Staff Report

# REVIEW OF FYs 2015-2018 FINANCIAL PLAN

July 22, 2014

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# I. Overview

The adopted FY 2015 budget was balanced thanks in part to constructive developments over the course of FY 2014: $3.7 billion higher-than-forecasted revenue collections, $1 billion increase in the release of prior-year payables, debt service savings of $618 million, the drawdown of $410 million from the general reserve, and other actions that generated roughly $5.9 billion of net surplus operating funds. The city applied almost $3.8 billion of this net operating surplus to the FY 2014 budget to restore funding to the Retiree Healthcare Benefits Trust (RHBT) and to cover costs related to its labor settlements. Additionally, the surplus was used to augment the prepayment of FY 2015 expenses by $1.8 billion, for a total prepayment nearing $2 billion. The city also assigned $450 million of the surplus to boost the general reserve to a historic high of $750 million.

The city's decision to reverse the planned withdrawals from the RHBT is a prudent and responsible move, as the unfunded liability for retiree health benefits continues to grow and now stands at $92.5 billion. The pay-as-you-go costs continue to grow each year and will eventually crowd out other needs. The city still needs to develop a long-term plan to both add funding to the trust and reduce the cost of healthcare for retirees.

The additional resources available for FY 2015 allowed the city to fund almost $1.1 billion of agency new needs, $283 million of City Council initiatives and PEG restorations of $64 million, while maintaining a balanced budget. Due to concerns over a tepid national economic recovery, the city still maintains conservative revenue assumptions in FY 2015 and the outyears of the financial plan. While the FY 2015 budget is balanced and contains higher reserves, it does not include any projection of a surplus that could be used to lower the projected outyear budget gaps.

The four-year financial plan projects that the rate of growth in expenditures will continue to exceed that of revenues. In FY 2018, revenues are expected to total $80.9 billion with expenditures growing to $84 billion. The areas of significant expenditure growth continue to be debt service, salaries and wages, pensions, and healthcare costs. Debt service is forecasted to grow by 20 percent between FYs 2015 and 2018. While the city uses conservative interest rate assumptions that may produce savings, the city, in reshaping its ten-year capital strategy in January, should be cognizant of the growing debt service costs and how it is paid for. Salaries and wages as well as pension costs are increasing by 11.5 percent and 9.6 percent, respectively, over the plan period, and now reflect funding of the labor reserve to cover all union settlements based on the pattern set with the United Federation of Teachers, DC 37, and other unions. Fringe benefits, led by healthcare costs, are projected to grow by 15 percent over the plan.

The city has cautiously maintained conservative revenue forecasts, and projects that the national economy will gradually accelerate through calendar years 2014 and 2015. The city is concerned that the lackluster national recovery is aging without having achieved the expansion milestones of past recoveries. Our analysis shows that while there are concerns over the strength of the national economy, the city's economy

continues to be strong. With that in mind, we project that there could be an upside in both nonproperty taxes and miscellaneous revenue totaling $650 million in FY 2015, $525 million in FY 2016, $300 million in FY 2017, and $250 million in FY 2018. The additional revenue will be offset by expenditure risks in uniformed overtime.

The inclusion of funding for the projected labor settlements, and the success in receiving some union approval, has removed a major unknown risk to the city's financial plan. FY 2015 is balanced, with projected budget gaps of $2.6 billion in FY 2016, $1.9 billion in FY 2017 and $3.1 billion in FY 2018. In addition, the budget gaps are likely to extend beyond FY 2018 as factors associated with the labor settlements such as lump sum payouts, pension costs, and the full impact of wage increases are likely to drive up projected gaps. These gaps are of the size that the city has shown the ability to manage.

While the FY 2015 budget does not now contain a projected surplus to help lower these outyear gaps, the city must manage FY 2015 in a way that builds up a surplus and creates recurring savings for future years. The city needs to continue the practices of forecasting conservative revenue estimates, which it has; and maintaining high levels of reserves, which it has. The third leg of the city's strategy has been to ask agencies to continue to review their priorities and recommend areas for expenditure savings. We strongly recommend that the city resume that practice. During FY 2015, whether needed for current-year budget balance or not, the city should implement a gap-closing program with recurring savings to both build up a surplus, as well as create recurring savings to deal with the projected outyear gaps.

## JUNE FINANCIAL PLAN:
## THE CITY'S OPERATING PROJECTIONS FOR
## FISCAL YEARS 2015-2018

**TABLE 1** ($ in millions)

| | FY 2015 | FY 2016 | FY 2017 | FY 2018 |
|---|---|---|---|---|
| **Revenues** | | | | |
| Taxes: | | | | |
| General Property | $20,721 | $21,816 | $22,759 | $23,694 |
| Other Taxes | 27,130 | 28,329 | 29,291 | 30,220 |
| Tax Audit Revenue | 709 | 709 | 709 | 709 |
| Sale of Property Tax Liens | 58 | 38 | 40 | 40 |
| Miscellaneous Revenues | 8,020 | 6,996 | 6,988 | 6624 |
| Less: Intracity Revenues | (1,797) | (1,822) | (1,825) | (1,830) |
| Disallowances | (15) | (15) | (15) | (15) |
| Total City Funds | $54,826 | $56,051 | $57,947 | $59,442 |
| | | | | |
| Other Categorical Grants | 809 | 876 | 872 | 867 |
| Interfund Revenues | 533 | 519 | 518 | 518 |
| Federal Categorical Grants | 6,458 | 6,329 | 6,306 | 6,293 |
| State Categorical Grants | 12,401 | 12,820 | 13,294 | 13,813 |
| **Total Revenues** | **$75,027** | **$76,595** | **$78,937** | **$80,933** |
| | | | | |
| **Expenditures** | | | | |
| Personal Service | $41,012 | $42,540 | $43,335 | $45,768 |
| Other Than Personal Service | 30,515 | 30,510 | 30,966 | 31,499 |
| General Obligation, Lease & TFA Debt Service | 6,530 | 7,242 | 7,582 | 7,839 |
| Budget Stabilization & Prepayments | (1,983) | -- | -- | -- |
| General Reserve | 750 | 750 | 750 | 750 |
| Subtotal | $76,824 | $81,042 | $82,633 | $85,856 |
| | | | | |
| Less: Intracity Expenditures | (1,797) | (1,822) | (1,825) | (1,830) |
| **Total Expenditures** | **$75,027** | **$79,220** | **$80,808** | **$84,026** |
| | | | | |
| **Gap To Be Closed** | **$0** | **($2,625)** | **($1,871)** | **($3,093)** |

## CHANGES TO THE CITY'S OPERATING PROJECTIONS FOR FISCAL YEARS 2015-2018
## JUNE FINANCIAL PLAN COMPARED TO FEBRUARY MODIFICATION

**TABLE 2** ($ in millions)

| | FY 2015 | FY 2016 | FY 2017 | FY 2018 |
|---|---|---|---|---|
| **Revenues** | | | | |
| Taxes: | | | | |
| General Property | ($3) | $39 | $96 | $155 |
| Other Taxes | (350) | (415) | (557) | (652) |
| Tax Audit Revenue | 0 | 0 | 0 | 0 |
| Sale of Property Tax Liens | 0 | 0 | 0 | 0 |
| Miscellaneous Revenues | 1,238 | 188 | 157 | 135 |
| Less: Intracity Revenues | (101) | (153) | (146) | (146) |
| Disallowances | 0 | 0 | 0 | 0 |
| Total City Funds | $784 | ($341) | ($450) | ($508) |
| | | | | |
| Other Categorical Grants | ($34) | $46 | $46 | $45 |
| Interfund Revenues | 13 | 6 | 5 | 5 |
| Federal Categorical Grants | 56 | (55) | (64) | (76) |
| State Categorical Grants | 496 | 545 | 547 | 670 |
| **Total Revenues** | **$1,315** | **$201** | **$84** | **$136** |
| | | | | |
| **Expenditures** | | | | |
| Personal Service | $1,043 | $1,508 | $1,208 | $2,347 |
| Other Than Personal Service | 639 | 314 | 255 | 494 |
| General Obligation, Lease & TFA Debt Service | (203) | (52) | (42) | 14 |
| Budget Stabilization & Prepayments | (213) | -- | -- | -- |
| General Reserve | 150 | 150 | 150 | 150 |
| Subtotal | $1,416 | $1,920 | $1,571 | $3,005 |
| | | | | |
| Less: Intracity Expenditures | (101) | (153) | (146) | (146) |
| **Total Expenditures** | **$1,315** | **$1,767** | **$1,425** | **$2,859** |
| | | | | |
| **Gap To Be Closed** | **$0** | **($1,566)** | **($1,341)** | **($2,723)** |

## RISKS TO THE FINANCIAL PLAN

**TABLE 3** ($ in millions, positive numbers are offsets to risks)

| | FY 2015 | FY 2016 | FY 2017 | FY 2018 |
|---|---|---|---|---|
| **Stated Financial Plan Gap** | **$0** | **($2,625)** | **($1,871)** | **($3,093)** |
| **Estimation** | | | | |
| Nonproperty Taxes | 500 | 400 | 200 | 150 |
| Miscellaneous Revenue | 150 | 125 | 100 | 100 |
| Uniformed Services Overtime | (202) | (257) | (286) | (331) |
| Police Overtime PEG | (50) | (50) | (50) | (50) |
| **Risk Total** | **$398** | **$218** | **($36)** | **($131)** |
| **Total FCB Estimated Surplus/(Gap)** | **$398** | **($2,407)** | **($1,907)** | **($3,224)** |

# II. Balancing the FY 2015 Budget

The June 2014 Financial Plan presents a balanced budget of $75 billion in total funds for FY 2015. City-fund revenues support $54.8 billion of the total budget, reflecting a year-over-year growth of $843 million. The improvement is led by gains in property tax receipts and nonrecurring revenues that are partially offset by conservatively estimated lower nonproperty tax, audit and miscellaneous revenues.

The FY 2015 budget was balanced thanks in part to constructive developments over the course of FY 2014: a $3.7 billion higher-than-forecasted revenue collection, $1 billion increase in the release of prior-year payables, debt service savings of $618 million, the drawdown of $410 million from the general reserve, and other actions that generated roughly $5.9 billion of net surplus operating funds. The city applied almost $3.8 billion of this net operating surplus to the FY 2014 budget to restore funding to the Retiree Healthcare Benefits Trust (RHBT) and to cover costs related to its labor settlement. Additionally, the surplus was used to augment the prepayment of FY 2015 expenses by $1.8 billion, for a total prepayment nearing $2 billion. The city also assigned $450 million of the surplus to boost the general reserve to a historical high of $750 million.

