

Staff Report

REVIEW OF FY 2009

June 4, 2009



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I. Overview

In the May modification to its financial plan, the city projects that FY 2009 will be in balance and it will be able to use a larger than expected surplus to help balance the FY 2010 budget. At the start of FY 2009, the city began the process of downsizing its budget. At that time, while predicting a mild national recession, the city correctly projected that its nonproperty tax revenues would fall sharply due to the fact that a downturn involving the financial sector tends to be more severe in the city than in the nation.

Even though the onset of the local economic downturn was lagging significantly behind that of the nation, the city was compelled to reduce its nonproperty tax forecast by \$890 million during FY 2009. In particular, layoffs and sharp reductions in consumer spending and income have negatively impacted the sales and personal income taxes. As a result of the steep decline in April personal income tax payments and an upsurge in business tax refunds, there is a \$400 million risk to the city's FY 2009 nonproperty tax estimate. With the projected surplus, this would not affect budget balance, but would require the city to take additional actions to balance the FY 2010 budget.

To offset slumping tax collections, the city enacted a seven percent midyear property tax rate increase to raise \$576 million in FY 2009 and more than \$1.2 billion annually, thereafter. The city also took early measures to generate recurring expenditure savings and continued to implement an agency reduction program that began in January 2008. These actions produced savings totaling more than \$1.6 billion in FY 2009 and \$3.4 billion for FY 2010. Additionally, the city was able to draw on increased federal aid from the stimulus package in FY 2009 that reduced its share of Medicaid costs.

In addition to these proactive measures taken by the city, the FY 2009 budget was supported by a combined \$5.3 billion of prior-year surpluses. The combination of these prior-year surpluses and the actions taken by the city during FY 2009 leaves a projected surplus of just over \$3 billion. The city has proposed using \$2.5 billion of the surplus to help balance FY 2010, and the remaining \$530 million to support the FY 2011 budget. With this application, the city will have consumed all of the prior-year surpluses, ending an era of large surplus rolls, making balancing the FY 2010 and FY 2011 budgets more difficult.

**MODIFICATION HISTORY OF
THE CITY'S OPERATING BUDGET FOR FISCAL YEAR 2009**

TABLE 1 (\$ in millions)

	Adopted Budget	November Modification	January Modification	Executive Budget
<u>Revenues</u>				
Taxes				
General Property	\$13,744	\$13,743	\$14,319	\$14,403
Other Taxes ^a	21,650	21,264	20,094	20,332
Discretionary Transfers	546	546	546	546
Debt Defeasances	--	--	362	362
Tax Audit Revenue	577	680	680	980
Tax Reduction Program	(3)	832	--	--
Anticipated State Actions	--	--	77	88
Sale of Property Tax Liens	38	38	38	5
Miscellaneous Revenues	6,700	6,896	7,049	7,244
Unrestricted Intergovernmental Aid	340	340	254	340
Interfund Revenues	463	464	477	472
Less: Intracity Revenues	(1,538)	(1,607)	(1,631)	(1,689)
Disallowances	(15)	(15)	(15)	(15)
Total City Funds	\$42,502	\$43,181	\$42,250	\$43,068
Federal Categorical Grants	5,366	5,816	6,037	6,198
State Categorical Grants	11,526	11,668	12,031	12,083
Total Revenues	\$59,394	\$60,665	\$60,318	\$61,349
<u>Expenditures</u>				
Personal Service	\$34,957	\$34,934	\$35,176	\$35,153
Other Than Personal Service	25,119	25,520	25,434	25,366
Debt Service	3,598	3,569	3,829	3,650
General Obligation & NYCTFA Debt Defeasances	--	--	(279)	252
NYCTFA Debt Service	225	225	225	170
Budget Stabilization & Discretionary Transfers	(3,267)	(2,276)	(2,536)	(1,593)
General Reserve	300	300	100	40
Subtotal	\$60,932	\$62,272	\$61,949	\$63,038
Less: Intracity Expenditures	(1,538)	(1,607)	(1,631)	(1,689)
Total Expenditures	\$59,394	\$60,665	\$60,318	\$61,349
<u>Gap To Be Closed</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
^a Allocates NYCTFA debt service to expenditures.				

**CHANGES TO THE CITY'S OPERATING BUDGET
FOR FISCAL YEAR 2009 SINCE BUDGET ADOPTION**

TABLE 2 (\$ in millions)

	November Modification	January Modification	Executive Budget
<u>Revenues</u>			
Taxes			
General Property	(\$1)	\$576	\$84
Other Taxes ^a	(386)	(1,170)	238
Discretionary Transfers	0	0	0
Debt Defeasances	0	362	0
Tax Audit Revenue	103	0	300
Tax Reduction Program	835	(832)	0
Anticipated State Actions	0	77	11
Sale of Property Tax Liens	0	0	(33)
Miscellaneous Revenues	196	153	195
Unrestricted Intergovernmental Aid	0	(86)	86
Interfund Revenues	1	13	(5)
Less: Intracity Revenues	(69)	(24)	(58)
Disallowances	0	0	0
Total City Funds	\$679	(\$931)	\$818
Federal Categorical Grants	450	221	161
State Categorical Grants	142	363	52
Total Revenues	<u>\$1,271</u>	<u>(\$347)</u>	<u>\$1,031</u>
<u>Expenditures</u>			
Personal Service	(\$23)	\$242	(\$23)
Other Than Personal Service	401	(86)	(68)
Debt Service	(29)	260	(179)
General Obligation & NYCTFA Debt Defeasance	0	(279)	531
NYCTFA Debt Service	0	0	(55)
Budget Stabilization & Discretionary Transfers	991	(260)	943
General Reserve	0	(200)	(60)
Subtotal	\$1,340	(\$323)	\$1,089
Less: Intracity Expenditures	(69)	(24)	(58)
Total Expenditures	<u>\$1,271</u>	<u>(\$347)</u>	<u>\$1,031</u>
<u>Gap To Be Closed</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
^a Allocates NYCTFA debt service to expenditures.			

II. Balancing the FY 2009 Budget

A steadily weakening economy compelled the city to reduce its nonproperty tax forecast by \$890 million since the start of FY 2009. In particular, layoffs and sharp reductions in consumer spending and income have negatively impacted the sales and personal income taxes. As a result of a steep decline in April personal income tax payments and an upsurge in business tax refunds, there is a \$400 million risk to the city's FY 2009 nonproperty tax estimate.

To offset slumping tax collections, the city enacted a midyear property tax rate increase to raise \$576 million in FY 2009 and more than \$1.2 billion annually, thereafter. Additionally, the city is pressing for a sales tax increase that would yield about \$90 million at the close of FY 2009, with a full-year effect of about \$1 billion in FY 2010 and beyond. The extra property tax revenue along with additional categorical aid (partly funded by the national economic stimulus program) have enabled the city to raise its forecast of total revenues by \$2 billion, of which \$473 million are city funds.

In anticipation of weakening fiscal conditions, the city took early measures to generate recurring expenditure savings. The city implemented an agency program beginning in January 2008, which produced savings totaling more than \$1.6 billion for FY 2009 and \$3.4 billion for FY 2010. Additionally, the city was able to draw on increased federal aid in FY 2009 that reduced its share of Medicaid costs.

As a result of its proactive approach to managing the budget, the city will end FY 2009 in balance and have \$3 billion of unspent resources to balance the FY 2010 budget and start to address the large deficit projected for FY 2011. With this allocation, the city will consume the entire accumulated budget surplus, ending an era of large surplus rolls.

