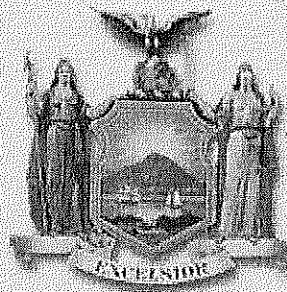


Staff Report

**REVIEW OF FYs 2009-2013
FINANCIAL PLAN**

March 18, 2009



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FINANCIAL CONTROL BOARD**

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*Expenditure and Covered
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*Finance and Capital
Analysis*

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Iwona Matusiak
Michelle McManus
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Edward C. Thurston

**ADMINISTRATIVE AND
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Barbara Marin
Margaret C. Oliver
Saundra L. Truell

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I. Overview

The city's January modification to its financial plan, including the preliminary budget for FY 2010, reflects the continued worsening of the national and city economies. The impact on tax collections has forced the city to reduce its revenue estimates, and propose expenditure reductions and tax increases.

In the January modification, the city has reduced its estimate of city-fund revenues by nearly \$1 billion for FY 2009. This loss has been offset by the reinstatement of the seven percent property tax increase, midyear, and the implementation of agency reduction actions that primarily help FY 2010 but generate some benefit in the current year. For the first time in the last several years, instead of being able to increase its Budget Stabilization Account to lower outyear budget gaps, the city was forced to reduce the account by \$250 million in order to help balance the current year. We have identified additional risks totaling \$328 million in FY 2009. If no other actions are taken, the city will have to further reduce its planned surplus in order to balance FY 2009 while increasing the size of the FY 2010 deficit. These actions are a clear reflection of the continued fiscal stress the city is under.

For FY 2010, even after reimposing the seven percent property tax increase and taking almost a billion dollars in agency reductions, the city forecasts a budget deficit of just under \$4 billion. Nonproperty tax revenues continue a drastic decline of over \$2 billion, while expenditures for health benefits, pensions, and debt service continue to grow. The city proposes a number of actions to close the projected budget gap. An additional agency reduction program of just under \$1 billion is planned. The city has recognized additional federal assistance for Medicaid of \$1 billion in each of FY 2010 and FY 2011, contained in the American Recovery and Reinvestment Act of 2009. In addition, the city has requested a number of changes to the sales tax that would increase revenues by almost \$1 billion and the restoration by the state of \$242 million annually in revenue sharing money that has been proposed for reduction. Similarly, the city has requested over \$550 million in health care savings, including the imposition of a 10 percent co-pay for health insurance. The city has also requested state legislation creating a new tier in its pension system for new employees, which it projects would save \$200 million in FY 2010 with the savings reaching over \$16 billion over the next 30 years.

Our review of the city's plan identifies large risks, mainly because most of the actions proposed are outside of its control. The agency program is largely achievable and it appears that the city will receive most of what it has planned for in federal assistance in Medicaid. However, there has not been any discernable progress made in the proposals for sales tax increases, restoration of revenue sharing aid, and labor savings. In addition, we believe that the city's assumptions for a recovery in the outyears of the plan may be optimistic and have taken nonproperty taxes down by \$500 million in FY 2011, \$350 million in FY 2012, and \$200 million in FY 2013. We have projected that the city, in the forthcoming executive budget, still needs to address budget gaps of over \$2 billion in FY 2010, \$6.5 billion in FY 2011, \$7.3 billion in FY 2012, and \$7.5 billion in FY 2013.

The city is likely to receive substantial assistance, in addition to Medicaid, from the federal stimulus bill. While it is too early to determine exactly how much the city will receive, and some aid must await adoption of the state's budget, most of the additional aid may be used to offset proposed state reductions in education aid. It must be remembered, however, that this federal aid is only for two years, so the city will still need to take significant actions to close the outyear budget gaps.

It is significant to note that the city, consistent with our review, has pointed out three areas of expenditures for which continued growth in the changing economic environment is unaffordable and unsustainable. These areas are debt service, health benefits including the unfunded liability for retired employees, and pension costs.

To address the growing debt service costs, last year the city proposed a stretch-out from four to five years for its capital plan. In the January modification the city has undertaken a second round of reductions by proposing a 30 percent reduction in the ten-year capital plan for those projects funded through the sale of general obligation bonds. This action will lower debt service expenses on a recurring basis and curb the share of tax revenues that is used for the payments.

In the area of health benefits and pensions the city has made a number of proposals, which have met with resistance from many of the stakeholders. If no agreements are made to slow the growth of these expenditures, the city will have no choice but to close the large outyear gaps with major service reductions or even larger tax increases than already proposed.

**JANUARY MODIFICATION:
THE CITY'S OPERATING PROJECTIONS FOR
FISCAL YEARS 2009-2013**

TABLE 1 (\$ in millions)

	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Revenues					
Taxes:					
General Property	\$14,319	\$16,212	\$17,147	\$17,736	\$18,124
Other Taxes ^a	20,094	17,448	20,216	21,791	23,303
Discretionary Transfers	546	546	--	--	--
Debt Defeasances	362	382	--	--	--
Tax Audit Revenue	680	596	596	595	594
Sales Tax Increase Program	77	894	920	972	1,023
Tax Reduction Program	0	0	0	0	0
Sale of Property Tax Liens	38	34	31	31	31
Miscellaneous Revenues	7,049	6,760	6,931	7,002	7,017
Unrestricted Intergovernmental Aid	254	254	254	254	254
Interfund Revenues	477	445	437	434	433
Less: Intracity Revenues	(1,631)	(1,462)	(1,462)	(1,462)	(1,462)
Disallowances	(15)	(15)	(15)	(15)	(15)
Total City Funds	\$42,250	\$42,094	\$45,055	\$47,338	\$49,302
Federal Categorical Grants	6,037	5,326	5,323	5,334	5,334
State Categorical Grants	12,031	11,629	12,127	12,390	12,833
Total Revenues	\$60,318	\$59,049	\$62,505	\$65,062	\$67,469
Expenditures					
Personal Service	\$35,176	\$34,770	\$36,515	\$37,250	\$38,737
Other Than Personal Service	25,434	23,842	24,816	26,644	27,403
Debt Service	3,829	4,353	4,783	5,211	5,496
NYCTFA Debt Defeasances	(279)	(2,313)	--	--	--
NYCTFA Debt Service	225	216	1,114	1,158	1,162
Budget Stabilization & Prepayments	(2,536)	(657)	(350)	--	--
General Reserve	100	300	300	300	300
Subtotal	\$61,949	\$60,511	\$67,178	\$70,563	\$73,098
Less: Intracity Expenditures	(1,631)	(1,462)	(1,462)	(1,462)	(1,462)
Total Expenditures	\$60,318	\$59,049	\$65,716	\$69,101	\$71,636
Gap To Be Closed	\$0	\$0	(\$3,211)	(\$4,039)	(\$4,167)

^aIncludes personal income tax revenue designated to pay NYCTFA debt service.

**CHANGES TO THE CITY'S OPERATING PROJECTIONS FOR
FISCAL YEARS 2009-2012
NOVEMBER MODIFICATION COMPARED TO JANUARY MODIFICATION**

TABLE 2 (\$ in millions)

	FY 2009	FY 2010	FY 2011	FY 2012
<u>Revenues</u>				
Taxes:				
General Property	\$576	\$1,511	\$1,505	\$1,348
Other Taxes ^a	(1,170)	(2,417)	(1,743)	(1,732)
Discretionary Transfers	0	0	--	--
Debt Defeasances	362	382	--	--
Tax Audit Revenue	0	7	7	6
Sales Tax Increase Program	77	894	920	972
Tax Reduction Program	(832)	(1,479)	(1,554)	(1,615)
Sale of Property Tax Liens	0	0	0	0
Miscellaneous Revenues	153	278	405	456
Unrestricted Intergovernmental Aid	(86)	(86)	(86)	(86)
Interfund Revenues	13	20	17	14
Less: Intracity Revenues	(24)	(15)	(16)	(16)
Disallowances	0	0	0	0
Total City Funds	(\$931)	(\$905)	(\$545)	(\$653)
Federal Categorical Grants	221	27	43	44
State Categorical Grants	363	(317)	(678)	(718)
Total Revenues	(\$347)	(\$1,195)	(\$1,180)	(\$1,327)
<u>Expenditures</u>				
Personal Service	\$242	(\$1,736)	(\$2,083)	(\$2,344)
Other Than Personal Service	(86)	(1,022)	(863)	289
Debt Service	260	2,304	(34)	(138)
NYCTFA Debt Defeasances	(279)	(2,313)	--	--
NYCTFA Debt Service	0	0	0	0
Budget Stabilization & Prepayments	(260)	250	0	0
General Reserve	(200)	0	0	0
Subtotal	(\$323)	(\$2,517)	(\$2,980)	(\$2,193)
Less: Intracity Expenditures	(24)	(15)	(16)	(16)
Total Expenditures	(\$347)	(\$2,532)	(\$2,996)	(\$2,209)
<u>Gap To Be Closed</u>	\$0	\$1,337	\$1,816	\$882

^aIncludes personal income tax revenue designated to pay NYCTFA debt service.

RISKS TO THE FINANCIAL PLAN

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

	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Stated Financial Plan Gap	\$0	\$0	(\$3,211)	(\$4,039)	(\$4,167)
Estimation					
Nonproperty Taxes	\$50	\$0	(\$500)	(\$350)	(\$200)
Property Tax	0	0	(100)	(200)	(300)
Uniformed Services Overtime	(59)	(104)	(83)	(82)	(82)
Subtotal	(\$9)	(\$104)	(\$683)	(\$632)	(\$582)
Implementation					
Pollution Remediation	\$0	\$0	(\$500)	(\$500)	(\$500)
Subtotal	\$0	\$0	(\$500)	(\$500)	(\$500)
Not in Mayor's Control					
Sales Tax Increase Program	(\$77)	(\$894)	(\$920)	(\$972)	(\$1,023)
Health Insurance Savings	0	(557)	(586)	(618)	(653)
Tier 5 Pension Legislation	0	(200)	(200)	(200)	(200)
State AIM Payments	(242)	(242)	(242)	(242)	(242)
Consumer Plastic Bag Use Fee	0	(100)	(160)	(140)	(140)
Subtotal	(\$319)	(\$1,993)	(\$2,108)	(\$2,172)	(\$2,258)
Risk Total	(\$328)	(\$2,097)	(\$3,291)	(\$3,304)	(\$3,340)
Total FCB Estimated Surplus/(Gap)	(\$328)	(\$2,097)	(\$6,502)	(\$7,343)	(\$7,507)
Notes: The city has set aside \$100 million in a general reserve in FY 2009 and \$300 million in each subsequent year of the financial plan.					

II. Balancing the FY 2009 Budget

In the January modification to the FYs 2009-12 Financial Plan, the city reduced its estimate of city-fund revenues by nearly \$1 billion in FY 2009 because of a recession-induced slowdown in nonproperty tax collections. The tax shortfall had a lesser impact upon total revenues, which decreased by a net \$347 million. The city's economic plan, which initially seemed excessively pessimistic, now appears less extreme, as negative economic reports compel other forecasters to move closer to the city's outlook. The city is aggressively confronting the revenue downturn by canceling tax cuts and pressing for new tax initiatives.

The city is also moving to control expenditures. To balance the FY 2009 budget, it has decreased expenditures by an equivalent \$347 million since the November modification, \$200 million of which reflects a reduction in the General Reserve from \$300 million to \$100 million. The city also expects to use \$250 million more of its accumulated budget surplus to close the budget gap in FY 2009, which leaves \$1 billion of resources available to help reduce the FY 2010 budget gap. Additionally, the city implemented an agency program that has served to partially offset increases in public assistance and personal service expenditures.

REVENUES

City-fund revenues for FY 2009 are down by \$973 million in the January plan, largely because of a shortfall in nonproperty tax collections, as shown in the figure to the right. The tax shortfall had a lesser impact upon total revenues, which decreased by \$347 million, because additional categorical grants of about \$600 million were included in the plan. A deepening national recession and the difficulties facing the finance industry have caused the city to reduce its nonproperty tax revenue target by \$815 million in FY 2009. As a result of the downturn, the city has reduced its tax collection targets for all of its major nonproperty taxes.