The city has yet to identify a surplus for FY 2015, leaving a projected budget deficit of $2.6 billion for FY 2016. Our analysis indicates that overtime expenses would likely be higher than estimated by about $250 million, but that there is an upside potential of approximately $500 million in nonproperty taxes and $150 million in miscellaneous revenues to more than offset the additional expenses. With this roughly net $400 million increase in resources, the city can begin the process of building a surplus to address the FY 2016 budget gap.

## CITY FUNDS CLIMB $843 MILLION IN FY 2015, AS TOTAL REVENUE FALLS

The June 2014 modification contains $482 million in additional FY 2014 city-funded revenue compared with the May modification. These revenue gains will be used to help future budgets by prepaying some expenses before the close of FY 2014. The real property tax contributed an extra $30 million to the year-end revenue gains, while the nonproperty taxes added $293 million, primarily due to strong results from the personal income and the real estate transactions taxes. Audits added $25 million while miscellaneous revenue contributed $134 million. Since the May modification, total revenues are up by $474 million in FY 2014 because of the previously mentioned city-fund increases and a net decrease of $8 million in categorical grants and interfund revenue.

Compared with the previous year, city-fund revenues increase by $843 million to $54.8 billion in FY 2015, as shown in the figure. Supplemented by gains in the final tax roll, FY 2015 property tax revenue increased by $779 million, year-to-year, to $20.8 billion. Other gains include a $694 million expansion of nonrecurring revenues and a STAR aid increase of $24 million. Partly offsetting these gains are reduced nonproperty tax receipts of $303 million and lower miscellaneous revenue and audits, each of which drop by $176 million. Total revenue declines by $459 million, to $75 billion.

| **FY 2015 City-Fund Revenues Increase by $843 Million** ($ in millions) | |
|---|---|
| Property Tax | $779 |
| Nonproperty Taxes | (303) |
| Audits | (176) |
| STAR Aid | 24 |
| Miscellaneous Revenue | (176) |
| Nonrecurring Revenue | 694 |
| **City Funds** | **$843** |
| Categorical Aid | (1,294) |
| Interfund Revenue | (8) |
| **Total Change in Revenues** | **($459)** |
| Note: Numbers may not add due to rounding. | |

The weaker FY 2015 total revenues include shifts in categorical grant programs, which are down by $1.3 billion. Categorical aid from all sources is $19.7 billion in FY 2015, of which $6.5 billion is federal aid, $12.4 billion is from state programs and $809 million is from private sources. Federal aid decreases by $1.8 billion, primarily due to the approval of $1.77 billion in Hurricane Sandy aid during the previous year. A pending supplemental allocation of $1.45 billion could enlarge FY 2015 grant estimates as it gains approval. State grants increase by $676 million, reflecting $729 million in additional education aid less planned decreases to other aid programs. Private grants decline by $130 million, reflecting two large cutbacks of $32 million in education construction grants and $29 million in transportation grants.

Miscellaneous revenue including one-time revenue is projected to yield $6.2 billion in FY 2015. This revenue estimate has increased by $518 million since the previous year, and is discussed in further detail in "Miscellaneous Revenue" on page 19. There are no tax program initiatives in the city's financial plan. The city's tax audit program declines by $176 million in FY 2015 to $709 million.

The city expects the nonproperty taxes to decline by $303 million to $26.3 billion in FY 2015. Following strong collections growth in FY 2014, the May plan had expected FY 2015 nonproperty tax receipts to hold steady at the strong collections level achieved in the previous year. By the June plan, FY 2014 receipts were augmented by a late-year surge, which was not added into the nonproperty tax plan for FY 2015, resulting in the projected revenue decline. This decline follows four years of rising nonproperty tax receipts since the start of the recovery. Growth started off with a strong 13 percent upturn in FY 2011, at the start of the recovery, and then weakened to four percent in FY 2012. Strong growth returned in FY 2013, with an 11 percent upturn driven by the spin-up in tax collections. Some of the tax revenue on transactions that were motivated by federal tax increases, which caused the local revenue spin-up in FY 2013, spilled into FY 2014. Collections growth bumped up to 5.7 percent in FY 2014, which was followed by a revenue decline of 1.1 percent in FY 2015.

Among the declining taxes, the personal income tax, which falls $304 million, or 3.2 percent, has the largest decrease in FY 2015. The property transactions taxes fall $262 million or 11 percent in FY 2015, following spin-up assisted growth of 26 percent in

FY2013 and 36 percent in FY 2014. The bank tax drops by $49 million for a decline of four percent. The city sales tax, with a gain of $206 million, or 3.2 percent, registers the biggest increase among the nonproperty taxes that show positive growth. The unincorporated business tax grows by $87 million, increasing by 4.7 percent, while the general corporation tax grows by a weak $14 million, or 0.5 percent. The utility tax grows by $22 million, or 5.6 percent, and the commercial rent tax shows weak growth of $18 million, or 2.6 percent. Overall, we believe that the city's nonproperty taxes could be higher in FY 2015 by $500 million, as seen in Table 3 on page 5 and discussed in more detail in "Nonproperty Taxes" starting on page 16.

## THE EFFECT OF BALANCING FY 2014 ON FY 2015

The June financial plan paints a financially sound picture of the city's fiscal health with planned spending for FY 2015 of $75 billion in total-funded expenditures. For city-funded expenditures, planned agency spending will be approximately $843 million higher in FY 2015 than in FY 2014. For all of FY 2014, the city assumed higher-than-forecasted revenue collection of $3.7 billion, a significantly higher-than-expected takedown of prior-year payables totaling about $1 billion, debt service savings of $618 million, the drawdown of $410 million from the general reserve, and other actions, which overall generated about $5.9 billion of net surplus operating funds. The city will use almost $3.8 billion of this net operating surplus in FY 2014 to restore funding to the Retiree Healthcare Benefits Trust (RHBT) and to also cover the costs of the labor settlement. In addition, approximately $2 billion of the surplus will be used to prepay FY 2015 expenses, which includes $142 million of surplus funds from FY 2013. The city will also add funds to the general reserve in each of FYs 2015-2018, increasing it to $750 million. Still, the plan does not project a surplus in FY 2015 to help close the FY 2016 $2.6 billion gap.

The city's operating surplus was mostly built upon the recognition of higher revenue but also recognized a larger-than-normal takedown of prior-year payables. This amount totaling about $1 billion includes the reestimate of payables accrued in the Department of Education (DOE) and other agencies in previous years to cover the cost of contract payments. This one-time reestimate of $593 million adds to the $400 million taken earlier in the fiscal year.

In the financial plan for FY 2014, the city will restore nearly $1.9 billion to the RHBT. In the February modification, the city had halted the last of the scheduled drawdowns, which would have nearly depleted the trust, and in the June plan added additional funds. This one-time funding in FY 2014 has now restored the RHBT to about 63 percent of its peak value before drawdowns of the trust began. The RHBT was created in FY 2006 not as a rainy-day fund but to address the Other Postemployment Benefits (OPEB) liability, which stood at $53.5 billion when it was initially recognized and has now grown to $92.5 billion. The growth is being driven by the annual increase in the city's healthcare costs provided to retirees, which we expect will add about $5 billion a year to the liability. The restored funding to the RHBT is a responsible but measured step in addressing this growing liability. We strongly recommend that the city adopt an annual recurring allocation of funds to the trust. Additionally, the city

should work to further reduce healthcare spending by building upon the expected savings that are part of the labor settlements and the recent reduction in the premiums paid to the Health Insurance Plan of New York (HIP).

Furthermore, beginning in FY 2015 to offset possible risks, the city maintains a higher-than-normal general reserve of $750 million, which is $150 million more than budgeted in the executive budget presented in May. The city routinely replenishes the general reserve at the start of the fiscal year and has held $300 million historically in the reserve to deal with any unforeseen events. The reserve is normally taken down at the end of the fiscal year, if those funds are not needed.

Since the FY 2014 adopted budget, the city's projection for FY 2015 spending has increased by about $1.8 billion, net of surplus funds. As shown in the figure to the right, the majority of the projected spending increase, totaling almost $1.1 billion, will cover agency new needs. Other spending, totaling $347 million, will focus on City Council initiatives and the restoration of agency PEGs. Also adding to expenditures are collective bargaining adjustments of $656 million, however, the city projects reduced agency spending of $272 million. The city had been able to build up additional surplus funds of about $1.8 billion in FY 2014 on top of $142 million of surplus funds from FY 2013. In total, the city has nearly $2 billion in surplus funds that it will use to prepay FY 2015 expenses. As shown in the figure, accounting for the additional surplus, city-funded expenditures actually decrease by a net $27 million.

| FY 2015 Expenditure Changes Since FY 2014 Adopted Budget<br>City Funds ($ in millions) | |
|---|---|
| Agency New Needs | $1,083 |
| Council Initiatives | 283 |
| PEG Restorations | 64 |
| Collective Bargaining Adjustment | 656 |
| Other Adjustments* | (272) |
| **Total Increase** | **$1,814** |
| Additional Surplus Funds | (1,841) |
| **Net Decrease** | **($27)** |
| *Net of Surplus Funds | |

A detailed look of agency new needs is shown in the figure to the right. Other Mayoral agencies will receive the highest allotment of more than $500 million. Of this amount, Youth and Community Services will receive $126 million, which will be used to fund the after-school initiative first proposed in the FY 2014 February modification.[1] Also, funding will be made available to the Departments of Environmental Protection and Transportation, which collectively will be allocated about $116 million. The remaining monies will be distributed to a number of departments in this budget area.

| FY 2015 Agency New Needs<br>City Funds ($ in millions) | |
|---|---|
| Other Mayoral | $501 |
| Uniformed Services | 237 |
| Health and Welfare | 145 |
| Major Organizations | 116 |
| Miscellaneous Budget | 53 |
| Elected Officials | 31 |
| **Total New Needs** | **$1,083** |

[1] In the FY 2014 February modification, the city had proposed a Universal Prekindergarten and an after-school initiative with projected costs of $340 million and $190 million, respectively. From a budgetary standpoint, the revenue and cost components of Universal Prekindergarten were budget neutral and have not been included in this analysis. We do, however, include the after-school initiative. Since the February modification, the city has secured funding for Universal Prekindergarten and the after-school initiative from the state.

In the Uniformed Services area, the four uniformed agencies (Police, Fire, Correction, and Sanitation) will in total receive $237 million with most of the funds directed to the Police and Fire Departments. The newly needed funding for the Police Department, summing to $109 million, will replace security costs normally paid by the New York City Housing Authority (NYCHA) to the Police Department. The payment relief of $70 million will free up funds for NYCHA to apply elsewhere. This payment relief is in addition to $52.5 million that was already scheduled in FY 2014. The Fire Department will be allocated about $91 million of extra funds to cover needs associated with uniformed personal services and Emergency Medical Services.

