 2010, a 16% reduction, without reducing service availability. Taken alone, with no other increases in costs, this savings would generate a 0.4% increase in farebox recovery, increasing the FY09 Baltimore local service farebox recovery ratio from 30.6% to 31.0%. However, union wage and pension increases, snow removal costs from blizzards in February of 2010, and increased insurance claims all increased total operating expense and reduced the FY 2010 farebox recovery ratio.

Conclusion

MTA's farebox recovery ratio is to a large extent affected by external factors that the MTA cannot influence. The current statutory requirement reflects the collective wisdom of the legislature in recognizing that an arbitrarily high recovery rate could lead to fare increases or service cuts that would disproportionately affect transit-dependent persons and lower-income individuals who cannot easily adjust their personal budgets to accommodate higher transportation costs.

Farebox recovery provides a good snapshot of changes to MTA's revenue in comparison to expenses. However, it is better to evaluate the MTA's effectiveness and efficiency in the broader context of the performance measures MTA reports annually to the General Assembly and of the MTA's overall mission. MTA was created to meet the need for a public service that could no longer be provided profitably by private enterprise. With that mission, the MTA works continuously to strike the delicate balance between reducing expenses and providing high quality transit service to attract a growing number of riders. MTA is committed to acting as a prudent steward of the taxpayers' resources that provide the majority of its funding, at a time when demand for transit service and the associated stress on the existing system continue to rise.