New York State
Office of the State Comptroller

Office of Budget and Policy Analysis

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New York State Thruway Authority
Audit Summary and Recommended Actions

Executive Summary

In October 2007, the New York State Thruway Authority announced plans for a new round of toll increases to take effect in July 2008, January 2009, July 2009 and January 2010. These proposed toll increases are expected to generate $520 million in additional toll revenues over a five-year period and follow recent increases, the last of which took effect in January 2008.

In response to numerous inquiries which questioned the necessity of the proposed increases, State Comptroller Thomas P. DiNapoli, in November 2007, directed his office to expeditiously undertake a highly focused examination of the finances and operations of the Thruway. The audit was to determine if the proposed increases were warranted.

The Comptroller's review concludes that the proposed toll increases, especially the proposed reduction in discounts afforded to E-ZPass customers scheduled for July 2008, are not justified at this time. The Thruway Authority should first undertake a thorough review of all policies and procedures to strengthen controls over costs and examine alternative revenue options.

The audit of Thruway Authority finances is being released with two additional audits, one which examined operations related to uncollected E-ZPass tolls and one which examined the Canal Corporation's capital spending and Board Governance.

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The findings of all three audits raise questions as to the management culture of the Thruway Authority that turns first to tolls to solve problems without fully addressing significant and recurring operating problems uncovered by the audits, such as:

- Uncollected E-ZPass tolls and the underestimation of federal revenues,
- Continuous cost overruns in canal capital projects and an absence of critical cost information on projects relating to the Thruway, as well as to the canal system,
- Lack of prioritization and oversight of capital projects to ensure critical projects are completed first within current budgets, and
- Wide fluctuations in annual operating costs which suggests inattention to cost controls.

It is critical that the Thruway Authority undertake a comprehensive review of all operations of the Authority to identify additional revenue streams and to reduce costs prior to the implementation of any toll increases. Toll increases should not be a substitute for sound management practices.

Improved management of the Thruway operations, accompanied by a maximization of current revenue streams, could mitigate the need for the future toll increases as presently envisioned. The Thruway Authority should immediately:

- Maximize all current revenue streams available to the Thruway Authority, including collection of unpaid E-ZPass tolls and pursuing promotion or sponsorship revenues,
- Take steps to improve financial controls over capital spending to minimize cost overruns and complete projects in a timely manner,
- Prioritize projects and project items in future capital plans to facilitate any adjustment needed to address unanticipated funding shortages within current revenue streams,
- Develop management reports showing progress to date and dollars spent on each individual project item for review by the Board of Directors of the Thruway Authority,
- More accurately estimate future federal aid based upon historical receipts, and

Executive Summary (Cont'd.)

- Most importantly, undertake a comprehensive, top to bottom analysis of Thruway operating costs to identify where costs can be reduced. In the future, this same analysis should be undertaken in connection with all proposed toll increases.

Some have suggested that an expedient alternative to increased tolls is to remove the State's canal system from the Authority's portfolio of responsibilities. This suggestion has been put forth as a mechanism by which future toll increases could be avoided and, indeed, the audit of the Thruway Authority financial condition found that approximately $1 billion has been expended on the State's canals and other non-Thruway related expenses since 1992.

However, the examination by the Office of the State Comptroller focused on the immediate need for toll increases and short-term options to mitigate the imposition of these tolls. While removing the financial burden of the State's canal system from the Thruway Authority would free up significant revenues (approximately $100 million in 2008), the future financial support of the canals is a long-term issue to be dealt with by the Executive and the Legislature.

Current Thruway Authority Financial Condition

The Thruway Authority's budget for 2008 totals $1.1 billion. Of this amount, approximately $355 million is budgeted for operating expenses related to the Thruway, $491 million for Thruway capital projects, $54 million for canal system operating expenses, $54 million for canal system capital projects and $163 million for debt service payments.

In 2008, the Thruway Authority expects to receive $597 million in revenues from tolls imposed on the Thruway system, $13 million in concession revenues from Thruway service areas, $8 million in interest income, $15 million in other miscellaneous income, $422 million in bond proceeds, $30 million in federal funding and $32 million in State and local funding. Total revenues are expected at $1.1 billion.

By improving capital plan management and fully accounting for all identified revenue, the Thruway Authority could extend existing resources and adjust its borrowing schedule, while management conducts a full and thorough analysis of the Thruway cost structure. By identifying and implementing cost reductions in conjunction with better capital planning, the Thruway Authority could eliminate, reduce or postpone additional toll increases.

Current Thruway Authority Financial Condition (Cont'd.)

Revenue

Tolls account for about 94 percent of Thruway Authority revenue with the remainder coming from concession payments and interest earnings on Authority funds.

While toll and concession revenue declined 2.3 percent in 2007, the Thruway Authority expects these revenues to increase over the next five years. If the proposed toll increases are adopted, the Thruway Authority expects 2012 revenue to increase by 36 percent from 2007. Without toll increases, 2012 revenues are expected to be 12.7 percent higher than 2007, a difference of $520 million.

