

Staff Report

**REVIEW OF FYs 2010-2014  
FINANCIAL PLAN**

March 16, 2010



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## I. Overview

Since the November modification the city has raised its estimate of city-fund revenues by \$1.1 billion in FY 2010 because of a Wall Street-led recovery in nonproperty tax collections. While the economic recovery has been uneven, the city assumes, given that the securities industry is producing record-breaking profits, that revenues from the personal income tax, as well as some business taxes will be higher. In addition, the city has implemented an agency reduction program of over \$480 million, reduced debt service costs, and drawn down money from the Retiree Health Benefit Trust fund. These actions have allowed the city to add \$2.3 billion to the Budget Stabilization Account, bringing its total to \$2.9 billion. The city plans to use the entire surplus to prepay FY 2011 expenses.

The January modification contains the city's preliminary FY 2011 budget and FYs 2011-14 Financial Plan. The January modification presents a balanced budget for FY 2011 based on the use of the \$2.9 billion budget surplus from FY 2010, a higher revenue forecast and an agency reduction program that when combined serves to close a previously projected gap of \$4.9 billion. However, budget deficits remain for FYs 2012-14 in the magnitude of \$3.2 billion, \$3.7 billion, and \$3.8 billion, respectively.

The city has raised its forecast for city-fund revenues by \$1 billion in FY 2011, largely on the expectation that a Wall Street-centered recovery will generate more than \$900 million in extra nonproperty tax collections. However, a weakening property tax will drag down tax revenue growth throughout the plan period, even as the nonproperty taxes continue to recover. The city's projection of higher revenues does not mean there is a full blown recovery. In fact, the city projects that nonproperty taxes will recover gradually from the recession-induced collections downturn that afflicted the previous two fiscal years. Even though our analysis shows that there may be a small upside for tax revenues in all years of the plan, nonproperty tax revenue will not surpass the previous FY 2008 peak until FY 2014 because of the slow pace of the recovery. This recovery differs markedly from past experience in that there is no double-digit growth surge, which characterized past recoveries. The city also proposes to augment its revenue plan by more than \$200 million by enacting two tax proposals that would extend the mortgage recording tax to cooperative apartment loans, and broaden the sales tax to include aviation fuel. Since both of these items require state legislative approval, we hold them at risk.

In addition to revenue increases, the city proposes to implement an agency reduction program that is expected to reduce expenditures by more than \$1.1 billion. The agency programs in both FY 2010 and FY 2011 would have required major reductions in the Department of Education's budget. To avoid the need to lay off teachers and other staff, the city has decided to make a change in its labor policy. The July financial plan had included sufficient funding for a potential contract containing four percent wage increases in both FYs 2010 and 2011, consistent with the pattern set by other collective bargaining agreements. The city has reduced the funding to cover a two percent increase on salaries up to \$70,000 for both years. The savings would be used to cover the Department's reduction target, as well as fund some special education needs.

The preliminary budget also proposes another change in the city's labor policy. Prior plans had reserved sufficient resources to fund a 1.25 percent wage increase for all unions starting in FY 2011. The city had also proposed two initiatives to start to deal with the unaffordable growth in employee healthcare and pension costs. Making no progress in achieving these initiatives, the city has now removed them from the plan. It has also removed the funding for the 1.25 percent wage increase. The city's new stated policy is that any collective bargaining agreement for FYs 2011 and 2012 must be self-funded by productivity improvements or savings in healthcare and pension costs.

The city, by relying on conservative revenue estimates and taking proactive measures to reduce agency expenditures, has increased its surplus in FY 2010 and laid out a credible plan to balance FY 2011. While our review shows that there may be some upside in revenue over the plan period, there are also some risks. These include primarily our projection of higher overtime costs, the city's need to fund environmental cleanup costs in the operating budget, and tax initiatives that require state legislative approval. The city has sufficient time to deal with these risks in the executive budget and we expect that the city will propose a balanced budget for FY 2011.

While the city is able to deal with the risks it has some control over, there are significant issues that will have to be dealt with that are not yet certain. The city estimates that the state executive budget would reduce funding over FYs 2010 and 2011 by about \$1.3 billion. The largest reductions would be \$328 million in both FYs 2010 and 2011 in Aid and Incentives for Municipalities funds. The other major proposed reduction is an almost \$500 million cut in education aid. Until a state budget is adopted, it is unclear if these proposals will be implemented. The city will have to develop plans to deal with any reductions in state aid when they are known. Any delay in the passage of the state budget could affect the city's ability to balance FY 2011.

In addition to any reductions in state education aid, the Department of Education will also have to develop plans to deal with a loss of \$825 million in federal stimulus funds in FY 2012. This loss of federal and state aid comes at a time when the Department already faces growing costs due to higher enrollment growth. If the city is not successful in reaching a collective bargaining agreement consistent with its new labor policy, the pressure on the Department will be that much greater.

While an economic recovery is under way, the city's financial plan contains over \$3 billion in budget gaps in each of FYs 2012-14. The escalating costs of fringe benefits, pension contributions and debt service, together with the end to federal stimulus funds that reduced Medicaid expenses, are driving the fast-paced growth in city expenditures, which the city will have to deal with over the life of the financial plan.

**JANUARY MODIFICATION:  
THE CITY'S OPERATING PROJECTIONS FOR  
FISCAL YEARS 2010-2014**

**TABLE 1** (\$ in millions)

	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
<b><u>Revenues</u></b>					
Taxes:					
General Property	\$16,017	\$16,847	\$17,496	\$17,706	\$17,842
Other Taxes	20,063	21,268	22,625	24,008	25,258
Tax Audit Revenue	890	612	611	610	610
Tax Fairness Program	--	219	241	262	284
Sale of Property Tax Liens	18	70	40	40	40
Miscellaneous Revenues	7,655	6,993	7,008	7,049	7,069
Unrestricted Intergovernmental Aid	340	340	340	340	340
Interfund Revenues	497	471	450	450	450
Less: Intracity Revenues	(1,804)	(1,545)	(1,547)	(1,552)	(1,552)
Disallowances	(15)	(15)	(15)	(15)	(15)
Total City, Capital IFA & Other Cat. Funds	\$43,661	\$45,260	\$47,249	\$48,898	\$50,326
Federal Categorical Grants	7,943	6,614	5,720	5,680	5,679
State Categorical Grants	11,476	11,766	12,407	13,057	13,195
<b>Total Revenues</b>	<b><u>\$63,080</u></b>	<b><u>\$63,640</u></b>	<b><u>\$65,376</u></b>	<b><u>\$67,635</u></b>	<b><u>\$69,200</u></b>
<b><u>Expenditures</u></b>					
Personal Service	\$36,295	\$36,190	\$36,296	\$38,048	\$38,832
Other Than Personal Service	25,928	26,042	27,201	27,925	28,654
General Obligation, Lease & TFA Debt Service	5,117	5,536	6,286	6,579	6,815
General Obligation & TFA Debt Defeasances	(2,726)	--	--	--	--
Budget Stabilization & Prepayments	70	(2,883)	--	--	--
General Reserve	200	300	300	300	300
Subtotal	\$64,884	\$65,185	\$70,083	\$72,852	\$74,601
Less: Intracity Expenditures	(1,804)	(1,545)	(1,547)	(1,552)	(1,552)
<b>Total Expenditures</b>	<b><u>\$63,080</u></b>	<b><u>\$63,640</u></b>	<b><u>\$68,536</u></b>	<b><u>\$71,300</u></b>	<b><u>\$73,049</u></b>
<b><u>Gap To Be Closed</u></b>	<b><u>\$0</u></b>	<b><u>\$0</u></b>	<b><u>(\$3,160)</u></b>	<b><u>(\$3,665)</u></b>	<b><u>(\$3,849)</u></b>

**CHANGES TO THE CITY'S OPERATING PROJECTIONS FOR  
FISCAL YEARS 2010-2013  
JANUARY MODIFICATION COMPARED TO NOVEMBER MODIFICATION**

TABLE 2 (\$ in millions)

	FY 2010	FY 2011	FY 2012	FY 2013
<b><u>Revenues</u></b>				
Taxes:				
General Property	\$1	(\$253)	(\$194)	(\$372)
Other Taxes	880	952	834	917
Tax Audit Revenue	144	16	16	16
Tax Fairness Program	--	219	241	262
Sale of Property Tax Liens	(30)	30	0	0
Miscellaneous Revenues	357	200	175	177
Unrestricted Intergovernmental Aid	0	0	0	0
Interfund Revenues	11	18	7	7
Less: Intracity Revenues	(36)	20	21	20
Disallowances	0	0	0	0
Total City, Capital IFA & Other Cat. Funds	<u>\$1,327</u>	<u>\$1,202</u>	<u>\$1,100</u>	<u>\$1,027</u>
Federal Categorical Grants	687	160	338	310
State Categorical Grants	(42)	(160)	21	(2)
<b>Total Revenues</b>	<b><u>\$1,972</u></b>	<b><u>\$1,202</u></b>	<b><u>\$1,459</u></b>	<b><u>\$1,335</u></b>
<b><u>Expenditures</u></b>				
Personal Service	(\$339)	(\$859)	(\$684)	(\$963)
Other Than Personal Service	219	282	318	348
General Obligation, Lease & TFA Debt Service	(116)	(40)	61	38
General Obligation & TFA Debt Defeasances	0	--	--	--
Budget Stabilization & Prepayments	2,344	(2,344)	--	--
General Reserve	(100)	0	0	0
Subtotal	<u>\$2,008</u>	<u>(\$2,961)</u>	<u>(\$305)</u>	<u>(\$577)</u>
Less: Intracity Expenditures	(36)	20	21	20
<b>Total Expenditures</b>	<b><u>\$1,972</u></b>	<b><u>(\$2,941)</u></b>	<b><u>(\$284)</u></b>	<b><u>(\$557)</u></b>
<b><u>Change in Gap</u></b>	<b><u>\$0</u></b>	<b><u>\$4,143</u></b>	<b><u>\$1,743</u></b>	<b><u>\$1,892</u></b>



# RISKS TO THE FINANCIAL PLAN

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

	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
<b>Stated Financial Plan Gap</b>	<b>\$0</b>	<b>\$0</b>	<b>(\$3,160)</b>	<b>(\$3,665)</b>	<b>(\$3,849)</b>
<b>Estimation</b>					
Nonproperty Taxes	\$350	\$200	\$200	\$200	\$200
Miscellaneous Revenue	25	50	75	100	125
Uniformed Services Overtime	(64)	(210)	(201)	(197)	(197)
<b>Subtotal</b>	<b>\$311</b>	<b>\$40</b>	<b>\$74</b>	<b>\$103</b>	<b>\$128</b>
<b>Implementation</b>					
Pollution Remediation	\$0	(\$176)	(\$176)	(\$176)	(\$176)
<b>Subtotal</b>	<b>\$0</b>	<b>(\$176)</b>	<b>(\$176)</b>	<b>(\$176)</b>	<b>(\$176)</b>
<b>Not in Mayor's Control</b>					
Aid and Incentives for Municipalities	(\$328)	(\$328)	(\$328)	(\$328)	(\$328)
Tax Fairness Proposals	0	(219)	(241)	(262)	(284)
<b>Subtotal</b>	<b>(\$328)</b>	<b>(\$547)</b>	<b>(\$569)</b>	<b>(\$590)</b>	<b>(\$612)</b>
<b>Risk Total</b>	<b>(\$17)</b>	<b>(\$683)</b>	<b>(\$671)</b>	<b>(\$663)</b>	<b>(\$660)</b>
<b>Total FCB Estimated Surplus/(Gap)</b>	<b>(\$17)</b>	<b>(\$683)</b>	<b>(\$3,831)</b>	<b>(\$4,328)</b>	<b>(\$4,509)</b>

## II. Balancing the FY 2010 Budget

In the January modification to the FYs 2010-13 Financial Plan, the city increased its estimate of city-fund revenues by \$1.1 billion in FY 2010 because of a Wall Street-led recovery in nonproperty tax collections. Total revenue gained \$2 billion, with an increase in federal categorical grants comprising most of the addition in noncity funds. Although proposed cutbacks in state aid are a serious concern, the city's revenue plan does not yet reflect these proposed cuts.

Additionally, the FY 2010 budget reflects a net reduction of approximately \$400 million in expenditures that is attributable to savings in city agency expenses and debt service costs, as well as a drawdown of the Retiree Health Benefits Trust fund and the routine decrease in the general reserve. The combination of the projected gain in revenue and the expenditure savings provides the city an additional \$2.3 billion of surplus funds in FY 2010, which it plans to use to increase the Budget Stabilization Account (BSA) to almost \$2.9 billion. The city expects to use all of the funds in the BSA in combination with higher forecasted revenues to close the previously estimated \$4.9 billion gap for FY 2011 and achieve budget balance.

### **REVENUES**

Higher anticipated tax collections resulting from a strong recovery on Wall Street lifted city-fund revenues by \$1.107 billion, in the January modification for FY 2010. Total revenue gained \$1.972 billion because \$854 million in additional categorical grants, mostly federally funded, were included in the plan, as shown in the figure to the right.

With the recession bottoming out, and the securities industry producing record-breaking profits, the city has lifted its nonproperty tax revenue target by \$879 million in FY 2010. Despite this significant plan-to-plan improvement, revenues for the major nonproperty taxes are down by two percent, compared with the previous year. After adjusting for changes in tax law, like the recent \$800 million program to increase the city's sales and business income taxes, collections are down about eight percent.

Most of the improvement in the nonproperty taxes is due to the personal income tax, which is up \$538 million primarily from the city's expectation of higher withholding and installment revenue, and the business income taxes, which gained \$236 million. The real property tax is down \$30 million due to the rescheduling of a tax lien sale to the next fiscal year. The city raised its target for tax audits by \$135 million, indicating that this ongoing collections effort is continuing to produce strong results. Capitalizing on this success, the city is implementing an \$11 million revenue initiative for its Program to Eliminate the Gap (PEG), which is largely focused on expanding audit collections.

<b>Improving Nonproperty Taxes</b>	
<b>Lift FY 2010 City Funds \$1.1 Billion</b>	
(\$ in millions, change since Nov. plan)	
Property Tax	(\$30)
Nonproperty Taxes	879
Tax Audits	135
Revenue PEGs	11
Unrestricted Aid	0
Miscellaneous Revenue	112
<b>City Funds</b>	<b>\$1,107</b>
Categorical Aid	854
Interfund Revenue	11
<b>Total Change in Revenues</b>	<b>\$1,972</b>

Miscellaneous revenue is up by \$112 million, with most of the increase tied to nonrecurring resources such as a deferred prosecution agreement with the District Attorney's Office and Credit Suisse.