CHANGES IN THE REVENUE PLAN

The city has increased its revenue forecast for FY 2009 by \$2 billion, to \$61.3 billion, since the budget was adopted last June. As shown in the figure to the right, city funds increased by \$473 million. The property tax, which gained \$626 million primarily due to a midyear rate increase, is the largest positive component of the city fund increase.

Concerns over the deepening recession led the city to rescind a seven percent property tax cut to raise \$576 million in FY 2009 and more than \$1.2 billion annually, thereafter. Additionally, the city is pressing for a sales tax increase that would yield about \$90 million at the close of FY 2009, with a full-year effect of about \$1 billion in FY 2010 and beyond.

FY 2009 Revenues Increase by \$2 Billion Since Adoption (\$ in millions)	
Property Tax	\$626
Nonproperty Taxes	(890)
Tax Program	91
Audit Revenue	403
STAR Aid	(66)
Miscellaneous Revenue	309
Intergovernmental Aid	0
City Funds	\$473
Categorical Grants	1,473
Other Revenue	9
Total Revenue Increase	\$1,955

The city's concerns and efforts to raise taxes were proven to be justified when nonproperty tax collections fell by \$890 million since the start of the fiscal year. But for a fortuitous and unanticipated nonrecurring increase in bank tax collections, the nonproperty taxes might have sunk by \$1.3 billion. A strong audit collection program added \$403 million to the revenue gain. Also contributing to the increase in city funds is a \$309 million increase in miscellaneous receipts.

Aside from taxes, the largest component of the revenue increase is categorical grants, which are up by nearly \$1.5 billion to \$19.4 billion. Medical assistance grants of \$447 million, funded by the national economic stimulus program, represent a major portion of the expanded categorical aid. The state, which funded \$12.1 billion of these program-specific grants, is the largest source of categorical aid. The city also received \$6.2 billion in federal grants and \$1.1 billion in private grants.

The city's allocation of the state's School Tax Relief (STAR) program was reduced by \$66 million in FY 2009. State budget cuts are scheduled to reduce city STAR payments by more than \$400 million in FY 2010 and thereafter. STAR program cutbacks will not affect the city's budget balance, but city taxpayers will have to pay extra personal income taxes to offset the diminished state STAR subsidy.

Most of the major nonproperty taxes were affected by the \$890 million slide in tax receipts. The largest downward adjustments were reported for the personal income tax, the real estate transactions taxes and the general corporation tax. Smaller revenue cutbacks affected the sales and hotel occupancy taxes.

The City Responds Proactively to a Deepening Recession

At the start of FY 2009, the city began the painful process of downsizing its budget. Even though the city was then predicting a mild national recession, the city correctly projected that its nonproperty tax revenues would fall sharply. At the very start of FY 2009, the city cut its nonproperty tax estimate by \$2.5 billion to \$20.9 billion from the \$23.4 billion collected in FY 2008. The city took this action because a downturn involving the financial sector tends to be more severe in the city than in the nation.

By the November modification, the city's economic outlook had turned decidedly more pessimistic, even though the full severity of the national downturn had not yet been felt. National output was slowing down but outright declines had not yet been recorded for real gross domestic product (GDP). The nation's job losses persisted but the losses had not yet intensified. The city responded proactively to the threat of a deepening recession and reduced the FY 2009 nonproperty tax estimates by \$386 million. To augment its dwindling tax receipts, the city proposed rescinding two popular property tax cut programs to raise \$832 million in FY 2009. The property tax rate change was enacted as of the middle of FY 2009 to yield an immediate \$576 million, which will have a full-year effect of at least \$1.2 billion starting in FY 2010. The \$400 homeowner rebate program was restored for FY 2009, at a cost to the city of \$256 million, but this rebate program has been removed from the plan effective FY 2010.

A sharp drop in GDP in the fourth quarter of calendar year (CY) 2008 along with accelerating national job losses convinced the city, in its January 2009 Modification, to

project that GDP would decline 2.5 percent in CY 2009. The city responded to this further economic weakening by cutting its FY 2009 nonproperty tax estimate by an additional \$815 million. When the city issued the January modification, its economic predictions were more pessimistic than those of other forecasters. Subsequent economic reports, however, showed that other economists had moved closer to the city's negative outlook, thereby validating its concerns regarding falling tax collections.

The deepening of the national recession is again reflected in the city's May 2009 Modification. In this latest economic plan, GDP falls 3.5 percent in CY 2009, after which output turns weakly upward with 1.4 percent growth in 2010, before growth accelerates to 3.5 percent in 2011 and four percent in 2012. The toll of the recession on national employment is projected at 7.3 million lost jobs from an employment peak of 138 million at the end of 2007 to a trough of 130.7 million jobs in the first quarter of 2010. Compared with the January modification, the current economic plan projects a one percent deeper decline in 2009 GDP and 2 million additional job losses. Thus far, GDP has fallen at a rate of 6.3 percent in the fourth quarter of 2008 and by 5.7 percent in the first quarter of 2009. Since the start of the recession, through April, the nation has lost 5.7 million jobs and the unemployment rate has climbed by four percentage points to 8.9 percent.

Despite the clear worsening of the national outlook, the city has restored \$312 million to its FY 2009 nonproperty tax estimates, since January. An unanticipated uptick in the bank tax is largely responsible for the revenue improvement. Until more is known about this unusually large collection, the city is treating it as a one-shot.

Revenues may also have held up because the onset of the local economic downturn is lagging significantly behind that of the nation. A comparison of employment reports indicates that the time lag is 10 months. National job losses began in January 2008, whereas local jobs did not begin a protracted decline until November 2008. Thus, the city has been given nearly one extra year to prepare for the brunt of this downturn.

Despite the delayed onset of the local downturn, the city is not minimizing its severity. The city sees real gross city product (GCP) falling 4.5 percent in CY 2008, 12 percent in 2009 and 1.9 percent in 2010, for a total GCP decline of 18 percent over the three-year period. The city also expects to lose 328,000 jobs through the third quarter of 2010, including 47,000 high-paying securities sector jobs. As of April, the city has lost 93,000 jobs compared with the previous year, and the local unemployment rate has climbed to 7.8 percent from 4.4 percent in the prior year.

Tax Revenues

Since adoption, the city decreased its FY 2009 tax collection plan by \$264 million, to an estimated \$34.5 billion. A more severe collections drop was averted when the city raised property tax rates to offset an \$890 million decline in nonproperty tax receipts, as shown in the figure to the right.

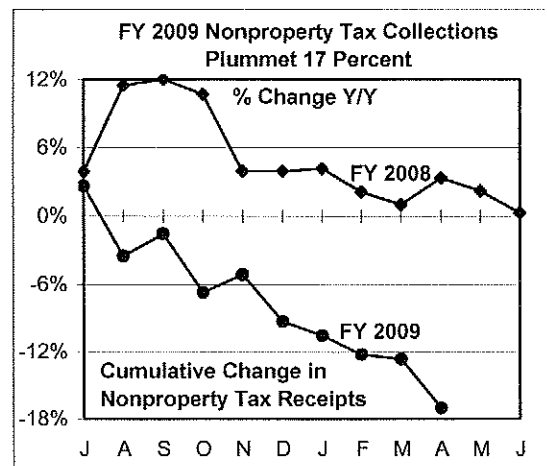
The city's estimate for the real property tax increased by \$626 million over the year to \$14.4 billion. The property tax gained \$576 million from the midyear rate increase and \$50 million from favorable reserve changes. These reserve adjustments include higher prior-year collections, reduced delinquencies, and smaller refund payouts. In addition to offsetting most of the nonproperty tax shortfall, the extra property tax collections enabled the city to postpone the sale of \$33 million in tax liens until the start of the next fiscal year to augment FY 2010 revenues.