Faltering Nonproperty Taxes Drag Down FY 09 City Funds \$1 Bil (\$ in millions, change since Nov. Plan)	
Property Tax	\$576
Nonproperty Taxes	(815)
Tax Program	(755)
STAR Aid	7
Unrestricted Aid	(86)
Miscellaneous Revenue	100
City Funds	(\$973)
Categorical Aid & Other Revenue	626
Total Change in Revenues	(\$347)

In addition to the \$815 million nonproperty tax shortfall, the city also reduced the amount of unrestricted aid expected from the state by \$86 million. Offsetting the revenue losses are a \$100 million increase to miscellaneous revenue and a \$7 million increase in the state's School Tax Relief program (STAR). A tax program decrease of \$755 million reflects three proposals which were implemented, postponed, or newly proposed.

The largest item in the \$755 million reduction to the tax program consists of a \$576 million proposal in the November plan to rescind a seven percent property tax cut. This proposal, which was implemented halfway into FY 2009, is shown as an increase to

property tax revenues and as an offsetting decrease to the tax program. The full year effect of this rate change is more than \$1.2 billion annually in FY 2010 and beyond. Another property tax proposal to raise \$256 million annually, by canceling the homeowner rebate program, was removed from the plan for FY 2009 and has been scheduled to take effect beginning in FY 2010. A newly-proposed sales tax program consists of a set of increases that could start to generate \$77 million at the end of FY 2009 and about \$1 billion annually when fully implemented.

The City Faces Up to the Recession

The city has removed more than \$800 million from its FY 2009 nonproperty tax plan to prepare for a recession-induced slowdown in tax collections. The city is also aggressively pursuing strategies to augment tax revenues by canceling previously approved tax cuts and pressing for new tax increases. The city has been fortunate in that it had set aside \$1.3 billion in surplus resources from the boom to apply to tax shortfalls in FYs 2009 and 2010. The city was also fortunate in that the downturns in the real estate and job markets started later here than elsewhere in the nation. Nevertheless, the involvement of the locally-based finance sector promises to make this recession exceedingly severe in the city, even though the onset was delayed.

When the city issued its January modification, its economic predictions were more pessimistic than those of other forecasters. Subsequent economic reports, however, indicate that other economists are moving closer to the city's view. The city sees real gross domestic product (GDP) falling by 2.5 percent in calendar year (CY) 2009. The Blue chip survey reported that their consensus estimate of GDP had moved to minus 2.6 percent in March from the 1.9 percent decline published in their January report. Moreover, 47 of their forecasters lowered their expectations versus three upward revisions. Thus, the consensus outlook has moved even lower than that of the city.

More significant than the negative shift of forecasters' opinions is the very grim economic news which also confirms the validity of city's dire outlook. Real GDP fell by 6.2 percent in the fourth quarter of 2008, sinking from the far less severe decline of 0.5 percent in the prior quarter. Consumers, jolted by job losses and by lost household wealth, curtailed their spending by 4.3 percent in the fourth quarter of 2008, deepening the spending slide of 3.8 percent in the third quarter. The personal savings rate increased to 3.2 percent in the fourth quarter, from 1.3 percent in the third quarter, indicating that consumers could be changing their behavior in response to economic stresses and excessive debt loads. Normally, a high savings rate can benefit the economy when banks are willing to lend and when businesses are ready to invest the savings. In the current environment, however, the shift to a higher savings rate could deepen and prolong the recession.

In the city's outlook, national employment will fall by five million jobs through the end of the recession, a number which could soon be surpassed as the recession deepens. Thus far 4.4 million jobs have disappeared through February 2009, since the start of the recession in December 2007, with more than half of the job losses occurring in the past four months. The city expects the nation's unemployment rate to increase to 8.5 percent in 2009 from 5.8 percent in 2008, and reach 9.1 percent in 2010. Accelerating job

losses have driven up the national unemployment rate from 7.6 percent in January to 8.1 percent in February, which is the highest rate in over 25 years.

The city expects the local economy to follow a steeper downward path than the nation because of the involvement of the local financial sector in the downturn. Thus far the city has identified half a trillion dollars in asset write-downs that were reported by city-centered financial institutions. Gross city product (GCP), which fell an estimated six percent in 2008, falls 11 percent further in 2009. GCP stabilizes in 2010 and rebounds with a four percent growth rate in both 2011 and 2012. A major factor in the local downturn is a 7.5 percent drop in the local wage rate in 2009 due to the loss of high-paying finance jobs and a downward trend in bonuses that began in 2008.¹

The city projects that local employment will fall by 4.7 percent in 2009 and 2.8 percent in 2010, before beginning to grow about one percent annually in 2011-2013. The city sees a total peak-to-trough loss of 294,000 local jobs, which includes 46,000 high-paying securities jobs. A newly revised labor market report indicates that local jobs remained strong much later into 2008 than had been previously thought, but that job losses had become pronounced by the end of 2008, and increasingly severe at the start of 2009.

Total employment increased by 46,000 jobs or 1.2 percent in CY 2008, a far better showing than the lackluster 0.5 percent growth that had been reported previously. This piece of good news could mean some extra short term tax revenue for the city in FY 2009. However, any improvement is unlikely to persist, as severe job losses were reported at the start of CY 2009. The local unemployment rate increased to 7.3 percent in January 2009, worsening from 5.3 percent in January 2008. The city lost 60,000 jobs in January, compared with the previous year, a loss rate of 1.6 percent. The hardest hit sector was finance, which lost 20,000 jobs, of which 15,000 lost jobs were in the securities industry. Other weakening sectors were professional and business services, retail and wholesale trade, and construction, each of which lost 13,000 jobs. The long term slide of manufacturing abruptly worsened with a loss of 12,000 jobs in January, about double the loss rate of recent years.

¹ See "DiNapoli: Wall Street Bonuses Fell 44% in 2008." *News from the Office of the New York State Comptroller Thomas DiNapoli* (January 28, 2009).

Tax Revenues

Since November, the city has reduced its tax collection plan for FY 2009 by \$239 million, as shown in the figure to the right. The nonproperty tax projection is down by a recession-induced \$815 million. A \$576 million property tax increase, resulting from the cancellation of an earlier seven percent tax cut, spared the city from a far more severe revenue shortfall. The personal income tax projection is down by \$242 million and the sales tax is lower by \$194 million. The general corporation tax and the banking corporation taxes are down \$86 million and \$70 million, respectively. Partially offsetting these business tax declines is a \$71 million increase for the unincorporated business tax. The property transfer and mortgage recording taxes are down \$202 million and \$116 million, respectively, because of a severe slowdown in the local real estate market.

Change in the FY 2009 Tax Revenue Projections Since November (\$ in millions)	
Real Property Tax	\$576
Nonproperty Taxes	(\$815)
Personal Income	(242)
Sales	(194)
General Corporation	(86)
Banking Corporation	(70)
Unincorporated Business	71
Property Transfer	(202)
Mortgage Recording	(116)
Other	24
Total Change in Tax Revenue	(\$239)

EXPENDITURES

Since the November modification to the FY 2009 budget, the city generated \$347 million in expenditure savings of which \$250 million is a change in the Budget Stabilization Account. Other Than Personal Service is reduced by \$208 million due mostly to a citywide gap-closing agency program. The General Reserve was reduced by \$200 million, as is customary at this time of the fiscal year, and debt service costs were trimmed by \$28 million along with \$15 million in other miscellaneous savings. Partially offsetting these savings is a combined \$364 million in spending increases--\$242 million for Personal Service and \$122 million for Public Assistance.

Uniformed Overtime

In its latest budget modification, the city has budgeted for slightly more than \$758 million of uniformed overtime expenditures, which includes uniform and civilian personnel, for FY 2009. This current projection is approximately \$72 million more than the November modification had anticipated and almost \$87 million higher than the adopted budget. As the figure to the right shows, the bulk of the overtime spending is driven by the Police Department, which is projected to account for nearly \$390 million, or about 51 percent, of the total uniformed overtime budget. Closely behind in spending is the Fire Department, which accounts for about 31 percent of spending. In total, the Correction and Sanitation Departments account for just about 18 percent of the overall expected spending.

Uniformed Overtime Budget FY 2009 (\$ in millions)	
Police	\$389.6
Fire	233.6
Correction	70.3
Sanitation	64.8
City Budgeted OT	\$758.3

The four uniformed agencies, consisting of the Police, Fire, Correction, and Sanitation Departments, are each comprised of two elements that generate overtime spending. The main driver of overtime expense is uniformed personnel, such as police officers and firefighters, with the other being civilian personnel whose overtime costs remain relatively flat during the fiscal year budget modification process.

As mentioned earlier, the overtime budget was increased by about \$72 million in the latest modification. Of that amount, additional funding of \$36 million was required by the Police Department. Almost all of the increase, or approximately \$30 million, was the result of costs related to recent collective bargaining agreements that called for higher salaries for uniformed personnel. Also, there was an additional allocation of funds for civilian personnel of \$3 million. The Fire Department increased its uniformed budget by slightly more than \$24 million, with \$10 million of that increase related also to collective bargaining agreements and the residual accounting for federal Homeland Security grants that will be expensed as needed to cover firefighter training. The remainder of the increase in expenditures was needed in the Department of Correction to again cover additional costs related to collective bargaining. However, some of that additional funding was also needed to cover overtime driven by a lower headcount in the department.

Currently, the city has spent almost \$477 million to fund overtime expenses for both its uniformed and civilian personnel through January 2009 or seven months into the current fiscal year. We project, based on current spending levels, that the city will likely exceed its forecasted budget of \$758 million and end the fiscal year having spent more than \$817 million. Hence, we hold at risk \$59 million in FY 2009.

Department of Education

The January modification increases funding to the Department of Education (DOE) in FY 2009 by \$29.4 million over the November modification bringing the DOE's operational budget to \$17.6 billion. Over 98 percent of this increase was in General Education and Special Education. This \$17.6 billion is roughly \$600 million more than the FY 2008 close.

Within the budget there were a number of shifts of funds from one category to another. These shifts are largely due to changes in student enrollment. Support services and central office, which include pupil transportation and school food services, had funding decreased by almost \$77 million. On the other hand, nonpublic school payments, which include Carter cases, had a corresponding increase of almost \$77 million. Fringe benefits increased \$25 million which was funded by a decrease in the collective bargaining reserve.

Of the \$17.6 billion in current funding, city funds comprise \$7.3 billion, or 41 percent. The state's share in the January modification remained at \$8.5 billion, or 48 percent. The balance of the DOE budget is comprised of \$1.8 billion in federal aid, or 10 percent, \$11 million in intra-city funds, and \$66 million in other categorical funds.

III. The Financial Plan for FYs 2010-13

The January modification contains the city's preliminary FY 2010 budget and FYs 2010-13 Financial Plan. In the January modification, the city reduced its forecast for city funds by a net \$900 million in FY 2010, with a staggering \$2 billion reduction in the nonproperty taxes being partially offset by property tax increases. The city expects the major nonproperty taxes to fall by 15 percent in FY 2009 and by an additional 12 percent in FY 2010 because of the impact of the severe national recession and the locally-based finance sector downturn. The city's revenue plan is supported by a program of tax increases, which includes the repeal of \$1.5 billion in property tax cuts and a proposed sales tax increase of \$1 billion. Additionally, property tax assessments showed strong growth despite the weakness of the real estate market.

Due to the weak revenue outlook, the city has put in place an agency program for FYs 2009 and 2010, with much of the savings to the operating budget recurring over the life of the plan. The Department of Education is providing a major portion of the savings, followed by the Police Department. Even with these savings, the city is projecting budget gaps of \$3.2 billion in FY 2011, \$4.0 billion in FY 2012 and \$4.2 billion in FY 2013. The escalating cost of fringe benefits, specifically health insurance, is a driving force behind the budget gaps. Moreover, the potential exists for the outyear budget gaps to worsen if the city has to augment its pension contributions due to a continued economic downturn. If the city is to have any success in closing the outyear budget gaps, it must contain the growth in both pension and health benefits. The city has proposed a number of measures to contain these cost increases going forward, which would require approval by labor and/or the state legislature.