A major concern for the city is the proposed reduction in unrestricted state aid. The primary source for this type of assistance is the state's Aid and Incentives for Municipalities (AIM) program, which is worth \$328 million in FY 2010 and an additional \$328 million in FY 2011. Should this aid be eliminated, the city would lose a significant highly desirable and flexible budget-balancing resource. Although the city revenue plan assumes that these reductions will not be implemented, there are concerns about the budgetary stress that could result from reductions in state aid. The city has sufficient resources to balance FY 2010; however, the city would have to take additional actions, over and above those already proposed, to make up the shortfall in FY 2011.

### **The Uneven Economic Recovery**

The city's financial services sector and its tourist industry are the main drivers of a very uneven local economic recovery. The city has added \$879 million to its FY 2010 nonproperty tax plan in the expectation that soaring Wall Street profits would flow through the city's tax base and generate stronger tax collections. Other sectors such as construction, manufacturing and real estate are lagging behind the recovery. The widening of the local recovery will be determined by the spending streams emanating from the leading sectors and by the pace of the national economic recovery. While this process works itself out, the local recovery remains narrow, fragile and vulnerable to setbacks.

The federal bailout of large financial institutions sparked a stock market rally in calendar year (CY) 2009, which produced \$50 billion in profits for New York Stock Exchange member firms through the third quarter of the year. Despite this good fortune, Wall Street firms have been slow to write bonus checks, with some preferring to issue stock options or other noncash bonuses. The resulting delay in developing a Wall Street-led spending stream could delay the realization of the city's tax revenue plan and it could also hold back the expansion of the recovery to the weaker lagging sectors of the local economy.

The city projects that securities industry profits will top \$58 billion in 2009, drop to \$23 billion in 2010, and fall to \$11 billion in 2011. Although the projected profits trend is downward, these positive results are magnified when compared with the \$54 billion of losses that were reported for the securities sector over the previous two years. The drop off in profits is inevitable not only because of the recent retreat of stock prices, but because the Federal Reserve Board could soon roll back its expansive monetary policy and curtail its interest-free loans to the big banks and brokerage houses. As earnings in the securities industry drop back to more normative levels, the city's revenue growth plan will only be achievable if the national economy resumes growth and the local expansion widens to include a recovery in jobs and incomes as well as a stronger real estate market.

In the city's outlook, national output growth as measured by GDP recovers to 2.3 percent in 2010 from a decline of 2.5 percent in 2009. Growth then accelerates to 2.8

percent in 2011 and 3.7 percent in 2012, before dropping back to the long-term trend growth of about three percent in the outyears. The nation's job market lags behind the recovery and continues to fall by 0.7 percent in 2010, following the more severe 3.7 percent drop in 2009. Jobs recover slowly in 2011, with weak growth of 1.7 percent. The city forecast sees national jobs growing about one percentage point slower than GDP from 2011 through 2014.

The Blue Chip consensus forecast is more optimistic than the city on a quicker upturn for output, and is slightly less pessimistic on the sluggishness of a labor market recovery. The survey average in their February report indicates GDP growth of three percent in 2010 and 3.1 percent in 2011, compared with the city's estimate of 2.3 percent in 2010 and 2.8 percent in 2011. The consensus survey also indicates a 10 percent unemployment rate in 2010, followed by a slow improvement to 9.2 percent in 2011. The city's estimates are slightly more negative, with 10.2 percent unemployment in 2010 and 9.6 percent in 2011. Both of these forecasts point to a slow-paced recovery for the national economy, followed by an even slower recovery for jobs.

With the nation plodding through a slow recovery, the city's economic recovery could be even more sluggish than the nation's. In the city's outlook, gross city product (GCP), which fell an estimated 3.5 percent in 2009, recovers unsteadily with 2.2 percent growth in 2010 and no growth in 2011, probably due to the retreat of Wall Street profits. Weak GCP growth in the mid-two percent range resumes in 2012 through 2014.

Employment in the city is also slower to recover than in the nation, but the city's outlook is substantially less grim than it was in June. The city now expects to lose 203,000 private jobs by the time the employment market bottoms out in mid-2010, which represents 108,000 fewer jobs lost than the earlier forecast. Nevertheless, the employment outlook remains weak, with local employment falling 2.7 percent in 2010, following a decline of 2.8 percent in 2009. Jobs recover with weak growth of 0.6 percent in 2011 followed by growth of at least one percent in 2012 through 2014.

The January employment report indicates that the city's economic plan appears to be accurate in its projection of 100,000 local job losses in 2010. However, revised survey results for 2009 reveal that the local labor market had fallen much harder than preliminary reports had suggested. Local employment was down by 106,000 jobs in 2009, which was far more negative than the pre-revision estimate of 83,000 job losses. Thus, with local employment falling harder than expected, the city is relying heavily on the flow-through of Wall Street profits to sustain its stronger tax forecast.

## **Tax Revenues**

Since November, the city has increased its tax collection plan for FY 2010 by \$849 million, as shown in the figure to the right. Nearly all the major taxes participated in the gains. The nonproperty tax projection is up by \$879 million. The personal income tax projection is up by \$538 million and the sales tax gained \$92 million. The general corporation tax and the banking corporation taxes are up \$132 million and \$20 million, respectively. The unincorporated business tax increased by \$84 million, following the trend set by the personal income tax. The property transfer tax gained \$23 million, a hopeful sign that the three-year slide of this tax is nearing an end.

<b>Outlook for FY 2010 Tax Collections Improves by \$849 Million Since Nov.</b> (\$ in millions)	
<b>Real Property Tax</b>	<b>(\$30)</b>
<b>Nonproperty Taxes</b>	<b>\$879</b>
Personal Income	538
Sales	92
General Corporation	132
Banking Corporation	20
Unincorporated Business	84
Commercial Rent	15
Utility	18
Property Transfer	23
Mortgage Recording	(67)
Other	24
<b>Total Change in Tax Revenue</b>	<b>\$849</b>

The real property tax, which is down by \$30 million due to the rescheduling of a lien sale until the next fiscal year, is one exception to the broad-based revenue upturn. Another exception is the mortgage recording tax, which is down \$67 million and is in the third year of a steep decline.

## **EXPENDITURES**

In the January modification, expenditures in FY 2010 are forecasted to be higher by \$2 billion compared to the November modification, reflecting an increase in the prepayment of FY 2011 expenses and additional spending for Public Assistance and Medical Assistance of \$181 million and \$35 million, respectively, as shown in the figure to the right. The rise in Public Assistance is due to an increase in caseloads and expenses that will eventually be reimbursed by state and federal grants.

<b>Changes in FY 2010 Expenses Since November Modification</b> (\$ in millions)	
Change in BSA	\$2,344
Public Assistance	181
Medical Assistance	35
Personal Service	(339)
Debt Service	(116)
General Reserve	(100)
Other	(33)
<b>Total Increase</b>	<b>\$1,972</b>

Expense budget savings are expected in a number of areas, particularly in personal service. The city has reduced its estimates for employee salaries and wages due to a major change in its labor policy regarding funding of future raises and the drawdown of the Retiree Health Benefits Trust fund of \$82 million. The city expects to see savings of \$570 million from reducing funding for the teachers' labor contract from four percent to two percent, and proposing that all other contract increases be funded through productivity and other labor savings. However, this is offset by higher pension and fringe benefit costs of \$60 million and \$253 million, respectively, thus producing a net savings of \$339 million in personal service, as shown in the figure. The January modification also recognizes \$116 million of debt service savings in FY 2010. The majority of the savings (\$104 million) is the result of actual interest rates on variable rate debt being lower than previously forecasted, which is discussed in detail in the section

of the report titled "Analysis of the City's Debt," on page 35. Lastly, the city reduced its general reserve to \$200 million from \$300 million.

In its November 2009 modification, the city had projected a budget gap of more than \$4.1 billion in FY 2011. With the net expenditure savings projected for FY 2010 added to higher revenue estimates, the city now expects to be able to apply \$2.3 billion to bring its Budget Stabilization Account (BSA) to \$2.9 billion, which will be used for prepayment of FY 2011 expenses to help achieve budget balance.

### **FY 2010 Agency Program**

In November 2009, the city asked all agency heads to find additional expenditure reductions in FY 2010 amounting to four percent for the majority of all city agencies, except in the uniformed agencies and the Department of Education (DOE), which were asked to reduce spending by two percent and 1.5 percent, respectively. In the January modification, city agencies have identified more than \$484 million of savings from a combination of expense reductions and increased revenues for FY 2010, as summarized in the figure to the right.

<b>FY 2010 Agency Program</b> (\$ in thousands)		
<b>Agency Category</b>	<b>Expense</b>	<b>Revenue</b>
Uniformed Services	(\$79,528)	(\$900)
Health and Welfare	(85,807)	(77)
Mayoral	(110,714)	(71,096)
Major Organizations	(122,646)	(3,438)
Elected Officials	(10,273)	--
<b>Total PEG Components</b>	<b>(\$408,968)</b>	<b>(\$75,511)</b>
<b>Total Program</b>		<b>(\$484,479)</b>
(Negative) numbers decrease the gap.		

As shown in the figure, the majority of the \$484 million in savings found for FY 2010 are from spending reductions that total almost \$409 million. Of the \$409 million in savings, more than 30 percent, or \$123 million, is being supplied by two main agencies in the Major Organizations category: the DOE with \$113 million in net savings, or 1.5 percent, of its total operating expense budget and approximately \$9 million from the City University of New York (CUNY), or four percent, of its total system's budget.<sup>1</sup> The entirety of DOE's Program to Eliminate the Gap (PEG) is based upon the recalculation of the collective bargaining contracts for the United Federation of Teachers (UFT) and the Council of School Supervisors and Administrators (CSA).<sup>2</sup>

In other areas such as Uniformed Services (Police, Fire, Correction, and Sanitation Departments), Health and Welfare agencies (Children, Social, and Homeless Services) and Health and Hygiene, nearly \$166 million in expenditure savings were found. One of the largest spending cuts is an expected \$25 million decrease in overtime expenditures generated by the Police Department, which stems from a new policy mandate that will be discussed in "Uniformed Overtime for FYs 2011 - 2014" on page 32.

<sup>1</sup> For CUNY, 60 percent of the savings stems from reductions to institutional and department research personal service and other than personal service costs. Additional savings come from numerous other areas of operations.

<sup>2</sup> The savings on the DOE contracts are expected to produce a surplus of about \$47 million, which will be used to fund services for disabled students as directed by state mandate.

Also, savings of almost \$16 million were found in the Sanitation Department from a waste export funding surplus. Further, additional staffing, administrative, and facility efficiencies in the Department of Correction account for more than \$21 million in savings.

Most of the PEG savings in the Health and Welfare agencies are centered in the Administration for Children Services (ACS) and the Department of Social Services (DSS) with about \$60 million of combined cuts to their operating budgets. The largest of these reductions is the reconciliation and payment of prior-year claims from the federal government, which will reduce expenditures in ACS by \$29 million. Other savings will come from DSS due to the reimbursement and collection of Medicaid costs and payments that will total more than \$21 million. Rounding out the reductions in Social Services are staff restructuring and administrative efficiencies in addition to increased collection of reimbursable agency costs.

Further spending reductions were identified in the Department of Health and Mental Hygiene and the Department of Homeless Services that total \$26 million with the bulk coming from the Department of Health with more than \$17 million of agency savings. The agency expects to reduce expenditures with Medicaid cost reestimates and staffing shifts. Most of the saving in Homeless Services will come from prior-year revenue collections and additional funding, but also from the elimination of shelter beds, staff redeployment, and other agency restructuring. In addition to the expenditure savings, there are a number of revenue PEGs that will generate more than \$75 million for FY 2010, with most of the revenues coming from miscellaneous sources that account for almost \$65 million and the remaining sum stemming from additional tax revenues.

### **Department of Education**

The January modification reduced funding to the Department of Education (DOE) in FY 2010 by \$15.6 million compared to the November modification, bringing the DOE's operating budget to \$18.4 billion. This current budget is \$536 million, or three percent, more than the FY 2009 close.

An overall, personal service, which is comprised mostly of teachers' salaries and fringe benefits, showed a reduction of over \$233 million, while other than personal service reflected an increase of almost \$218 million. Categories that showed increases in anticipated spending were general education, support services, central offices and non-public school payments, which include Carter cases.<sup>3</sup>

As part of the citywide PEG program, the DOE was given a target reduction of 1.5 percent. To meet this target the city chose to lower its salary schedule for its collective bargaining agreement with the teachers' union. Originally, the city had reserved funding for a four percent increase in FY 2010 and another four percent

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<sup>3</sup> Based on a U.S. Supreme Court ruling from 1993, Carter cases represent instances in which parents that placed their handicapped children in nonapproved private schools are entitled to tuition reimbursement from DOE, if the court determines that the department failed to provide a suitable education for these students.

increase in FY 2011. The city is now projecting a labor settlement increase of two percent in each year on salaries up to \$70,000. These savings, if achieved, total \$160 million in FY 2010. This will meet the DOE's PEG target, as well as fund \$47 million for the state mandated Carter cases.

Of the \$18.4 billion in current funding, city funds make up \$7.3 billion, or 40 percent, while the state's contribution totals \$8.1 billion, or 44 percent. The balance of the DOE operational budget is funded by federal aid at \$2.9 billion, or 16 percent.

### **FY 2010 Uniformed Overtime**

The city estimates that total uniformed service overtime expenditures will reach \$809 million for FY 2010. As shown in the figure to the right, more than half of that spending will be done in the Police Department and more than a quarter of expenses will be generated in the Fire Department. While overtime spending in the Police Department has been historically high, the Fire Department has needed to account for higher costs in this financial plan because of an above average sick rate among its firefighters. The needed funds to cover this additional cost have increased by \$15 million.

<b>FY 2010 Uniformed Overtime</b> (\$ in millions)	
Police Dept	\$451
Fire Dept	230
Dept of Correction	70
Dept of Sanitation	58
Total City Projected	\$809
Total FCB Projected	873
<b>Potential Risk</b>	<b>(\$64)</b>
Total Uniformed and Civilian Personnel	

Starting in FY 2010, and becoming more pronounced over the life of the financial plan, the Police Department, along with other city agencies, have implemented a comprehensive reduction and control system to rein in overtime expenditures. The savings in the Police Department are projected to be \$25 million for the current fiscal year, but are expected to grow to \$50 million annually thereafter. We will discuss this plan in depth in "Uniformed Overtime for FYs 2011 - 2014," starting on page 32. However, based upon current spending levels for the first seven months of FY 2010, we estimate a potential risk of \$64 million to the budget.