Midyear Property Tax Increase Offsets Slumping Nonproperty Taxes (\$ in millions)	
Property Tax	\$626
Nonproperty Taxes	(\$890)
Personal Income	(390)
Sales	(73)
General Corporation	(249)
Banking Corporation	187
Unincorporated Business	136
Property Transfer	(284)
Mortgage Recording	(304)
Utility	40
Hotel	(33)
Other	80
Tax Revenue Decrease	(\$264)
Note: Excludes STAR and audit programs.	

The nonproperty taxes fell by \$890 million to \$20.1 billion in FY 2009. Large downward revisions were reported for the personal income and the general corporation taxes, which fell \$390 million and \$249 million, respectively, indicating that the employment and income losses inflicted by the recession are severely affecting tax collections. The mortgage recording and real property transfer taxes are down by \$304 million and \$284 million, respectively, showing that the local real estate industry is in a severe slump. Additionally, the sales tax is down \$73 million due to weakening employment and falling tourism. Likewise, the hotel tax is down \$33 million, also due to the downturn in tourism.

In contrast to the collections losses noted for most of the nonproperty taxes, three of the city's major taxes benefited from large positive adjustments. The banking corporation tax was revised up by \$187 million, the unincorporated business tax increased by \$136 million, and the utility tax increased by \$40 million. Even though collections for these taxes held up well in FY 2009, the improvement appears to be transitory and collections are likely to weaken in FY 2010 along with the other nonproperty taxes.

Nonproperty tax growth, which has been sliding for the past two years, plummeted to minus 17 percent in April. The figure at the right, which shows the cumulative growth rates of the city's nonproperty tax collections for the past two fiscal years, indicates that the nonproperty taxes are in a worsening slump. The previous year



started strongly, with FY 2008 collections growth rising to 12 percent, a growth rate that appeared to be a continuation of the double-digit growth trend that had prevailed for the previous four years. At that point, the long-delayed recession started to catch up with the city's tax collections and growth sank to zero by the end of FY 2008.

FY 2009 started with slight positive growth, but falling collections quickly transformed the positive growth into a steeply negative growth trend. By March, the slide seemed to be leveling off at minus 12 percent. Weak April personal income tax and general corporation tax receipts dragged down year-to-date growth to minus 17 percent, signaling that June collections might also fall short. With actual collections nearly three percentage points below the city's nonproperty revenue target of minus 14.4 percent, the city may have to reduce its tax collection plan.

Business Income Taxes. Since the start of FY 2009, revenues for the general corporation tax declined by \$249 million; while the banking corporation and the unincorporated business taxes improved by \$187 million and \$136 million, respectively. Taken together, revenue for this group of taxes has fallen by 7.4 percent in FY 2009, to \$5 billion following a 10 percent slide in FY 2008. Business tax collections are \$1 billion below the FY 2007 collections peak of \$6 billion and the city projects that collections will fall by another \$1 billion, or 21 percent, in FY 2010.

Business tax collections are being depressed by poor earnings and by an unfavorable trend in refunds for past overpayments. National pretax corporate profits fell by a staggering 37 percent in the fourth quarter of CY 2008, compared with the prior year. Closer to home, the securities industry lost \$42.6 billion in 2008, following an \$11.3 billion loss in 2007. An uptrend in refund issuance is also weakening net revenues for all three business taxes. Through April, the city has issued \$770 million in business tax refunds, an adverse increase of \$286 million over the previous year. The city has set aside a refund reserve of \$926 million, but a few more large payouts could deplete the reserve before the fiscal year has ended and necessitate an additional \$100 million to support the refund reserve in the next financial plan.

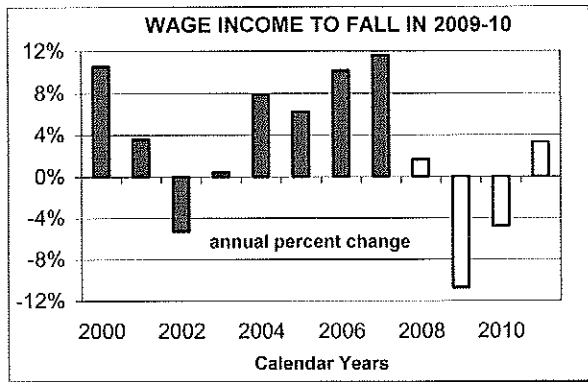
Real Estate Transactions Taxes. The city has reduced its FY 2009 revenue plan for the transactions taxes by \$588 million, to a total of \$1.3 billion, since budget adoption. The two taxes in this group, the real property transfer tax and the mortgage recording tax, have been hit by the severe slowdown in the real estate market. The new revenue estimate represents a 47 percent decline from the actual collections of the prior year. Since the revenue peak of \$3.3 billion in FY 2007, the transactions taxes have fallen by \$2 billion or 59 percent. The city revenue plan sees the revenue slide bottoming out in FY 2010 with revenues having fallen another 19 percent to \$1.1 billion.

Sales Tax. FY 2009 was an unusual year for the sales tax because after recording a solid gain of six percent in the first quarter (collections on a nominal year-over-year basis), growth steadily eroded and turned sharply negative in subsequent quarters.¹

¹ The sales tax proposals recently announced by the Mayor and the City Council would most likely benefit FY 2010 revenues rather than FY 2009 from raising the city sales tax rate by 0.5 percent to 4.5 percent (\$518 million) and repealing the exemption on purchases of clothing and footwear priced at or above \$110

The downward trend in collections signaled that several years of robust personal consumption expenditures, which were fueled by employment gains, large Wall Street bonuses, and tourism (domestic and international, for business or leisure), had come to an end. Since budget adoption last June, the FY 2009 sales tax projection was lowered by \$73 million to \$4.6 billion, which represents a year-over-year decline of 5.5 percent on a continuing base, after an advance of 7.6 percent (on a continuing base) in FY 2008.²

In FY 2009, consumers severely cut back on spending for a number of reasons including job losses and lower compensation for those still employed (e.g. financial industry). The figure on the right illustrates the abrupt change in wage income (estimated by the city) in 2008 and 2009, which negatively impacted taxable consumption that was reflected in FY 2009 sales tax collections. After advancing by 11.5 percent on a year-over-year basis in 2007 to \$290.9 billion, wage income is estimated to have grown by just 1.6 percent in 2008, tumbled by a negative 10.7 percent to \$264 billion in 2009 as layoffs began in the financial sector and spread citywide.



For example, job losses started in June 2008 (on a year-to-year basis) in the high-paying financial sector (including the securities industry) and increased in magnitude as the year progressed. In 2008, New York Stock Exchange member firms were reeling from a loss of \$42.6 billion for the year, after the securities industry recorded a loss of \$11.3 billion in 2007. For other sectors of the local economy, job losses began later in the fiscal year in November 2008, and also rose during the course of the year. As the city expects job losses to reach 172,000 in 2009 and 129,000 in 2010, wage income is expected to decline further by 4.8 percent in 2010 to \$251.2 billion, before resuming positive annual growth of 3.3 percent in 2011.