The city has also budgeted $145 million of extra funds to its Health and Welfare agencies. The Department of Social Services will use $47 million to meet its cash assistance needs and support a delay in realizing administrative savings from the Client Services Reengineering initiative. Another portion of the allocation, amounting to about $29 million, will maintain a reduction and cap on rent paid by HIV/AIDS clients. The Departments of Homeless Services, and Health and Mental Hygiene will receive supplementary funds of $26.6 million and $24.6 million, respectively.

The DOE and the City University of New York (CUNY), both part of the city's Major Organizations, will be allocated $116 million. Most of this amount, more than $97 million, will go toward the DOE budget. Some of the funds are for programs such as arts instruction and English Language Learners but other funds will be directed to charter schools, leases, and new district schools. Lastly, higher-than-anticipated miscellaneous spending will require an extra $53 million of funds and the budget for Elected Officials will increase by $31 million.

The City Council has adopted a number of initiatives that will require funding summing to $283 million.[2] About $50 million of this amount will be disbursed to City Council members for their individual districts. About half of the remaining funds will be allocated to such areas as Youth and Community Services, Housing, Education, and Children Services.

While the city has not proposed a new PEG initiative, it will restore, or substitute, $64 million of cuts that were part of the FY 2014 PEG, with more than $50 million of the restorations occurring in the Fire Department. Included in the Fire Department's PEG restoration is almost $44 million to keep 20 fire companies open and to retain 505 of uniformed personnel. As we have recommended in previous reports, the city should continue to implement agency PEGs. In doing so, it has shown the capability of closing projected budget deficits in past years by employing this long held practice. In addition to the program being an effective gap-closing measure, the practice of requesting agencies to review their operations at least once a year and submitting

[2] As part of the City Council initiatives the city will offer free lunch for all city middle school students, which will result in a revenue loss of $3.25 million. The revenue loss increases the total funding for initiatives to about $287 million.

proposals to reduce costs, shift funding sources, or increase revenues serves as an efficient and productive management tool.

Also, as part of the labor deal with the United Federation of Teachers (UFT), the city recognized in FY 2014 the cost for lump sum payments to UFT members, and other union members, who retire on or after July 1, 2014 rather than in the fiscal year in which the member is expected to retire. Additionally, the city will recognize $1 billion from the Health Insurance Stabilization Fund. These two actions increase labor reserve funding in FY 2015 by $656 million.[3]

| FY 2015 Other Adjustments<br>City Funds ($ in millions) | |
|---|---|
| Other Mayoral | $214 |
| Health and Welfare | 89 |
| Uniformed Services | 50 |
| Elected Officials | 14 |
| Misc, Pension, & Debt | (560) |
| Major Organizations | (79) |
| **Total Adjustments** | **($272)** |

Offsetting agency new needs are other adjustments made to agency budgets that the city expects will reduce FY 2015 spending by a net $272 million. As shown in the figure to the right, $367 million of net higher spending, which is not categorized in the budget as either new needs or as a PEG restoration, will be counterbalanced by cost reduction adjustments of $639 million. Much of the cost reduction adjustment comes from the reestimate of premiums paid to HIP and healthcare savings expected from the labor settlements. Also, the financial plan accounts for the six-year phase-in of the actuarial gains in pension investments from FY 2013 that will start in FY 2015. The phase-in is expected to reduce pension costs by $86 million in FY 2015. Lastly, a reestimate in the projection to costs related to Judgment and Claims is also expected to reduce agency costs.

[3] A full discussion of the UFT labor settlement can be read in the June 12, 2014 FCB Staff Report starting on page 18.

# III. The FYs 2015-2018 Financial Plan

While the June 2014 Financial Plan presents a balanced budget of $75 billion for FY 2015, it forecasts expenditures growing faster than revenues thereafter through FY 2018, when expenditures total $84 billion and revenues $80.9 billion. The gap between expenditures and revenues fluctuates from $2.6 billion in FY 2016 to $1.9 billion in FY 2017 and $3.1 billion in FY 2018, driven by rapidly growing costs in such areas as debt service, salary and wages, pension, and healthcare.

The growth in debt service costs is due to the high amount of debt that has been and is expected to be issued to support the city's capital program. Debt service is forecasted to grow by 20 percent between FYs 2015 and 2018. In projecting debt service costs, the city utilizes conservative interest rate assumptions, allowing for the possibility of savings that can be applied to reducing budget gaps. We present the alternative of applying a portion of such savings as pay-as-you-go capital financing, which would serve to lower the city's very high debt load and generate additional debt service relief for the operating budget.

Salary and wages as well as pension costs are increasing by 11.5 percent and 9.6 percent, respectively, over FYs 2015-18, to now reflect funding of the labor reserve to cover all union settlements based on the same collective bargaining pattern as the recent settlement with the United Federation of Teachers, DC 37, and other unions. Fringe benefits, led by the cost of healthcare insurance, are projected to grow by 15 percent over the FYs 2015-18 period. The financial plan incorporates a separate reduction in healthcare costs totaling $3.4 billion between FYs 2015 and 2018, as a component of the recent labor agreement. This reduction in healthcare cost has not been itemized, but the city notes that the total value is enforceable by binding arbitration.

Meanwhile, the city has cautiously maintained conservative revenue forecasts, and projects that the national economy will gradually accelerate through calendar years 2014 and 2015. The city is concerned that the lackluster national recovery is aging without having achieved the expansion milestones of past recoveries. Our analysis shows that while there are concerns over the strength of the national economy, the city's economy continues to be strong. With that in mind, we project that there could be an upside in both nonproperty taxes and miscellaneous revenue totaling $650 million in FY 2015, $525 million in FY 2016, $300 million in FY 2017, and $250 million in FY 2018. The additional revenue will be offset by expenditure risks in uniformed overtime.

## THE OUTLOOK FOR REVENUE GROWTH

Total revenue increases by $5.4 billion, or 7.2 percent, from $75.5 billion in FY 2014 to $80.9 billion in FY 2018, as shown in Table 4 on page 13. At the start of the plan, revenues decline by 0.6 percent in FY 2015. This weaker projection follows two years of six percent growth for total revenue, but those strong increases in FYs 2013 and 2014 were augmented by spin-up driven tax collections and by federal disaster aid to pay for the rebuilding that was needed after the destruction caused by Hurricane Sandy. After

the weakness in FY 2015, growth accelerates to 2.1 percent in FY 2016, 3.1 percent in FY 2017 and 2.5 percent in FY 2018. Thus, moderate growth in the later years of the plan enables revenues to climb despite the weakness at the start of the plan.

TABLE 4

**CITY FUNDS INCREASE BY $5.5 BILLION OVER THE NEXT FOUR YEARS**

($ in millions)

| | FY 2014 | FY 2015 | FY 2016 | FY 2017 | FY 2018 | FY 2014-18 % Change | FY 2014-18 $ Change |
|---|---|---|---|---|---|---|---|
| Property Tax | $19,999 | $20,779 | $21,854 | $22,799 | $23,734 | 18.7% | $3,735 |
| Nonproperty Taxes | 26,570 | 26,267 | 27,451 | 28,410 | 29,338 | 10.4 | 2,768 |
| Audit Revenue | 885 | 709 | 709 | 709 | 709 | (19.9) | (176) |
| Miscellaneous | 4,831 | 4,655 | 4,699 | 4,748 | 4,779 | (1.1) | (52) |
| Nonrecurring | 874 | 1,568 | 475 | 415 | 15 | (98.3) | (859) |
| STAR Aid | 838 | 862 | 877 | 881 | 881 | 5.2 | 43 |
| Disallowances | (15) | (15) | (15) | (15) | (15) | 0.0 | 0 |
| **Total City Funds** | **$53,983** | **$54,826** | **$56,051** | **$57,947** | **$59,442** | **10.1%** | **$5,459** |
| | | | | | | | |
| Federal Grants | $8,298 | $6,458 | $6,329 | $6,306 | $6,293 | (24.2%) | ($2,005) |
| State Grants | 11,725 | 12,401 | 12,820 | 13,294 | 13,813 | 17.8 | 2,088 |
| Private Grants | 939 | 809 | 876 | 872 | 867 | (7.7) | (72) |
| **Categorical Aid** | **$20,962** | **$19,668** | **$20,025** | **$20,472** | **$20,973** | **0.1%** | **$11** |
| | | | | | | | |
| Interfund Revenue | 541 | 533 | 519 | 518 | 518 | (4.3) | (23) |
| **Total Funds** | **$75,486** | **$75,027** | **$76,595** | **$78,937** | **$80,933** | **7.2%** | **$5,447** |

Note: Numbers may not add due to rounding.

City-fund revenues increase by $5.5 billion, or 10.1 percent, from $54 billion in FY 2014 to $59.4 billion in FY 2018. Growth ebbs to 1.6 percent in FY 2015, following strong growth of 7.3 percent in FY 2014 and 5.8 percent in FY 2013. Weak projected tax collections initially diminish city-funded revenue growth in FY 2015. Growth increases to 2.2 percent in FY 2016, reaching a modest peak of 3.4 percent in FY 2017 before slowing to 2.6 percent in FY 2018. Rising tax receipts are driving the revenue growth, with the real property tax growing by $3.7 billion, or 18.7 percent, and nonproperty tax collections increasing by $2.8 billion, or 10.4 percent, over the next four years.

Categorical aid, which consists of federal, state and private program-specific grants, falls at the start of the plan and then gradually recovers so that these grants reach $21 billion by FY 2018, virtually unchanged from grants in FY 2014. Gains in state aid offset decreases in federal and private grants to leave the total unchanged. Over the next four years, state aid increases by $2.1 billion, or 18 percent, due to the state's generous support for the city's education budget, particularly for the new prekindergarten program. Federal aid diminishes by $2 billion, or 24 percent. This decline reflects the federal response to Hurricane Sandy, which lifted grants in FYs 2013 and FY 2014 and which could possibly also lift grants again in FY 2015, is not planned to continue into the outyears. Private grants fall by $72 million, for a decline of 7.7 percent.

## Economic Outlook

In its economic plan, the city projects that the national economy will gradually accelerate through CYs 2014 and 2015, while local economic growth will stall in 2014 before moving higher in 2015. Subsequent reports indicate stronger than expected growth for the local economy, even as national economic growth weakens. The city is concerned that the lackluster national recovery is aging without having achieved the

expansion milestones of past recoveries. National economic growth dropped sharply at the start of 2014, accompanied by weak hiring during the harsh winter. Even though job growth has accelerated since the midwinter lull, economic growth for 2014 could be depressed by the poor results at the start of the year.

National economic output fell by 2.9 percent in the first quarter of CY 2014, probably as a result of harsh winter weather. Factors contributing to this negative result were declines in exports, inventories, and investment spending. Personal consumption expenditures were also weak, largely due to declining health care expenditures. Prior to this negative report, the city had projected that national growth would improve to 2.5 percent in 2014, up from the weak 1.9 percent growth recorded in 2013. Economic growth then climbs to 3.1 percent in 2015 and growth remains at or above three percent through 2018. The city's 2014 target for national economic growth now appears to be unattainable, given the magnitude of the first quarter decline.