### **III. The Financial Plan for FYs 2011-14**

The January modification contains the city's preliminary FY 2011 budget and FYs 2011-14 Financial Plan. The January modification presents a balanced budget for FY 2011 based on use of the \$2.9 billion budget surplus from FY 2010, a higher revenue forecast and an agency reduction program that when combined serves to close a previously projected gap of \$4.9 billion. However, budget deficits remain for FYs 2012-14 in the magnitude of \$3.2 billion, \$3.7 billion, and \$3.8 billion, respectively.

In the January modification, the city raised its forecast for city funds by \$1 billion in FY 2011, largely on the expectation that a Wall Street-centered recovery will generate more than \$900 million in extra nonproperty tax collections. A weakening property tax, however, will drag down tax revenue growth throughout the plan period, even as the nonproperty taxes continue to recover. Based upon its economic outlook that the recession has bottomed out, the city expects the major nonproperty taxes to grow by about six percent annually in FYs 2011-2014, reversing the negative growth trend of the previous two years. The city supports two "tax fairness" initiatives that would extend the mortgage recording tax to cooperative apartment loans and broaden the sales tax to include aviation fuel. If enacted, these two tax program items would augment revenue by more than \$200 million annually, while closing long-standing tax loopholes.

To help close the budget gap in FY 2011 and narrow the remaining gaps in FYs 2012 through 2014, the city has put in place an agency program that is expected to reduce expenditures by more than \$1.1 billion annually over the life of the financial plan. The Department of Education (DOE) is providing a major portion of the savings, followed by uniformed agencies. Additionally, the task of closing the FY 2011 budget gap was facilitated by the restructuring of outstanding debt as well as the realization of low interest rates on new and existing bonds. Meanwhile, the city intends to draw down a combined \$1 billion from its Retiree Health Benefits Fund in FYs 2012 and 2013 to fund healthcare payments.

Even with these savings, the growth in expenditures is forecasted to outpace revenues, resulting in budget deficits in excess of \$3 billion in each of FYs 2012-14. The escalating costs of fringe benefits, pension contributions and debt service, together with the end to stimulus funds that reduced Medicaid expenses, are driving the fast-paced growth in city expenditures. The budget gaps exist even though the city has reduced the expected wage increases in DOE for teachers and has assumed that salary increases for all other city employees will be self-funded through productivity and other savings.

## REVENUE CHANGES IN THE JANUARY PLAN

The city raised its FY 2011 projection for city-fund revenues by \$1 billion in the January modification, while total revenue improved by \$1.2 billion. A nascent recovery in the nonproperty taxes, which gained \$931 million, is responsible for the improved revenue outlook, as shown in the figure to the right. The property tax is down \$226 million due to weak market values on the FY 2011 tax roll.

<b>Faltering Property Tax Partially Offsets Nonproperty Tax Gains in FY 2011</b> (\$ in millions, change since Nov. plan)	
Property Tax	(\$226)
Nonproperty Taxes	931
Tax Program	219
STAR Aid	22
Revenue PEGs	19
Miscellaneous Revenue	53
<b>City Funds</b>	<b>\$1,018</b>
Categorical Aid & Other Revenue	185
<b>Total Change in Revenues</b>	<b>\$1,203</b>

Two tax program proposals add \$219 million to the city's revenue plan in FY 2011, and increase to \$284 million by FY 2014. These "tax fairness" initiatives would extend the mortgage recording tax to cooperative apartment loans and would broaden the city's sales tax base to include the sale of aviation fuel to commercial airliners. These tax programs would require legislative approval to be implemented.

## REVENUES BEGIN AN UNCERTAIN RECOVERY

Total revenue increases by \$6.1 billion, in the city's plan, to \$69.2 billion in FY 2014 from \$63.1 billion in FY 2010, for growth of 9.7 percent over the four-year span. City-funded revenue grows by \$6.9 billion, or 17 percent, over the plan. City-fund growth accelerates from 4.3 percent in FY 2011 to a maximum of 4.7 percent in FY 2012 and then drops back to slower growth of three percent by FY 2014, as shown below in Table 4.

### SLIDING PROPERTY TAX GROWTH OFFSETS NONPROPERTY TAX RECOVERY

TABLE 4

(percent change, \$ in millions)

	FY 11	FY 12	FY 13	FY 14	FY 10	FY 14	FYs 10 - 14
Property Tax	5.5%	3.6%	1.2%	0.8%	\$16,221	\$18,088	11.5%
Nonproperty Taxes	4.4	6.3	6.0	5.1	20,767	25,662	23.6
Tax Program	-	10.0	8.7	8.4	0	284	-
Miscellaneous	(1.5)	1.6	1.0	0.5	4,292	4,355	1.5
Nonrecurring	(88.1)	(34.0)	(25.3)	0.0	187	11	(94.1)
Unrestricted Aid	0.0	0.0	0.0	0.0	340	340	0.0
Disallowances	0.0	0.0	0.0	0.0	(15)	(15)	0.0
<b>Total City Funds</b>	<b>4.3%</b>	<b>4.7%</b>	<b>3.6%</b>	<b>3.0%</b>	<b>\$41,792</b>	<b>\$48,725</b>	<b>16.6%</b>
Categorical Aid*	(5.8%)	(1.5%)	3.1%	0.7%	\$20,791	\$20,025	(3.7%)
Interfund Revenue	(5.2)	(4.5)	(0.0)	(0.0)	497	450	(9.5%)
<b>Total Funds</b>	<b>(0.9%)</b>	<b>2.7%</b>	<b>3.5%</b>	<b>2.3%</b>	<b>\$63,080</b>	<b>\$69,200</b>	<b>9.7%</b>

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

The property tax, which grows by 11.5 percent over the plan, increases from \$16.2 billion in FY 2010 to \$18.1 billion in FY 2014. The property tax grows by 5.5 percent in FY 2011 but growth sinks below one percent by FY 2014. The declining growth trend is a consequence of the stagnation of the market values recorded on the

city's tax assessment roll, as discussed in "Property Values Fail to Grow" beginning on page 23.

While the real property tax slows, the nonproperty taxes are staging a weak recovery from the declines sustained over the preceding two recessionary years. Nonproperty tax growth recovers slowly, with growth never deviating substantially from five percent. Over the four-year plan period, the nonproperty taxes are projected to grow by 24 percent from \$20.8 billion in FY 2011 to \$25.7 billion in FY 2014.

Miscellaneous revenue increases by a very slight 1.5 percent from \$4.3 billion in FY 2010 to \$4.4 billion in FY 2014. Nonrecurring actions of \$187 million are projected for FY 2010 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 \$340 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.

### **Nonproperty Taxes Stage a Weak Recovery**

The city projects that the nonproperty taxes will recover very gradually from the recession-induced collections downturn that afflicted the previous two fiscal years. On a continuing base, the major nonproperty taxes, which fell by 15 percent in FY 2009 and are down an estimated eight percent in FY 2010, recover at a lackluster five percent rate in FY 2011.<sup>4</sup> Growth increases slightly to six percent in FYs 2012 and 2013, before dropping back to five percent in FY 2014. Because of the slow pace of this recovery, nonproperty tax revenue will not surpass its previous FY 2008 peak until FY 2014. This recovery differs markedly from past experience in that there is no double-digit growth surge that characterized past recoveries. This weak tax collection plan is consistent with the city's forecast of a slow national economic recovery that is lagged by an even more sluggish local economic recovery.

Pending the advent of a stronger and more broad-based economic advance, the city has pegged its nonproperty tax plan to the rebound of Wall Street profits. The personal income and business income taxes are likely to be the first of the city's taxes to benefit from the stronger finance sector. As the recovery gains strength and spreads to other sectors, most of the city's nonproperty taxes should start to show some growth. The real estate transactions taxes are likely to be the slowest to recover because of the steepness of their decline. Also, the real estate sector tends to have a cyclical pattern that can be longer than the typical business cycle.

Due to the strength of the finance sector recovery, we see an upside potential for the city's nonproperty taxes of \$350 million in FY 2010 and an extra \$200 million in each of FYs 2011-2014. We expect stronger collections primarily for the business income taxes and the sales and personal income taxes.

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<sup>4</sup> "Common rate and base" or "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.

**Business Taxes.** The city expects collections for this group of taxes to begin recovering in FY 2011, following three negative years when these taxes are estimated to have fallen by 23 percent. These three years of sinking tax receipts would bring the business tax revenue loss to \$1.4 billion, from a high of \$6 billion collected in FY 2007 to a low of \$4.6 billion projected for FY 2010. Revenue growth returns in FY 2011 with increases of about eight percent through FY 2013. The city recently implemented a business tax conformity program that will raise about \$150 million annually from FY 2010 through FY 2014. This program would make city business tax rules conform more closely to existing state tax rules. Although this plan raises business tax revenue in the near term, businesses will see their taxes reduced when the conformity program is fully phased in.

Concerned about an adverse two-year surge in business tax refunds, the city enlarged its reserve for refunds by \$263 million since the November modification, to \$995 million in FY 2010. Refund issuance amounted to \$338 million in the first five months of FY 2010, so the city appears to have ample reserves to deal with an upturn in refunds later in the fiscal year.

FY 2010 marks a transition for the general corporation tax (GCT), between the downtrend of the previous two years and the projected resurgence of growth in the next four years. The GCT, which is the largest of the business taxes, fell by more than 25 percent over the two years FYs 2008 and 2009. The city estimates that GCT collections will not change substantially in FY 2010 and then increase by 15 percent in FY 2011. Growth decelerates in the outyears, dropping below six percent in FY 2014.

The two main determinants of the GCT are national corporate profits and securities industry profits, both of which have strengthened. National pretax corporate profits are in the process of shifting from negative growth to positive growth. Profits fell by 18 percent in CY 2008 and are likely to also end 2009 slightly lower. However, a strong positive sign is that 2009 profits increased by 20 percent over the half-year period from the first quarter of the year to the third quarter. Furthermore, the securities industry, which lost a staggering \$54 billion in CYs 2007 and 2008, has earned \$50 billion in the first three quarters of 2009. The rebound in corporate profits and the return of securities firms to profitability indicate that the GCT could see a strong recovery. GCT collections for FY 2010 through January are down by 24 percent, but we nevertheless see upside potential for this tax and expect a collections recovery later in the year.

Collections for the banking corporation tax have been far more volatile than the other business taxes. The bank tax, which surged by 86 percent in FY 2007, plummeted by nearly 50 percent in FY 2008 when the banking sector recognized massive losses in mortgage-backed assets. Tax collections surged again in FY 2009, soaring by 75 percent on the strength of profits earned with the help of federal bailout funds and zero-cost Federal Reserve loans. The city does not expect a repeat of this windfall from this very volatile revenue source, and estimates that bank tax revenue will drop by 37 percent in FY 2010 and decline by an additional seven percent in FY 2011. Collections then recover with 16 percent growth in FY 2012, followed by an unsteady retreat in outyear growth rates. Current bank tax collections are up by more than 100 percent, through January, indicating that collections could exceed the city's estimate.

The unincorporated business tax (UBT) is the only one of the business taxes that did not sink too deeply in the downturn, dropping only four percent in FY 2009. The city projects that UBT revenue will decline nine percent in FY 2010, after which collections would slowly recover with growth of three percent in FY 2011 and about five percent in FYs 2012 through 2014.

**Property Transactions Taxes.** With the real estate market in the third year of a severe slump, revenue for this group, consisting of the real property transfer and mortgage recording taxes, will remain at depressed levels long after growth resumes. Transaction tax revenues fell by a staggering 70 percent, to an estimated \$970 million in FY 2010 from the \$3.3 billion that was collected in FY 2007, for a peak-to-trough revenue loss of \$2.3 billion. The plan projects a resumption of growth in FY 2011, with growth averaging 13 percent through FY 2014. Sadly, even if the recovery goes as planned, without any further setbacks, the transaction taxes will have reached \$1.6 billion by FY 2014, which is still less than half of the \$3.3 billion collected in FY 2007, prior to the onset of the real estate slump.

Federal homebuyer tax credits have been an important factor in stabilizing the real estate market. Hopefully, when this incentive program expires, the mortgage banking industry will have recovered sufficient liquidity to enable the real estate market to recover.

As one of its tax fairness initiatives, the city proposes to tax cooperative apartment loans. This proposal is also contained in the Governor's executive budget. A similar proposal in FY 1994 was not approved. In addition to a loophole in the city's mortgage tax, the city estimates that this tax-base broadener would generate \$50 million in FY 2011, with revenue increasing to \$78 million by FY 2014. We are holding this revenue program at risk because its enactment is outside the city's control.

**Sales Tax.** Compared with the prior modification, the sales tax forecast for FY 2011 was raised by \$172 million to \$5.1 billion based on the city's expectation of local job growth by the end of 2011 that will release pent-up demand and discretionary spending, which will be augmented by large numbers of tourists. The new forecast and plan-to-plan variance do not reflect the proposed tax program, which, if approved by the state legislature, would add aviation fuel to the sales tax base.<sup>5</sup>

An alternative view of the city's latest sales tax forecast, on a common rate and base, is that after two years of negative growth of 5.5 percent in FY 2009 and eight percent in FY 2010, collections will rebound by 3.5 percent in FY 2011, 4.6 percent in FY 2012, 5.5 percent in FY 2013, and 5.2 percent in FY 2014.<sup>6</sup> While the city's forecast appears reasonable, there are substantive issues that may negatively affect personal

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<sup>5</sup> The city estimates that taxing aviation fuel would raise \$169 million in FY 2011, \$183 million in FY 2012, \$191 million in FY 2013, and \$206 million in FY 2014. We are holding this initiative at risk because enactment is outside of the city's control.

<sup>6</sup> "On a common rate and base" or "on a continuing base" refer 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.

consumption expenditures, which encompass employment, household income, debt, and housing. These issues, which are largely outside of the city's control, may take some time to resolve and put pressure on the city's sales tax forecast.