In addition to layoff announcements at the local and national levels, consumers are still facing declining home values, rising foreclosures, difficulties in obtaining credit, and stock market volatility that has drained retirement and college savings accounts. For all of these reasons, personal spending severely fell in the holiday season (second quarter of FY 2009) and will likely be restrained in the foreseeable future. While the federal government's spending and tax cuts related to the stimulus program are having a positive effect on consumer spending, so far, it appears the benefit has been modest and not reflected in a consistent improvement in retail sales. The city believes that these

(\$119 million). Under the agreement, purchases of clothing and footwear priced under \$110 would still be exempt from the city's sales tax. However, enactment of the new sales tax initiatives needs state approval.

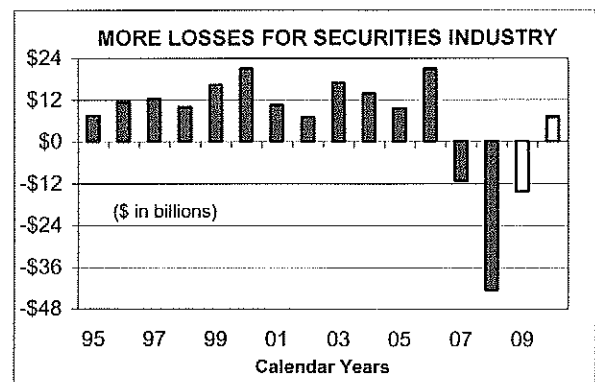
² "On a continuing base" or "on a common rate and base" refers to tax collections that have been adjusted to remove the effects of tax programs and law changes to focus on the influence of the economy.

tough economic conditions will continue through 2010 and cause FY 2010 sales tax revenue to stumble by 11.1 percent on a continuing base from the prior year, before a recovery in the local and national economies in FY 2011.

Personal Income Tax. From last June's adopted budget to the May modification, the FY 2009 personal income tax (PIT) estimate was lowered by \$390 million to \$7.2 billion, which would have been worse if not for the severance packages received by laid-off workers in the financial sector that propped up withholding revenue during the year. Even with such assistance, withholding revenue (on a nominal year-to-year basis) is estimated to have fallen by a negative 5.3 percent to \$5.7 billion after leaping 7.5 percent in the prior year. PIT revenue in FY 2009 may be described by how far wage and nonwage income sources that support the tax base fell during 2008 and the grim outlook for 2009 (and FY 2010). On a continuing base, the city expects PIT collections to plummet to a negative 15.7 percent in FY 2009 and a negative 18.1 percent in FY 2010 due to steep employment losses at the national and local levels that constrain local wage income (and bonus payouts), which exacerbate feelings of uncertainty and pessimism over recoveries in the credit, equity, and housing markets.

In FY 2009, total wage earnings were impacted by income and employment declines in the finance sector in 2008, which grew in magnitude and scope in 2009 to include the other sectors in the city.³ Finance sector compensation (including bonus payouts) is estimated to have fallen by three percent in 2008 and by 28.7 percent, or \$27 billion, in 2009 to \$67.2 billion. Such declines in finance sector compensation are reflected in total wage income growth of only 1.6 percent in 2008 and a decline of 10.7 percent, or \$31.7 billion, to \$264 billion in 2009. While the city estimates employment grew by 47,000 in 2008, spreading job losses from the finance sector are anticipated to reach 172,000 in 2009 and 129,000 in 2010.

One of the primary reasons for the decline in finance sector compensation and employment (and the ripple effect on related industries) is the unprecedented amount of losses (e.g. from write-downs) affecting the New York Stock Exchange member firms. As seen in the figure to the right, after almost setting a new profit record of \$20.9 billion in 2006, the securities industry lost (pre-tax) \$11.3 billion in 2007, \$42.6 billion in 2008, and the city estimates a further loss of \$14.3 billion in 2009, before business conditions improve and profitability reaches \$6.9 billion in 2010.



In terms of nonwage revenue, the outlook is about as dismal as for wage income growth in FY 2009 and FY 2010. As an illustration, capital gains occur when a financial

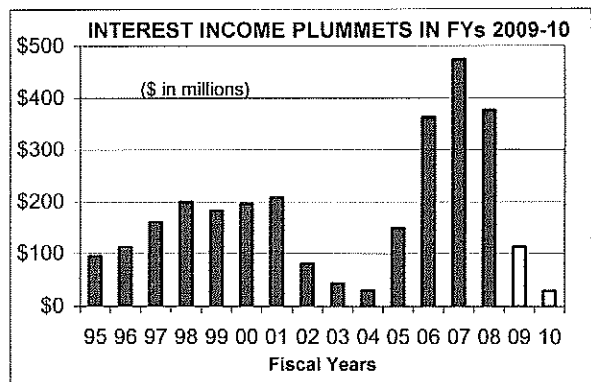
³ In particular, FY 2009 marks the second year in a row that bonus payouts fell on a year-over-year basis and the city estimates that bonuses will drop further in FY 2010 based on earnings in 2009.

or physical asset has appreciated in value from the time it was purchased to when it is sold. Recent reports indicate continued stock market volatility, tight credit conditions for individuals and businesses (e.g. commercial real estate development), and sustained foreclosure activity nationwide. As a result, the city is estimating that after five years of double-digit growth from 2003 to 2007, capital gains realizations slipped by 55.9 percent, or \$32.3 billion, in 2008 to \$25.5 billion from the prior year, followed by a further drop of 14 percent in 2009 to \$21.9 billion.

In addition, there are concerns with other sources of nonwage income that include investment and fee income from hedge fund and private equity fund managers, and income from industries with a large number of self-employed workers, such as professional services, information, and real estate. The city correctly anticipated that the record level of investment and fee income earned by hedge fund managers last year would not be repeated in FY 2009, such that extension payments on final returns in April 2009 collections plummeted by 64.9 percent, or \$902.7 million, from the April 2008 record of \$1.4 billion. Due to the surprising weakness seen in April collections, e.g. installments and extensions that will likely continue through the last months of FY 2009 and into FY 2010, the city's FY 2009 estimate may fall short by \$300 million. This risk is manageable and could lead to a smaller surplus roll from FY 2009 into FY 2010, which would result in a concomitant increase in the gap for FY 2010.

Miscellaneous Revenue

The city's FY 2009 miscellaneous revenue projection advanced by \$309 million to \$4.4 billion from last June's adopted budget through the May modification. If we exclude those parts of the city's miscellaneous revenue forecast that do not foster long-term growth and budget balance, and focus on the remaining core categories, the total projected increase amounted to \$192.8 million.⁴ The \$192.8 million improvement in the FY 2009 estimate was broad-based and represents a gain of about \$20 million to \$50 million among the six core categories. As a group, possibly the most surprising outcome for the core categories was the projected increase, rather than a decrease, of \$27.9 million in the FY 2009 interest income estimate to \$113.3 million. As seen in the figure to the right, interest income is projected to fall by 69.9 percent (or \$263.5 million) in FY 2009 to \$113.3 million from the prior year. From FYs 2006 to 2008 interest income ranged from \$360 million to \$470 million annually because of comparatively higher interest rates and more cash to invest from stronger-



⁴ The core categories are licenses, fees or charges, interest, rents, fines, and a residual miscellaneous category (less nonrecurring resources, tobacco proceeds, and payments from the Health and Hospitals Corporation). Dedicated funds such as water and sewer charges are also excluded from the analysis because they act as an offset to city expenditures and do not assist in achieving budget balance.

than-expected nonproperty tax revenue. FY 2009 marks a turning point because of an estimated year-over-year decline in nonproperty tax revenue and a mid-year announcement in December 2008 by the Federal Reserve to set a target range for the federal funds rate at a new low of 0 to 0.25 percent.