In addition, to address the structural imbalance of its budget, the city has taken a significant step to rein in debt service expenses, one of the largest and fastest growing components of the budget. In the January modification, the city undertook a second round of reductions to the portion of its capital plan that is funded through the sale of general obligation bonds, which lowers debt service expenses on a recurring basis and curbs growth in the share of tax revenues that is used for the payments.

It should be noted that the current modification includes \$2 billion of funds from the American Recovery and Reinvestment Act of 2009 ("Stimulus") to cover Medicaid expenses in FYs 2010 and 2011. Though all of the details are not yet available as to the total amount of funds the city will receive from the Stimulus package, particularly since some items require adoption of the state budget, the city could receive a significant amount of funds and savings over the next two fiscal years for areas such as education and Medicaid. Given that the Stimulus funds are not recurring, the city would still be required to carry out cost saving measures to deal with the large budget deficits in FYs 2011 and beyond.

REVENUE CHANGES IN THE JANUARY MODIFICATION

Citing a recession-induced tax collections downturn, the city reduced its FY 2010 projection for city fund revenues by \$927 million in the January modification, while total revenue declines by \$1.2 billion. Nonproperty taxes are down a staggering \$2 billion and unrestricted state aid is down \$86 million, as shown in the figure to the right.

The city's tax revenue plan was supported by a combination of four tax programs which are projected to yield \$2.5 billion in FY 2010. The city implemented two property tax proposals that are worth about \$1.5 billion in FY 2010, and a temporary hotel occupancy tax increase of 0.875 percent that yields \$62 million. Additionally, the city has proposed a set of sales tax increases that, if enacted, would yield about \$900 million in FY 2010, and over \$1 billion by FY 2013.

Nonproperty Taxes Reduced \$2 Billion in Plan for FY 2010	
(\$ in millions, change since Nov. Mod)	
Property Tax	\$1,511
Nonproperty Taxes	(2,044)
Tax Program	(585)
STAR Aid	8
Unrestricted Aid	(86)
Miscellaneous Revenue	261
Other City-Funded Revenue	8
City Funds	(\$927)
Categorical Aid & Other Revenue	(268)
Total Change in Revenues	(\$1,195)

The city's tax program is shown in the figure as being reduced by \$585 million. A seven percent property tax restoration worth \$1.2 billion in FY 2010, which was proposed in November, was implemented and then removed from the list of pending tax program proposals. Also, the proposed cancellation of the \$256 million property tax rebate program, which was rejected for FY 2009, is being implemented beginning in FY 2010. These property tax changes appear twice in the figure: they form most of the \$1.5 billion increase shown for property tax revenue; and they also form a negative offset to the \$900 million sales tax increase, leaving the tax program reduced by a net \$585 million.

REVENUE GROWTH RATES

The city's plan projects that total revenue will increase by \$7.2 billion to \$67.5 billion in FY 2013 from \$60.3 billion in FY 2009, for growth of 12 percent over the four-year span. City-funded revenue also grows by \$7.2 billion, which represents 18 percent growth. City funds, which fall slightly in FY 2010, rebound with seven percent growth in FY 2011 and slower growth in the outyears, as shown in Table 4 on page 13.

TABLE 4

TAX INCREASES BOOST WEAK TAX COLLECTIONS GROWTH

(percent change, \$ in millions)

	FY 10	FY 11	FY 12	FY 13	FY 09	FY 13	FYs 09-13
Property Tax	13.0%	5.7%	3.4%	2.2%	\$14,500	\$18,299	26.2%
Nonproperty Taxes	(12.6)	9.8	7.6	6.8	21,539	23,753	10.3
Tax Program	1,061.0	2.9	5.7	5.2	77	1,023	1,228.6
Miscellaneous	4.6	4.2	1.7	0.4	4,063	4,523	11.3
Nonrecurring	(88.7)	(36.8)	(36.7)	(37.2)	251	7	(97.1)
Unrestricted Aid	0.0	0.0	0.0	0.0	239	239	0.0
Total City Funds	(0.1%)	7.3%	5.2%	4.3%	\$40,669	\$47,844	17.6%
Categorical Aid*	(6.2)	2.8	1.5	2.4	\$19,172	\$19,192	0.1
Interfund Revenue	(6.7)	(1.8)	(0.7)	(0.2)	477	433	(9.2)
Total Funds	(2.1%)	5.9%	4.1%	3.7%	\$60,318	\$67,469	11.9%

*Categorical Aid is the sum of, state, federal and other categorical grants.

The property tax, which grows by 26 percent over the plan, increases from \$14.5 billion in FY 2009 to \$18.3 billion in FY 2013. The property tax grows by 13 percent in FY 2010 but growth sinks to just two percent by FY 2013. The rapid growth at the start of the plan is due to the cancellation of two property tax cut programs, and also due to the strong assessment gains estimated for commercial properties on the FY 2010 tax roll, as discussed in "The Property Tax Surges Even As Market Values Fall" beginning on page 19.

The nonproperty taxes follow a completely different growth path than the property tax. Nonproperty tax collections fall by 13 percent in FY 2010 and recover with 10 percent growth in FY 2011 and more moderate growth in the outyears. Over the four-year plan period, the nonproperty taxes are projected to grow by 10 percent from \$21.5 billion in FY 2009 to \$23.8 billion in FY 2013. Miscellaneous revenue increases by 11 percent from \$4.1 billion in FY 2009 to \$4.5 billion in FY 2013. Nonrecurring actions are projected to exceed \$250 million in FY 2009 and drop rapidly thereafter. By their nature, the amount of nonrecurring actions will change during the course of a year and are front-loaded in the plan.

Unrestricted aid, which is shown as a constant \$239 million in Table 4, consists primarily of the state's Aid and Incentives for Municipalities (AIM) program. This source of state assistance, which had been contested in previous state budgets, has again been proposed for elimination in the upcoming state budget. The city's share of this aid, which yielded \$242 million in FY 2008, had been cut to \$20 million in FY 2007. Previously, the city had been receiving a more generous allocation of \$328 million annually from the state's unrestricted aid program.

Nonproperty Taxes Turn Downward

The city projects that the major nonproperty taxes will decline by 15 percent in FY 2009 and fall by an additional 12 percent in FY 2010, on a common rate and base.²

² "On a common rate and base" or "on a continuing 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.

This steep two-year decline follows the weak one percent growth estimated for FY 2008 and marks a radical shift from the four-year growth surge extending through FYs 2004-2007, which saw the nonproperty taxes soar more than 85 percent. The business taxes and the real estate transactions taxes had already started to weaken in FY 2008. These taxes, which continue their decline into FYs 2009 and 2010, are followed down by other major taxes, including the personal income and sales taxes. Thus a tax collections slowdown, which started with a downturn in real estate transactions and with severe losses in the financial sector, is spreading to all the major nonproperty taxes.

Business Taxes. Collections for this group of taxes, consisting of the general corporation, the banking corporation and the unincorporated business taxes, fell by 10 percent in FY 2008. The city projects further declines of 15 percent in FY 2009 and eight percent in FY 2010. These three years of sinking tax receipts would bring the business tax revenue loss to \$1.8 billion, from a high of \$6 billion collected in FY 2007 to a low of \$4.2 billion projected for FY 2010. Revenue growth returns in FY 2011 with increases of about nine percent through FY 2013. In response to a year-long surge in business tax refunds, the city has enlarged its reserve for refunds by over \$100 million, to \$800 million, in FY 2009.

The banking corporation tax has been hit much harder than the other business taxes by the losses in mortgage-backed assets and the restructuring of the financial services sector. The bank tax, which plummeted by nearly 50 percent in FY 2008 is projected to fall almost 30 percent in FY 2009. The plan for this tax calls for a rebound with 28 percent growth in FY 2010, but the ongoing distress of the banking industry makes this projected strong early upturn increasingly unlikely. We therefore see a risk of \$50 million to the bank tax in FYs 2010 and 2011.

The general corporation tax (GCT), which is the largest of the business taxes, falls less steeply than the bank tax, but the slide involves a greater and a longer lasting revenue loss. In the plan, the GCT falls by \$900 million or 30 percent over the three years from \$3.1 billion in FY 2007 to an estimated \$2.2 billion in FY 2010. The two main determinants of the GCT are national corporate profits and securities industry profits, both of which are weak. National corporate profits are down by eight percent over the first three quarters of CY 2008; and the securities industry, which lost \$11 billion in CY 2007, has lost \$31 billion in the first three quarters of CY 2008. The weakness in corporate profits and the losses of Wall Street firms indicate that the city is correct in forecasting a protracted downturn for the GCT, followed by a gradual recovery.

The unincorporated business tax (UBT) is the only one of the business taxes that is showing any growth. This tax, which grew 11 percent in FY 2008, has thus far been growing at a five percent rate in FY 2009, through January. This growth reflects earnings from CY 2008, but collections could weaken later in the fiscal year when payments reflect weaker CY 2009 earnings. Noting the early strength of this tax, the city raised the UBT revenue projection by \$71 million in the January modification. The city projects that UBT will fall by six percent in FY 2009 and 16 percent in FY 2010, before beginning a gradual recovery in FY 2011. We estimate that the UBT could yield \$50 million extra in FYs 2009 and 2010.

Property Transactions Taxes. Revenue for this group, consisting of the real property transfer and mortgage recording taxes, are already sinking, with collections having fallen 23 percent in FY 2008. The city expects the transactions taxes to decline by \$1 billion, or 41 percent, to \$1.5 billion in FY 2009 from \$2.5 billion in FY 2008. Revenue falls an additional 23 percent in FY 2010. The large declines early in the plan would bring revenue down to \$1.2 billion in FY 2011 from the peak of \$3.3 billion that was collected in FY 2007, for a peak-to-trough revenue loss of \$2.1 billion.

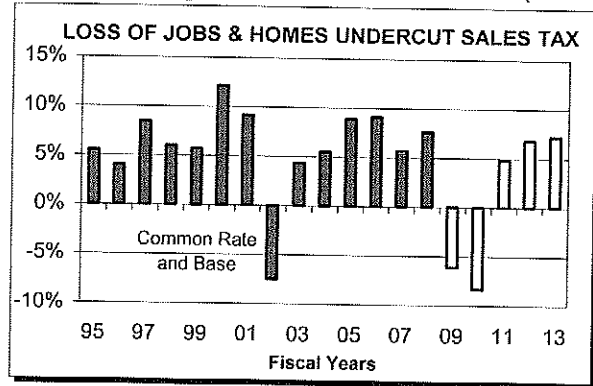
The plan projects a resumption of growth in FY 2011, with growth averaging nine percent annually through FY 2013. If the city's revenue plan is accurate, transaction tax revenue will have reached \$1.5 billion by FY 2013, which is close to the amount collected by these taxes in FY 2004.

The extremely negative city outlook is supported by current monthly collections reports, which show collections falling precipitously. Thus far in FY 2009, collections through January for the transaction taxes are down by 45 percent, which indicates a slightly steeper decline than the 41 percent drop-off that was projected by the city.

The severe slowdown in these property-related tax collections points to a freezing up of the real estate market. Many buyers and sellers seem to be waiting on the sidelines either for financing or for signs that market prices are stabilizing. Once financing does become more obtainable and transactions volume starts to turn upward, real estate prices could shift markedly from accustomed levels. The uncertainty regarding market prices could pose a risk to the transactions taxes. New federal programs offering incentives for mortgage refinancing could boost transactions and lift city mortgage tax collections.

Sales Tax. Without an indication of an end to falling home prices, rising foreclosures, tight credit, and job losses locally and nationally, consumers are likely to further reduce discretionary spending for the foreseeable future. While it is also likely that recent federal legislation that is designed to stimulate the local and national economies, recapitalize and stabilize the financial sector, forestall home foreclosures and promote mortgage refinancings will have some beneficial effects, these remedies will not have immediate positive results. Consequently, the city has presented a new sales tax forecast in the January modification that is defined by layoffs, particularly in the higher-paying securities industry, lower wages, and fewer tourists in FYs 2009 and 2010, which leads to a steep drop in revenue in both fiscal years (on a common rate and base). A delay in the recovery in the residential housing market, in terms of volume and price, until FY 2011, also serves to reduce personal consumption spending and sales tax revenue.