### **Employment**

The city estimates that after losing 85,000 jobs in 2009 and 102,000 jobs in 2010, there will be 22,000 new jobs or 0.6 percent year-to-year growth by the end of 2011. At present, the data shows that on a year-to-year basis in January, the city lost 98,400 jobs, which include the financial, professional and business services, and retail and wholesale trade sectors. Recent forecasts by the Federal Reserve and the National Association for Business Economics point to a national economy in the early stages of a recovery, where the unemployment rate is not expected by either group to significantly decline below nine percent in the next two years. Although the pace of job losses nationally is decreasing, the total amount of jobs lost since December 2007 was revised upward to 8.4 million, and some analysts estimate that if the economy can generate one million to two million jobs this year, it will take at least three to four years for the job market to return to anything like normal.<sup>7</sup>

In addition, recent data for 2009 on rising worker productivity, falling labor costs, and anemic gains in compensation (e.g. wages and benefits) point to companies that are still cutting costs and putting off hiring even as the economy recovers.<sup>8</sup> Other economists point to the increased use of temporary workers over the last several months and suggest that it may not be a reliable indicator of the need for full-time employment since companies are more concerned about the resiliency of the recovery and may hire part-time workers.<sup>9</sup>

### **Household Income**

Although consumers spent more on basic and luxury goods this holiday season than in the prior year, federal statistics show that in December consumers lowered their total borrowing for the 11<sup>th</sup> consecutive month. Despite an appreciation in stock-based education and retirement portfolios in the December 2009 quarter, it is possible that consumers are still in a frugal mindset and plan to pay down debt and build up reserves for emergencies and retirement. Also, wages and benefits rose by 0.5 percent in the December 2009 quarter and were up only 1.5 percent for the year, which was the weakest showing since 1982. Credit remains tight with numerous banks lowering outstanding lines of credit and increasing credit card rates.

### **Housing**

While the trouble in the residential housing market may have started with owners of subprime mortgages, households with prime mortgages are now increasingly

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<sup>7</sup> "January Unemployment Rate Drops to 9.7 Percent," by Christopher S. Rugaber, Associated Press (online) February 5, 2010.

<sup>8</sup> "Productivity Up in Q4 as Jobless Claims Rise," by Christopher S. Rugaber, Associated Press (online) February 4, 2010.

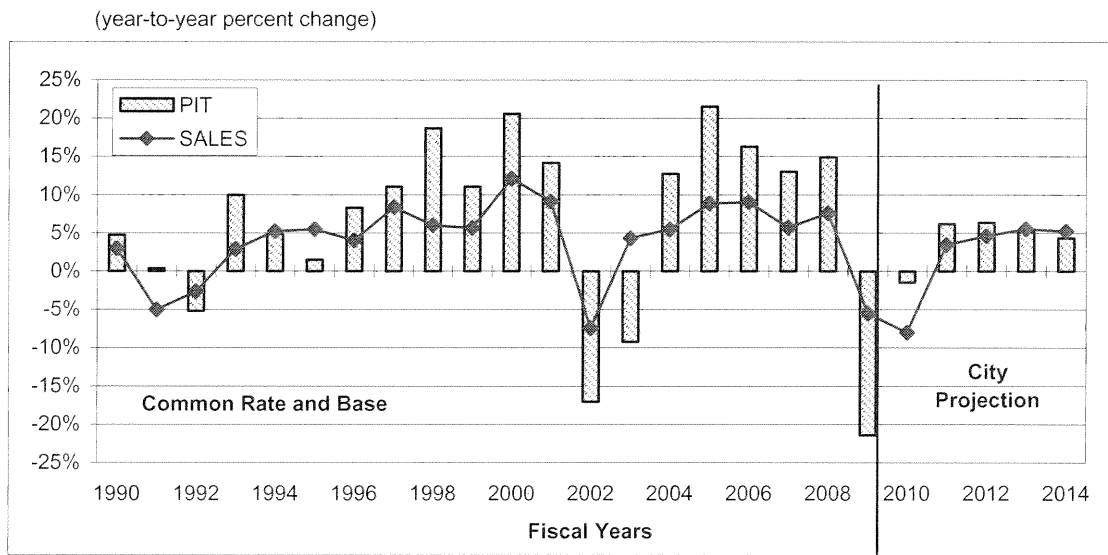
<sup>9</sup> "Use of Temps May No Longer Signal Permanent Hiring," by Jeannine Aversa, Associated Press (online) February 15, 2010.

facing delinquencies and foreclosures largely due to unemployment. As a consequence of falling home prices, a recent study reported in the Wall Street Journal showed that as of the third quarter of 2009, the proportion of U.S. homeowners who owe more on their mortgages than the properties are worth has swelled to about 23 percent, which the authors claim threatens prospects for a sustained housing recovery.<sup>10</sup> Unfortunately, not all homeowners with negative equity qualify for loan modifications and some are considering walking away from the debt—even though some can pay it—when their homes' value falls below 75 percent of the amount owed on the mortgage.<sup>11</sup>

On its face, the city's latest sales tax forecast is not unduly risky or anticipates aggressive growth immediately after two years of declining revenue in FYs 2009 and 2010, on a continuing base. As seen in Chart 1, during a recession when collections fell to a negative five percent in FY 1991 and a negative 2.6 percent in FY 1992 on a continuing base, sales tax revenue only grew by 2.9 percent in the following year. Also, looking at the growth rates after the next fall-off in revenue in FY 2002, sales tax collections from FY 2003 to FY 2008 ranged from a low of 4.3 percent to a high of 9.1 percent in FY 2006.

#### THE CITY EXPECTS PERSONAL INCOME TAX AND SALES TAX REVENUES TO REBOUND STARTING IN FY 2011 AFTER A TWO-YEAR DECLINE

CHART 1



However, it needs to be remembered that during the rebound after September 11<sup>th</sup>, one of the chief supports to the very strong growth in sales tax revenue was superlative Wall Street compensation, which had a high proportion of cash to stocks and

<sup>10</sup> "One in Four Borrowers Is Underwater," by Ruth Simon and James R. Hagerty, Wall Street Journal (online) November 25, 2009.

<sup>11</sup> "No Help in Sight, More Homeowners Walk Away," by David Streitfeld, New York Times (online) February 3, 2010.

options in the bonus payout.<sup>12</sup> Securities industry jobs have a multiplier effect among other city industries and their high compensation lifts total wage income citywide and fosters the consumption of luxury goods and real estate.

It is a different environment now in terms of the amount and composition of Wall Street compensation. Moreover, there is a degree of uncertainty as to what will happen to personal consumption when federal tax credits and programs designed by the Federal Reserve to lower business and consumer borrowing costs are allowed to end, and short-term interest rates begin to rise. For now, a measure of consumer sentiment released by the Conference Board for February shows that consumers have become much more pessimistic in their current outlook and, to a lesser extent, six months in the future.

**Personal Income Tax.** In the January modification, the FY 2011 personal income tax (PIT) forecast was raised by \$434 million to \$7.3 billion because of a projected year-to-year increase in Wall Street compensation based on 2010 earnings and a rebound in capital gains realizations in 2010 after a two-year slide. Withholding revenue, though boosted by higher bonus payouts, is projected to be undercut by ongoing job losses. Chart 1 on page 19 shows that on a common rate and base, the city anticipates that after exhibiting negative growth of 21.4 percent in FY 2009 and 1.5 percent in FY 2010, higher wage (e.g. Wall Street bonuses) and nonwage income (e.g. selling appreciated stocks) will propel PIT collections by 6.2 percent in FY 2011, 6.4 percent in FY 2012, 5.1 percent in FY 2013, and 4.4 percent in FY 2014.

The city's latest PIT forecast is conservative and likely achievable, but somewhat out of character with the historical data seen in Chart 1 on page 19. Since FY 1997, collections have posted double-digit gains of at least 11 percent annually on a continuing base and showed a remarkable tendency to bounce back the year after a decline, as seen in FYs 1993 and 2004. Although there are always distinct financial or economic events in each fiscal year, as long as interest rates rise slowly and new federal regulations are not seen as onerous, firms in the securities industry will adapt to the new environment and remain profitable (although not to the degree experienced in 2009).

The special circumstance at this point continues to be the very low interest rate environment created by the Federal Reserve that allowed major Wall Street firms to cut interest expenses and focus on resuming trading and investment banking (among other activities), which propelled profits to \$49.7 billion for the first three quarters of 2009. Many banks and bank holding companies in Wall Street were eager to repay the federal government and leave the Troubled Asset Relief Program, even if it produced a loss for their firms, and gain more leeway on executive compensation. For these reasons, there might be a bigger rebound in PIT collections than the city anticipates.

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<sup>12</sup> Besides Wall Street compensation, another support of higher sales tax revenue has been the resurgence in tourism after September 11<sup>th</sup>, particularly among higher-spending international visitors taking advantage of favorable exchange rates with the dollar.

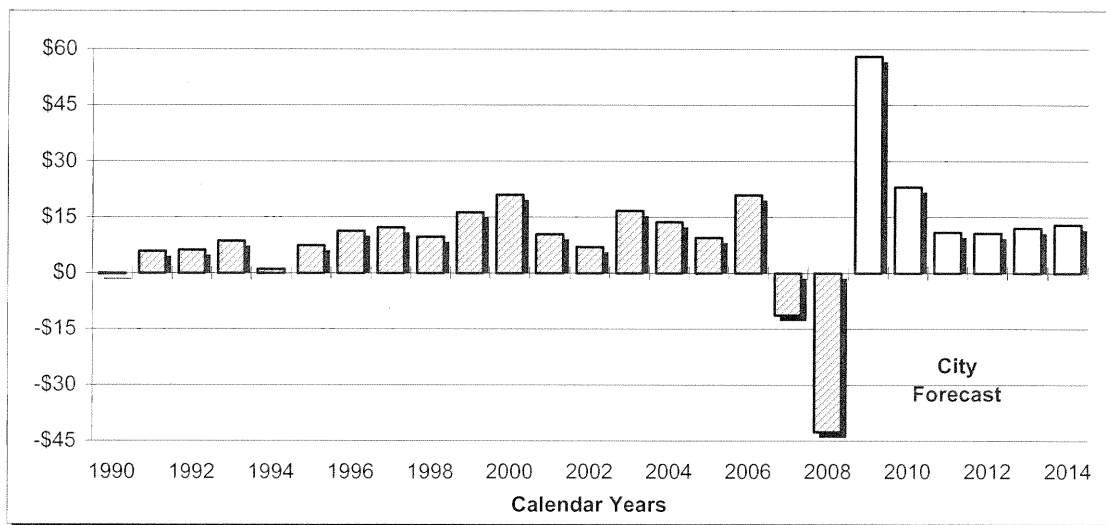


At this time, the paramount issue affecting PIT collections is the amount and type of compensation (or bonuses) that executives and other workers will receive based on securities industry profits for 2009, which may reach a historic high of \$60 billion for all of 2009. As seen in Chart 2, the city projects that profits for New York Stock Exchange (NYSE) member firms will top out at \$58.1 billion in 2009 and slip by \$35 billion in 2010 to \$23.1 billion, which would still be another record. As NYSE member firm profits reach a sustainable level after two years of extraordinary earnings, the city expects profitability to drop by \$12.1 billion in 2011 to \$11 billion and eventually reach \$12.9 billion by 2014. To put the city's forecast of securities industry profits for 2009 and 2010 into perspective, Chart 2 illustrates that from 1990 to 2006 profits only exceeded \$15 billion four times--in 1999 (\$16.3 billion), 2000 (\$21 billion), 2003 (\$16.8 billion), and 2006 (\$20.9 billion).

### CITY EXPECTS NYSE MEMBER FIRM PROFITS TO HIT NEW HIGHS IN 2009 AND 2010 AND REMAIN UNDER \$15 BILLION ANNUALLY THEREAFTER

CHART 2

(\$ in billions; pre-tax profits)



Bonus payouts are based on earnings from Wall Street firms from the prior year and are typically reflected in withholding collections from December through March. Based on year-over-year declines in withholding collections for December and January, it appears that the displeasure of policymakers in Washington and the general public have been heard on Wall Street.<sup>13</sup> As a result, the amount of compensation as a percent of revenue for several major banks and bank holding companies was reduced from the typical estimate of about 50 percent, and that numerous top executives will receive a much greater proportion of their bonuses in the form of stocks and options instead of cash. This bonus payout is distinct from other types of compensation used for employee retention and executive performance above agreed-to-levels that are often included in employee contracts. The city is currently expecting growth in the bonus pool from 30 to

<sup>13</sup> On a year-over-year basis, withholding collections fell by 6.8 percent in December and 11.6 percent in January, but are up 29.5 percent in February.

40 percent in FY 2010 over the prior year, which will support a 1.5 percent gain in withholding revenue during the same period.<sup>14</sup>

Since the current composition of the bonus payout favors stocks and options over cash for executives, there may be less of a boost to withholding revenue. However, it does not necessarily follow that there is a downward risk to the PIT forecast for FYs 2011-14 at this time, for several reasons. There are executives at financial services companies out of the spotlight and individuals with limited executive responsibilities (i.e. bankers, traders, brokers, and asset managers) whose compensation resembles the largesse of prior years, which may not have to be disclosed publicly.<sup>15</sup> The city may see additional revenue in the April final settlement as capital gains are realized on existing and new stock holdings and options, as well as other increases to taxable income.<sup>16</sup> For example, for certain employees, bonus payments in the form of restricted stock may be vested in months and not years.<sup>17</sup> Also, some companies pay dividends on restricted stock awarded to executives that has not vested yet.<sup>18</sup>

It is surprising how quickly major Wall Street firms were able to recover from the freezing up of the credit markets in 2008 and resume traditional activities such as trading, investment banking, and debt and equity underwriting, by taking advantage of new loan programs and an accommodative interest rate policy sponsored by the Federal Reserve. At this time, it is not clear if the dialogue concerning re-regulation of the financial sector, with legislation similar to the purpose behind Glass-Steagall or the Banking Act of 1933, will result in new laws.<sup>19</sup>

So far the proposals range from a fee on the liabilities of financial firms, limiting the size or complexity of banks, to a prohibition on proprietary trading (i.e. trading for their own accounts). While this discussion is taking place in Washington, there will be a

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<sup>14</sup> Besides less cash in the bonus payouts, job losses in the financial and non-financial sectors of the economy are also undercutting withholding revenue. The city estimates that from peak-to-trough 203,000 jobs will be lost citywide from the third quarter of 2008 to the third quarter of 2010. Of this amount, 54,000 jobs will be lost in the financial industry from the fourth quarter of 2007 to the third quarter of 2010. The securities subsector, part of the financial industry, may lose 33,000 highly-paid positions during the same time frame.

<sup>15</sup> "Wall St.'s Biggest Bonuses Go to Not-So-Big Names," by Eric Dash, New York Times (online) February 11, 2010.

<sup>16</sup> Due to weakness in the housing and stock markets, the city estimates that capital gains realizations slipped 43.4 percent in 2008 and 33.8 percent in 2009, before leaping 49.9 percent to \$36.3 billion in 2010 from an appreciation in the equity markets and a spin-up before the tax cut expires in 2011.