Of the other five core categories, the largest projected increase of \$50.8 million to \$641.6 million was in charges, largely because of housing and other fees, and meter revenue. Fines are projected to have grown by \$44.3 million to \$792.5 million in FY 2009 due to enforcement of building, environmental, and parking violations. Rents grew by nearly \$30 million from the adopted budget estimate to \$247.6 million from strength in collections from commercial and other city-owned properties. The projections for licenses (e.g. cable revenue and permits) and other miscellaneous (e.g. legal settlements and recycling) rose by about \$20 million each during the course of FY 2009, to \$480 million and \$254.5 million, respectively. As of the FY 2010 Executive Budget, the city expects that core category revenue will do better in FY 2010 than in FY 2009 from new initiatives and continued code enforcement, despite the steep projected decline in interest earnings as less cash becomes available for investment at the prevailing low interest rates.

CHANGES IN EXPENDITURE PROJECTIONS

After taking a number of expenditure reduction measures since the adopted budget, the city has been able to increase its surplus for FY 2009 to deal with its budget imbalance in FY 2010. With FY 2009 in balance, the city's effort to cut costs has produced significant savings from most expenditure areas, though some cost increases are expected to arise. In the figure to the right, some of the more prominent expenditure changes in spending from the adopted budget to the May modification are shown. Among the most substantial decreases to spending for the fiscal year is more than \$500 million achieved from a citywide agency program that was initiated in January 2008. To date, the Program to Eliminate the Gap (PEG) is anticipated to produce total savings of more than \$1.6 billion for FY 2009 and \$3.4 billion for FY 2010 through a combination of expense reductions and revenue increases.

Expenditure Changes from Adopted Budget to May Modification (\$ in millions)	
Agency Program	(\$506)
Medical Assistance	(\$411)
Debt Service	(\$290)
Education	(\$97)
Uniformed Overtime	\$105
Pension Costs	\$96
(Decrease) / Increase Expenditures	

Other significant reductions in the FY 2009 budget took place in Medical Assistance, debt service, and Education. A large decrease comes from the city's Medicaid costs, which was made possible by increased federal funds contained in the stimulus package. The city has budgeted for more than \$400 million in savings in FY 2009 and \$850 million in FY 2010. Additionally, the city estimates that debt service costs have been reduced by \$290 million since the FY 2009 budget was adopted. The Department of Education forecasts a reduction in expenditures of \$97 million.

Alternatively, the city estimates that the overtime budget for its uniformed services will increase by \$105 million to \$777 million. Based on an analysis of actual FY 2009 expenditures, we expect the city to spend approximately \$19 million more in

uniformed overtime in FY 2009 than it is forecasting. In addition, the city's pension cost is expected to increase moderately by \$96 million by the end of the fiscal year due to a valuation update.

However, there remains some uncertainty in FY 2010. The city has proposed \$1.4 billion in tax and labor actions that need state and City Council approvals. The city reached an agreement on restructuring of healthcare costs to produce \$200 million in annual savings. The city has requested state approval for the formation of a Tier 5 in the pension systems for another \$200 million in annual savings. The city had also proposed a 10 percent healthcare co-pay contribution for healthcare insurance that was expected to produce an additional savings of \$357 million in FY 2010, but that proposal was pushed to FY 2011.

FYs 2009 and 2010 Agency Program

In September 2007, all city agencies were asked to identify expense reductions and revenue enhancements to mitigate the impact of what was the beginning of an economic downturn. The extent of the severity of the downturn was not fully realized at that time; however, the city took the prudent step of implementing the first stage of a citywide PEG in response to an expected reduction in its tax revenues. The city asked for a 2.5 percent reduction of expenditures in FY 2008, a savings of \$500 million, and a five percent reduction in FY 2009, a savings of \$1 billion. It was expected that the reductions would be recurring and extend into FY 2010 and beyond to reduce projected multi-billion dollar budget gaps in the outyears of the financial plan.

The city's agency program, initiated in the January 2008 Modification, is detailed in Table 3. In that modification, the city achieved total savings of \$543 million, or 2.7 percent, of total agency expenditures through a combination of \$458 million in expense reductions and \$85 million of revenue increases. The savings continued in FY 2009 with over \$1 billion in expenditure reductions (including a \$200 million restructuring of employee health insurance) and \$77 billion in revenue enhancements.

CITY'S AGENCY PROGRAM SINCE JANUARY 2008

TABLE 3 (\$ in millions)

	FY 2008		FY 2009		FY 2010	
	Expense	Revenue	Expense	Revenue	Expense	Revenue
FY 2008						
January 2008	(\$458)	(\$85)	(\$1,008)	(\$77)	(\$867)	(\$79)
May 2008	(53)	(21)	(157)	(65)	(409)	(51)
FY 2009						
June 2008	--	--	--	--	--	--
November 2008	--	--	(381)	(80)	(867)	(216)
January 2009	--	--	(14)	(24)	(750)	(168)
May 2009	--	--	(7)	--	(296)	(29)
Total Expense & Revenue	(\$511)	(\$106)	(\$1,567)	(\$246)	(\$3,189)	(\$543)
Total Agency Programs*		(\$617)		(\$1,813)		(\$3,732)
(Negative) numbers decrease the gap. *Before adjustments for restorations and reversals.						

As the national economy fell deeper into a recession, the city continued to pursue expenditure reductions in its May 2008 Modification, for a total savings in FY 2008 of \$617 million and further savings of \$222 million (\$157 million in expense and \$65 million

in revenue) and \$460 million (\$409 million in expense and \$51 million in revenue) in FYs 2009 and 2010, respectively, as shown in Table 3.

After the FY 2009 budget was adopted in June of 2008, the city called for further spending cuts and revenue increases in its FY 2009 November and January Modifications. The city trimmed agency spending by a combined \$2 billion to help close a projected budget gap in FY 2010 and reduced by \$500 million the FY 2009 expense budget. Finally, in its May 2009 Modification, the city asked all agencies to reduce FY 2010 spending further by \$325 million. In total, the city has identified gap reduction actions that total more than \$1.8 billion in FY 2009 and over \$3.7 billion in FY 2010, as shown in Table 3.⁵ The majority of those savings are expected to continue in FYs 2011 through 2013 as part of the city's financial plan.

FY 2009 AND FY 2010 AGENCY PROGRAM BY CATEGORY SINCE JANUARY 2008

TABLE 4

(\$ in millions)

Agency Category	FY 2009		FY 2010	
	Expense	Revenue	Expense	Revenue
Uniformed Services	(\$336)	(\$44)	(\$635)	(\$150)
Health and Welfare	(204)	(10)	(438)	(20)
Mayoral	(198)	(185)	(435)	(239)
Major Organizations	(620)	(5)	(1,205)	(25)
Elected Officials	(29)	--	(45)	--
All Other	(180)	(2)	(431)	(109)
Subtotal	(\$1,567)	(\$246)	(\$3,189)	(\$543)
PEG Adjustments	161	--	325	--
Total Expense & Revenue	(\$1,406)	(\$246)	(\$2,864)	(\$543)
Total Agency Programs		(\$1,652)		(\$3,407)
Positive numbers increase the gap / (negative) numbers decrease the gap.				