As seen in the figure to the right, the city expects sales tax revenue (on a continuing base) to fall by 6.1 percent in FY 2009 and by a further 8.3 percent in FY 2010.³ Underpinning the forecast are two salient facts concerning jobs and income. The first is that the city expects job losses (including the finance, and professional & business services sectors) of 175,000 in 2009 and 100,000 in 2010, with only a small recovery of 24,000 jobs or 0.7 percent annual growth in 2011. Anticipating a severe drop in finance sector compensation after 2008--from \$91.7 billion in 2008 to \$60.1 billion by 2010--total wage income is projected to fall in both 2009 and 2010. With employment growth expected to return in 2011 from a modest recovery in the local and national economies, sales tax revenue turns positive on a common rate and base and exhibits 4.8 percent growth in FY 2011, reaches 6.8 percent in FY 2012, and ends the plan period ahead by 7.2 percent by FY 2013.



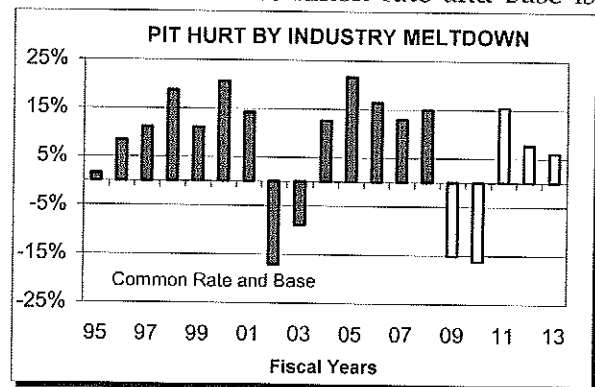
It is possible that the city's severe near-term tax and economic forecasts may come to pass. Other forecasters, such as from the Federal Reserve and the National Association for Business Economics, have spoken of an increasingly negative outlook for 2009, and better conditions or even the possibility of a recovery in 2010, if the credit and financial markets can be stabilized and begin functioning. However, any type of recovery, e.g. labor and housing markets, may be very gradual in nature and not resemble past rebounds. For example, after the September 11th attacks, sales tax revenue on a continuing base dropped by 7.4 percent in FY 2002 and achieved 4.3 percent growth in the following year. Unlike FYs 2002 and 2003, there may be comparatively little pent-up demand by consumers in the outyears of the current financial plan. After September 11th, the mood was one of guarded optimism and of rising to the challenge of rebuilding, where personal consumption was no longer artificially suppressed. In terms of the outlook for FYs 2011-13, consumers are facing the task of rebuilding their retirement funds and a new labor market, where companies and industries are restructured and at a smaller scale (e.g. automobile industry), which may lead them to continue to practice frugality in personal spending. For these reasons, the sales tax may be lower by \$75 million in FY 2011, \$150 million in FY 2012, and \$200 million in FY 2013.

Personal Income Tax. Despite unprecedented efforts by the federal government--funds, loan guarantees, and new programs sponsored by the Federal Reserve that are

³ Separate from its baseline sales tax forecast, the city presented several options in its gap-closing program to raise sales tax revenue starting in June 1, 2009 by increasing the local sales tax rate and removing the current exemption on the purchase of clothing and footwear. Either type of revenue-raising initiative would have to be approved by the state legislature before enactment. In addition, changes proposed in the recent state executive budget that would broaden the state sales tax base would also benefit the city. The city projects that the yield from all three initiatives would total \$77 million in FY 2009, \$894 million in FY 2010, \$920 million in FY 2011, \$972 million in FY 2012, and \$1,023 million in FY 2013. Since it is not clear which proposal(s) will be signed into law by the Governor, we hold the entire program at risk.

designed to reinvigorate and recapitalize the financial and credit markets, and financial services companies (e.g. banks and insurers)—current business conditions are still marked by fear over the length of the recession and possible bank insolvencies, investor pessimism, new lows in stock prices, and concern over cutbacks in consumer spending that is spurring more layoff announcements. The issue for the local finance sector has broadened from trying to estimate how much more write-offs might be forthcoming to asking for more taxpayer funds and/or changes in the federal government's equity stakes, and avoiding bank nationalization. With this backdrop in mind, the city's latest economic and personal income tax (PIT) forecast is grim in the near term for FYs 2009 and 2010 with projections of more private sector layoffs, losses in the securities industry, and sharp declines in both wage and nonwage income. Like prior forecasts, the city expects a strong turnaround in the first year after the local and national economies rebound (FY 2011), and more tempered revenue growth in the remaining outyears.

As seen in the figure to the right, PIT revenue on a common rate and base is projected to plunge 15.2 percent in FY 2009 and by an additional 16.3 percent in FY 2010 before exhibiting positive gains of 15.4 percent in FY 2011, 7.7 percent in FY 2012, and 5.9 percent in FY 2013.⁴ There are several assumptions by the city that explain the gyrations in PIT revenue growth during the forecast period. In terms of layoffs, the recession will act as a drag on the city's economy as national job losses are poised to exceed five million individuals from the fourth quarter of 2007 to the fourth quarter of 2009 (peak-to-trough). Significant job losses in the city are expected to start later and end later than the nation and total 294,000 from the third quarter of 2008 to the second quarter of 2010 (peak-to-trough).

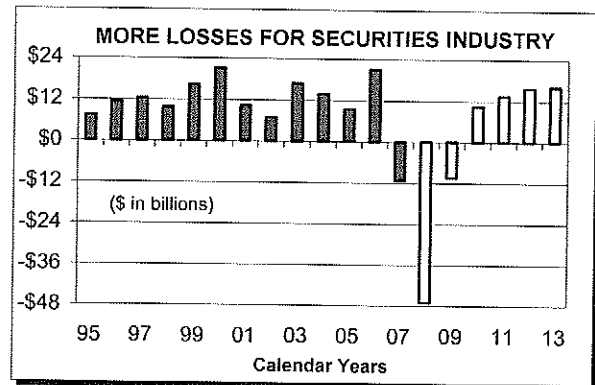


The city projects that layoffs in the securities industry started a year earlier than other industries in the third quarter of 2007 and will total 46,200 from peak-to-trough in the second quarter of 2010.⁵ Also, those still employed on Wall Street may receive over 50 percent less in the bonus payout in FY 2009 than in the prior year, and a further reduction in the bonus payout in FY 2010. After reaching a high of \$97.1 billion in 2007, finance sector compensation including bonuses is projected to fall for three straight years, from \$91.7 billion in 2008 to a plan low of \$60.1 billion in 2010, before reversing course and posting annual gains through 2013 to \$78.6 billion. The combination of employment losses in both the finance and non-finance sectors is expected to cause total wage income to fall in both 2009 and 2010, constraining withholding revenue.

⁴ The city's baseline PIT forecast does not include any revenue-raising initiatives although there have been discussions at the city and state level. For a PIT increase to be implemented for the city, state legislation would be required.

⁵ Job losses in the finance sector, of which the securities industry is a part, is expected to reach 71,900 from the third quarter of 2007 to the second quarter of 2010 (peak-to-trough).

The reason for the sharp reduction in finance sector compensation can be traced to an \$11.3 billion loss in the securities industry in 2007 and a loss of \$31.4 billion for the first three quarters of 2008. The city estimates that the damage to the securities industry will total \$47.1 billion in 2008 and \$10.4 billion in 2009. As seen in the figure to the right, profitability is not expected by the city to return to the securities industry until 2010, where there is a \$20 billion swing in profitability to \$10.3 billion in 2010. By this time, hopefully, the amount of write-downs will be minimized and a plan by the federal government to take illiquid assets (e.g. residential and commercial mortgages and related securities) off of banks' balance sheets will be in effect. After 2010, securities industry profits are forecast to rise steadily from \$13.4 billion in 2011 to \$15.9 billion by 2013.



Rounding out the problems identified by the city facing the PIT base--citywide layoffs, reduced finance sector compensation and total wage income, and securities industry losses--there is also the factor of a steep decline in nonwage income in the near term led by capital gains realizations. Capital gains occur when a financial or physical asset is sold at a higher price than originally purchased. Currently the stock market is testing new lows amid extreme volatility as the Dow Jones industrial average and the Standard & Poor's 500 indexes approach levels not seen since 1997. Recently released reports on the housing market show a continuation of steep year-over-year declines in home prices and volume, and that the only source of home sales nationwide is from distressed sales, e.g. foreclosed homes. Consequently, the city is estimating that after five years of double-digit growth from 2003 to 2007, capital gains realizations may fall by 55.9 percent or \$32.3 billion in 2008 to \$25.5 billion from the prior year, followed by a further decline of 14 percent in 2009 to \$21.9 billion. Aside from a spin-up in 2010 that is related to the expiration of lower capital gains tax rate in 2011, this revenue source is forecast to remain under \$30 billion annually.

One can make a case that the city is acting reasonably to put forth a very conservative scenario in terms of its economic and PIT forecast for FY 2009 and FY 2010, given the evidence available at the time the January modification was released and the current air of uncertainty and unease in the financial markets. It is also possible that 2010 may turn out to be a better year than 2009 for the local and national economies, but the city is wise to minimize its risk by being conservative. Yet, the real problem may be the outyear PIT forecast for FY 2011 through FY 2013, because of a fundamental change in the landscape of the financial sector and particularly for Wall Street firms. The commercial and investment banks that were around the last time PIT revenue fell dramatically in FYs 2002 and 2003 after the September 11th attacks are now either sold (e.g. Merrill Lynch), bankrupt (e.g. Bear Stearns, Lehman Brothers), exist as bank holding companies (e.g. Goldman Sachs, Morgan Stanley), or weighed down by bad investments in real estate among other areas. Several commercial banks need federal

assistance to remain solvent while they deal with write-downs on illiquid assets (e.g. mortgage-backed securities) and risky loans even before the full effects of the recession on consumer debt are realized. For these reasons, the city's PIT forecast could be lower by \$400 million in FY 2011 and \$200 million in FY 2012.

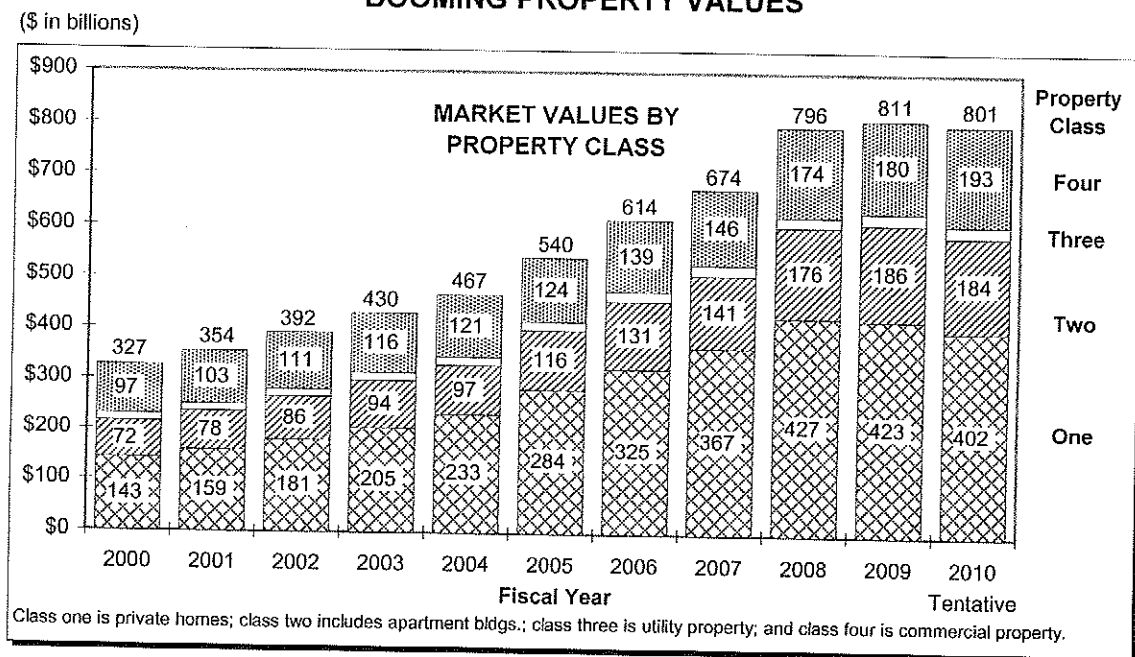
The Property Tax Surges Even As Market Values Fall

Market values fell by one percent in the city's tentative FY 2010 tax roll, following the meager two percent growth that was reported for FY 2009. These two weak market value reports mark the end of a decade-long run-up of city property values. Despite the weakness in market values, the city expects property tax revenue to surge by 13 percent in FY 2010.