<sup>17</sup> "Banks See Ways Past Pay Limits," by David Enrich, Sara Schaefer Munoz, and Aaron Lucchetti, Wall Street Journal (online) January 28, 2010.

<sup>18</sup> "Bank Pay Gets Boost on the Sly," by Aaron Elstein, Crain's New York Business (online) January 31, 2010.

<sup>19</sup> Until its repeal in 1999, Glass-Steagall prohibited commercial banks from engaging in investment banking, selling securities and trading for their own accounts.

different and more normal economic environment for Wall Street firms to operate in during the financial plan period as the Federal Reserve implements an exit strategy. Such a strategy will include raising short-term interest rates (i.e. discount and federal funds rates), closing down additional loan facilities, and ending programs that supplied liquidity to credit markets by federal purchases of commercial paper, consumer debt, and mortgage securities.

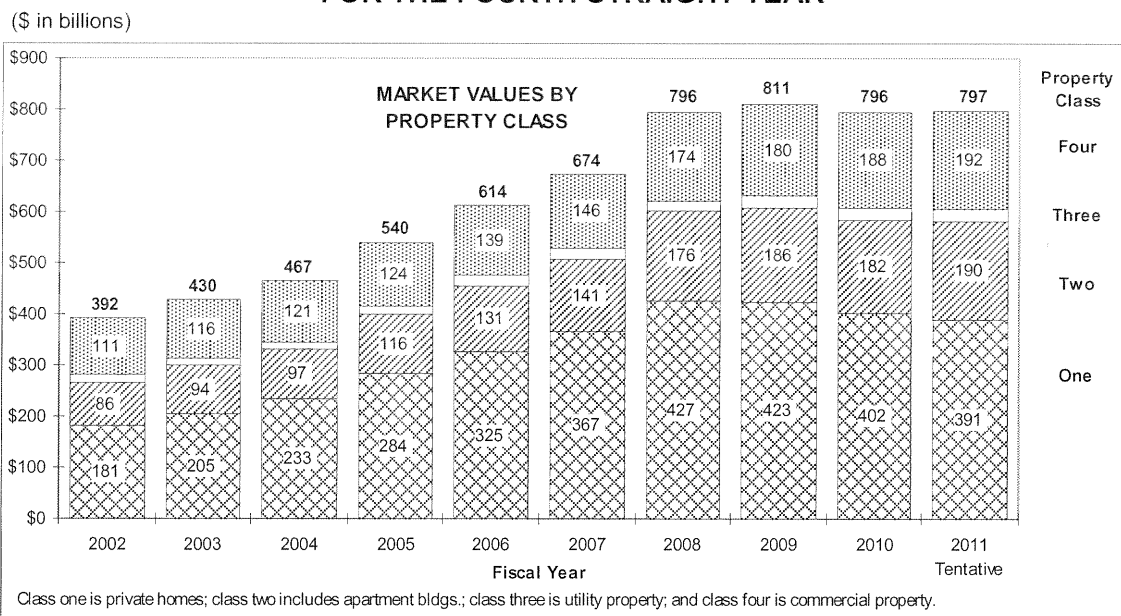
### **Property Values Fail to Grow**

Market values failed to grow on the city's tentative FY 2011 tax roll, remaining stagnant at about \$800 billion for a fourth consecutive year since this level was approached in FY 2008. These weak market value reports stand in sharp contrast to the 12.5 percent average annual market value growth achieved from FY 2002 to FY 2008. Despite the weakness in market values, the city expects property tax revenue to grow by nearly 5.5 percent, to about \$17 billion in FY 2011, largely due to the pass-through of untaxed market value growth that occurred before the local real estate market began to soften. The property tax growth rate drops below four percent in FY 2012, in the city's revenue plan, and then sinks to about one percent in FYs 2013 and 2014.

Were it not for several recent tax increases, the property tax would be much weaker. The city raised property tax rates by 18.5 percent in FY 2003, an increase that is still in effect. The city attempted to moderate the impact of this large rate increase by cutting tax rates by seven percent in FY 2008. As the recession took hold, looming deficits in FY 2009 forced the city to rescind the short-lived seven percent rate cut, along with a popular \$400 rebate program for home and apartment owners. With the repeal of these tax cuts, the 18.5 percent rate increase was fully restored and is scheduled to yield nearly \$3 billion annually in FYs 2011-2014.

### **MARKET VALUES STAGNATE AT THE \$800 BILLION LEVEL FOR THE FOURTH STRAIGHT YEAR**

CHART 3



The city's recent report on the tentative assessment roll for FY 2011 indicates that the market value of all taxable city property is \$797 billion. Market values have not changed appreciably since FY 2008 when properties were valued at \$796 billion, as shown on Chart 3 on page 23. The stagnation of market values indicates that the rapid growth of the real property tax must soon come to an end. Property tax assessments are extremely slow to respond to changes in market values because of a system of lags and phase-ins that are built into the city's assessment regulations.

In particular, for most commercial properties and large residential buildings, changes in market values are phased in over five years. To set FY 2011 billable assessments, these properties will phase in three years of subpar growth, blended with two substantial increases dating from before the stagnation hit. By FY 2012, these properties could have four years of weak growth to balance against the one remaining year of strong growth. It is for this reason that the city scaled back its property tax estimates by about \$200 million in FYs 2011 and 2012 and by \$375 million in FY 2013. Weak property tax estimates are likely to persist in all future city revenue plans until the real estate market recovers and shows several years of strong market value growth.

Although overall market values were virtually unchanged in FY 2011, private homes declined, while apartment buildings and commercial properties increased in value. Private home values fell by three percent to \$391 billion. Residential apartment buildings grew by four percent to \$190 billion, while commercial properties increased slightly by two percent to \$192 billion.

Among the major sectors of the commercial market, offices and stores kept pace with the two percent overall growth of the entire commercial property class. The hotel sector, which had previously been among the growth leaders, weakened severely. The negative trend for hotels is only partly revealed by the two percent decline of hotel market values in FY 2011. The tax roll report also indicates that the hotel sector expanded by 7,000,000 square feet, or 12 percent, during the year. Thus, the combination of a two percent decline in hotel market values with a 12 percent expansion in hotel capacity indicates that hotel values, on a square-footage basis, slipped by 14 percent.

Billable assessments increased 4.7 percent on the tentative roll for FY 2011. The city estimates that by June, corrections to the tentative roll will reduce the billable growth rate on the final tax roll to 4.1 percent, which represents a severe slowdown from the 6.7 percent billable growth in the previous year. The city expects the property tax to grow 5.5 percent, somewhat faster than billable growth because of a reduction in its estimated need for contingency reserves. In particular, the city rescheduled a \$30 million lien sale into FY 2011 from the previous year. Additionally, the city reduced its refund reserve by \$117 million, to \$319 million in FY 2011, from \$436 million in FY 2010.

Thus far in the first five months of FY 2010, the city has issued only \$98 million in property tax refunds, an amount that is smaller than most recent years. These results justify the relatively small refund reserve for FY 2011 and they also indicate that the FY 2010 refund reserve might be trimmed, provided there is no upturn in refunds later in the year. Despite the favorable property refund trend, the city must exert caution before cutting its refund reserves, especially in the late stages of a real estate downturn, when

assessment disputes tend to proliferate. It can take many years for over-assessment complaints to wind their way through Tax Commission hearings and Law Department reviews before ending up in court. Thus the city needs to monitor the outyear risk of a surge in assessment lawsuits and the possible resulting refund claims.

Most properties in the city decreased in market value. There were 398,000 properties that increased in value due to market changes, versus 604,000 properties that decreased in value. This downtrend was most pronounced for private homes, which had 222,000 properties that increased versus 452,000 that decreased. Apartment properties were almost evenly divided, with 117,000 increases versus 113,000 decreases. Most commercial properties tended higher, with 59,000 increases versus 39,000 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.

Construction-related tax base growth does not appear to be an important factor in the tax roll report. The residential housing stock increased by 16,000 units, or 0.5 percent in FY 2011, which is down slightly from the 18,000 new units in FY 2010. Both of these recent apartment growth numbers are substantially smaller than the 40,000 unit growth that was the norm at the end of the building boom in FYs 2007-2009.

Office space increased on the FY 2011 tax roll by nearly 15,000,000 square feet, but this increase was completely offset by a corresponding decrease in the commercial condominium sector in the previous year. It appears that weak sales of commercial condominiums necessitated the reclassification of about 15,000,000 square feet of commercial condominium space to standard office rental space, shrinking the one sector while expanding the other. Hotels expanded by 7,000,000 square feet, or 12 percent, in FY 2011, following similar strong growth in the previous year.

### **Miscellaneous Revenue**

Compared with the November modification, the city's latest projections for the core categories of miscellaneous revenue in FY 2011 advanced by \$62.3 million to \$2.6 billion, because of higher fees (\$31.7 million), licenses (\$9.5 million), fines (\$9.2 million), and rent (\$9 million).<sup>20</sup> In FY 2011, core category revenue is anticipated to grow by only 0.8 percent from the prior year to \$2.6 billion, but gain momentum over the course of the plan period and end FY 2014 up 2.2 percent at just under \$2.7 billion.

Charge revenue, led by higher parking meter rates, Department of Buildings fees, and Fire Department inspections, is expected to grow by 2.3 percent from the prior

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<sup>20</sup> The core categories are licenses (with franchises), fees (or charges), interest, rent, fines, and a residual miscellaneous category that omits nonrecurring actions, housing revenue, tobacco proceeds, and payments from the Health and Hospitals Corporation. Revenues that are designed to offset related expenditures, such as water and sewer charges, are also excluded from the analysis because they cannot help achieve budget balance.

year to \$755 million in FY 2011 and remain at that level through FY 2014. In a new initiative, passenger and commercial parking rates will rise from \$2 to \$2.50 per hour at multi-space meters in Manhattan, which will lift parking meter collections to \$157.3 million in each of FYs 2011-14. Higher projected revenue from the city's cable television franchise, which is forecast at over \$122 million annually in FYs 2011-14, is the main impetus in the license category. Licenses are expected to grow three percent in FY 2011 to \$493.4 million and reach \$500 million by FY 2014.

With the purpose of improving the enforcement and adjudication of code violations related to buildings, health, traffic, and the environment, fine revenue is expected to reach \$896 million in FY 2011, but fall by three percent or \$26.8 million by FY 2014. The slip in the outyear fine projection is not related to weakness among the various types of fines, but to the ending of a two-year program in FY 2011 that is designed to collect overdue debt. Rental income is likely to benefit from additional revenue from hotel leases and other commercial agreements that total \$65.9 million in each year of FYs 2011-14. While there may be growth among other sources of rental income, commercial rents and airport rent from the Port Authority are expected to be the main supports for the category forecast of \$223 million annually in each year of the plan. Based on historical patterns of growth and new initiatives, the core categories could be higher by \$25 million in FY 2010, \$50 million in FY 2011, \$75 million in FY 2012, \$100 million in FY 2013, and \$125 million in FY 2014.

## **EXPENDITURE CHANGES IN THE JANUARY MODIFICATION**

Facing a \$4.1 billion budget gap in FY 2011 at the time of the November modification, the city has since been able to close the gap by reducing its expenditures by \$2.9 billion accompanied by \$1.2 billion in additional revenues. As shown in the figure to the right, the largest component of the reduction is the change in the city's Budget Stabilization Account (BSA), which was increased by \$2.3 billion in FY 2010 and subsequently rolled into FY 2011 to prepay debt service.

<b>Changes in FY 2011 Expenses Since November Modification</b> (\$ in millions)	
Change in BSA	(\$2,344)
Personal Service	(859)
Debt Service	(39)
Public Assistance	264
Medical Assistance	22
Other	15
<b>Total Changes</b>	<b>(\$2,941)</b>

Also, personal service cost estimates were taken down from a reduction in wage costs of \$1.6 billion and a drawdown of the Retiree Health Benefits Trust of \$395 million. However, offsetting this almost \$2 billion reduction is a \$259 million increase in pension costs and a \$917 million increase in fringe benefits, thus producing \$859 million in net savings. Lastly, debt service was reduced by \$39 million. Conversely, spending has risen in Public Assistance due to a rise in caseloads and reimbursable grants of \$264 million, followed by a rise in Medical Assistance costs of \$22 million.

## **SOURCES OF EXPENDITURE GROWTH**

Projected spending over the life of the city's financial plan will grow by 16 percent between FYs 2010 to 2014. The January modification estimates total expenditures of \$62.6 billion in FY 2010, rising by more than \$10 billion, to \$72.6 billion

by FY 2014, as shown in Table 5. Over the same period, it is expected that personal service will increase by eight percent, driven mainly by growing expenditures in fringe benefits of \$1.7 billion, or 24.5 percent, and increasing pension costs to about \$1.2 billion, or 17.9 percent.

**TABLE 5 THE CITY'S EXPECTED EXPENDITURE GROWTH BETWEEN FYs 2010 AND 2014**  
(yr/yr percent change, \$ in millions)

	FYs 2010-11	FYs 2011-12	FYs 2012-13	FYs 2013-14	FYs 2010-14	Level in FY 2010	Level in FY 2014
<b>Total Expenditures</b>	<b>0.9%</b>	<b>7.8%</b>	<b>4.1%</b>	<b>2.5%</b>	<b>16.0%</b>	<b>\$62,583</b>	<b>\$72,598</b>
<b>Total PS</b>	<b>0.4%</b>	<b>0.3%</b>	<b>4.9%</b>	<b>2.1%</b>	<b>8.0%</b>	<b>\$35,217</b>	<b>\$38,018</b>
Salaries and Wages	(2.7%)	(1.6%)	3.1%	0.8%	(0.5%)	21,581	21,479
Fringe Benefits	3.3%	0.3%	13.3%	6.1%	24.5%	7,000	8,715
Pensions	7.6%	6.0%	1.9%	1.4%	17.9%	6,636	7,825
<b>Total OTPS</b>	<b>1.6%</b>	<b>17.2%</b>	<b>3.1%</b>	<b>2.9%</b>	<b>26.4%</b>	<b>\$27,366</b>	<b>\$34,580</b>
Public Assistance	(1.1%)	2.6%	(0.7%)	0.0%	0.7%	1,580	1,591
Medicaid	14.0%	8.3%	3.0%	2.9%	30.8%	4,951	6,478
Debt Service	22.4%	13.5%	4.7%	3.6%	50.7%	4,524	6,815
Other OTPS	(7.7%)	23.5%	3.0%	2.8%	20.7%	16,312	19,695

Note: Includes city, state, and federal funds. Numbers may not add due to rounding.