The total agency program for FYs 2009 and 2010, grouped by agency, is shown in Table 4. The primary savings in the program are expenditure reductions. As shown in the table, significant cost cuts were achieved throughout all city agencies, with the bulk coming from the major organizations category. The largest organization in this category, the Department of Education (DOE), provided cuts of \$479 million, or 6.4 percent, of the DOE budget in FY 2009, and more than \$1 billion of cuts in FY 2010 or greater than 13 percent of the Department's budget. The city had also found savings in their uniformed agencies (Police, Fire, Correction, and Sanitation Departments) accounting for more than \$300 million and \$600 million in FYs 2009 and 2010, respectively. In all, after PEG adjustments, the city anticipates about an eight percent budget reduction for FY 2009, or \$1.6 billion, with \$1.4 billion coming from the expenditures side. In FY 2010, the savings expected to be achieved are more than twice the savings in FY 2009, with more than \$2.8 billion in expense cuts and over \$500 million in additional revenues expected to be generated.

The city expects to be able to save more than \$2.8 billion in expenditures in FY 2010 as part of its agency program. Some of those targeted expense reductions will come from reducing the city's workforce and imposing a citywide hiring freeze, which

⁵ For FYs 2009 and 2010, the city has restored PEGs totaling \$161 million and \$325 million, respectively, reducing the agency programs for those fiscal years to \$1.6 billion and \$3.4 billion.

includes new teachers for the next school year. As shown in Table 5 on page 15, the city has budgeted for over 13,500 fewer employees for FY 2010 with nearly three-fourths of the reductions found through attrition. Hence, the city will be able to save the salary and pension costs of almost 10,000 workers by not replacing the vacancies.

TABLE 5

HEADCOUNT REDUCTION PROJECTED FOR FY 2010

Agency Category	Layoffs	Attrition	Total
Uniformed Services	(398)	(4,470)	(4,868)
Health and Welfare	(975)	(1,076)	(2,051)
Mayoral	(225)	(1,271)	(1,496)
Major Organizations	(344)	(1,571)	(1,915)
All Other	(1,817)	(1,394)	(3,211)
Total Reduction	(3,759)	(9,782)	(13,541)

Nonetheless, to meet its fiscal responsibilities and balance its budget, the city will need to reduce its payroll above the attrition amount by about 3,700 workers.⁶ The need for the additional layoffs stems from the diminishing rate of attrition the city is currently experiencing. The retirement of city employees has slowed from historical trends of about six to seven percent to approximately 4.2 percent due to the economic downturn. Alternatively, the proposed layoffs would have been greater if not for the impact of federal stimulus funds, which saved more than 14,000 Department of Education jobs.

As discussed, the city recognized early that trouble in the economy would quickly impact the city's finances. The city took aggressive actions that have produced significant resources to be used for budget balance in FY 2009 and FY 2010, although risks in FY 2010 remain. The savings from the program are expected to continue into the outyears of the financial plan, which will help to offset the large budget gaps projected for those years.

Medical Assistance

In the May modification for FY 2009, the city has lowered its Medical Assistance expenditure projection to about \$5.2 billion from its June 2008 Adopted Budget forecast of \$5.6 billion. The savings of slightly more than \$400 million are due to a change in the Federal Medical Assistance Percentages (FMAP) rates enacted by the federal government as a part of its stimulus package. The FMAP rates determine the cost-sharing percentage of a state's Medicaid cost that the federal government will pay. The FMAP rate is based on a state's relative wealth, with New York getting the minimum rate of 50 percent. Additionally, the payment is based on a state's unemployment rate. Thus, if the unemployment rate for a state moves higher, a greater number of people can qualify for Medicaid, which lowers the state's share of the cost. As part of the stimulus package, the federal government's cost was increased nationally by a base level of 6.2 percent, resulting in lower cost-sharing rates for Medicaid expenses that states are

⁶ On June 2, 2009, the city reached an agreement with the municipal labor unions on health benefits cost containment, which will generate recurring annual savings. The city also agreed to defer the implementation of a number of scheduled layoffs for a period of 90 days.

required to make. The federal share has been raised for a temporary period of about two years (the enhanced rates will expire on December 31, 2010).

The city has more than 2.6 million enrolled Medicaid recipients as of March 2009, and along with the state, contributes to paying the cost of providing those benefits. In FY 2006, the state put a three percent cap on Medicaid growth and pays the difference for any growth higher than the cap. This state action mitigates the costs the city and other state localities must bear. Prior to the cap, the city's share is 25 percent of the cost for Medicaid-related expenses and 10 percent of the cost for long-term care expenses.⁷ However, those cost-sharing percentages fluctuate along with Medicaid growth. In more recent years, the growth rate in Medicaid costs averaged about six to seven percent a year.

The state had a 50 percent Medicaid share rate with the federal government prior to the change in FMAP. With the FMAP change, the federal rate for New York State is now 56.2 percent, which means that the state government will pay 43.8 percent of the cost. With an increase in unemployment, New York State will see the federal rate increase as well, which means the state cost will decrease beyond the 43.8 percent. Because of the FMAP increase, the city's federal aid allocated to Medicaid expenditures was increased by nearly \$1.6 billion over a three-year period. The city expects to receive \$447 million in FY 2009, \$850 million in FY 2010, and \$296 million in FY 2011. These available resources serve as an integral part in the city's gap-closing actions.

The Department of Education

The May modification shows a reduction in FY 2009 funding for the Department of Education (DOE) from the adopted budget released in June 2008. As shown in Table 6, DOE operational expenditures of \$17.756 billion were reduced by \$97 million. Both city and federal funds have been reduced; however, state and other categorical funds have increased.

TABLE 6 **CHANGES TO DOE BUDGET IN FY 2009**
(\$ in millions)

	June 2008 Adopted Budget	May 2009 Modification	Change
City	\$7,415	\$7,264	(\$151)
State	8,511	8,560	49
Federal	1,766	1,740	(26)
Other Categorical	52	83	31
Intracity	12	12	0
Total	\$17,756	\$17,659	(\$97)

⁷ Before the allocation of federal funds received by the state, the city pays 50 percent of Medicaid costs and 20 percent of long-term care costs on a city-funded basis. Those cost-sharing percentages for the city are reduced to 25 percent and 10 percent, respectively, when federal funds the state receives from its FMAP agreement are allocated by the state to the city.

The city's FY 2009 funding for DOE decreased by \$151 million from \$7.415 billion in June 2008 to \$7.264 billion in May 2009. Most of this change occurred in the November modification when funding to the FY 2009 Adopted Budget decreased by \$178 million. This reduction was a direct impact of the citywide agency program that called for a 2.5 percent decrease in spending by all city agencies including DOE. To meet this objective, the department developed a program that minimized direct reductions to schools' budgets. Principals were given an across-the-board reduction target and asked to specify how they would implement their reduction, which achieved savings of almost \$104 million. In addition, central administration and field offices, such as legal, human resources, and others made an impact of over \$40 million in savings. An additional \$27 million of savings was achieved through a number of other indirect classroom actions including decreases to maintenance and repair contracts for facilities, transportation and food-related services. Personnel reduction in nonessential services accounted for \$7.5 million in fringe benefits savings. The \$178 million reduction was offset by a \$27 million increase in the subsequent modifications through combination of transfers, new needs and collective bargaining reserves.