The property tax strengthened in a down market because of four factors. The city repealed two property tax cuts that will yield \$1.5 billion in FY 2010. Also, commercial market values increased even as residential property values were falling. Additionally, the downward trending residential sector also produced assessment gains due to the upward momentum generated during the real estate boom. Finally, new construction, begun during the boom years, is now appearing on the tax roll and augmenting the tax base. Nevertheless, despite the FY 2010 surge in tax revenue, the decline in market values portends a weakening of the city's tax base and the stagnation of property tax revenues later in the plan period.

FY 2010 MARKET VALUE DROPS BY ONE PERCENT, ENDING A DECADE OF BOOMING PROPERTY VALUES

CHART 1



The city's recent report on the tentative assessment roll for FY 2010 shows that property values have fallen by one percent in FY 2010 to \$801 billion, from \$811 billion in FY 2009, as shown in Chart 1. This decline is the first negative report in a decade in which the value of city real estate had soared by about 150 percent from \$327 billion in

FY 2000 to a peak of \$811 billion in FY 2009. The downturn in market values affected the residential classes of property but the commercial sector continued to grow. Private home values fell by five percent to \$402 billion, while residential apartment buildings fell by one percent to \$184 billion. Commercial properties bucked the downtrend and market values grew by seven percent to \$193 billion.

Among the fastest growing sectors of the commercial market were hotels, commercial condominiums, and health and education properties, which increased by more than 15 percent. An even greater increase was logged for culture and recreation properties, which gained 25 percent. Office properties lagged with four percent growth. Store buildings fell slightly, reflecting the malaise in the retail sector.

Billable assessments accelerated to eight percent growth in FY 2010, from a 6.8 percent increase in FY 2009. The city estimates that by June, corrections to the tentative roll will reduce the billable growth rate on the final FY 2010 tax roll to 6.9 percent, which would be approximately the same growth rate as the previous year. The city projects that billable growth rate will decline from 6.9 percent in FY 2010, to five percent in FY 2011, 3.5 percent in FY 2012, and two percent in FY 2013. Thus, the real estate tax would cease to be the steady and reliable source of revenue growth that it had been for the past decade.

Despite the softening of the residential market, billable assessments for private homes increased by four percent. After years of rapid growth, many homes remain below the city's six percent assessment ratio target; and these homes can be assessed upward even in a down market. Apartment building assessments increased by a very strong eight percent growth rate. Commercial properties, which recorded market value growth of seven percent, had an even stronger assessment gain of 10 percent.

Assessments for these properties grew faster than the market largely due to unused market value increases left over from previous high-growth years. This reservoir of unused market value increases, often called the pipeline, can effectively sustain property tax growth in a flat market. In a sharply falling market, however, the pipeline cannot be counted on to deliver tax revenue growth.

Most properties in the city decreased in market value. There were 277,000 properties that increased in value due to market changes, versus 714,000 properties that decreased in value. This downtrend was most pronounced for private homes, which had 111,000 properties that increased versus 573,000 that decreased. Apartment properties were more evenly divided, with 108,000 increases versus 113,000 decreases. Most commercial properties tended higher, with 57,000 increases versus 28,000 decreases. This data shows that some of the pipeline of past market value increases for commercial and large apartment properties could be lost. This could happen because market value decreases can often have an immediate effect on assessments, whereas increases have a delayed impact due to the five-year phase-in rule for these property types.

Another important factor behind rising tax revenues is the real growth of the tax base due to newly constructed buildings being added to the tax base. The residential housing stock increased by 24,000 units, or 0.8 percent in FY 2010. The rental apartment

sector, with 1.5 percent growth, accounted for nearly all of the residential increase, indicating weakness in the market for condominiums and cooperative apartments. Some smaller segments of the market are also showing growth. Condops increased by 2.7 percent and small-home condominiums are up 1.5 percent.

Commercial space expanded by about 26,000,000 square feet, or 2.1 percent. Office space surged by 16,000,000 square feet or 4.1 percent, while health and educational buildings increased by about 5,000,000 square feet, or 14 percent. Hotels expanded by over 7,000,000 square feet, or 14 percent and commercial condominiums expanded by 4,000,000 square feet, or 4.1 percent. About 5,000,000 square feet of loft space were removed from the tax rolls, equivalent to a decline of seven percent. Also declining were factory buildings, which lost about 4,000,000 square feet, shrinking this sector by about four percent.

This data suggests that most of the market value increases reported this year for offices, hotels, and health and educational buildings, is attributable to new construction rather than to market price appreciation. Although these new properties represent permanent additions to the tax base, they do not augment the pipeline of unused past market value increases. We see assessment growth falling short of expectations, resulting in a property tax risk of \$100 million in FY 2011, \$200 million in FY 2012 and \$300 million in FY 2013.

Miscellaneous Revenue

At first glance, the city's FY 2010 miscellaneous revenue forecast appears to show only a small year-over-year decline of less than one percent, but that view obscures new activities and priorities within miscellaneous revenue. If we look at the core categories, FY 2010 revenue is projected to spurt 9.6 percent or \$236.3 million (to \$2.7 billion) over the prior year's estimate primarily because of new initiatives in the fine and other miscellaneous categories, despite a nose dive in interest income.⁶ After FY 2010, core category revenue is anticipated to grow 5.8 percent in FY 2011 and 2.4 percent in FY 2012, and to remain at the \$2.9 billion level in FY 2013.

Fine revenue is projected to soar 28.5 percent in FY 2010 to over \$1 billion from the FY 2009 estimate of \$782.1 million, largely due to an increased emphasis on code enforcement related to the environment, buildings, food service establishments and, particularly, vehicular traffic. For example, the city plans to add 20 red light cameras at existing monitoring locations that will be positioned opposite existing cameras. Also, the city is seeking state permission to exceed the current limit of 100 red light cameras at intersections and to double the amount of the fine from \$50 to \$100 per violation. If successful on all fronts, the total amount of revenue produced by the red light camera

⁶ The core categories are licenses, fees or charges, interest, rent, fines, and a residual miscellaneous category (less nonrecurring actions, housing revenue, 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.

program will reach \$172.1 million in FY 2010, \$225.1 million in FY 2011, \$287.9 million in FY 2012, and \$286.9 million in FY 2013.

Another major initiative, designed with the intention to change individual behavior, involves a new fee that is largely responsible for propelling the other miscellaneous category in FY 2010 by 36.9 percent or \$91.2 million to \$338.4 million. The city is requesting state legislation to levy a five-cent fee to encourage consumers to switch from plastic to reusable bags. If approved by the state legislature, the measure is expected to yield \$100 million in FY 2010, \$160 million in FY 2011, and \$140 million in both FYs 2012 and 2013.

Despite the variety of short-term investment vehicles accessible to the city to earn interest on available cash balances, the interest income forecast is often quite dependent upon the interest rate policy of the Federal Reserve.⁷ On December 16, 2008, the Federal Reserve decided to establish a target range for the federal funds rate of 0 to .25 percent, which prompted the city to lower the FY 2010 interest income forecast by 78.1 percent or \$70.5 million to \$19.8 million. Past FY 2010, the city expects short-term interest rates to begin to trend upward during the plan period, causing interest income to rise from \$94 million in FY 2011 to \$142.5 million by FY 2013.

SOURCES OF EXPENDITURE GROWTH

The city's projected spending growth between FYs 2009 and 2013 is 17.8 percent, with total spending reaching \$71.2 billion in the final year of the plan, as shown in Table 5 on page 23. Personal Service (PS) increases 11.9 percent between FYs 2009 and 2013. The growth in Salaries and Wages is projected at 6.9 percent or almost \$1.5 billion by FY 2013.

Fringe benefit costs increase by 2.2 percent between FYs 2009 and 2010. Between FYs 2009 and 2013, fringe benefit expense increases 22.1 percent from approximately \$6.3 billion to just over \$7.7 billion mostly due to increasing health insurance costs. The city's pension contribution increases 18.7 percent between FYs 2009 and 2013. Most of the growth is between FYs 2010-11 at 8.3 percent. This additional spending is due to salary increases and benefit enhancements reached through recent collective bargaining agreements and the phase-in of prior-year investment losses. The growth rate slows somewhat to 3.6 percent between FYs 2011 and 2012 and 3.8 percent between FYs 2012 and 2013. In FY 2013, pension costs will be over \$7.4 billion. These pension projections incorporate the impact of a 5.4 percent investment loss that occurred in FY 2008. The financial plan is also assuming an additional 20 percent loss by June 30, 2009.

Under the Other Than Personal Service (OTPS) category, both debt service and Medicaid increase between FYs 2009 and 2013. Debt service increases 54.4 percent from over \$4.3 billion in FY 2009 to almost \$6.7 billion in FY 2013, driven largely by over 22 percent growth from FYs 2010 to 2011. Under Title V – State Fiscal Relief of the federal

⁷ The amount of cash available for investment, separate from funds set aside to maintain balances to offset city banking fees, is also a factor in determining the city's interest income forecast.

American Recovery and Reinvestment Act of 2009, there will be a two-year temporary increase in the Federal Medical Assistance Percentages (FMAP) beginning in FY 2010. The FMAP will be increased from 50 percent to 56.2 percent. The city expects to receive \$2 billion in Medicaid expense relief over the two-year period.⁸ Thus Medicaid expense decreases 15.7 percent between FYs 2009 and 2010. Once the FMAP returns to its prior level, Medicaid will show an increase of 23.9 percent between FY 2011 and FY 2012. Between FYs 2010 and 2011 there is an increase in Medicaid expense of 3.4 percent and an increase of three percent between FYs 2012 and 2013. This moderate growth is due largely to the cap imposed on the city's Medicaid costs by the state. Public Assistance is projected to remain at the \$1.3 billion level between FY 2009 and FY 2013.

TABLE 5 THE CITY'S EXPECTED EXPENDITURE GROWTH BETWEEN FYs 2009 AND 2013
(yr/yr percent change, \$ in millions)

	FYs 2009-10	FYs 2010-11	FYs 2011-12	FYs 2012-13	FYs 2009-13	Level in FY 2009	Level in FY 2013
Total Expenditures	(2.1%)	10.4%	5.2%	3.7%	17.8%	\$ 60,433	\$ 71,202
Total PS	0.2%	5.1%	2.1%	4.1%	11.9%	\$ 33,963	\$ 38,010
Salaries and Wages	(0.9)	5.5	1.0	1.2	6.9	21,391	22,869
Fringe Benefits	2.2	0.8	4.1	14.0	22.1	6,314	7,712
Pensions	1.9	8.3	3.6	3.8	18.7	6,259	7,429
Total OTPS	(5.1%)	17.4%	9.0%	3.3%	25.4%	\$ 26,470	\$ 33,192
Public Assistance	(1.0)	0.0	0.0	0.0	(1.0)	1,313	1,299
Medicaid	(15.7)	3.4	23.9	3.0	11.1	5,644	6,270
Debt Service	12.2	21.9	8.0	4.5	54.4	4,311	6,657
Other OTPS	(6.5)	22.2	5.8	3.1	24.8	15,202	18,965

Note: Includes city, state, and federal funds. Total Expenditures exclude Intracity Funds and Interfund Agreements. Numbers may not add due to rounding.