Positive developments include an upturn in industrial production, gains in hiring, and falling unemployment. National job growth has accelerated from a December 2013 low of 84,000 jobs to 288,000 by June 2014, driving down the unemployment rate to 6.1 percent, a six-year low.

Gross city product (GCP) growth drops to 0.1 percent in the city's plan for 2014, down from 2.8 percent in 2013. Growth accelerates to 1.8 percent in 2015 and levels off at about 2.4 percent in 2016-18. The city's outlook is predicated on the softening of local labor market growth, weaker Wall Street profits and slow wage rate growth. Local job growth drops to 58,000 new jobs in 2014 and 51,000 jobs in 2015, from the supercharged 86,000 average employment gains of the previous three years. Hiring data for the current year, which dropped steadily from 90,000 new jobs in January to 66,000 jobs in April, at first appeared to show that a slowdown was in effect. Job growth abruptly picked up to 76,000 in May and to 94,000 in June, indicating that the local hiring boom might not yet be over. The sustained employment growth is finally bringing down unemployment. The June 2014 local unemployment rate declined to 7.7 percent from 8.9 percent in June 2013 and 9.7 percent in June 2012.

Many of the new jobs are in low paying sectors such as retail and wholesale trade, leisure and hospitality services, or home health care services. In the long-stalled high-paying finance sector, banking and securities industry jobs appear to be starting to recover. The high pay professional and business services sector, which includes the rapidly growing technology industry, is in the fourth year of a vigorous expansion. This expansion includes accountants, but does not include the legal services industry, which is shedding jobs. The count of government jobs, which has been shrinking in the city for about five years is still in decline, due to the loss of federal and state jobs in the city; local government hiring appears poised for an upturn, possibly due to new education programs.

Despite the expanding local job market, personal income gains appear to be edging down in the city. Local personal income growth slowed to 3.1 percent in 2012, down from 6.1 percent in 2011 and 5.7 percent in 2010. Consistent with this observed slowdown for these earlier years, the city's economic plan estimates that personal

income growth will soften to 2.7 percent in 2013, then gradually accelerate to 3.4 percent in 2014 and 3.7 percent in 2015, before climbing to five percent in 2017.

The resurgence of lower Manhattan gained a boost from strong leasing at two newly built towers at the World Trade Center. The construction of a third tower is likely to accelerate now that necessary approvals, financing and an anchor tenant have all been secured.

Wall Street profits decline, in the city's plan, to $14 billion in 2014 from $16.7 billion earned in 2013 and $23.9 billion in 2012. Results for the first quarter of 2014 show profits of $5.3 billion, which indicates a downturn from the $6.6 billion earned in comparable period of the previous year. Recent stock market record highs, however, indicate that Wall Street profits could be headed upward, despite the slippage in the first quarter.

### Property Tax Growth

Property tax revenue is among the fastest growing revenue sources, increasing by $3.7 billion, or 18.7 percent, from $20 billion in FY 2014 to $23.7 billion in FY 2018. Property tax growth drops to 3.9 percent in FY 2015 from 6.7 percent in FY 2014, after which revenue growth wavers between a high of 5.2 percent in FY 2016 and a low of 4.1 percent in FY 2018. The accelerated growth in FY 2014 partly reflects the city's success in controlling tax breaks, such as rescinding abatements to nonresident owners of cooperative and condominium apartments and a review of tax exemptions to restore ineligible properties to the tax roll. Even though these revenue-producing programs continue in FY 2015, the growth rate drops in comparison to the upsurge in the previous year.

The June plan raised the FY 2015 real property tax forecast to $20.8 billion, adding $100 million to the previous estimate in the May modification. The extra revenue was recognized after billable assessment growth improved to 6.1 percent in the final tax roll for FY 2015, up from the 5.7 percent estimate in May. Billable assessment growth increases from 4.4 percent in FY 2013 to 5.7 percent in FY 2014 and to 6.1 percent in FY 2015 before slowing to 5.3 percent in FY 2016 and to about four percent in each of FYs 2017 and 2018.

The billable growth plan was enabled by four consecutive increases in market values, which accelerated to 5.6 percent on the city's FY 2015 final tax roll from the tepid below three percent growth rate of the previous three years. The upward trend of market values indicates that the local real estate market has normalized following the slump that hit in FY 2009. Each successive year of market value growth helps lift billable growth because assessments of most large properties are phased in over five years.

In our March staff report, we included positive risks of an extra $110 million in property tax revenue in FY 2016, $120 million in FY 2017, and $130 million in FY 2018. The city has subsequently raised its property tax plan by $39 million in FY 2016, $96 million in FY 2017 and $155 million in FY 2018. These increases consist of large positive

increments to the levy, averaging $214 million, partially offset by about $118 million in extra contingency reserves. If these reserves are not needed, they could be used to supplement property tax revenues before the close of each fiscal year. Notwithstanding the extra reserves, we think that the city has satisfied our upside risks, with its substantial levy increases.

## Nonproperty Taxes

The nonproperty taxes account for about half of the projection of city funds growth. These taxes increase by $2.8 billion, or 10.4 percent, from $26.6 billion in FY 2014 to $29.3 billion in FY 2018, as shown in Table 4 on page 13. FY 2015 tax projections fail to keep up with the strong collections achieved in FY 2014 and decline by $303 million or 1.1 percent. Collections rebound with 4.5 percent growth in FY 2016, after which growth drops to 3.5 percent in FY 2017 and 3.3 percent in FY 2018. Previously, at the start of the recovery, these taxes surged by 13 percent in FY 2011 but growth then dropped to four percent in FY 2012. The nonproperty taxes soared by 11 percent in FY 2013 when taxpayers acted to recognize incomes early in order to avoid impending federal tax increases. The resulting spin-up also helped lift FY 2014 collections growth to 5.7 percent.

The fastest growing nonproperty taxes are the unincorporated business, sales, and commercial rent taxes, each of which increases by about 17 percent over the next four years, as well as the hotel tax which increases 11 percent. Three taxes with more moderate growth of about 10 percent are the general corporation, the utility, and the mortgage recording taxes. The personal income tax grows by about eight percent, the real property transfer tax grows by a subpar four percent, while the banking corporation tax stagnates with growth of one percent. The cigarette tax drops by 11 percent and the minor taxes decline by six percent.

### Business Taxes

The city's collection plan for the general corporation tax (GCT), the banking corporation tax (BCT) and the unincorporated business tax (UBT) is mixed. As a group, the business taxes climb an impressive 11 percent from $5.9 billion in FY 2014 to $6.5 billion in FY 2018, but these taxes are not all participating in this growth. Whereas GCT and UBT increase by 10.3 percent and 17.4 percent, respectively; the BCT stagnates with a slight increase of 0.7 percent over the plan.

The projected plan-period growth of 11 percent for business taxes could turn out to be stronger than expected. The city's economic plan suggests that national corporate profits will jump from a lethargic CY 2013 growth rate of 3.2 percent to 16.4 percent in 2014, after which profits flatten to near-zero growth in calendar years 2015 through 2018. First-quarter national corporate profits increased by eight percent, which marks a welcome improvement from the one percent growth of the previous year. National profits could continue to accelerate to meet the city's economic plan of 16.4 percent growth in 2014.

Securities industry profits dropped from $23.9 billion in 2012 to a still respectable $16.7 billion in 2013, after which the city projects that the securities industry will earn $14 billion in 2014. Through the first quarter of 2014, the securities industry earned $5.3 billion, down from $6.6 billion in the previous year. Despite the decline, Wall Street profits are on track to exceed the city's $14 billion target in 2014. Also, recent record-breaking stock market highs suggest that the securities industry is in the midst of a very good year.

The banking industry is facing particularly difficult challenges, and the city assumes no growth for the bank tax through the plan period. Banks are adapting to the closer scrutiny of regulators required by the Dodd-Frank Act. The Volcker rule, a provision of that legislation, restricts bank proprietary trading and the relationships of banks with hedge funds and private equity funds. Another difficulty is the large penalties that banks have been assessed to settle mortgage lending and other abuses. Furthermore, not all banks passed the Federal Reserve's stress tests. Five out of 30 banks failed the capital requirement stress test, including Citigroup. These results indicate that the banking industry has not fully recovered from the severe financial shocks of the recent recession.

The banks, which benefited from the upturn in mortgage lending resulting from low interest rates, could face a more difficult business environment now that the Fed is withdrawing its monetary stimulus. The Federal Deposit Insurance Corporation (FDIC) reports that bank profits are down by eight percent in the first quarter of 2014, largely due to a one-time gain in the previous year at one institution. Also contributing to the decline was reduced mortgage activity. New York State bank profits improved by 107 percent in the first quarter, after having dropped by 51 percent in the previous year. The net effect of these gyrations is that profits for the state's banks are slightly ahead of where they were two years ago.

The state has approved a business tax relief program, which includes the elimination of a separate tax for banks and tax relief for firms providing services to out-of-state customers. These reforms are scheduled to go into effect for tax years starting on or after January 2015 and could start impacting tax collections in FY 2015. Additionally, the state has proposed an 8.5 percent corporate tax rate reduction that will go into effect in January 2016. The city has indicated interest in business tax reforms, provided that the reforms are revenue neutral to the city.

Our risk assessment is that despite the weakness of the banking sector, the business taxes could exceed plan by $100 million in each of FY 2015 and FY 2016 because of strengthening securities industry and corporate profits.

**Sales Tax**

In the latest plan, the city expects a good, but not dazzling performance from the sales tax during FYs 2014-18. In the adopted budget, sales tax collections in FY 2015 are expected to increase 3.2 percent from the prior year to $6.7 billion. Underlying the sales tax forecast are the city's projections for moderate wage and employment gains, and a continued boost from tourism. Total wage income is projected to increase in each year

of 2013 through 2018 although the pace temporarily slows in 2015 from a small decline in finance sector compensation. By 2016 through 2018, wages are expected to advance by over four percent annually, which enables sales tax growth in a similar range.

The city expects 58,000 jobs will be created in 2014, and that the economy will generate from 50,000 to 58,000 jobs annually from 2015 to 2018, with no layoffs in the private sector, including the securities industry. This amount of job gains, in the 50,000 range, is more likely to be sustained as compared with private sector job growth of over 90,000 in both 2011 and 2012, and 85,500 in 2013. Taxable consumption is also enhanced by the city's assumption that the large number of people visiting New York City, and the benefits resulting from their direct spending and broader economic impact, will continue past 2013. The latest estimate is for 55.8 million visitors during 2014, after records were set in both 2012 and 2013 when over 50 million domestic and foreign travelers came to New York City.