The climb in fringe benefits is associated with the rising cost of health insurance and workers' compensation for city employees. Also, reflected in the growth is the removal of a healthcare-related initiative that would have reduced the city's annual health cost from the collection of an employee 10 percent contribution. Lastly, a technical adjustment for the restoration of a planned drawdown of the Retiree Health Benefits Trust in FY 2013 to help fund pension system losses is also reflected in the budget, causing costs to jump between FYs 2012 and 2013.

The city's pension costs will increase due to the inclusion of a valuation update that incorporates investment losses from prior years and the impact of changes to actuarial assumptions and methods used to calculate pension benefits and liabilities. Further, the city has removed planned annual savings of \$200 million from the creation of a Tier 5 in the pension systems and has restored those savings to its expense budget. Alternatively, due to a change in collective bargaining policy with city employees, the city expects to reduce proposed increases in wages in total by about \$103 million from FY 2010 to FY 2014. Between FYs 2010 and 2011 and FYs 2011 and 2012, the city expects savings of \$588 million and \$326 million, respectively. However, offsetting these financial plan savings are anticipated wage increases of 1.25 percent in each of FYs 2013 and 2014.

The city's other than personal service expenditures are expected to increase by 26.4 percent, or more than \$7 billion, in FYs 2010-2014. The primary cause of the growth in this area is debt service, which is projected to increase by about \$2.3 billion, or more than 50 percent, between FYs 2010 and 2014. While the city expects that public assistance costs will remain relatively flat at about \$1.6 billion, medical assistance spending will revert to its historical growth level of three percent after FY 2011 (costs are capped at three percent annually with the state financing any costs above the cap) when

federal stimulus money ends. The changes in the Federal Medical Assistance Percentages (FMAP) rates enacted by the federal government as part of its stimulus package enabled the city to reduce expenditures for Medicaid from October 2009 to December 2011 by \$1.6 billion. After receiving \$447 million in FY 2009, the city will see further savings of \$850 million in FY 2010 and \$295 million in FY 2011.<sup>21</sup>

### **Agency Program for FYs 2011 - 2014**

While the city projects that FY 2011 will end in balance, substantial budget gaps will remain in FYs 2012 through 2014. The city's ability to balance its budget in FY 2011 and reduce gaps in the outyears of the financial plan is attributable in part to significant cuts in agency spending. As previously discussed, city agencies are expected to reduce spending by more than \$484 million in FY 2010. Subsequent reductions are expected to save substantially more starting in FY 2011 with reduction targets that were asked for in November 2009 of four percent for the Department of Education (DOE) and uniformed agencies, and eight percent for all other agencies, amounting to \$1.2 billion in FY 2011 and recurring annually thereafter.

As shown in Table 6, agencies found expenditure savings of more than \$1 billion in each of FYs 2011 through 2014, with slightly higher savings expected in FY 2013 of \$1.1 billion. Additionally, some agencies were able to find ways to collect new or higher revenues, which added to the total agency program of about \$90 million in FY 2011, more than \$83 million in each of FYs 2012 and 2013, and \$78 million in FY 2014. In total, the city expects to be able to reduce operating expenses by more than \$1.1 billion in each of FYs 2011 to 2014, with FY 2013 coming very close to the requested targeted savings of \$1.2 billion.

TABLE 6

### **AGENCY PROGRAM FOR FYs 2011 - 2014**

(\$ in thousands)

<b>Agency Category</b>	<b>FY 2011</b>	<b>FY 2012</b>	<b>FY 2013</b>	<b>FY 2014</b>
Uniformed Services	(\$259,934)	(\$313,863)	(\$341,790)	(\$289,904)
Health and Welfare	(163,336)	(159,400)	(157,338)	(158,011)
Mayoral	(180,562)	(175,559)	(166,851)	(169,601)
Major Organizations	(332,240)	(332,240)	(332,240)	(332,240)
Elected Officials	(30,398)	(30,432)	(30,432)	(30,432)
All Other	(59,916)	(59,916)	(79,307)	(90,142)
<b>Total Expense PEG</b>	<b>(\$1,026,386)</b>	<b>(\$1,071,410)</b>	<b>(\$1,107,958)</b>	<b>(\$1,070,330)</b>
<b>Total Revenue PEG</b>	<b>(89,528)</b>	<b>(83,191)</b>	<b>(83,517)</b>	<b>(78,348)</b>
<b>Total Program</b>	<b>(\$1,115,914)</b>	<b>(\$1,154,601)</b>	<b>(\$1,191,475)</b>	<b>(\$1,148,678)</b>
(Negative) numbers decrease the gap.				

As part of the citywide spending cuts, reductions to headcount are planned, though much of the reductions will stem from attrition. For example, uniformed services will reduce expenditures by \$260 million in FY 2011, over \$300 million in FYs 2012 and 2013, and about \$290 million by FY 2014. In this area, the Police Department,

<sup>21</sup> A bill, which has since been passed by the House of Representatives, would extend FMAP and save the city an additional \$433 million. The bill, known as Jobs for Main Street Act, still requires Senate approval, which remains uncertain.



having the largest budget of the four agencies, will produce much of the savings from maintaining a lower number of police officers by deferring scheduled cadet classes until FY 2012 and allowing for positions to remain vacant after officers retire.<sup>22</sup> The attrition savings from this action, which is expected to reduce headcount by 1,292 uniformed personnel, is expected to save the Department more than \$55 million in FY 2011, about \$113 million in FY 2012, and over \$130 million in each of FYs 2013 and 2014. Also, the Department has set in place an overtime reduction policy that is expected to yield \$50 million in annual savings.

Further targeted headcount reductions will impact the Fire Department, which will attrite 400 firefighters by eliminating the fifth firefighter on 60 engine companies and by also eliminating 20 firefighter posts. These department PEGs will produce combined savings of almost \$8 million in FY 2011 that will ramp up to \$22 million in FY 2012, \$25 million in FY 2013, and exceed \$27 million in FY 2014.

Other substantially large reductions in the agency program will come from the Major Organizations category, the majority of which will come from the DOE. As mentioned in "FY 2010 Agency Program" starting on page 10, the city anticipates considerable savings from reducing the United Federation of Teachers (UFT) and the Council of School Supervisors and Administrators (CSA) projected raises by two percent. The net savings, after federally mandated funding for disabled students, will increase significantly in FYs 2011 to 2014, over the savings in FY 2010, with the addition of a pension credit and the full phase-in of the contract savings. The city expects to save nearly \$317 million in each of those fiscal years.

As previously mentioned, to meet some PEG savings, reducing headcount was deemed necessary, though the majority of the reductions will be through attrition. As the figure to the right shows, 4,286 personnel will be either laid off or their positions left vacant when they leave the city's employment. Of this amount, 834 will be layoffs and 3,452 will be through attrition. Absent are any headcount adjustments to Major Organizations, particularly the DOE. The city reports that the targeted PEG for the Department would have resulted in 2,500 fewer teachers, but the savings generated from the two percent decrease in the upcoming labor contract with the DOE has allowed the Department to circumvent the loss of personnel.

<b>FY 2011 Total Headcount Reductions</b>	
<b><u>Agency Category</u></b>	
Uniformed Services	(1,966)
Health and Welfare	(780)
Mayoral	(1,540)
<b>Total Reduction</b>	<b>(4,286)</b>

There are expected headcount reductions in FY 2010 as well, which will total 891. The need for the additional layoffs stems from the diminishing rate of attrition the city is currently experiencing. The retirement of city employees has slowed from the historical trend of about six to seven percent to approximately 4.2 percent due to the economic downturn.

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<sup>22</sup> However, the city was able to launch a small cadet class in January 2010 with the aid of federal funding.

## **Collective Bargaining and Labor Contracts**

The city negotiates with 17 different unions, which represent more than 300,000 city employees. About half of these contracts expire in 2010 with the remaining expirations split between 2011 and 2012, as shown in the figure to the right. One standout is the UFT labor contract, which expired on October 31, 2009, and has now moved to nonbinding arbitration after an impasse resulted in the last round of labor negotiations.

Labor Contract Expirations		
Employee Union	Start	Expiration
UFT	10/13/07	10/31/09
NYS Nurses	12/01/07	01/20/10
DC 37	03/03/08	03/02/10
CSA	07/01/03	03/05/10
PBA	08/01/06	07/31/10
Uniformed Firefighters	08/01/08	07/31/10
EMS and EMTs	07/01/06	09/05/10
Local 237	09/13/08	09/25/10
Correction Officers	11/01/09	10/31/10
Uniformed Fire Officers	03/20/07	03/19/11
Sergeants' Benevolent	06/01/05	07/31/11
Uniformed Sanitationmen	03/02/07	09/20/11
Lieutenants' Benevolent	11/01/09	10/31/11
Detective Endowment	04/01/08	03/31/12
Captains' Endowment	11/01/03	03/31/12
Asst & Deputy Wardens	03/01/08	06/30/12
Sanitation Officers	11/13/07	07/01/12

Under pressure to balance the FY 2011 budget and narrow the gaps in FYs 2012 to 2014, the city has reduced their assumed wage increases for the UFT and the CSA by two percent to generate the necessary spending reductions in the DOE while staving off any headcount reductions.<sup>23</sup> Under the new labor assumptions, pedagogical employees of the DOE will receive increases of two percent per year on salaries of \$70,000 and below, but capped at \$2,828 for salaries over \$70,000 for the period starting on November 1, 2009 and ending November 1, 2010. The members of the CSA will have an identical increase structure starting March 6, 2010 and ending March 6, 2011.

Additionally, in the January modification, funding for the next round of collective bargaining for the remaining labor contracts, previously assumed to be 1.25 percent has been removed from the budget. Alternatively, the city has proposed that any wage increase in the next round of collective bargaining be self-funded through productivity or other savings. Possible funding could come from employee contributions to health insurance and the creation of a Tier 5 in the pension system.<sup>24</sup> The city estimates that these funding proposals could produce potential labor savings of \$557 million in FY 2011 and grow to \$651 million by FY 2014. However, to the extent that wage increases are not self-funded, we estimate that a one percent wage increase could cost the city about \$335 million.

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<sup>23</sup> The projected savings from the wage reductions are fully summarized in "Agency Program for FYs 2011 - 2014" starting on page 28.

<sup>24</sup> The state legislature has passed the Governor's pension reform bill, which contains provisions that implement a Tier 5 agreement between the city and the United Federation of Teachers. The new tier will apply to all new hires and will require a 10-year vesting, employee contributions of 4.85 percent for the first 27 years of service and 1.85 percent thereafter, and set an annual return of seven percent on annuity accounts, which is 1.25 percent lower. In addition, there may be future savings in the Police and Fire pension systems due to the Governor's veto of legislation allowing new hires to join the more lucrative Tier 2 of the pension system.

## Department of Education

The January modification is projecting the Department of Education (DOE) budget to rise from \$18.821 billion in FY 2011 to \$19.716 billion in FY 2014. This is a reduction from the November modification where the FY 2011 budget was projected at \$19.367 billion and the FY 2014 budget was \$19.781 billion. As shown in Table 7, the reductions were made in personal service (PS), which includes salaries and wages, and fringe benefits. Conversely, other than personal service (OTPS) shows an increase over the life of the plan averaging \$219 million annually. These changes net to decreases of \$546 million in FY 2011 to \$65 million in FY 2014.

**DOE EXPENSE BUDGET JANUARY MODIFICATION COMPARED TO THE NOVEMBER MODIFICATION**

TABLE 7

(\$ in millions)				
	FY 2011	FY 2012	FY 2013	FY 2014
January PS	\$12,809	\$12,356	\$12,895	\$13,056
November PS	<u>13,563</u>	<u>12,677</u>	<u>13,201</u>	<u>13,359</u>
Increase/ (Decrease)	(\$753)	(\$321)	(\$306)	(\$303)
January OTPS	\$6,011	\$6,236	\$6,468	\$6,661
November OTPS	<u>5,805</u>	<u>6,040</u>	<u>6,233</u>	<u>6,423</u>
Increase/ (Decrease)	\$206	\$196	\$235	\$238
January Total	\$18,821	\$18,592	\$19,363	\$19,716
November Total	<u>19,367</u>	<u>18,717</u>	<u>19,433</u>	<u>19,781</u>
Increase/ (Decrease)	(\$546)	(\$125)	(\$70)	(\$65)
Note: Numbers may not add due to rounding.				

According to the city, the state Executive Budget for SFY 2010-11 proposed a reduction in education funding of \$493 million. The majority of the reduction, \$442 million, is in aid to New York City schools. The remaining \$51 million is a shift in cost to the city from the state for mandated special education services. It is uncertain, at this time, if the adopted state budget will include any of this proposed reduction. The January modification does not address this potential loss of state aid.

In an attempt to offset additional state aid reductions, the state has advanced \$129 million of the federal stimulus funds from the American Recovery and Reinvestment Act (ARRA) that was expected to be allocated in FY 2011 to FY 2010, bringing this fiscal year's appropriation of stimulus funds to \$555 million, while reducing FY 2011 by the same amount to \$227 million. With the state and city facing large budget gaps, the end of this federal program in FY 2012 will leave a gap of over \$825 million in DOE's budget going forward.

The city had placed sufficient resources into the labor reserve to fund the teachers' contract that included four percent wage increases in both FYs 2010 and 2011. In the January modification, the city has stated that this was no longer affordable without a major reduction in teaching positions. The city now proposes increases of two percent on the first \$70,000 of salary for teachers, principals and managers in both FYs 2010 and 2011. This change is expected to generate savings of \$357 million in FY 2011.

Of this savings, \$317 million will go towards the Program to Eliminate the Gap (PEG) and \$40 million to special education expenses.

Federal stimulus funds provided by the ARRA continue to provide an offset to reductions in state aid. Federal aid in FY 2011 is expected to provide 14 percent of DOE's funding. In FY 2012, without the stimulus funding, federal aid diminishes by more than \$825 million, providing only a nine percent share of DOE's budget. The Department will face difficult challenges in FYs 2011 and 2012 to deal with an indeterminate reduction in state aid, as well as the impending loss of federal stimulus funds.

#### **Uniformed Overtime for FYs 2011 - 2014**

Overtime spending in the four agencies that comprise the uniformed services is expected to exceed \$800 million in FY 2010. However, the city can control this operating expense, unlike other budgetary areas like pension costs. The growth in employee overtime costs has been examined carefully in the city's latest financial plan and is prudently being addressed. Much of the spending issue lies within the ranks of the Police and Fire Departments. While historically, cost overruns are typical in the Police Department, it is of recent concern that additional resources have been allocated to deal with a number of issues in the Fire Department with one being a greater sick rate among uniformed personnel.