Uniformed Overtime

In "Uniformed Overtime" beginning on page 9, we discussed the city's projection that the uniformed departments' overtime budget in FY 2009 will likely exceed a spending level of more than \$758 million after increasing by \$72 million from the November modification.

In its January modification, the city has proposed overtime savings of about \$3 million in the Department of Correction in each of FYs 2010 to 2013 which will be achieved by compressing visitation schedules. There are also expected savings in the Department of Sanitation due to outsourcing security on Sundays and holidays that is projected to save nearly \$1.9 million in each of FYs 2010 to 2013. The Police and Fire Departments have not identified any overtime cost savings measures in the financial plan and have both required additional funding to compensate for expected higher overtime costs related to recent collective bargaining agreements.

⁸ On March 4, 2009, the state published a press release indicating that the city will be receiving \$1.9 billion in FMAP funding over 27 months beginning in state fiscal year 2008-2009.

In the outyears of the financial plan, the city estimates that overtime expenses will likely increase from the initial projections in the November modification by approximately \$47 million in FY 2010 and about \$51 million in each of FYs 2011 and 2012. As shown in Table 6, the city projects it will spend \$713 million in FY 2010, \$734 million in FY 2011, and \$736 million in each of FYs 2012 and 2013.

TABLE 6

TOTAL UNIFORMED OVERTIME BUDGET FOR FYs 2010-13
(\$ in millions)

	FY 2010	FY 2011	FY 2012	FY 2013
Police Department	\$374.1	\$390.8	\$390.7	\$390.9
Fire Department	214.0	213.5	213.3	213.2
Department of Correction	65.4	65.9	66.2	66.2
Department of Sanitation	59.8	64.2	65.2	65.2
City Budgeted Overtime	\$713.4	\$734.3	\$735.5	\$735.6
FCB Projected Overtime	817.2	817.2	817.2	817.2
Under / (Over) Budget	(\$103.9)	(\$82.9)	(\$81.8)	(\$81.6)
Note: Numbers may not add due to rounding.				

Based on an analysis of actual uniformed and civilian overtime spending by the four departments since the beginning of FY 2009, we are anticipating risks to the overtime budget in the outyears of the financial plan. We project an increased level of spending in all years of the financial plan with \$104 million more in FY 2010, \$83 million in FY 2011, and \$82 million in each of FYs 2012 and 2013, as shown in Table 6. The city historically underestimates its overtime budget at the beginning of each fiscal year and increases it with each budget modification based on the current level of spending. As this action occurs, the projected overtime risk to the city is mitigated.

Pension Costs

In the city's latest budget modification, pension costs are expected to increase by more than \$1 billion (city funds) over the life of the financial plan. The increase in annual costs reflects the severity of an economic downturn that has caused the stock market to decline precipitously over the last two fiscal years. In addition to accounting for investment losses, the increase in costs also includes an updated contribution valuation. However, from the November modification to the January modification, pension costs have been reduced through a number of cost-containment initiatives.

TABLE 7

NOVEMBER MODIFICATION TO JANUARY MODIFICATION CHANGES
(\$ in millions, city funds)

	FY 2010	FY 2011	FY 2012	FY 2013
Nov Mod Projections	\$6,727.5	\$7,100.0	\$7,466.0	\$7,853.5
Headcount Changes			(107.4)	(108.1)
Valuation Update	362.6	300.6	326.0	235.3
Reserve Adjustments	(364.1)	(507.4)	(684.1)	(860.1)
Audit Adjustment	(200.0)			
FY 09 Investment Loss		188.0	347.0	513.0
Investment Fees		(35.0)	(55.0)	(75.0)
Noncity Systems	(1.0)	4.0	6.0	11.0
Tier 5 Savings	(200.0)	(200.0)	(200.0)	(200.0)
Savings Subtotal	(\$402.5)	(\$249.8)	(\$367.5)	(\$483.9)
Jan Mod Projections	\$6,325.0	\$6,850.2	\$7,098.5	\$7,369.6

As shown in Table 7 on page 24, the city has targeted a number of cost-saving measures in its financial plan that are expected to reduce pension costs in each year of the plan. The city proposes to create a Tier 5 for new city employees that will save \$200 million each year. If implemented, this recurring annual savings is expected to add up to billions of dollars in pension cost-containment over the next 20 years. Other important initiatives are audit savings of \$200 million in FY 2010, reduced investment fees totaling \$165 million in FYs 2011 through 2013, and savings of \$107 million and \$108 million in FYs 2012 and 2013, respectively, occurring from city-wide headcount reductions. Additionally, the city has adjusted for funds allocated to an updated valuation of the city's annual pension contribution. This adjustment reduces pension costs to reflect funds included in the valuation update.

The city has also accounted for expenses which will diminish the impact of proposed savings. As shown on the table, the city has added additional funds to cover projected investment losses of 20 percent for FY 2009. These added funds are in addition to funds allocated in the November plan that covered losses anticipated to be no more than eight percent. With updated loss projections, the city has allocated an additional \$188 million to cover losses phased-in in FY 2011, \$347 million in FY 2012 and \$513 million in FY 2013.

The city accounts for valuation updates when necessary to adjust their annual contribution. In this latest valuation update, the city has adjusted for changes in actuarial assumptions, collective bargaining settlements and asset losses from FY 2008. The total of these adjustments are \$363 million, \$301 million, \$326 million and \$235 million in FYs 2010, 2011, 2012, and 2013, respectively. Accounting for the valuation updates, investment losses, and technical adjustments, the city projects to reduce pension costs by \$403 million in FY 2010, \$250 million in FY 2011, \$368 million in FY 2012, and \$484 million in FY 2013.

Earlier, we mentioned that the city had allocated additional funds to cover expected losses of 20 percent for FY 2009. The allocation is an adjusted amount to cover a greater investment loss than had been expected at the release of the November modification. The city's target loss of 20 percent may be underestimated given the worsening conditions in the equity markets. We project that losses could top 30 percent based upon current market data. A loss of this magnitude would result in an actuarial asset value loss of about 38 percent. The actuarial loss includes the required rate of return on assets of eight percent plus the actual investment loss realized of 30 percent.

Quantifying the impact of a loss of this size in dollar terms, the pension systems' assets could fall by nearly \$40 billion. However, the city has cost-sharing plans with many of the pension systems that mitigate the cost of funding the loss. Additionally, the city is able to phase in losses over a six-year period at 15 percent for the first four years and 20 percent thereafter with a cumulative phase-in of 15 percent, 30 percent, 45 percent, 60 percent, 80 percent and 100 percent. Our analysis projects that the city will need to phase in losses of \$576 million starting in FY 2011 to cover a loss of 30 percent. The phase-in amount will grow to about \$1.2 billion in FY 2012, and more than \$1.7 billion in FY 2013. The city has provided funding in both the November and January modifications to cover losses for 20 percent. In total, the city has allocated resources of \$431 million in FY 2011, \$794 million in FY 2012, and about \$1.2 billion in FY 2013.

Retiree Health Benefits Trust Fund

As noted in the November modification, the city is planning to reduce the funding allocated to the Retiree Health Benefits Trust (RHBT) by \$82 million in FY 2010, \$395 million in FY 2011, and \$672 million in FY 2012, which would have funded other post-employment benefits paid to retirees. The reduction of funding would require a drawdown of the RHBT by more than \$1.1 billion. The drawdown and reallocation of funds are intended to help offset investment losses expected in FY 2009. The city does not plan to make any additional drawdowns to the RHBT beyond FY 2012.

Collective Bargaining and Labor

With substantial budget gaps remaining in FYs 2011 to 2013, and with costs for both pensions and healthcare increasing at an unsustainable rate, the city has proposed two substantial cost-containment measures in its latest budget modification that will directly affect municipal workers and retirees. If achieved, these initiatives are expected to save the city billions, cumulatively, in the fiscal years ahead and more than \$750 million in FY 2010. The success of these proposals depends on acceptance by the city's labor unions and the state legislature.

The first of these proposed initiatives is a 10 percent cost-sharing healthcare contribution to be made by active and retired city workers to partially offset the cost of their healthcare insurance. Currently, active city workers and retirees do not pay for basic healthcare coverage, however, those who opt for better coverage do contribute for the additional cost. The basic coverage averages about \$8,500 annually thus a 10 percent contribution would average \$850 for the year or about \$32.39 per bi-weekly paycheck for a city worker. In total, the city expects to save \$357 million in FY 2010 in addition to a targeted \$200 million in savings expected from health insurance restructuring which was included in the adopted budget. It is anticipated that savings from the 10 percent contribution will grow to \$386 million in FY 2011, \$418 million in FY 2012 and \$453 million in FY 2013, if this cost-saving measure is implemented.

The second proposal concerns pension cost 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 over the course of the financial plan and, cumulatively, would save the city about \$16 billion over the next 30 years. The state, at the request of the Mayor, has also included this same savings proposal in its FY 2009 – 2010 budget as a means to produce recurring savings in its pension costs.

Currently, Tier I and Tier II member contribution rates are based upon age at membership and retirement plan election. Tier III and Tier IV members make annual contributions of three percent of salary to the pension system regardless of age at membership and they are not required to make annual contributions after the 10th anniversary of their membership date or completion of ten years of credited service, whichever is earlier. Certain members of the New York City Employees' Retirement System (NYCERS), the Teachers' Retirement System (TRS) and the Board of Education

Retirement System (BERS) also make additional member contributions.⁹ Additionally, the city allows retirement with full benefits after 20 years of service for uniformed personnel and at the age of 55 or greater for all other employees.

The newly created Tier 5 would require all newly hired city employees to contribute three percent of their salary annually to the pension system during all years of service. Also, the minimum retirement age would increase to 62 from the current age of 55. Further, uniformed workers' new minimum retirement age will be 50 and retirement with full benefits will be after 25 years of service.

The city's labor reserve, which is used to fund collective bargaining agreements, contains the funding needed for the latest round of contract agreements. The reserve also includes funding for nonuniformed contracts beyond FY 2010 whose wage increases are assumed to be 1.25 percent per year.

Also, as mentioned in "Uniformed Overtime" on page 9, much of the overtime budget's increase for FY 2009 and the outyears of the financial plan, were generated by the reopening of a number of contract agreements that called for higher wage increases. The reopeners were tied to clauses in those agreements and were triggered by the latest Patrolmen's Benevolent Association's (PBA) contract deal. These additional wage increases have also been funded by the labor reserve. However, the overtime increases require the city to allocate additional resources to cover the expected rise in overtime spending.

Medicaid

Under Title V - State Fiscal Relief of the federal American Recovery and Reinvestment Act of 2009 there will be a two-year temporary increase in the Federal Medical Assistance Percentages (FMAP) beginning in FY 2010. The FMAP will be increased from 50 percent to 56.2 percent. The city expects to receive \$2 billion in Medicaid expense relief over the two year period.¹⁰

The city's estimates for Medicaid costs throughout the life of plan are projected to go from \$5.6 billion in FY 2009 to almost \$6.3 billion in FY 2013. Between FYs 2009 and 2010 Medicaid expense will decrease by 15.7 percent due to the influx of additional stimulus funds and then return to prior levels increasing by 23.9 percent between FYs 2011 and 2012. Between FYs 2010 and 2011 there is an increase in Medicaid expense of 3.4 percent and an increase of three percent between FYs 2012 and 2013. This moderate growth is due largely to the cap imposed on the city's Medicaid costs by the state.

⁹ Report of the Comptroller for Fiscal 2008.

¹⁰ On March 4, 2009, the state published a press release indicating that the city will be receiving \$1.9 billion in FMAP funding over 27 months beginning in state fiscal year 2008-2009.