Federal funding to DOE was also reduced by \$26 million to \$1.74 billion. Most of this was realized in a downward adjustment to the Reading First Program totaling \$21 million. Changes in other programs accounted for a net decrease making up the remaining balance of \$5 million.

As shown in Table 6 on page 16, both state and other categorical funds increased since the June 2008 Adopted Budget. Since the adopted budget, the state augmented funding to the DOE by \$49 million to a total of \$8.56 billion. Funding for pre-kindergarten family court, summer school for handicapped pupils and occupational education aid services was increased by \$29.8 million, \$21 million, and \$15.6 million, respectively. Offsetting these increases was a reduction in universal pre-kindergarten totaling \$35 million. Changes to a number of other state-funded divisions made up the remaining balance of the increase.

Other categorical, with a \$31 million upswing in funding to education, totaled \$83 million. This was comprised mainly of \$20.2 million, from the reimbursement to the division of school facilities for capital work done, and \$11.5 million provided by private foundations. Intracity funds remained level at \$12 million throughout the fiscal year.

Overtime

In the FY 2009 adopted budget, the city had projected uniformed services' overtime expenditures, for its uniformed and civilian personnel, to total about \$672 million for FY 2009. This estimated amount is expected to increase by more than \$100 million or close to 16 percent, as reported in the city's May modification. Our analysis indicates that the city's four uniformed agencies (Police, Fire, Correction, and Sanitation Departments) will likely exceed their budgeted spending versus their actual expenditures, fiscal year-to-date, by a relatively modest amount of about \$19 million.

As discussed in the city's agency program, starting on page 13, the city proposed numerous cost saving measures and revenue increases for all its agencies. In FY 2009, total uniformed agency actions amounted to \$380 million since January 2008, when the

agency program was initiated. But of those savings, only a small portion was devoted to overtime spending reductions.

As shown in Table 7, in the May modification, the city expects to spend \$777 million in total uniformed agency overtime for FY 2009. For FY 2009, the city originally estimated its overtime budget at \$672 million. As the fiscal year progresses, the city analyzes agency spending and modifies its overtime budget as it deems necessary. As the table shows, overtime spending estimates increased from the adopted budget by more than \$14 million to \$686 million in the November modification and were increased further in the January modification by about \$72 million and again raised in May by almost \$19 million. In all, the projection was increased by more than \$105 million from the adopted budget to the May modification.

TABLE 7

FY 2009 UNIFORMED SERVICES' OVERTIME BUDGET SUMMARY
(\$ in millions)

	Adopted Budget	November Modification	January Modification	May Modification	Actual YTD Spending*
Police	\$331.3	\$353.5	\$389.6	\$400.4	\$397.3
Fire	206.4	209.2	233.6	205.6	139.0
Correction	69.3	58.8	70.3	106.3	81.5
Sanitation	64.5	64.5	64.8	64.8	45.6
Totals	\$671.5	\$686.0	\$758.3	\$777.1	\$663.4

*Fiscal year-to-date actual expenditures through April 2009.

It is clear that in total, uniformed agency budgeted expenditures have been raised through the fiscal year, but taken separately each agency has a very different variance. For example, the Sanitation Department's overtime budget remained flat through all FY 2009 modifications. Historically, the Department would see a spike in its overtime when inclement weather, such as a severe snow storm, arose. Given the relatively mild winter and only one major snowstorm, this event did not occur.

The Fire Department anticipated an increase in its expenditures in the January modification of approximately \$27 million over the adopted budget. However, the city placed a cap on overtime expenditures that were deemed "nonemergency" such as office-related work, other administrative functions, and firefighter training. The cap lowered estimates to \$205.6 million or about what expenditures were expected to be in the adopted budget. In the past, the Fire Department's budget was less than \$200 million but because of a higher-than-normal sick rate among firefighters in recent years, overtime spending increased to compensate for the loss of manpower.

Alternatively, the Police and Correction Departments have seen their projections raised. As the table shows, through April 2009, the city has recorded almost \$400 million in overtime spending by the Police Department, which is the total projected annual budget, but at only 10 months into the fiscal year. Mainly, Police Department overtime is driven by arrests. Generally, when there is a headcount increase in the Police Department, overtime will increase because more arrests are made. The majority of overtime hours are for completing a criminal's booking and transportation to a holding facility, which are routinely expensed as overtime when the extra hours extend an officer's shift.

The city has also raised its estimates for the Correction Department by \$37 million since the adopted budget in order to compensate for overspending. The Department had suffered from recruitment problems and overtime expenditures have been greatly impacted by this. In total, the city has recorded more than \$663 million in actual spending through April of this fiscal year. In our analysis, we project that actual spending for the fiscal year ending in June will be \$796 million or about \$66 million more for each of the two remaining months. With the city projecting total overtime spending at \$777 million, we hold at risk about \$19 million.

Pension

The city projects its pension cost for FY 2009 to be about \$6.4 billion, an increase of \$96 million over the adopted budget forecast released in June 2008. The increase is due to a valuation update, which consists of an adjustment for changes in actuarial assumptions, the impact of collective bargaining agreements, and adjustments for other labor settlements. Subsequently, pension costs are expected to move higher in FY 2010 and beyond when investment losses from FYs 2008 and 2009, which carry a two-year phase-in lag, start to be accounted for by the city.

In an approach to deal with those higher pension costs in the near term, the city is seeking savings that would entail the creation of a Tier 5 for newly employed city workers. The city expects that the new tier, if created, will yield \$200 million in annual savings starting in FY 2010 and, cumulatively, would save the city about \$16 billion over the next 30 years.

At the end of the third quarter of FY 2009, the city's pension systems' annualized investment return on its assets is negative 25 percent. The pension systems have an actuarial required rate of return of eight percent. When investment performance is below eight percent, the city must contribute the difference. For the current fiscal year, the city will need to fund an investment loss of 33 percent in future years (the loss of 25 percent plus the required eight percent return), if the investment return remains unchanged at fiscal year end. In dollar terms, the unexpected investment loss would equate to over \$36 billion. Based on a six-year phase-in at a two-year lag, the loss would cost the city about \$524 million in FY 2011, \$1 billion in FY 2012, \$1.6 billion in FY 2013, \$2.1 billion in FY 2014, \$2.8 billion in FY 2015, and \$3.5 billion in FY 2016. The loss is phased in cumulatively over six years at 15 percent, 30 percent, 45 percent, 60 percent, 80 percent and 100 percent, which lends manageability to losses in the near term but creates a much larger financial burden in the future.

The stock markets have been in turmoil since reaching an apex in October 2007. Since then, the markets have plunged wiping out trillions of dollars in equity value. In response to the fallout, the city has assumed that the pension systems, which are heavily weighted in equity investments, would realize a negative 20 percent return for the fiscal year. Accordingly, additional funds were allocated by the city to compensate for the expected asset losses. The city has budgeted for allocations of \$431 million in FY 2011, \$794 million in FY 2012, \$1.2 billion in FY 2013, \$1.7 billion in FY 2014, \$2.3 billion in FY 2015, and \$2.9 billion in FY 2016.

As mentioned earlier, the phase-in of losses is at a two-year lag; hence, there is no budgetary impact to FY 2009 or FY 2010 for losses incurred in FY 2009. The city had already funded a 5.4 percent loss, which occurred in FY 2008, by allocating \$82 million for FY 2010, the first year of that six-year phase-in. To provide this resource, the city is reducing the funding allocated to the Retiree Health Benefits Trust (RHBT) by \$82 million in FY 2010. It plans further reductions to the RHBT of \$395 million in FY 2011 and \$672 million in FY 2012, to offset the phase-in of pension losses in those fiscal years. The reduction of funding will require a total drawdown of the RHBT by more than \$1.1 billion; an unfortunate step back from starting to deal with this growing unfunded liability.