The revenue decline in 2007 could reflect the combined effects of a reduction in travel due to rising gas prices and higher toll costs, as well as declining national economic activity. To the extent this decline in toll and concession revenue is a function of a driver's sensitivity to increasing costs, the Thruway Authority must consider actions to hold the line on costs rather than amplifying detrimental economic trends with higher prices. In addition, the Authority should immediately enhance revenue collection from the E-ZPass program as recommended in the E-ZPass Audit (Report 2006-S-101), as well as pursue additional means of raising revenue through private sector advertising and sponsorships as recommended in the Toll Increase Audit (Report 2008-S-6).

Operating Expenses

As seen in the chart below, over the past ten years the day-to-day expenses of operating the Thruway have grown 70.8 percent, from $197.9 million in 1998 to $338.0 million in 2007. Last year, maintenance and engineering accounted for 30.7 percent of total operating expenses, toll collections and State Police services for 24.7 percent, employee fringe benefits for 33.8 percent, and administrative, information technology and other activities for 10.8 percent.

Thruway Authority
Key Financial Results 1998-2007
(In Millions)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Revenue	398.8	423.8	427.8	434.7	441.8	445.8	463.5	547.6	594.0	580.6
Operating Expenses	197.9	197.7	219.4	228.3	267.9	272.5	291.7	303.8	310.7	338.0
Debt Service	74.9	78.3	83.3	84.9	85.1	85.2	82.1	103.8	127.4	132.3
Non-Thruway Activities	34.0	30.3	14.7	36.2	42.4	42.5	17.8	50.7	54.3	56.9

Current Thruway Authority Financial Condition (Cont'd.)

For the period 1988 through 2000, Thruway operating expenses averaged just over 50 percent of total revenue. As growth in traffic began to slow in 2000, the percentage of revenue necessary for operations increased steadily, reaching a peak of 63 percent in 2004. This rapid growth should have then suggested that cost containment was deserving of attention. Instead, the Authority raised tolls; yet, even with that new revenue, operating expenses still exceeded the historical average and by 2007 reached 58 percent of total revenue.

The total cost to operate the Thruway, including management overhead, was about $527,000 per mile in 2007; however, recent years have seen wide fluctuations in the growth rate for these costs. For example, operating costs in 2002 increased by 17.3 percent from the prior year. Yet in 2003, the increase was 1.7 percent, then jumped up to 7 percent in 2004 and 4.1 percent in 2005.

Alternatives to current practices that can achieve immediate cost reductions should be implemented, and long-term savings through more efficient operational and managerial policies should be pursued. In consideration of current financial realities for the Thruway Authority and the traveling public, "business as usual" can no longer be an everyday practice. In order to achieve most of its financial objectives without new toll increases, the Authority should seek to identify savings which are sufficient to ensure that 2008 operating expenses do not exceed 2007 levels and subsequent growth is kept under tight controls.

Debt Service

Since 1992 when the Legislature and Governor decided to continue the tolls even as the original bonds were paid off, the Authority has gone to market with eight separate General Revenue Bond issues. At present, $2.4 billion in bonds is outstanding.

With an infrastructure over 50 years of age and the need for constant attention to safety, ongoing capital investment is necessary to maintain the safe and efficient operation of the Thruway. At present, the Authority expects debt service costs to continue to climb steadily. Payments are estimated to reach $163.5 million in 2008, an increase of 118 percent over levels in 1998.

New borrowings planned for 2009 and 2010 will raise Authority debt service costs by an estimated $60 million. In concert, the actions recommended in the Toll Increase Audit (Report 2008-S-6) would enable the Authority to slow the growth in debt service by postponing certain projects and better managing those that move forward.

Current Thruway Authority Financial Condition (Cont'd.)

Non-Thruway Activities

In the early 1990s, the Authority became responsible for the State's canal system, which had traditionally been part of the Department of Transportation, as well as for maintenance of I-84 and I-287, both non-tolled, limited access highways located in the lower Hudson Valley. The Authority was also directed to pay for a number of upstate economic development projects. These additional responsibilities have cost the Authority more than $1 billion. Despite legislative appropriations to cover certain highway costs, by 2007, these expenses had grown 67.4 percent over levels in 1998.

Since 1990, the Authority has spent Thruway generated revenue on the following non-Thruway projects:

- Canal System - $700.4 million,
- I-84 - $164.1 million,
- I-287 - $100.7 million, and
- Economic Development Projects - $61.4 million.

Thruway Authority Audits: Summary Findings

The Office of the State Comptroller has conducted three recent audits involving different aspects of Thruway Authority operations. These reviews have identified specific areas in need of management attention, including cost control, improved capital planning and enhanced revenue collection.

<u>Toll Increase Audit</u>: The most recent audit, *Proposed Toll Increases for July 2008 Through January 2010* (Report 2008-S-6) completed in January 2008, focused on the need for additional toll increases. Key findings and recommendations include:

Management and Cost Control:

Most significantly, the audit found that the Thruway Authority has no comprehensive plan in place to reduce or limit the growth of operating costs. While management asserts that such a plan has been implemented in conjunction with the preparation of annual budgets, in fact, the audit revealed that even a base level analysis of its operations has not been performed to determine where costs could be reduced. The Audit recommends that the Thruway Authority conduct a thorough, top-to-bottom review of all cost centers and institute additional financial oversight and reporting. Further, the Audit recommends management consider additional means of raising revenue through private sector sponsorship.