As a result of the gains in wages, employment, and tourism, sales tax revenue rose by over five percent on a continuing base in both FYs 2013 and 2014. The positive outlook for these factors will continue in the forecast period, but growth in collections is projected to slow to 3.2 percent in FY 2015, before rising to 4.3 percent in each of FYs 2016 through FY 2018.[4] It is possible that sales tax collections may improve to a greater degree in FY 2015 and FY 2016, by $50 million in each year, than the city estimates due to a stronger local economy that may encourage more discretionary spending by consumers.

Recent data show that households are increasing their savings after a spike in spending in March, while they cautiously use their credit cards. With the rise in stock and home prices, some households are feeling wealthier as the nominal value of their net worth rose to a record level in the first quarter of 2014. Yet, there are other homeowners with negative equity in their homes, even after the run-up in home prices. With an optimistic outlook by consumers, momentum might be generated that would accelerate the national economic recovery and drive income growth. This would also help first-time homebuyers and those with home equity lines of credit taken out earlier in the housing boom that are due to reset.

**Personal Income Tax**

In the June financial plan, the city expects personal income tax revenue to fall 3.2 percent from the prior year to $9.191 billion in FY 2015 due to a sharp decline in bonus payouts (cash and deferred stock) in both the private sector and the securities industry, and flat nonwage income growth. During the plan period, collections reach a relative low of $9.191 billion in FY 2015 before advancing in each year of FYs 2016-2018 to $10.220 billion in FY 2018. While personal income tax revenue reached new highs in FY

[4] "Continuing base" or "common rate and base" refers to tax collections that have been modified to remove the effects of tax programs and other adjustments to focus on the influence of the economy.

2013 and FY 2014 of over $9 billion, New York Stock Exchange (NYSE) member firms earned a quite respectable $23.9 billion in 2012 and $16.7 billion in 2013.

Another reason for the drop in personal income tax revenue in FY 2015 is the city's assumption that securities industry profits will decrease 16.1 percent in 2014 to $14 billion and remain in the $14 billion range through the years covered by the plan. By the outyears, payment patterns return to historical trends and are not distorted by tax code changes, which occurred in FY 2013. After increasing 3.5 percent in FY 2014 on a continuing base, personal income tax revenue is projected to slide 2.3 percent in FY 2015, before reversing course and rising 3.9 percent in FY 2016, 3.4 percent in FY 2017, and 2.5 percent in FY 2018.

It is remarkable that this time last year, there was concern about excessive volatility in the financial markets, particularly in bonds. Now, the focus is on possible complacency in the markets that could lead to undue risk-taking, where the second quarter of 2014 has been marked by historically low volume and little volatility, as measured by the Chicago Board Options Exchange Volatility Index. FICC (fixed income, currencies, and commodities) units at banks, hedge funds and other financial companies that rely on price movements to make a market or a profit are facing challenges in generating revenue. In addition, some financial companies are reporting less client activity, processing fewer large trades used to hedge positions, and dealing with wrong bets on U.S. government treasuries and foreign economies. As it turned out, second quarter earnings of several banks reflected overall trading revenue that either did not fall as much as expected or remained flat from last year as trading activity started to pick up at the end of the quarter. While facing sharp declines in mortgage originations, some banks posted gains in investment banking.

What hasn't changed is that units at financial firms that are involved in mergers and acquisitions, initial public offerings, bond issuance for nonfinancial companies, and wealth management are continuing to do well and contributed to NYSE member firms earning $5.3 billion in the first quarter of 2014. The federal government continues to pursue investigations against banks for possible improprieties regarding mortgage securitizations, tax evasion, dark pools, etc. While formulating an exit strategy, the Federal Reserve is also turning its attention to nonbank financial companies who took over businesses formerly run by banks, but operate with less capital, regulation and different risk models than banks.

Despite economic uncertainty and regulatory issues facing the financial markets and Wall Street, personal income tax revenue in FYs 2015-2018 could be higher than the city projects due to current strength in wage and nonwage income that is reflected in withholding and installment payments that may benefit FY 2015 collections, and, to a lesser extent, receipts in FYs 2016-2018. We believe that there is an upside potential in the personal income tax of $350 million in FY 2015, $250 million in FY 2016, $200 million in FY 2017, and $150 million in FY 2018. There have been layoffs in mortgage and FICC units and other cost-cutting measures, but it doesn't necessarily follow that overall compensation (including bonuses) will decline for those still employed in the securities industry and the private sector. In addition, nonwage income such as capital gains

realizations in 2014 may reflect more sales of stock than initially projected given the numerous records set by the Standard & Poor's 500 Index and the Dow Jones Industrial Average so far this year.

## Miscellaneous Revenue

On a year-to-year basis, the city's FY 2015 miscellaneous revenue forecast is projected to increase 9.1 percent, or $517.7 million, to $6.2 billion largely due to a greater reliance on nonrecurring actions in FY 2015 than in FY 2014. The largest of these initiatives is the $1 billion Health Stabilization Fund payment that is part of the city's settlement with the United Federation of Teachers.[5] If nonrecurring actions such as major asset sales and other third-party payments, and dedicated resources are removed from the city's FY 2015 miscellaneous revenue forecast, the remaining core categories are projected to decline by 7.5 percent, or $226.6 million, to $2.8 billion from the prior year.[6]

The $226.6 million negative variance encompasses all six of the core categories and most likely reflects conservative forecasting rather than weakness in collections. However, the outlook for the fine category is a slightly different case, where revenue is expected to drop 9.7 percent to $788.9 million from FY 2014 to FY 2015. In this case, greater compliance to traffic laws from the Mayor's Vision Zero action plan and a new city policy to offer relief to small businesses that can lower the frequency a fine is levied and the dollar value of the violation, will act to constrain growth in fine revenue while meeting other goals.

So far, the state legislature has approved two initiatives under the Vision Zero plan. The city can now increase the number of speed enforcement cameras from 20 to 140 that are placed near schools, and will be able to reduce the default speed limit from 30 to 25 mph. While the additional speed enforcement cameras in school zones are not likely to raise a significant amount of revenue due to the relatively limited time during the day that the cameras will be operational, it is another question how long it will take some drivers to lower their speed to new legal limit.

### Forecast Period FY 2014 to FY 2018

In the forecast period from FY 2014 through FY 2018, the city expects that miscellaneous revenue will fall 16 percent, or $911.4 million, to $4.8 billion. The projected decline arises from both fewer nonrecurring resources generated by the end of the plan period, and less revenue expected in most of the revenue categories. The use of

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[5] Third-party payments such as receipts from a union's health and welfare fund often are placed in miscellaneous revenue, because a revenue source that is neither a tax nor categorical aid needs to be brought into the budget, and may represent an offset to expenditures or reimbursement for prior-year expenses.

[6] Core category revenue consists of licenses, charges for services (fees), interest earnings, rents, fines, and a miscellaneous category without major nonrecurring actions, tobacco proceeds, housing revenue, and HHC payments. Another revenue category called water and sewer charges is excluded from the analysis, because it is dedicated to programmatic expenditures and unavailable for gap-closing assistance.

nonrecurring resources is generally skewed to the beginning of the plan period to help close near-term budget deficits or offset an unexpected expenditure in the current year.

Excluding water and sewer charges, which are tied to expenditures in the Department of Environment Protection and other funds that are not part of core category revenue, the adjusted revenue stream is forecast to decline 2.2 percent, or $65.6 million, to $2.9 billion from FY 2014 to FY 2018. The negative variance would have been larger if not for a resurgence in interest income tied to higher interest rates by the outyears of the plan. Based on historical collections, we believe that miscellaneous revenue could be higher than the city's forecast by $150 million in FY 2015, $125 million in FY 2016, and $100 million in each of FYs 2017-18, as shown in Table 3 on page 5.

The Federal Reserve will adopt a less accommodative monetary policy and start to raise short-term interest rates sometime in 2015 or 2016. The city's outlook for interest income already takes this into account and collections are expected to exceed $130 million in both FYs 2017 and 2018, as short- and long-term interest rates begin to resemble historical norms. In FY 2014, only $16.3 million was earned from the short-term investment of available city funds. The Federal Reserve has kept the short-term federal funds rate at 0 to 0.25 percent since December 2008 and designed bond-buying programs to put downward pressure on long-term interest rates.

Another important issue in miscellaneous revenue during the forecast period is the planned sale of the remaining 1,600 out of the 2,000 handicapped taxicab medallions permitted by state law. In FY 2014, 400 medallions for accessible vehicles were sold that raised $337 million. Sales of the rest of the medallions are expected to occur in each year of FYs 2015-2017 and yield $1.313 billion. However, medallion sales in FY 2015 and beyond are contingent upon the city receiving approval of its Disabled Accessibility Plan from the New York State Department of Transportation, which was submitted in June. Based on the Taxi and Limousine Commission's track record of completing the milestones included in the enabling legislation, we believe the city will be successful, and the taxicab medallion sales planned for FY 2015 will take place during the year.

## SOURCES OF EXPENDITURE GROWTH

Projected total-funded expenditure growth from FY 2015 to FY 2018 is presented in Table 5. Also shown in the table is the spending variance between FYs 2014 and 2015.

TABLE 5

## PROJECTED EXPENDITURE GROWTH IN FYs 2015-2018

(yr/yr percent change, $ in millions)

| | FYs 2014-15 | FYs 2015-16 | FYs 2016-17 | FYs 2017-18 | FYs 2015-18 | Level in FY 2015 | Level in FY 2018 |
|---|---|---|---|---|---|---|---|
| **Total Expenditures** | **(0.6%)** | **5.6%** | **2.0%** | **4.0%** | **12.1%** | **$74,494** | **$83,508** |
| | | | | | | | |
| **Total PS** | **(3.3%)** | **3.8%** | **1.9%** | **5.7%** | **11.8%** | **$40,084** | **$44,833** |
| Salaries and Wages | (3.0%) | 4.0% | 1.3% | 5.8% | 11.5% | 22,946 | 25,582 |
| Fringe Benefits | (9.9%) | 4.3% | 4.7% | 5.4% | 15.0% | 8,670 | 9,972 |
| Pensions | 3.5% | 2.8% | 0.8% | 5.8% | 9.6% | 8,469 | 9,279 |
| | | | | | | | |
| **Total OTPS** | **2.7%** | **7.8%** | **2.2%** | **2.1%** | **12.4%** | **$34,410** | **$38,675** |
| Public Assistance | 3.5% | (1.4%) | 0.4% | 0.0% | (1.0%) | 1,428 | 1,413 |
| Medical Assistance | 1.3% | (0.5%) | 0.0% | 0.0% | (0.5%) | 6,447 | 6,415 |
| Debt Service | 16.5% | 10.9% | 4.7% | 3.4% | 20.1% | 6,530 | 7,840 |
| Other OTPS | (0.7%) | 10.1% | 2.1% | 2.4% | 15.0% | 20,006 | 23,006 |

Note: Includes city, state, and federal funds. Excludes intracity expenses and interfund agreements. Numbers may not add due to rounding.