Department of Education

The January modification projects the Department of Education (DOE) budget to rise from \$17.3 billion in FY 2010 to \$19.2 billion in FY 2013. This is a decrease since the November modification where the FY 2010 budget was \$18.3 billion and FY 2013 was \$20.5 billion. As shown in Table 8, Personal Service (PS), which includes Salary and Wages and fringe benefits, is where the majority of the reductions occur, going from a decrease of \$840 million in FY 2010 to \$1.2 billion in FY 2013 with the largest decrease of \$1.3 billion in FY 2012. The Other Than Personal Service (OTPS) cuts are much smaller and their size decreases in each year of the plan, going from \$140 million in FY 2010 to \$93 million in FY 2013. Most of the major reductions are in General Education Instruction & School Leadership with smaller cuts in Support Services and Central Office. The major portion of these cuts is in state funds with a decrease from the November modification of \$720 million in FY 2010, \$1.1 billion in FY 2011 and \$1.2 billion in FY 2012.

TABLE 8

	FY 2010	FY 2011	FY 2012	FY 2013
January PS	\$12,036	\$12,755	\$12,741	\$12,973
November PS	12,876	13,982	14,087	14,195
Increase/(Decrease)	(840)	(1,227)	(1,346)	(1,222)
January OTPS	\$5,280	\$5,676	\$5,921	\$6,193
November OTPS	5,420	5,814	6,040	6,286
Increase/(Decrease)	(140)	(138)	(119)	(93)
January Total	\$17,316	\$18,431	\$18,662	\$19,166
November Total	18,296	19,796	20,127	20,481
Increase/(Decrease)	(980)	(1,365)	(1,465)	(1,315)

In FY 2013 the DOE budget of \$19.2 billion is comprised of city funds of \$8 billion, or 42 percent, state aid of \$9.3 billion, or 48 percent, and federal funds of \$1.8 billion, or just over 9 percent. There is also \$9 million in intra-city funds and \$51 million in other categorical funds.

The January 2009 Agency Program proposes slightly over \$306 million in DOE city-funded expense reductions in FY 2010. Almost \$113 million of these reductions are due to an initiative that takes down surpluses in food, transportation and fringe benefits. Slightly over \$91 million will be due to PS cuts to schools which will entail not filling 1,440 vacancies created by attrition. An additional \$29 million is expected to be realized by OTPS reductions in individual school budgets. All \$306 million of the expense reductions recur throughout the life of the plan.

Once the state budget is enacted on April 1, 2009, if the projected reductions to education aid remain, the city projects that it will have to lay off 13,930 teachers with an additional 260 positions being eliminated through attrition.

Though all of the details are still unknown the city expects that the federal American Recovery and Reinvestment Act of 2009 ("Stimulus") will provide it with

significant education aid over the next two fiscal years and eliminate the need for most of the projected layoffs. The city projects receiving \$535 million, passed through the state, in each of FYs 2010 and 2011. The Stimulus is also expected to provide other education funding which will flow directly to the city during FYs 2010 and 2011:

- \$555 million through Title 1 funding for high-needs students.
- \$229 million through Individuals with Disabilities Education Act funding.
- \$37 million for education technology.

This Stimulus funding for education will not contribute to the city's closing of its budget gap for FY 2010, but rather would offset the proposed reductions in state aid.

January 2009 Agency Programs

In the January modification the city has proposed additional measures to decrease the gap. As shown in Table 9, the FY 2009 program consists of \$14 million in expense reductions and \$24 million in increased revenues. The FY 2010 agency program consists of \$750 million in expense reductions and \$168 million in increased revenues. Of these two amounts approximately \$839 million or 91.4 percent are of a recurring nature. It is important to note that these agency programs could be altered once the details of the American Recovery and Reinvestment Act of 2009 ("Stimulus") and its impact on the city's financial plan becomes known.

In FY 2010, the Department of Education has the largest amount of savings with approximately \$306 million. These savings are spread across a number of individual initiatives which are discussed in more detail in "Department of Education" on page 28 of this report.

TABLE 9 (\$ in millions) **THE CITY'S JANUARY 2009 AGENCY PROGRAMS**

<u>Department</u>	<u>FY 2009</u>		<u>FY 2010</u>	
	<u>Expenditures</u>	<u>Revenues</u>	<u>Expenditures</u>	<u>Revenues</u>
Education	\$4	---	(\$306)	---
Police	8	---	(93)	---
Children's Services	---	---	(45)	---
Social Services	(12)	---	(45)	---
Fire	---	---	(39)	---
Sanitation	---	---	(35)	---
Transportation	(1)	(8)	(3)	(28)
Health & Mental Hygiene	---	---	(18)	(7)
Homeless Services	---	---	(20)	---
Correction	---	---	(18)	---
Parks & Recreation	---	---	(14)	(4)
Youth & Community Dev	---	---	(12)	---
Procurement Savings	---	---	---	---
Fleet Reduction	---	---	---	---
Plastic Bag User Fee	---	---	---	(84)
Data Mining	---	---	---	---
Other Agencies	(13)	(16)	(102)	(45)
Total	(\$14)	(\$24)	(\$750)	(\$168)

Note: Negative numbers represent a reduction in the city's budget gap.

The Police Department plans to reduce expenses by approximately \$93 million in FY 2010 of which almost \$49 million will result from a reduction in uniformed headcount by 1,000. An additional \$10 million will be realized by a reduction through attrition of 342 civilian vacancies.

The Administration for Children's Services is forecasting expense reductions totaling \$45 million in FY 2010. The largest savings will be approximately \$8 million due to staff reductions in Family Permanency and the streamlining of operations in Family Support Services. Almost \$8 million will be saved because of operational efficiencies resulting in agency-wide staff reductions in administration and child care. The Administration will reduce low-priority child care for families that do not have a mandate for care which will realize savings of slightly over \$7 million.

Expense reductions in the Department of Social Services in FY 2010 are slightly over \$45 million. Of this amount, approximately \$12 million are savings derived from the elimination of 379 vacant positions throughout the Department. Reimbursement for medical evaluations used to assess Cash Assistance clients' employability and to diagnose and document any disabilities will save over \$6 million.

The Fire Department is proposing almost \$39 million in expense reductions. The largest reduction is over \$16 million due to the elimination of the manning of 12 companies in dual company firehouses where the remaining company will continue to be fully staffed. Over \$3 million will be realized through the elimination of 30 Basic Life Support ambulance tours.

The Department of Sanitation plans to reduce expenses by \$35 million in FY 2010, of which \$20 million will be saved due to the reestimate of the waste export contract budget. An additional expense reduction of \$9 million will be due to a cut in the Fresh Kills Landfill closure budget.

The largest projected increase in FY 2010 revenues is \$84 million as seen in Table 9 on page 29. The city expects to raise this revenue through proposed legislation to impose a five cent fee on plastic bag usage to encourage consumers to switch to reusable bags. The Department of Transportation proposes to collect additional revenue of almost \$17 million from an increase in rates for single-space meters from 50 cents to 75 cents an hour. In FY 2010, over \$102 million in expense reductions and \$45 million in revenue increases will be spread across a number of city agencies.

TABLE 10 (\$ in millions)

THE CITY'S AGENCY PROGRAMS SINCE JANUARY 2008

Department	FY 2009		FY 2010	
	Expenditures	Revenues	Expenditures	Revenues
Education	(\$479)	---	(\$944)	---
Police	(163)	(10)	(315)	(76)
Sanitation	(89)	(23)	(106)	(37)
Children's Services	(76)	---	(142)	---
Social Services	(65)	(1)	(114)	---
Fire	(50)	(12)	(96)	(35)
Transportation	(25)	(29)	(34)	(53)
Finance	(7)	(40)	(18)	(47)
Health & Mental Hygiene	(30)	(9)	(54)	(18)
Citywide Admin Services	(8)	(27)	(12)	(22)
Homeless Services	(32)	---	(56)	---
Parks & Recreation	(14)	(17)	(34)	(20)
Correction	(30)	---	(74)	---
Procurement Savings	(56)	---	(111)	---
Fleet Reduction	---	---	(20)	---
Plastic Bag User Fee	---	---	---	(84)
Data Mining	---	(2)	---	(25)
Other Agencies	(275)	(75)	(438)	(97)
Total	(\$1,399)	(\$245)	(\$2,568)	(\$514)

Note: Negative numbers represent a reduction in the city's budget gap.

As shown in the table above, since January 2008 the city has taken more than \$1.6 billion, or eight percent, in agency actions in FY 2009 and almost \$3.1 billion, or 14.7 percent, in FY 2010.

RISKS AND OFFSETS

Our evaluation of the city's financial plan is shown in Table 3 on page 5. We project an increase in nonproperty tax revenue of \$50 million in FY 2009, and decreases of \$500 million in FY 2011 and \$350 million in FY 2012 and \$200 million in FY 2013. We also project shortfalls in property tax revenue, due to uncertainty regarding property values, of \$100 million in FY 2011, \$200 million in FY 2012 and \$300 million in FY 2013. We estimate that uniformed services overtime, based on our analysis and historical growth rates, will exceed what the city has budgeted by \$59 million in FY 2009, \$104 million in FY 2010, \$83 million in FY 2011 and \$82 million in each of FYs 2012 and 2013.

In April 2008 the city requested and the Financial Control Board granted a deferral of budgetary implementation of Statement 49 of the Government Accounting Standards Board (GASB), which requires specific pollution remediation costs that currently are categorized as capital items to be accounted for in the expense budget. Due to this deferral the city is to begin funding pollution remediation projects in FY 2011 in its expense budget instead of the capital budget. The city estimates this could cost up to \$500 million annually. The city has engaged the accounting firm of KPMG to determine exactly what the impact would be of implementing GASB 49. The funding is not included in the current financial plan.

The city has proposed a sales tax program as a revenue-raising initiative but since it is not clear what parts of the program will be enacted, we hold the entire program at risk at \$77 million in FY 2009, \$894 million in FY 2010, \$920 million in FY 2011, \$972 million in FY 2012 and \$1 billion in FY 2013. The city is proposing that a 10 percent healthcare contribution be made by active and retired city workers. This proposal will add savings to those already projected from a restructuring of the health plan. Since both of these proposals will need approval from the city's organized labor we hold at risk \$557 million in FY 2010, \$586 million in FY 2011, \$618 million in FY 2012 and \$653 million in FY 2013. The city hopes to achieve pension savings of \$200 million beginning in FY 2010 and continuing throughout the life of the plan. These savings are expected to be realized through the creation of a Tier 5 pension plan for newly employed city workers which will need approval by the state legislature.

The financial plan assumes the restoration of state revenue sharing, Aid and Incentives for Municipalities (AIM), at the FY 2008 level of \$242 million annually throughout the plan. The city has proposed that stores charge customers a five cent fee for each plastic carryout bag from which the city expects revenue of \$100 million in FY 2010, \$160 million in FY 2011 and \$140 million in each of FYs 2012 and 2013. This program will require state legislation.

We now estimate that the city will have a possible budget gap of \$328 million in FY 2009. If there are no additional actions, the city would have to reduce the \$1 billion Budget Stabilization Account which would increase the size of the gap in FY 2010. The city also faces possible gaps of almost \$2.1 billion in FY 2010, \$6.5 billion in FY 2011, over \$7.3 billion in FY 2012 and 7.5 billion in FY 2013.

MANAGING CITY DEBT SERVICE COSTS

The city has taken a significant step to address the structural imbalance of its budget by reining in debt service expenses, one of the largest and fastest growing components of the budget. In the January modification, the city undertook a second round of reductions to the portion of its capital plan that is funded through the sale of general obligation (g.o.) bonds, which will lower debt service expenses on a recurring basis. Annual g.o.-funded debt service projections have also been reduced as a result of the city utilizing a new model for the calculation that more closely reflects the debt-structuring methodology currently in use. The lower combined debt service costs yield annual savings to the city's budget that grow to \$236 million in FY 2013, compared to the November modification. This helps to mitigate the impact of a \$715 million reduction in tax revenues now forecasted for FY 2013 and curbs the share of tax revenues that is allocated for debt service to under 16 percent.