Thruway Authority Audits: Summary Findings (Cont'd.)

The audit also found that Thruway Authority management has insufficient controls over capital spending, was unable to provide cost detail on future equipment purchases ($38 million per year), was unable to document how its operational spending estimates were developed, used inflation analysis for capital projects with no supporting documentation, and had not conducted analyses of economic trends to support its revenue and budget forecasts.

Capital Plan:

Federal highway aid for the Thruway Authority averaged $33.5 million per year for the period 1988 to 2007. Future levels of federal funding can be difficult to predict, but the Thruway Authority has elected to estimate only $4.9 million per year for the future. Accounting for a conservatively estimated $125 million in federal highway funding through 2012 would reduce the need for other funds by an equivalent amount.

In addition, the audit also found that Thruway Authority capital plans include over $160 million in projects that might be desirable, but cannot be justified by the Authority's present financial position. By deferring these projects—such as creating and improving E-ZPass lanes and building pedestrian bridges and parking lots—existing capital resources can be directed to higher priority needs. This audit also recommended the Thruway Authority prioritize all capital projects and identify lower priority projects that could be deferred for additional savings.

<u>E-ZPass Audit</u>**:** *Uncollected E-ZPass Tolls and Fees* (Report 2006-S-101) found:

Uncollected Revenue:

The Thruway Authority has failed to maximize collections of tolls and penalties due from toll violators. These motorists failed to pay about $4.5 million in tolls and another $22.9 million in administrative fee penalties during the audit period. If the Thruway Authority had hired a private collection agency to pursue toll scofflaws as other transportation agencies have, it could have netted millions in additional revenue.

<u>Canal Corporation Financial Controls Audit</u>**:** The third audit examined B*oard Governance and Controls over Selected Financial Practices* at the Canal Corporation (Report 2005-S-66). By law, the Thruway Authority Board of Governors also serves as the board of the Canal Corporation. This audit found:

Thruway Authority Audits: Summary Findings (Cont'd.)

Capital Project Management

The Corporation's project management system does not allow management to track each canal project through its life cycle with continual comparisons of actual expenses to original budget costs and remaining estimated costs for completion.

Canal Options

Since 1992, approximately $700 million in Thruway toll and concession revenues has been spent to support the Canal Corporation. Current Thruway Authority estimates project the expenditure of another $395 million to operate and repair the canals between 2008 and 2012.

To suggest removal of canal operations as the only solution to toll increases greatly oversimplifies the problems facing the Thruway Authority. All three audits highlighted areas in need of significant improvement ranging from uncollected E-ZPass revenues to a lack of oversight associated with the implementation of capital projects to unsubstantiated budget projections. Focusing on the financial burden posed by the canal system does not resolve these management shortcomings.

The New York State Constitution (Article 15, section 1) states that the canals "shall remain the property of the state and under its management and control forever." Although the Thruway Authority has spent $700 million dollars to maintain and upgrade the infrastructure of the canal system, revenues derived from the State's canals have remained stagnant, hovering around $2 million per year. However, even within the constraints of the Constitution, a number of options for the future of the canal system could be considered in an effort to relieve the Thruway Authority of this financial burden:

- <u>Seek Transfer of the Canals to the Federal Government:</u> The Legislature is permitted by the New York State Constitution to transfer the canals to the federal government for inclusion in the federal inland waterway system. Currently, the federal government funds the Erie Canalway National Heritage Corridor Commission. The Corridor includes the existing canals, more than 200 adjacent cities, towns and villages, and the historic area of the original canal extending through Buffalo and Albany.

- <u>Lease to Private Developer(s):</u> Another option is leasing the canals, which is permitted under a 1991 amendment to the Constitution. However, with more than $100 million per year currently needed to operate and meet the capital needs of the canals, a creative combination of development incentives and funding options would have to be defined in order to create a financially viable leasing scenario.

Canal Options (Cont'd.)

- Return Canals to General Fund Support: In 2005, the Canal Corporation issued a report on the future of the canal system recommending it be converted to an independent public benefit corporation and its costs shifted to the General Fund. Legislation that would have implemented this proposal was not acted upon during the 2006-07 Legislative Session.

  Alternatively:
  - Return the canals to the portfolio of the Department of Transportation (DOT), or
  - Have DOT pay the Thruway Authority for the capital and/or operating costs of the canals. DOT currently supports the capital expenses for the Thruway Authority operated I-84 and I-287 highways. The State Fiscal Year 2008-09 Executive Budget would continue the payments.

- Sell or Lease Lands Adjacent to the Canals: The State could attempt to sell or lease the State-owned lands adjacent to the canals, using the proceeds to establish an endowment to maintain and operate the canal system, while retaining regulatory control through environmental laws and prior approval of proposed economic development projects.

Removing canal system operations and other non-Thruway related programs would significantly reduce Authority expenditures and restore the Authority to its core mission. However, no workable alternatives are under active discussion to address the future of New York's canal system.

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