From FY 2014 to FY 2015, the city anticipates it will spend 0.6 percent less, or about $451 million. Much of the decrease in Personal Service (PS) expenditures is expected in salaries and wages, and fringe benefits while higher spending is expected for pension costs. The lower costs in salaries and wages, and fringe benefits are due to technical adjustments associated with the accrued cost of the labor settlement. As presented in the May modification, the city had reached a labor deal with the UFT, and since then, other settlements have also been reached. Following governmental accounting standards the city recognized the cost accrual of lump sum payments in FY 2014 totaling $790 million, which will be paid to UFT members and other similarly situated employees who retire on or after July 1, 2014 and before October 1, 2020.[7] When compared to FY 2015, the accrued cost makes the labor reserve higher in FY 2014. Similarly, the city will make a one-time allocation to the RHBT of $864 million in FY 2014, which is in addition to the restored funding of $1 billion made earlier in the fiscal year. The impact of the added funds increases fringe benefit costs in FY 2014 in comparison to FY 2015.

For FYs 2015 to 2018, the city projects total-funded expenditures, excluding intracity expenses and interfund agreements, to grow by $9 billion from $74.5 billion to $83.5 billion, or an increase of 12.1 percent. All budget areas in both PS and Other Than Personal Service (OTPS) are expected to contribute to the growth with the exception of Public Assistance (PA) and Medical Assistance (MA), which are expected to decrease by 1.0 percent and 0.5 percent, respectively. Much of the decline in MA is due to the state's

[7] In addition to the contract settlement with the UFT, the city has also reached agreements with the New York State Nurses Association and 1199 SEIU United Healthcare Workers East. The dates for distinguishing different retirement groups may vary. The settlements follow the same pattern as the UFT deal, which include lump sum payments and raises for CYs 2008 and 2010. Additionally, the city has also come to an agreement on a contract deal with District Council 37, which is the city's largest civilian union. The deal with DC 37 largely follows the assumed settlement pattern funded by the city covering CYs 2011-2018 with the exception of being extended by an extra four months beyond the 84 months assumed. The extra four months will carry a wage cost of about one-half percent.

initiative to take over the growth in the city's share of Medicaid costs, which had been previously capped at three percent. This was part of the SFY 2012-13 state budget and has incrementally reduced the city's Medicaid growth. Beginning in SFY 2013-14, the growth was initially reduced from three to two percent followed by an additional one percent reduction annually over the next two fiscal years.

The major contributor to PS expenditure growth is fringe benefits (excluding pension costs) awarded to city employees. The spending for this budget area is expected to grow by 15 percent over FYs 2015-2018, or by more than $1.3 billion. Fringe benefits include the employer portion for Social Security Tax (also know as FICA), unemployment insurance, Supplemental Welfare Benefits, workers' compensation, and healthcare insurance.

The cost of healthcare insurance is the largest of the fringe benefit expenses. Estimated healthcare spending for active and retired city workers, including payments to Supplemental Welfare Funds, is expected to increase from about $6.4 billion in FY 2015 to $7.4 billion in FY 2018. It represents about 12 percent of the city-funded budget of $54.8 billion and $62.5 billion in those respective fiscal years. The annual growth of the cost on average translates to $338 million, or about five percent.

The growth in healthcare spending is driven by a number of factors, such as premium payments. The financial plan assumes, however, that the city will be able to reduce spending. The plan contains the reestimate for premiums paid to HIP and is projected to save around $400 million a year. Additionally, a major part of the recent labor settlements is an agreement between the city and the Municipal Labor Committee (MLC) to reduce the cost of healthcare provided to the entire city workforce by $3.4 billion over the life of financial plan with the cost reduction enforceable by binding arbitration. The savings are expected to produce $1.3 billion annually, growing by health trend, beyond the financial plan period. Still, growth for this pay-as-you-go expense is likely to continue to increase from year-to-year and will drive the Other Postemployment Benefits (OPEB) liability higher.

The cost of labor and pensions increase by 11.5 percent and 9.6 percent, respectively, over FYs 2015-2018. The higher spending reflects the cost of the labor settlements, but will be offset by savings from investment gains in pensions. The city had funded the labor reserve to cover all other union settlements after it had reached a deal with the UFT assuming that all other settlements will follow the same collective bargaining pattern. Some of the increase in pension costs will be offset by the phase-in of FY 2013 investment gains. The city reported an investment return of 12.12 percent for FY 2013, which is 5.12 percentage points greater than the actuarial required seven percent return for the fund. The financial plan accounts for the six year phase-in of the actuarial gain starting in FY 2015.

In the OTPS budget area, the largest source of growth over the plan period is in the city's debt service expense (net of prepayments). As shown in Table 5 on page 21, the city projects debt service will increase by 20.1 percent from $6.5 billion in FY 2015 to $7.8 billion in FY 2018. For a further discussion of debt service see "The Affordability of the Capital Program" starting on page 25. Also increasing at a fast pace are Other OTPS

expenditures, which are expected to increase by 15 percent. This budget area, which serves to support city operational needs such as administrative, technical, facility, equipment, and motor fleets, also accounts for the impact of prepaid expenses of debt service and library subsidies. The increase between FYs 2015 and 2018 mainly reflects higher operational spending in the DOE and the miscellaneous budget but adjustments in energy, leasing, and inflation estimates are also attributable.

The financial plan assumes budget gaps of $2.6 billion in FY 2016, $1.9 billion in FY 2017, and $3.1 billion in FY 2018. One of the risks that could increase the outyear gaps is uniformed overtime spending. Based on actual overtime expenditures through May 2014, we project total fiscal year-end spending of $1.170 billion, while the city assumed $1.131 billion in overtime expenses. The city projects uniformed overtime expenditures of $968 million for FY 2015, $914 million for FY 2016, $885 million for FY 2017, and $839 million for FY 2018. Based on the FY 2014 projected total, we hold at risk $202 million for FY 2015, $257 million for FY 2016, $286 million for FY 2017, and $331 million for FY 2018, as seen in Table 3 on page 5.

## LONG-TERM ISSUES BEYOND THE FINANCIAL PLAN

As reported in our March 2014 staff report, there are two issues that will have a long-term impact on the city's ability to balance future budgets. The first is the growing and mostly unfunded OPEB liability. We have stated in past reports that left largely unfunded, the OPEB liability will continue to grow at about a pace of $5 billion annually. At last count, the liability is $92.5 billion and will likely top $100 billion by FY 2017. The growth in the liability has been driven by the continued growth in healthcare costs. The city's healthcare cost, which is paid annually on a pay-as-you-go basis, covers both active workers and retirees. The cost for active workers in FY 2015 is projected to be $4.3 billion rising to $4.8 billion by FY 2018. The cost for retirees is expected to be $2.1 billion increasing to $2.6 billion over the same period. This represents on average annual growth in costs of four percent for active workers and seven percent for retirees.

To address the OPEB liability, the city had created the RHBT, which peaked at about $3 billion. However, following the financial crisis, the city drew upon the RHBT to support other gap-closing actions and compensate for pension fund investment losses. The final withdrawal of funds, amounting to $1 billion, was scheduled for FY 2014 and would have nearly depleted the trust. Conversely, during FY 2014 the city had halted the drawdown and restored funding by almost $1.9 billion. While restoring funds to the RHBT is a prudent and responsible move, the continued growth of the liability is of concern since there is only a relatively small amount of assets available to cover it. As we stated earlier, the city needs to continue to find ways to mitigate the cost of healthcare and to add funds to the RHBT on a consistent basis.

Elsewhere, a draft guidance to change reporting standards was recently approved by the Governmental Accounting Standards Board (GASB). The guidance, which has yet to be finalized, proposes new OPEB standards that are similar to the pension standards GASB approved in CY 2012. If approved by the GASB, state and local governments will be required to report net OPEB liabilities in their financial

statements and, in addition, may be required to use a GASB selected actuarial cost method. However, it should be noted that the city had already recognized the OPEB liability in its financial statements as an addition to its long-term liabilities in FY 2006 when the RHBT was created.

The second long-term issue involves the pension system. Starting in FY 2012, pension contributions are calculated under revised actuarial assumptions and methods, which include a new actuarial cost method.[8] This new actuarial cost method is a required element for determining obligations starting in FY 2015 under the newly-issued GASB Statements Number 67 and 68. The GASB rules, however, do not affect the city's pension cost. The new actuarial cost method recognizes an explicit initial Unfunded Actuarial Accrued Liability (UAAL), which is attributable to all historical benefit changes, actuarial investment gains/losses and all other actuarial experience of the pension systems. The city has been reporting the new unfunded liability as of the June 30, 2010 valuation. This leaves a UAAL totaling $72 billion for a funded ratio of just about 61 percent. Meaning, for every one dollar of actuarial accrued liability, there is just 61 cents of actuarial assets available to cover it. For financial reporting purposes in FY 2015, this means that when combined with the OPEB liability, the city's unfunded obligations will total about $170 billion. While these issues do not create an immediate concern for the city's budget, the long-term effect will likely add stress to the city's fiscal condition.

## THE AFFORDABILITY OF THE CAPITAL PROGRAM

The city is in the process of establishing new capital program priorities. In general, the capital program funds outlays for the repair, replacement and expansion of such traditional infrastructure areas as streets, highways, bridges, mass transit, and the water and sewer system; as well as facilities, equipment, vehicles and technology for the areas of education, housing, parks, corrections, hospitals, courts, police, fire, libraries, and economic development. In the May 2014 financial plan, the city presented a capital plan for FYs 2015-18 that incorporated an additional $10.6 billion of commitments, including $5.5 billion of contracts that were deferred from FY 2014. As is the historical norm, the city did not release a new capital plan at the time of the adopted budget in June. However, the Mayor indicated that the full scope of his priorities will be encompassed in the ten-year capital strategy for FYs 2016-25 that is scheduled to be released in January 2015.

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[8] The revised actuarial assumptions and methods were passed by the state legislature and signed by the Governor into law in January 2013.

| Four-Year Capital Plan FYs 2015-18 ($ in billions) | |
|---|---|
| City Funded: | |
| G.O./NYCTFA | $20.0 |
| Water Authority | 6.6 |
| Subtotal | $26.6 |
| NonCity Funded | $8.6 |
| **Total Commitments** | **$35.2** |

As shown in the figure to the right, the current capital plan for FYs 2015-18 totals $35.2 billion, of which $8.6 billion is funded with noncity resources, including state and federal grants, and $26.6 billion is city funded. The city-funded commitments include $6.6 billion of contracts to be supported by New York City Municipal Water Finance Authority fee-based revenue bonds, the debt service on which is not a component of the city's operating budget. The other $20 billion of city-funded commitments are expected to be financed with general obligation (g.o.) bonds sold by the city and revenue bonds sold by the New York City Transitional Finance Authority (NYCTFA), with these bonds being backed by city tax revenues. The annual debt service costs on tax revenue bonds are included in the city's operating budget and must compete with spending for basic services and employee benefits in a constrained revenue environment.