Capital Program Reduction

In the January 2009 Financial Plan, the city announced that it will reduce its large pool of authorized capital projects funded with g.o. bonds by 30 percent for each of the ten years commencing FY 2010. From the large pool of authorized contracts, the city assembled a capital plan of targeted commitments that is based on practical schedules and programmatic considerations. The targeted capital plan, which totals \$23.7 billion

for FYs 2009-2013, was reduced by 22 percent in FYs 2010-2013 when factoring in unattained commitments from FY 2009. Beyond FY 2013, the final year of the financial plan, targeted commitments are slated to be reduced by 30 percent in each year through FY 2019.

These reductions to the capital program represent the second round of cuts that the city made within the past year. When the executive budget was released last May, the city announced a 20 percent deferral of capital projects funded with g.o. bonds from each of FYs 2009-2012 to FY 2013. The city has now cut a combined total \$5 billion of capital commitments for FYs 2009-2013 since the January 2008 Financial Plan, as illustrated in the figure to the right.

Reduction in January 2009 G.O. Capital Commitments Compared To January 2008 (\$ in millions)				
FYs	Jan 2009	Jan 2008	\$ Change	% Change
2009	\$8,068	\$8,929	(\$861)	(9.6%)
2010	5,479	6,398	(919)	(14.4%)
2011	3,797	5,313	(1,516)	(28.5%)
2012	2,705	4,215	(1,510)	(35.8%)
2013	<u>3,628</u>	<u>3,799</u>	<u>(171)</u>	<u>(4.5%)</u>
Total	\$23,677	\$28,654	(\$4,977)	(17.4%)

At the time the current plan was released, the city had not identified the specific g.o.-funded capital projects that will be affected. The city expects to release a final Ten-Year Capital Strategy for FYs 2010-19 that will reflect the cuts.¹¹ For now, the city has simply assumed that the 30 percent cut would be applied across all project areas.

In the current plan, environmental protection capital projects that are funded with revenue bonds sold by the New York City Water Authority remained largely unchanged in dollar value at \$8.9 billion for FYs 2009-13. Meanwhile, noncity-funded capital contracts have been scaled back by a net \$1.15 billion and now total \$8.3 billion. The reduction reflects the decision to cut state-funded projects for the Department of Education (DOE) in each of FYs 2010-13 by 30 percent to maintain a 50-50 split between city- and state-funded commitments.¹² The current plan assumes that the city and the state will each fund \$3 billion of education capital commitments for FYs 2010-13. For the state-funded education projects, the New York City Transitional Finance Authority (NYCTFA) issues revenue bonds backed by state building aid payments to the city.¹³

¹¹ The city released a Preliminary Ten-Year Capital Strategy for FYs 2010-19 on November 26, 2008. The preliminary strategy captured the deferral of commitments announced when the executive budget was released last May. The final ten-year strategy is expected to be 30 percent smaller. We will review the final strategy when it is released with the annual executive budget to determine the programmatic impact of the cuts.

¹² The city assumes the state will continue to provide 50 percent of the funding for DOE's capital plan. DOE is currently in the final year of its Five-Year Capital Plan that totals \$13.5 billion, with \$6.6 billion of commitments supported by the state in an agreement following the Campaign for Fiscal Equity lawsuit against the state.

¹³ The NYCTFA is authorized to sell revenue bonds as an ongoing source of financing for school construction in an amount outstanding of up to \$9.4 billion to be secured by state building aid payable to the city and assigned to the NYCTFA.

The federal government has passed a stimulus package that will provide an infusion of funds to support state and municipal capital projects. The stimulus aid, to a limited extent, will enable the city to make critical infrastructure improvements that otherwise would have been deferred in accordance with the announced reduction in city and state resources for capital projects.

Debt Service Growth

The reduction to city-funded capital commitments will serve to contain the growth in debt service costs. The current financial plan shows debt service costs for the city and the NYCTFA growing at an average annual rate of 11.5 percent from \$4.311 billion in FY 2009 to \$6.657 billion in FY 2013. This growth rate has been lowered from 12.3 percent in the November modification mainly due to a net reduction in FY 2013 of \$236 million, as illustrated in Table 11.

THE VOLATILITY IN TAX REVENUES REQUIRED A REDUCTION IN DEBT SERVICE COSTS

TABLE 11 (\$ in millions)

	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FYs 2009-13 Avg. Annual Growth Rate
<u>Debt Service</u>						
November 2008	\$4,340	\$4,847	\$5,931	\$6,507	\$6,893	12.3%
January 2009	<u>4,311</u>	<u>4,838</u>	<u>5,898</u>	<u>6,369</u>	<u>6,657</u>	11.5%
Reduction	(\$28)	(\$9)	(\$33)	(\$138)	(\$236)	
<u>Tax Revenues</u>						
November 2008	\$37,102	\$37,214	\$39,775	\$42,146	\$43,789	4.2%
January 2009	<u>36,116</u>	<u>36,112</u>	<u>38,910</u>	<u>41,125</u>	<u>43,075</u>	4.5%
Reduction	(\$987)	(\$1,102)	(\$865)	(\$1,021)	(\$715)	
<u>Debt Service as a % of Tax Revenues</u>						
November 2008	11.7%	13.0%	14.9%	15.4%	15.7%	-
January 2009	11.9%	13.4%	15.2%	15.5%	15.5%	-

Note: Numbers may not add due to rounding.

City debt service projections in the current plan are reduced by \$1 million in FY 2009, \$11 million in FY 2010, \$35 million in FY 2011, \$141 million in FY 2012 and \$242 million in FY 2013 as a result of changes to the long-term borrowing assumptions. Specifically, a portion of the debt service reduction, \$4 million in FY 2010, \$25 million in FY 2011, \$68 million in FY 2012 and \$130 million in FY 2013, is attributable to projected smaller borrowing amounts. Between FYs 2010 and 2013, the amount of g.o. bonds projected to be borrowed totals \$21.14 billion, which is \$2.46 billion less than previously forecasted. The amount of annual debt service savings from a smaller financing program climbs to \$655 million in FY 2019, as the reduction in borrowing is compounded.

The city also changed the model it uses to calculate debt service projections to one that assumes a longer average life on bond issuances. The new model assumes a

19.3-year average life on the combined amount of bonds to be sold whereas the older model assumed the average life was approximately 17.6 years.¹⁴ The longer average life is based on a level debt service calculation where annual principal payments are low during the early years of the outstanding bonds then increase in succeeding years. While the new model reduces annual debt service payments in the near term, it increases total debt service costs over the life of the bonds because after midway the annual debt service payments under the new model exceed those for the old model. Additionally, during the early years when the bonds are being retired at a slower pace, the legal debt incurring margin to finance future capital needs could be compromised.

The new model also changes the interest rate assumption used to calculate debt service projections on bonds to be issued from FY 2010 forward. The city now assumes an across the board rate of 6.28 percent for bond sales through the first half of FY 2011 and 6.78 percent on sales thereafter, as compared to the previous model that used an interest rate scale with lower rates in the near term and higher rates at the back end of the bonds. The combination of the new model with the different interest rate assumption generates \$62 million of savings to the city's budget in FY 2012 and \$104 million in FY 2013. Table 12 on page 36 provides an illustration of the principal redemption and debt service cost tradeoffs under the new and old models, based on the issuance of \$1 billion of bonds in FY 2010.

¹⁴ It should be noted that the new model captures the fact that the city will sell g.o. bonds for city-funded school construction projects and that all of these bonds will have a 30-year maturity.

**THE NEW MODEL PRODUCES DEBT SERVICE SAVINGS IN THE EARLY YEARS
BUT INCREASES COSTS OVER THE LIFE OF THE BONDS**

TABLE 12

(\$ in millions)

FYs	Current Debt Service Model Using 6.28% Interest Rate		Prior Debt Service Model Using 4.68% to 6.50% Interest Rate Scale	
	Principal	Debt Service	Principal	Debt Service
2010	--	--	--	--
2011	--	\$62.80	--	\$62.76
2012	\$13.94	76.74	\$21.06	83.82
2013	14.82	76.74	22.05	83.83
2014	15.75	76.74	23.19	83.82
2015	16.74	76.74	24.46	83.82
2016	17.79	76.74	25.83	83.83
2017	18.91	76.74	27.29	83.82
2018	20.10	76.74	28.87	83.82
2019	21.36	76.74	30.60	83.83
2020	22.70	76.74	32.46	83.83
2021	24.13	76.74	34.46	83.82
2022	25.64	76.74	36.63	83.83
2023	27.25	76.74	38.95	83.83
2024	28.96	76.74	41.43	83.82
2025	30.78	76.74	44.86	84.59
2026	32.71	76.74	47.79	84.63
2027	34.77	76.74	23.95	57.72
2028	36.95	76.74	25.49	57.72
2029	39.27	76.74	27.14	57.72
2030	41.74	76.74	28.90	57.72
2031	44.36	76.74	30.77	57.72
2032	47.14	76.74	32.77	57.72
2033	50.11	76.74	34.90	57.72
2034	53.25	76.74	37.17	57.72
2035	56.60	76.74	39.58	57.71
2036	60.15	76.74	42.16	57.72
2037	63.93	76.74	44.90	57.72
2038	67.94	76.74	47.78	57.68
2039	72.21	76.74	50.33	57.13
2040	--	--	54.23	57.75
Total	\$1,000.00	\$2,211.52	\$1,000.00	\$2,129.17
Average Life	19.3 years		17.6 years	

Despite the fact that the city trimmed debt service projections in the plan years, the average annual growth rate of 11.5 percent from FYs 2009-13 is still relatively high, particularly when compared to the 4.5 percent growth rate of tax revenues, the source of debt service payment.¹⁵ The city forecasts that tax revenues will grow from \$36.1 billion in FY 2009 to \$43.1 billion in FY 2013, as illustrated in Table 11 on page 34.

¹⁵ As a way of providing budgetary relief, the city and the NYCTFA used FY 2007 budget resources to redeem and defease debt originally scheduled to mature in FY 2009, which reduced debt service costs by \$639 million in FY 2009. Without these actions, FY 2009 debt service costs would be a higher \$4.95 billion, resulting in an average annual growth rate through FY 2013 of 7.7 percent.

Given the current nationwide economic crisis, the city has reduced its tax revenue projections by \$1 billion for FY 2009, \$1.1 billion in FY 2010, \$865 million in FY 2011, \$1 billion in FY 2012 and \$715 million in FY 2013, illustrating the volatility in tax receipts. At the lower levels, tax revenues will be absorbed by a larger share to pay debt service costs in each of FYs 2009-12 than previously assumed. It is not until FY 2013, when debt service savings grow to the level of \$236 million, that the burden is reduced to 15.5 percent of tax revenues from 15.7 percent in the prior plan. Debt service as a percent of tax revenues is now expected to climb from 11.9 percent in FY 2009 to 13.4 percent in FY 2010 and 15.2 percent in FY 2011, before leveling off at 15.5 percent in each of FYs 2012 and 2013. The increase in the debt service burden over time is a manifestation of the faster growth rate for debt service compared to tax revenues. The city has consistently kept its projection of the future debt service burden within 16 percent.

Beyond the plan years, the city expects that reduction in the capital program will curb the debt service growth rate substantially. We calculate that debt service will grow at a slower average annual rate of 5.2 percent over the ten-year period of FYs 2010-19, as savings accumulate from the scaled down g.o.-funded capital program. The city has forecasted a growth rate of 3.4 percent for tax revenues during the same ten-year period.

Glossary of Acronyms

AIM	Aid and Incentives for Municipalities
BERS	Board of Education Retirement System
CY	Calendar Year
DOE	Department of Education
FCB	Financial Control Board
FMAP	Federal Medical Assistance Percentages
FY	Fiscal Year
GASB	Government Accounting Standards Board
GCP	Gross City Product
GCT	General Corporation Tax
GDP	Gross Domestic Product
G.O. Bonds	General Obligation Bonds
NYCERS	New York City Employees' Retirement System
NYCTFA	New York City Transitional Finance Authority
OT	Overtime
OTPS	Other than Personal Service
PBA	Patrolmen's Benevolent Association
PIT	Personal Income Tax
PS	Personal Service
RHBT	Retiree Health Benefits Trust
STAR	School Tax Relief program
TRS	Teachers' Retirement System
UBT	Unincorporated Business Tax