To address the issue, the city is implementing a comprehensive mandated overtime reduction and control system to rein in expenditures in this budgetary area. While the plan is to blanket agencies citywide, the most prominent area of focus will be in the Police Department, where substantial savings are expected to be obtained. The locus of the reduction in these spending levels will materialize through a change in management strategies. The city's decentralized approach will concentrate the accounting of overtime spending at the precinct level and any efficiency found to reduce spending will be brought to the agency level.

The Police Department is considering a strategy that will entail a significantly wider observation of the top overtime per hour earners in the Department. Currently, that observation is conducted over the top 400 earners. The use of a larger and more diverse pool could make it clearer to management which personnel are disproportionately receiving overtime hours as compared to other earners. Management believes that major efficiencies will be found in this high-cost area. The quantified savings from this initiative were summarized in "Agency Program for FYs 2011 - 2014" starting on page 28.<sup>25</sup>

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<sup>25</sup> While mandated reductions in the Police Department will be put in place agency-wide, important and successful ongoing operations such as Impact and Atlas, which are funded mainly with overtime expenditures, will continue to operate with no disruptions.

While in the past, there was resistance to reduce spending of overtime or curb its growth, Department management fully expects these measures, as part of its agency program, to occur and bring forth the targeted PEG savings. Nonetheless, based on historical spending patterns in the uniformed agencies, we believe that the city underbudgeted overtime by approximately \$200 million annually, as shown in the figure to the right. Of course, if these cost-containment measures are effectively executed by management, then our risks will be reduced.

Overtime Estimates and Risk (\$ in millions)		
Fiscal Year	City Estimate*	Budget Risk**
2011	\$663	(\$210)
2012	\$672	(\$201)
2013	\$676	(\$197)
2014	\$676	(\$197)
* Uniformed and Civilian Personnel		
**(Negative) numbers increase gap		

### **Pension Costs**

As shown in the growth table on page 27, the city estimates that employee wages, benefits, and pension costs will grow by eight percent, or \$2.8 billion, from FY 2010 to FY 2014. While wages fall by about \$103 million due to the change in the city's labor policy, the net difference in the increase is being driven by employee fringe benefit and pension expenses. As noted in the table, pension costs over the period are projected to rise from \$6.6 billion to \$7.8 billion, an increase of \$1.2 billion, or nearly 18 percent. We estimate that at an annual average, city pension costs are growing at 4.2 percent, which is a figure higher than the average annual growth of total city expenditures.

The city's pension obligations have been compounded by poor investment performance in FY 2008 and FY 2009, with consecutive losses of 5.4 percent and 18.3 percent, respectively. The losses resulted in the erosion of billions of dollars of asset value and required the city to turn to drawing down the Retiree Health Benefits Trust fund to mitigate the losses, as reflected in the current plan, by about \$1.1 billion over FYs 2010 to 2012. Losses in the pension systems' actuarial value occur if the systems do not reach a required rate of return of eight percent.

The fiscal year started off well for the pension systems as the markets climbed steadily and pushed the pension systems' returns above 15 percent, bringing the market value of assets held by the systems to almost \$100 billion, thus making up for a great deal of the loss incurred in FY 2009. However, at the start of 2010, the markets have become jittery and have lost momentum as uncertainties in the Euro Zone over financial troubles in Greece have become center stage. This uncertainty is compounded by the possibility that the Federal Reserve Bank may begin to start to tighten its monetary policy. Our analysis shows, through February, returns in the pension systems have lost ground and we estimate a 14.4 percent return, or an asset gain of about \$12 billion.

## **RISKS AND OFFSETS**

Our risk evaluation of the city's financial plan is shown in Table 3 on page 5. Due to the strength of the finance sector recovery, we see an upside potential for the city's nonproperty taxes of \$350 million in FY 2010 and an extra \$200 million in each of FYs 2011-2014. We expect stronger collections primarily for the business income taxes and the sales and personal income taxes.

We also hold at risk two tax fairness proposals that would add \$219 million in FY 2011, \$241 million in FY 2012, \$262 million in FY 2013, and \$284 million in FY 2014, because their enactment is outside of the city's control. One initiative would broaden the city's sales tax base to include the sale of aviation fuel to commercial airliners. The city estimates that this measure would raise \$169 million in FY 2011, \$183 million in FY 2012, \$191 million in FY 2013, and \$206 million in FY 2014. The other initiative would extend the city's mortgage recording tax to cooperative apartment loans. In addition to closing a loophole in the city's mortgage tax, this proposal would generate \$50 million in FY 2011, \$58 million in FY 2012, \$71 million in FY 2013, and \$78 million in FY 2014. This proposal is also contained in the Governor's executive budget, but a similar proposal in FY 1994 was not approved.

Based on historical patterns of growth and new initiatives, the core categories of miscellaneous revenue could be higher by \$25 million in FY 2010, \$50 million in FY 2011, \$75 million in FY 2012, \$100 million in FY 2013, and \$125 million in FY 2014. We estimate that uniformed services overtime, based on our analysis and historical growth rates, will exceed what the city has budgeted by \$64 million in FY 2010, \$210 million in FY 2011, \$201 million in FY 2012, and \$197 million in each of FYs 2013 and 2014.

Additionally, the city has not allocated funding to cover operating expenditures for pollution remediation for each of FYs 2011-14. The Comprehensive Annual Financial Report of the Comptroller identified such expenses at \$176 million for FY 2009, when the city was allowed to issue bonds for this purpose. The city was permitted by the Financial Control Board to defer implementation of the Government Accounting Standards Board requirement to fund pollution remediation in its operating budget until July 1, 2010. Beginning in FY 2011, the city will need to comply with the funding requirement. We expect that funding for pollution remediation will commence in the executive budget.

The proposed reduction in the state's assistance to municipalities is a potential risk to the city's financial plan. The state has planned a reduction to the Aid and Incentives for Municipalities (AIM) program, which would result in decreases in funding to the city of \$328 million in each of FYs 2010 and 2011. The city has sufficient surplus resources in FY 2010 to make up the potential reduction in state aid. However, use of the surplus in this way would reduce the amount of funds available to prepayment FY 2011 expenses, creating a combined budget shortfall for FY 2011 of \$656 million that would have to be addressed with additional actions. Based on the state's fiscal condition, we have chosen to continue to risk \$328 million of AIM funding in each of FYs 2012 to 2014, as it is possible for the reduction in state aid to remain throughout the life of the plan.

Based on our risk evaluation, we estimate that the city could have additional expenses of \$17 million, \$683 million, \$671 million, \$663 million and \$660 million in FYs 2010-14, respectively. The additional expenses in FYs 2012 to 2014 add to the city's currently projected multi-billion dollar budget gaps in these fiscal years. Consequently, we project the city is facing budget gaps estimated at \$3.8 billion in FY 2012, \$4.3 billion in FY 2013 and \$4.5 billion in FY 2014.

In its January modification, the city has chosen not to include any budgetary impact of the state executive budget. The city has decided to wait until the state budget is adopted since there are likely to be major changes. By city estimates, the potential impact of the state's proposed budget would reduce state funding by about \$1.3 billion and require the city to make further difficult budgetary decisions.

## **ANALYSIS OF THE CITY'S DEBT**

In the city's operating budget, debt service cost is one of the largest and fastest growing components. It is driven primarily by the amount of bonds sold to finance the capital program. In addition, the schedule of debt service payments is a function of the maturity structure of and the interest rates on the outstanding bonds. In the current modification, the size of the capital program increased, continuing an expansion from the scaled-down plan that was presented in January 2009. Nonetheless, debt service costs have been lowered in FYs 2010 and 2011 through the restructuring of debt and the realization of low interest rates. In this section of the report, we discuss how, in utilizing bond refundings and capitalizing on a low interest rate environment, the city is able to generate debt service savings for the operating budget and temporarily neutralize the impact of its augmentation of the capital program. In the process, we highlight current developments and lay out the structural composition of the city's outstanding debt.

### **An Expanding Capital Program**

The city's capital plan in the January modification totals \$43 billion for FYs 2010-14, which amounts to an annual average \$8.6 billion of contracts, otherwise known as commitments. As can be determined from the figure to the right, 60 percent of the total amount of capital commitments is scheduled to be funded with tax-supported city general obligation (g.o.) and New York City Transitional Finance Authority (NYCTFA) revenue bonds, while 18 percent will be funded with fee-based revenue bonds sold by the Water Authority for environmental projects, and the remaining 22 percent will be supported by noncity funds.

<b>Capital Commitments by Funding Sources</b> (\$ in billions)	
	<b>FYs 2010-14</b>
City Funded:	
G.O./NYCTFA	\$25.8
Water Authority	7.7
Subtotal	\$33.5
Noncity Funded	\$9.5
<b>Total</b>	<b>\$43.0</b>

The current size of the capital plan reflects a \$779 million increase in commitments since November 2009, \$663 million of which are funded by city g.o. and NYCTFA revenue bonds. The city's capital program has been growing incrementally since it was last reduced in January 2009 to contain the growth in debt service costs.<sup>26</sup> Indeed, since January 2009, tax-supported commitments have grown in increments by a combined \$4 billion for FYs 2009-14, as illustrated in the figure to the right.<sup>27</sup>

G.O. & NYCTFA Capital Commitments January 2010 Compared to January 2009 (\$ in millions)				
FYs	Jan 2010	Jan 2009	\$ Change	% Change
2009	\$5,081*	\$8,068	(\$2,987)	(37.0%)
2010	8,478	5,479	2,999	54.7%
2011	5,636	3,797	1,839	48.4%
2012	3,872	2,705	1,167	43.1%
2013	4,087	3,628	459	12.7%
2014	3,714	3,207	507	15.8%
<b>Total</b>	<b>\$30,868</b>	<b>\$26,884</b>	<b>\$3,984</b>	<b>14.8%</b>
*Actual				

### **Debt Profile**

With an expanding capital program, one might expect debt service costs would increase from plan to plan. In the January 2010 modification to the financial plan, debt service costs for the city and NYCTFA, excluding prepayments, are projected to increase from \$4.5 billion in FY 2010 to \$6.8 billion in FY 2014, for an average annual growth rate of 10.8 percent. However, compared to projections in the November 2009 modification, debt service costs are lower in FYs 2010 and 2011 by \$116 million and \$39 million, respectively; but higher in FYs 2012-14 by \$60 million, \$39 million and \$30 million, respectively. The reductions in debt service costs for FYs 2010 and 2011 represent savings that were achieved from actual interest rates on bonds being lower than previously assumed and from the restructuring of debt through the sale of refunding bonds. The increases in debt service costs for FYs 2012-14 can be traced to additional borrowing for the capital program, but mostly to changes in the accounting for and timing of federally-sponsored interest savings.

### **Interest Costs**

As bond issuers, the city and the NYCTFA have been beneficiaries of a low interest rate climate during the current fiscal year. By the end of the fiscal year, the two are expected to have sold a combined \$10.2 billion of bonds – \$6.9 billion to support capital spending and \$3.3 billion to generate refunding savings. The interest rates on bonds already sold in the fiscal year generally have been lower than projected. Even more so, the rates on outstanding variable rate bonds have been significantly lower for the current fiscal year than previously assumed. The plan captured \$104 million of savings expected to be realized in FY 2010 on \$6.8 billion of outstanding variable rate city debt. For the duration of the fiscal year, the city is still using conservative interest

<sup>26</sup> The January 2009 Financial Plan reflected a 22 percent reduction in targeted commitments for FYs 2010-13, after adjusting for unattained commitments in FY 2009. Beyond FY 2013, targeted commitments were reduced by 30 percent in each year through FY 2019.

<sup>27</sup> The \$3 billion increase in commitments for FY 2010 primarily reflects the roll of unattained contracts from FY 2009. When the shortfall in contracts for FY 2009 is taken into account, commitments are projected to expand by a net \$4 billion.

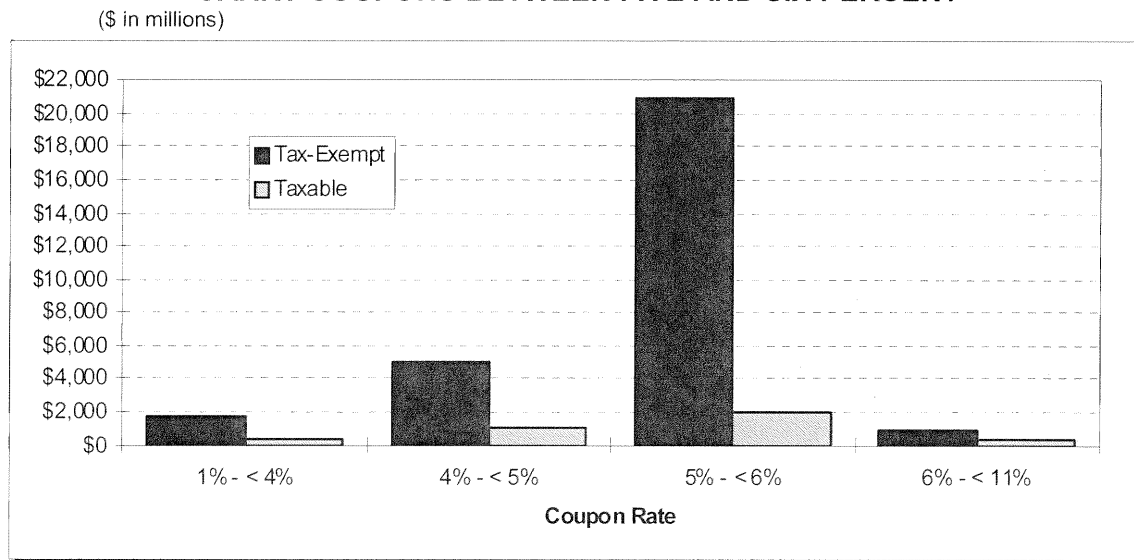


rate projections on its outstanding variable rate debt, at 2.32 percent for tax-exempt bonds and 4.21 percent for taxable bonds, as the variable rate market has been known to be volatile.

On the sale of fixed rate debt, the January modification assumes conservatively that the city will pay a flat rate of 5.78 percent on all issuances undertaken in FYs 2010 and 2011, as well as higher rates of 6.28 and 6.78 percent thereafter, while the NYCTFA will pay 5.58 percent in FYs 2010 and 2011, as well as 6.08 and 6.58 percent thereafter. The coupons on securities to be sold ultimately will depend on market rates, the issuer's credit worthiness, the distribution of tax-exempt and taxable bonds, as well as the bonds' maturity structure.