Debt service costs are currently projected to grow from $5.6 billion in FY 2014 to $7.8 billion in FY 2018, with the absorption of tax revenues estimated to be increasing from 11.6 percent in FY 2014 to 14.4 percent in FY 2018. The city was able to contain its debt service projections under 15 percent of tax revenues, as its de facto measure of affordability, despite expanding its capital program. The debt service burden may prove to be even lower, as the city prudently has applied conservative interest rate assumptions in projecting debt service costs in light of the fact that history has shown market rates can spike up suddenly. However, we point to the fact that with other expenses also climbing and total operating expenditures estimated to outpace total revenues in the outyears of the financial plan, the city needs to be cautious in further expanding its capital program when developing a new ten-year strategy. Of particular concern is the tremendous amount of debt that already has accumulated to support the city's capital program. Indeed, the level of outstanding debt has been cited as a credit weakness by the three major credit rating companies. We offer that as a debt management strategy, the city could utilize a portion of future debt service savings to fund capital projects on a pay-as-you-go basis, which would serve to slow the growth in its high and rising outstanding debt.

## The Four-Year Capital Plan for FYs 2015-18

In the May modification, the city made a $5.5 billion downward adjustment in total-funded capital commitments slated for FY 2014, recognizing early that some projects will not occur on schedule and rolling these projects into FYs 2015-18. The city also added new projects to the capital program. In all, the current capital plan for FYs 2015-18 totals $35.2 billion, representing a $5.2 billion plan-to-plan increase when the $5.5 billion FY 2014 deferral is netted out. In presenting the current capital plan, the Mayor highlighted the inclusion of additional commitments to reflect his priority to

create and preserve more affordable housing.[9] Commitments in many other areas were also augmented.

As illustrated in Table 6, the current four-year capital plan schedules total-funded commitments on a front-loaded basis, where $12.6 billion will be undertaken in FY 2015, followed by $7.9 billion in FY 2016, $8 billion in FY 2017 and $6.8 billion in FY 2018. Typically, if the city falls short of its commitment target in a given year, it rolls the shortfall into succeeding years. Overall, commitments are projected to average $8.8 billion annually for the four-year period.

**TABLE 6**

**CAPITAL COMMITMENTS ARE LARGELY FRONT LOADED AND CITY FUNDED**

($ in millions)

| | FY 2015 | FY 2016 | FY 2017 | FY 2018 | Total |
|---|---|---|---|---|---|
| City Funded: | | | | | |
| G.O./NYCTFA | $6,616 | $5,210 | $4,437 | $3,761 | $20,024 |
| Water Authority | 2,992 | 838 | 1,296 | 1,445 | 6,571 |
| Subtotal | $9,608 | $6,048 | $5,733 | $5,206 | $26,595 |
| NonCity Funded | $2,943 | $1,821 | $2,269 | $1,577 | $8,610 |
| **Total Commitments** | **$12,551** | **$7,869** | **$8,002** | **$6,783** | **$35,205** |

To fund the sizable commitment levels, the FYs 2015-18 capital plan assumes varied sources of financing, as also illustrated in Table 6. The vast majority of the capital commitments, $26.6 billion, are expected to be city funded. Such funding is derived from the sale of bonds, with no allocation from current operating resources, otherwise known as pay-as-you-go financing. Twenty billion dollars of the commitments are expected to be financed by the sale of g.o. bonds by the city and revenue bonds by the NYCTFA, both of which are backed by city tax revenues and comprise the overwhelming majority of debt service costs in the financial plan. Additionally, environmental protection projects totaling $6.6 billion are slated to be financed with the sale of bonds by the Water Authority, the debt service on which is paid from water and sewer user fees and is not an expense included in the city's financial plan. Noncity commitments comprise $8.6 billion, including approximately $2.6 billion in federal funds and $5.4 billion of state-supported education projects funded through the issuance of Building Aid Revenue Bonds (BARBs). It should be noted that state-funded commitments for education may be overstated by as much as $1.8 billion as the financing vehicle for such commitments may expire in FY 2017.[10]

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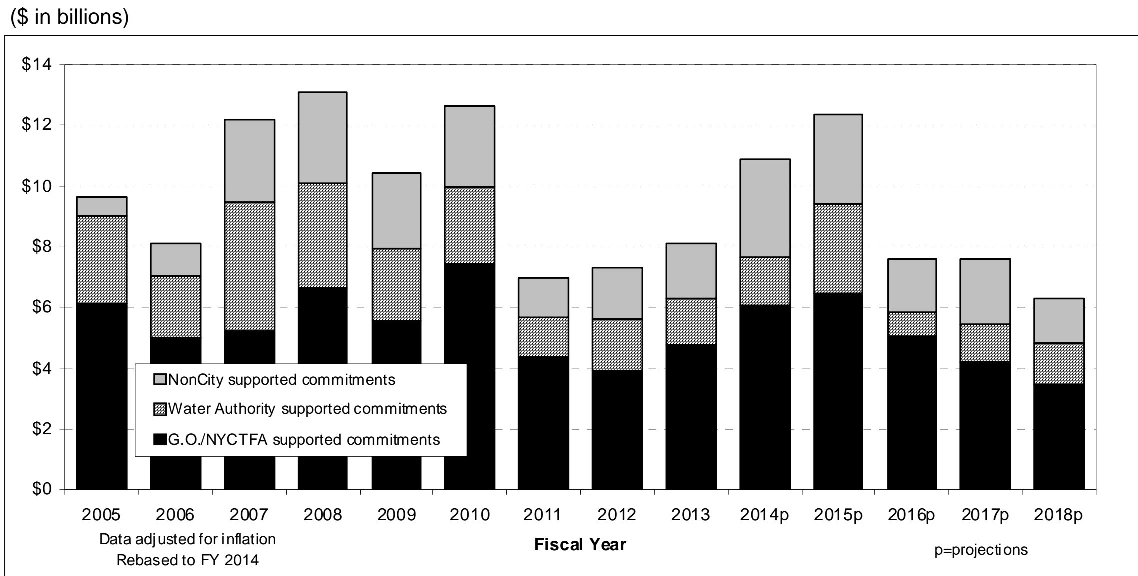
[9] The Mayor's housing initiative calls for $11.1 billion of public investments (a combination of city, state and federal funds) to leverage the creation of 80,000 new units and preservation of 120,000 existing ones over the next 10 years for more than a half million low- to middle-income residents.

[10] The NYCTFA has been authorized by the state to sell bonds in an amount outstanding of up to $9.4 billion to specifically support school construction, with the debt service being paid from state building aid. Between FYs 2007 and 2014, the NYCTFA held 12 sales of BARBs totaling $6.42 billion, of which $6.05 billion was outstanding. The current financial plan assumes the continued issuance of BARBs totaling $5.79 billion in FYs 2015-18. Under this assumption, the total amount of BARBs outstanding will exceed the authorized level in FY 2017, unless the state increases the authorization.

To put the size of the capital plan into context, we compare the projections for FYs 2015-18 to actual total-funded commitments for the prior ten fiscal years, adjusting for inflation with the use of constant dollar amounts that were rebased to FY 2014.[11] As Chart 1 depicts, in the aggregate, projected total-funded capital commitments for FYs 2015-18 are comparable to levels in FYs 2011-14. Indeed, commitments for FYs 2015-18 are expected to total $33.8 billion in constant dollars, as compared to $33.3 billion for FYs 2011-14. After a run up in FYs 2005-10 where commitments totaled $66.2 billion and generated a stockpile of outstanding contract liabilities, capital contracts entered into during FY 2011 tapered off given the logistical constraints of the availability of skilled contractors for the large volume of specialized work.

**IN AGGREGATE, PROJECTED TOTAL-FUNDED CAPITAL COMMITMENTS FOR FYs 2015-18 ARE COMPARABLE TO LEVELS THAT EXISTED IN FYs 2011-14**

**CHART 1** ($ in billions)




The distribution of commitments by funding sources for FYs 2015-18 is projected to be similar to that of the prior four-year period of FYs 2011-14, at 57 percent supported by city g.o. and NYCTFA revenue bonds, 19 percent supported by Water Authority user fee bonds, and 24 percent supported by noncity funds. Within the projected four-year period, however, the distribution of commitments fluctuates annually, with the assumption that the amounts funded by Water Authority user fee bonds and by noncity resources will rise and fall, while the amount funded by city g.o. and NYCTFA revenue bonds will decrease steadily.

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[11] For FY 2014 commitments, we used the targeted level taken from the executive budget, as the city has yet to publish the actual commitment level for FY 2014.

The distribution of commitments may change considerably when a new ten-year capital strategy is created that will reflect the Mayor's priorities.[12] The city has enormous infrastructure needs that are a function of wide-ranging societal and economic developments. The city serves as a global center for finance and is expanding in such business areas as media, arts, entertainment and communications. The city's overall population has been on the rise in recent years and is projected to continue growing through 2030, with expansive needs for transportation, cultural institutions, libraries, schools and housing. To this end, the Mayor has made the infusion of investment in affordable housing one of his priorities.

Meanwhile, the city is an old American municipality that must invest in its aging infrastructure. The city's FY 2014 Asset Information Management System (AIMS) Report revealed that a $6.2 billion capital investment will be required over the four-year period of FYs 2015-18 to bring certain of its physical assets up to a state of good repair.[13] Further, the AIMS report disclosed that only 61 percent, or $3.8 billion, have been identified as funded in the capital plan. This funding proportion is comparatively the highest ever reported, with recommended investments for school repairs identified as fully funded for the first time. Nevertheless, funding deficiencies remain for such areas as streets and highways where, for example, the city has funded 59 percent of the recommended $2.2 billion of investments in such infrastructure that is vital to economic growth. In some cases, work is deferred for logistical reasons. However, in delaying maintenance, the repair work will become more extensive and costly. The recommendations in the maintenance report provide the city a framework to effectively allocate resources to fund work that is critical to the structural integrity of the capital stock, and as such need to be given great consideration.