In contrast to last year's dismal market performance, the markets have recovered somewhat with a surge in April 2009, which reduced the loss the city had reported at the end of the third quarter in the fiscal year. Our analysis shows that the pension systems are down by about 22 percent after calculating for the better performance. Though this figure still equates to a significant unexpected loss of about \$31 billion, it does ameliorate the impact of funding the phase-in of losses. If the pension systems' return stays closer to their forecasted negative 20 percent return, then the city's funding assumptions will be on target.

Debt Service Costs

Over the course of FY 2009, the city and the New York City Transitional Finance Authority (NYCTFA) achieved \$290 million of debt service savings. The vast majority of the reduction in debt service was derived from interest savings on variable rate and fixed rate bonds, as well as savings on leased-back debt and more favorable payments on derivative products that are more than offset by a decline in derivative receipts.

FY 2009 City and NYCTFA Debt Service Savings (\$ in millions)			
	Adopted Budget	May Modification	Savings/ (Costs)
Fixed Rate	\$3,801	\$3,781	\$20
Variable Rate	298	79	219
Derivative	101	76	25
Lease Debt	184	128	56
Other Adjustments	(16)	14	(30)
Total	\$4,368	\$4,078	\$290

FY 2009 debt service, net of prepayment, is projected to total \$4.1 billion, which is lower compared to FY 2008 by \$800 million. It should be noted that FY 2009 debt service is reduced by \$639 million to reflect the use of \$1.25 billion of a FY 2007 budget surplus that retired city bonds and legally defeased NYCTFA bonds originally scheduled to mature in FYs 2009 and 2010.

Debt service is generally paid from current-year tax revenues. However, of the \$4.1 billion FY 2009 debt service costs, the city paid \$3.7 billion in FY 2008 by mainly flowing that year's budget surplus through the budget stabilization account to pay the principal and interest on general obligation bonds, as well as providing a grant to the NYCTFA to satisfy its debt obligation. Similarly, the city plans to use \$1.9 billion of the surplus it expects to generate in FY 2009 to pay FY 2010 debt service costs. The use of budget surpluses to pay debt service has diminished substantially in FY 2009 and will be mostly exhausted in FY 2010.

THE BUDGET SURPLUS

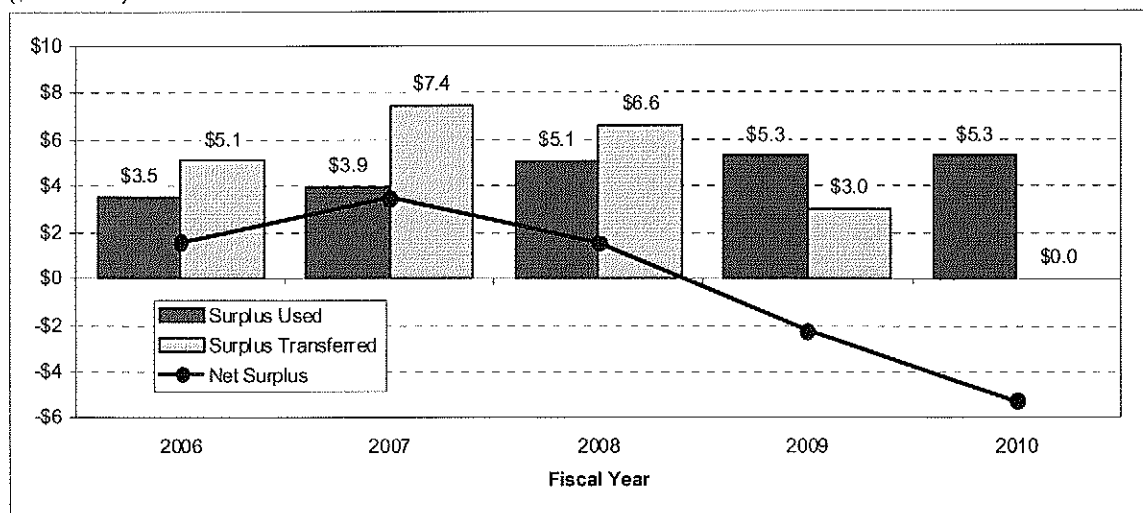
The FY 2009 budget was supported by a combined \$5.3 billion of prior-year surpluses. Of that total, \$4.6 billion of a variety of expenses were prepaid in FY 2008 and \$639 million of debt service costs were paid off in FY 2007. The city expects to end FY 2009 in balance and have \$3.03 billion of additional funds to address the budget shortfalls projected for FYs 2010 and 2011. The city has applied \$2.5 billion of FY 2009 unspent resources to help balance the FY 2010 budget and the remaining \$530 million to support the FY 2011 budget. With this application, the city will consume all of the prior-year surpluses, ending an era of large surplus rolls.

Coming into FY 2009, the budget surpluses had been growing incrementally. As can be seen in Chart 1, the budget surpluses were positive in each of FYs 2006-2008, meaning the surpluses at the end of the year available to pay future-year expenses exceeded surpluses that were used to support current-year spending. For example, the city transferred \$7.4 billion of surplus resources from FY 2007 that was \$3.5 billion greater than the \$3.9 billion prior-year surplus that it used to support FY 2007 expenses. The year-end FY 2007 surplus was used for the following expenses:

- to prepay \$3.3 billion of FY 2008 debt service costs,
- to execute the early retirement of \$1.25 billion of debt originally scheduled to mature in FYs 2009 and 2010,
- to provide a \$546 million grant to the NYCTFA to pay the FY 2008 debt service on its revenue bonds,
- to prepay \$165 million of lease-backed debt,
- to prepay \$639 million of subsidies, and
- to deposit \$1.5 billion into the Retiree Health Benefits Trust Fund.

CHART 1

THE BUDGET SURPLUS SHRANK IN FY 2009 AND WILL BE DEPLETED IN FY 2010 (\$ in billions)



In FY 2008 when the economy started to slow, the net increase in the surplus was not as dramatic at \$1.5 billion. For FY 2009, the city is projecting a precipitous decline of more than \$2.2 billion in the surplus. More importantly, the city does not expect that the

economy will allow for the generation of a surplus in FY 2010. In fact, the city is relying on the use of \$2.5 billion of the FY 2009 surplus and \$2.8 billion of surpluses from earlier years to balance the FY 2010 budget. In the absence of an unexpected revenue boon, the city will have to take major gap-closing actions that produce recurring savings and/or resources to close the budget gaps it has projected beyond FY 2010.

Glossary of Acronyms

CY	Calendar Year
DOE	Department of Education
FCB	Financial Control Board
FMAP	Federal Medical Assistance Percentages
FY	Fiscal Year
GCP	Gross City Product
GCT	General Corporation Tax
GDP	Gross Domestic Product
G.O. Bonds	General Obligation Bonds
NYCTFA	New York City Transitional Finance Authority
OT	Overtime
OTPS	Other than Personal Service
PBA	Patrolmen's Benevolent Association
PEG	Program to Eliminate the Gap
PIT	Personal Income Tax
PS	Personal Service
RHBT	Retiree Health Benefits Trust
STAR	School Tax Relief program