#### THE VAST MAJORITY OF OUTSTANDING FIXED RATE CITY G.O. BONDS CARRY COUPONS BETWEEN FIVE AND SIX PERCENT

CHART 4



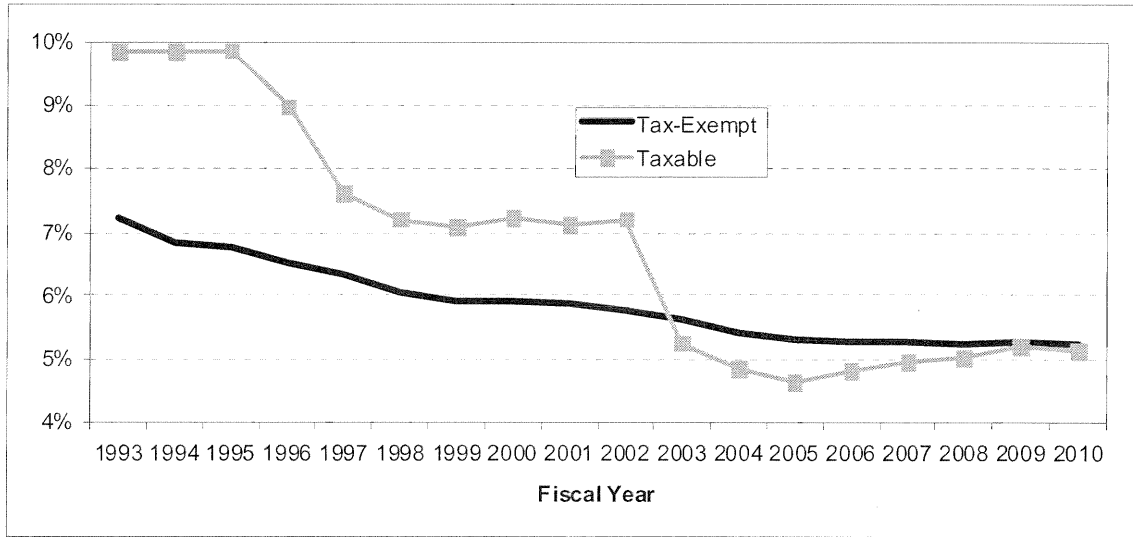
A review of the city's debt reveals that generally the average interest rate incurred by the city has been falling over the years. With the vast majority of coupons on \$32.3 billion of outstanding city fixed-rate g.o. bonds falling within the 5-6 percent range, as illustrated in Chart 4 above, currently the weighted average interest rate on the tax-exempt component is 5.24 percent, while the weighted average interest cost on the taxable portion is lower at 5.13 percent.<sup>28</sup> As shown in Chart 5 on page 38, these rates have dropped from 7.22 percent and 9.86 percent, respectively, since FY 1993 when we began tracking the statistics. The reductions in the weighted average interest rates mainly reflect improvements in the city's credit, a decline in market rates and a

<sup>28</sup> The amount of fixed rate outstanding debt includes roughly \$284 million of capital appreciation bonds at the implied yields at maturity, but does not include approximately \$100 million of bonds that were issued prior to FY 1981.

comprehensive program to refund high coupon bonds with lower coupon bonds.<sup>29</sup> Since FY 2003, the weighted average interest rate on the city's outstanding taxable bonds has been lower than on tax-exempt bonds, as the city shortened the amortization of its taxable bonds to minimize the interest cost for projects that do not qualify for tax-exempt financing.

CHART 5

### THE WEIGHTED AVERAGE INTEREST RATE THE CITY PAYS ON ITS DEBT HAS BEEN FALLING OVER TIME



### Federal Interest Subsidy

The overall maturity structure of the city's taxable debt may begin to lengthen as the city takes advantage of the Build America Bond (BAB) program created by the American Recovery and Reinvestment Act of 2009 to sell federally subsidized taxable bonds. The program authorizes state and local governments to issue BABs as taxable bonds in 2009 and 2010 to finance any capital expenditures for which they otherwise would issue tax-exempt bonds. State and local governments receive a direct federal subsidy payment equal to 35 percent of the total interest paid to the BAB investors.

As of the date of the modification, the city had sold \$1.4 billion of BABs, while the NYCTFA had sold \$690 million. For BABs sold by both the city and the NYCTFA, the taxable interest rates were lower than the financial plan assumptions for tax-exempt rates even before application of the federal interest subsidy. The interest subsidies are expected to yield savings of \$479 million for the city and \$292 million for the NYCTFA

<sup>29</sup> Presently, the city's g.o. bonds are rated AA by the Standard and Poor's Corporation, Aa3 by Moody's Investors Service, and AA- by Fitch Ratings. These are the highest ratings on city bonds since the fiscal crisis of the 1970s. Back in FY 1993, Standard and Poor's rated the city's g.o. bonds A- and Moody's rated them Baa1. Fitch began officially evaluating the city's credit in FY 1994 with an A- rating.

over the life of the BABs. The President has proposed to renew the BAB program beyond 2010, but with a lower 28 percent interest subsidy that will make the after-subsidy borrowing costs for BABs more consistent with borrowing costs in the tax-exempt market. With the interest subsidy on BABs, the city may find it advantageous to carry longer-term taxable rate bonds on a large scale.

The city has been accounting for the interest subsidy on the revenue side of the budget. The current modification shows a similar presentation for the NYCTFA, instead of the previous one where the interest subsidy was accounted for on the expense side to offset debt service costs. With this technical switch, the NYCTFA debt service costs increase by \$4 million in FY 2010 and \$14 million in each of FYs 2011-14, with matching increases in revenues.

The BABs have been well received in the market, much more so than federal tax credit bonds for school construction where for the majority of issuers the bonds sold incur no interest cost. Prior financial plans assumed the city would begin selling these tax credit bonds as early as this fiscal year. However, as Congress is considering restructuring this program to make it similar to the BAB program by providing a full interest subsidy to issuers instead of granting tax credits to investors, the city in the current plan has deferred issuance of these bonds. Accordingly, debt service costs are higher in the current plan by \$22 million, \$46 million, \$33 million, \$15 million and \$10 million in FYs 2010-14, respectively, to reflect the delay in receipt of the subsidy.

### **Refunding Savings**

With market rates being generally low in FY 2010, the city and the NYCTFA have seized opportunities to sell a combined \$3.3 billion of refunding bonds to replace high coupon bonds with lower coupon bonds. In these refunding sales, the city also achieved \$208 million of debt service savings for FY 2011 and the NYCTFA achieved another \$122 million primarily by reducing the amount of debt maturing in that fiscal year.

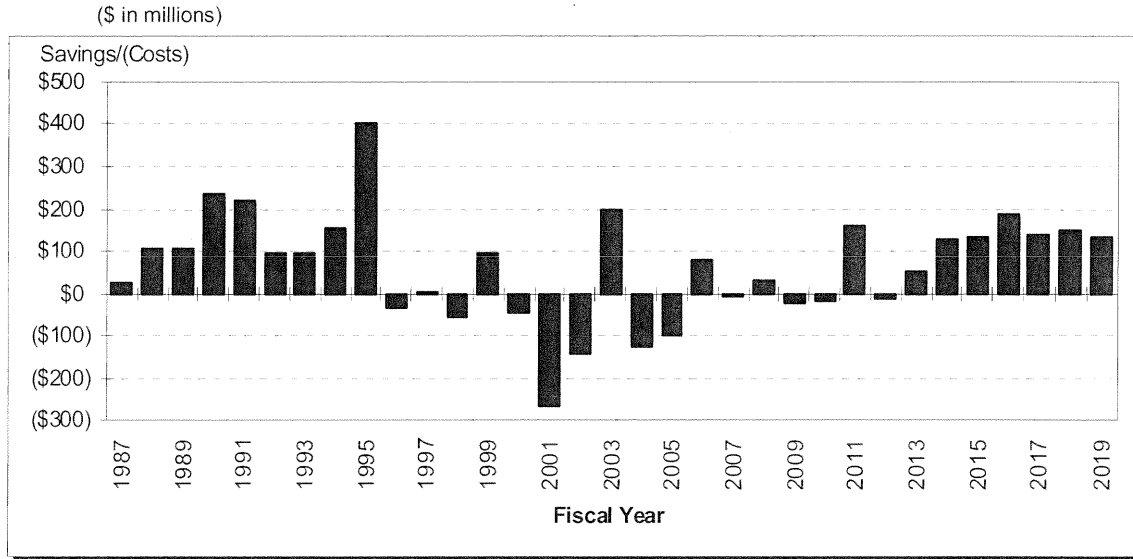
The city and the NYCTFA were able to achieve these refunding savings without creating costs in any of the outyears of the life of the bonds. For the city, the savings served to offset added debt service costs that were generated by past g.o. bond refinancings. Since FY 1987, the city has sold over \$42 billion of refunding bonds that will generate a net \$2.4 billion of debt service savings through FY 2037. Some of these sales had produced savings for a particular year at the expense of costs in other years. Since FY 1996, the city has actively structured its refunding bond sales so as not to create future-year costs. The exceptions were during the recessionary year 2002, when in two refunding bond sales totaling \$2 billion the city traded \$368 million of savings for the FY 2003 operating budget for a net \$364 million of costs in other years. Those refunding sales added \$47 million of debt service costs for FY 2011.

When debt service savings and costs for FY 2011 are combined from all city bond refundings, there is a net savings of \$161 million, as can be seen in Chart 6 on page 40. The chart also shows a net budgetary cost of \$14 million exists for FY 2012 from bond refinancings. Additionally, net savings in FY 2013 and beyond were generated from refunding deals that were undertaken in the first half of the 1990s to produce budgetary

relief. These savings were accomplished through debt restructurings that yielded costs in the middle years of the refunding debt, including FYs 2001 and 2002.

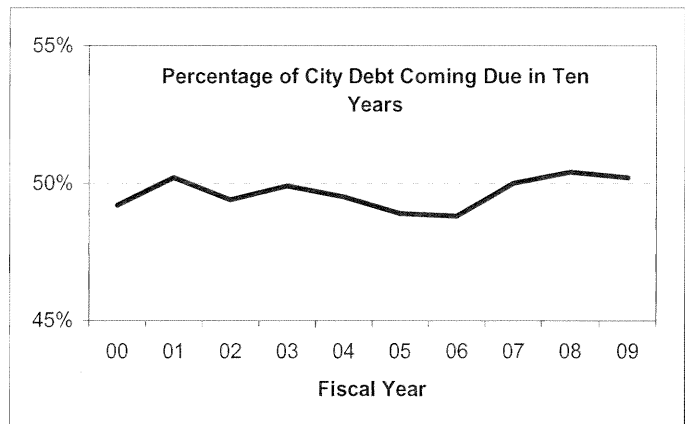
### THE CUMULATIVE IMPACT OF REFUNDING BOND SALES ON CITY DEBT SERVICE

CHART 6



### Maturity Structure of Debt

Over the years, the principal amortization of the city's outstanding bonds has fluctuated, with the schedule now considered average. Credit rating agencies consider an average maturity schedule for capital financing is one in which about 50 percent of the debt is retired in ten years. The city's bond issuances adhere to a level debt service structure that is restricted by the useful life of projects being financed. As illustrated in the figure to the right, for the past decade the amount of outstanding city bonds scheduled to mature within ten years has been hovering around 50 percent.



A schedule that is faster than the 50 percent threshold, particularly when the bond maturities are shorter than the life of the projects being financed, could be considered prudent only if it does not place excessive pressure on the operating budget and the local economy. The result would be that current taxpayers are bearing a disproportionate share of the cost for capital that will benefit future taxpayers.

Alternatively, a slower maturity structure would serve to diminish future borrowing capacity to support the continuing need for capital improvements.

### Debt Service Burden

City and NYCTFA debt service costs are paid primarily from tax revenues, with noncity funds, including the federal subsidy for BABs, providing additional support totaling between \$115 million and \$184 million in each of FYs 2010-14. After elimination of the use of surplus resources for prepayments, the city-funded only debt service cost as a percentage of tax revenues is forecasted to climb from 11.9 percent in FY 2010 to 15.1 percent in FY 2014, as illustrated in

City-Funded Debt Service as Percentage of Tax Revenue (\$ in millions)			
<u>FYs</u>	<u>Debt Service</u>	<u>Tax Revenue</u>	<u>Debt Service as Percent of Tax Revenue</u>
2010	\$4,409	\$36,988	11.9%
2011	5,352	39,016	13.7%
2012	6,104	41,013	14.9%
2013	6,400	42,626	15.0%
2014	6,641	44,034	15.1%

the figure to the right. The share of tax revenues that will be allocated for the payment of debt service is increasing because the average annual growth rate for debt service at 10.8 percent is outstripping the growth rate for tax revenue at 4.5 percent. The use of 15.1 percent of tax revenues for the payment of debt service costs has proven to be manageable for the city in past years. Of concern, however, is that in FY 2014, when the debt service burden is 15.1 percent, a budget deficit is projected where total expenditures exceed total revenues by \$3.8 billion. In the absence of a spike in revenues for FY 2014, the city may be forced to reduce debt service costs by downsizing its capital program and/or generating savings as a means of meeting the requirement to balance its budget.

## **Glossary of Acronyms**

<b>ACS</b>	Administration for Children Services
<b>AIM</b>	Aid and Incentives for Municipalities
<b>ARRA</b>	American Recovery and Reinvestment Act
<b>BAB</b>	Build America Bond
<b>BERS</b>	Board of Education Retirement System
<b>BSA</b>	Budget Stabilization Account
<b>CSA</b>	Council of School Supervisors and Administrators
<b>CUNY</b>	City University of New York
<b>CY</b>	Calendar Year
<b>DOE</b>	Department of Education
<b>DC 37</b>	District Council 37
<b>DSS</b>	Department of Social Services
<b>EMS</b>	Emergency Medical Service
<b>EMTs</b>	Emergency Medical Technical Service
<b>FCB</b>	Financial Control Board
<b>FMAP</b>	Federal Medical Assistance Percentages
<b>FY</b>	Fiscal Year
<b>GCP</b>	Gross City Product
<b>GCT</b>	General Corporation Tax
<b>GDP</b>	Gross Domestic Product
<b>G.O. Bonds</b>	General Obligation Bonds
<b>NYCTFA</b>	New York City Transitional Finance Authority
<b>NYSE</b>	New York Stock Exchange
<b>OT</b>	Overtime
<b>OTPS</b>	Other than Personal Service
<b>PBA</b>	Patrolmen's Benevolent Association
<b>PEG</b>	Program to Eliminate the Gap

<b>PIT</b>	Personal Income Tax
<b>PS</b>	Personal Service
<b>STAR</b>	School Tax Relief program
<b>UBT</b>	Unincorporated Business Tax
<b>UFT</b>	United Federation of Teachers