### Debt Affordability

The city's operating budget reflects the impact of the capital program through the allocation for debt service costs related to the sale of city g.o. and NYCTFA revenue bonds. For a comprehensive analysis of the debt resulting from the city's capital program for the years covered by the financial plan, we use the framework of the annual Statement of Debt Affordability that was released by the city at the time of the executive budget. The Statement of Debt Affordability presents the aggregate debt and debt service levels for all bonds backed by city tax revenues sold to support the capital

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[12] Every two years, the city presents a strategy that identifies the capital goals and anticipated sources of financing for the ensuing ten-year period. The strategy incorporates the city's four-year capital commitments in the initial years, and extends the forecast for an additional six years. The Mayor will have the opportunity to craft a new strategy that represents his priorities and publish it in its preliminary form in January 2015, at which time it could be examined and debated. A final strategy will be released a few months later at the time of the executive budget.

[13] The city is required by charter to produce an annual maintenance report each October that details the recommended amounts of funding over the ensuing four fiscal years to maintain assets and asset systems with a replacement cost of $10 million or greater and a useful life in excess of 10 years. Additionally, the city produces a separate document, usually published around the time the executive budget is released, that reconciles the funding needs to the planned funding for each agency.

program, including city and NYCTFA securities, as well as city lease agreements. Table 7 displays measures used in the Statement of Debt Affordability.

**TABLE 7**

**DEBT AFFORDABILITY MEASURES**

($ in millions, except per capita)

| | FY 2015 | FY 2016 | FY 2017 | FY 2018 | Average Annual Growth |
|---|---|---|---|---|---|
| City & NYCTFA Debt Service | $ 6,665 | $ 7,242 | $ 7,582 | $ 7,840 | 5.6% |
| Debt Service Per Capita | 815 | 886 | 928 | 959 | |
| **Debt Service as Percentage of:** | | | | | |
| Tax Revenues | 13.7% | 14.3% | 14.4% | 14.4% | |
| Total Revenues | 9.0% | 9.5% | 9.6% | 9.7% | |
| Local Personal Income | 1.3% | 1.4% | 1.4% | 1.3% | |
| City, NYCTFA & Conduit Outstanding Debt | $ 70,788 | $ 72,629 | $ 74,334 | $ 75,777 | 2.3% |
| Outstanding Debt Per Capita | 8,659 | 8,884 | 9,093 | 9,269 | |
| **Outstanding Debt as Percentage of:** | | | | | |
| Local Personal Income | 13.9% | 13.7% | 13.3% | 13.0% | |
| Tax Revenues | $ 48,537 | $ 50,746 | $ 52,597 | $ 54,401 | 3.9% |
| Total Revenue | 73,915 | 76,492 | 78,801 | 80,773 | 3.0% |
| Local Personal Income | 509,370 | 531,350 | 557,190 | 585,100 | 4.7% |

In its Statement of Debt Affordability, the city projects that debt service will climb from $6.7 billion in FY 2015 to $7.8 billion in FY 2018, with the vast majority derived from bond sales related to $50.3 billion of tax-supported commitments entered into during FYs 2005-14.[14] As forecasted, debt service will grow at an average annual growth rate of 5.6 percent. In projecting debt service costs, the city aptly applies conservative assumptions to the terms of the portion that is not locked in – the existing variable rate debt and planned financings. Then, the city incorporates actual debt service costs as they are incurred. For FY 2014, debt service savings totaled roughly $600 million over the course of the year. If market and economic conditions remain stable, the city would likely realize significant debt service savings from lower than forecasted interest rates, the undertaking of bond refundings and continued abstention from seasonal financing.

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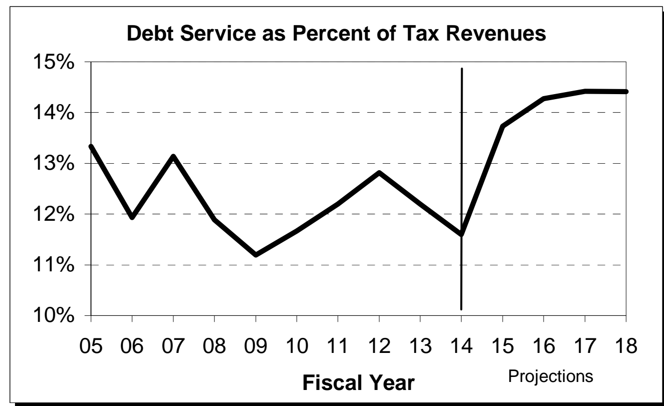
[14] Debt service projections are based on long-term financing assumptions in the executive budget and are net of prepayments. Debt service estimates based on assumptions in the adopted budget amount to $6.53 billion in FY 2015, $7.242 billion in FY 2016, $7.582 billion in FY 2017 and $7.839 billion in FY 2018, for an average annual growth rate of 6.3 percent.

To enhance its already strong debt management, the city could adopt a policy of applying a portion of such savings towards pay-as-you-go capital financing, serving to reduce borrowing and the corresponding growth in debt service costs. Assuming the city substitutes $500 million of pay-as-you-go financing for g.o. borrowing in each of FYs 2015-18, debt service costs could be further reduced by $161 million annually with the full $2 billion use of current resources. Surely, there are numerous expenses competing for the debt service savings, particularly given existing budget gaps. However, we offer the use of debt service savings to fund pay-as-you-go financing, with the singular objective of enhancing debt management.

The city projects tax revenues, with which debt service is paid, will increase from $48.5 billion in FY 2015 to $54.4 billion in FY 2018, representing a 3.9 percent average annual growth rate over the plan years. The share of tax revenues that debt service will absorb is forecasted to grow from 13.7 percent in FY 2015 to 14.4 percent in FY 2018, as the 5.6 percent average annual growth rate for debt service is faster than the 3.9 percent for tax revenues. At these levels, the projected debt service burden falls below the 15 percent threshold that the city historically has used as an affordability gauge in planning its capital financing. Nonetheless, as illustrated in the figure to the right, these levels would be higher than levels experienced within the most recent ten-year period. If the city is fortunate to realize debt service savings or if tax revenue collections are higher than forecasted, the burden could fall in line with the historical norm.[15]




Similarly, debt service is forecasted to consume an overall larger share of local personal income, rising from 1.3 percent in FY 2015 to 1.4 percent in FYs 2016 and 2017, then scaling back to 1.3 percent in FY 2018, with its average annual growth rate of 5.6 percent faster than the 4.7 percent assumed for local personal income. Based on the assumption that population size will hold steady at 8,175,000, per capita debt service is projected to increase from $815 in FY 2015 to $959 in FY 2018. Additionally, as a share of total revenue, debt service is projected to grow from nine percent in FY 2015 to 9.7 percent in FY 2018. Total revenue is forecasted to advance at an average annual rate of three percent over the four years, lagging a 4.3 percent increase for total expenditure that is largely driven by the surging debt service cost and resulting in projected budget gaps of $2.6 billion in FY 2016, $1.9 billion in FY 2017 and $3.1 billion in FY 2018.

Table 7 on page 29 also shows that the combined outstanding debt resulting from the ongoing financing of the city's sizeable tax-supported capital program is expected to

[15] Actual debt service and tax revenues for FY 2014 will be published in the annual city comptroller report scheduled to be released in October. We use the levels for FY 2014 from the June 2014 Financial Plan.

climb from the tremendously high starting point of $70.8 billion at the end of FY 2015 to $75.8 billion at the end of FY 2018, for an average annual growth rate of 2.3 percent. Outstanding debt is growing from the compounding effects of new bond issuances exceeding annual principal redemption. The city and the NYCTFA are projected to issue a combined $20.65 billion of bonds during FYs 2015-18. The three major credit rating agencies, Moody's Investors Service, Standard and Poor's Rating Services and FitchRatings, in assigning equivalent AA ratings to city g.o. bonds, have consistently cited the city's high debt load as a credit weakness.[16] The incorporation of pay-as-you-go capital financing, where debt service savings are used to support capital spending, could slow the growth of outstanding debt. Applying $2 billion of pay-as-you-go over the four-year period could reduce the growth rate for outstanding debt to 1.6 percent.

Table 7 on page 29 also shows that the amount of outstanding debt allotted to each New York City resident is expected to rise from $8,659 in FY 2015 to $9,269 in FY 2018. However, with the growth rate for personal income anticipated to be faster than that for outstanding debt, the debt to income ratio is forecasted to decrease from 13.9 percent in FY 2015 to 13 percent in FY 2018.

The Statement of Debt Affordability does not include the debt service and outstanding debt associated with the Water Authority bonds that are sold to finance city environmental protection projects. The New York City Water Board levies user fees on city rate payers to fund the debt service on Water Authority bonds. As discussed earlier, environmental protection projects comprise $6.6 billion of the commitments in the May financial plan, which is added to the $21.2 billion undertaken during FYs 2005-14. At the time the Statement of Debt Affordability was released, the Water Authority projected the annual debt service on its bonds will surge at an average annual rate of 6.7 percent, from $1.6 billion in FY 2015 to $2 billion in FY 2018, based on the forecast for outstanding bonds increasing at an average annual rate of 2.6 percent from $31.3 billion at the end of FY 2015 to $33.8 billion at the end of FY 2018. The payment of Water Authority debt service is made primarily by the same economic base as for debt service on city g.o. and NYCTFA debt service.

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[16] The section of the December 2013 FCB staff report titled "Ensuring Capital Investment is Affordable" features an analysis of the city's outstanding debt as a credit challenge.

# Glossary of Acronyms

| | |
|---|---|
| **AIMS** | Asset Information Management System |
| **BARBs** | Building Aid Revenue Bonds |
| **BCT** | Banking Corporation Tax |
| **CSA** | Council of Supervisors and Administrators |
| **CUNY** | City University of New York |
| **CY** | Calendar Year |
| **DC 37** | District Council 37 |
| **DOE** | Department of Education |
| **FCB** | Financial Control Board |
| **FDIC** | Federal Deposit Insurance Corporation |
| **FICA** | Federal Insurance Contributions Act |
| **FICC** | Fixed Income, Currencies, and Commodities |
| **FY** | Fiscal Year |
| **GASB** | Governmental Accounting Standards Board |
| **GCP** | Gross City Product |
| **GCT** | General Corporation Tax |
| **G.O. Bonds** | General Obligation Bonds |
| **HHC** | Health and Hospitals Corporation |
| **HIP** | Health Insurance Plan of New York |
| **MA** | Medical Assistance |
| **MLC** | Municipal Labor Committee |
| **NYCHA** | New York City Housing Authority |
| **NYCTFA** | New York City Transitional Finance Authority |
| **NYSE** | New York Stock Exchange |
| **OPEB** | Other Postemployment Benefits |
| **OTPS** | Other than Personal Service |
| **PA** | Public Assistance |

| | |
|---|---|
| **PEG** | Program to Eliminate the Gap |
| **PS** | Personal Service |
| **RHBT** | Retiree Healthcare Benefits Trust |
| **SFY** | State Fiscal Year |
| **STAR** | School Tax Relief program |
| **UAAL** | Unfunded Actuarial Accrued Liability |
| **UBT** | Unincorporated Business Tax |
| **UFT** | United Federation of Teachers |