

Staff Report

**REVIEW OF FYs 2012-2015  
FINANCIAL PLAN**

July 21, 2011



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## I. Overview

The city has adopted a balanced budget of \$65.9 billion for FY 2012. At budget adoption the city was able to identify, through increased business tax revenue and tax audits, as well as some decreased expenditures, an additional \$521 million in resources in FY 2011. This allowed the city to increase the FY 2011 surplus to \$3.7 billion, with the entire amount being used to help balance the FY 2012 budget. These actions along with additional actions to be taken in FY 2012 allowed the city to restore some of the most contentious expenditure reductions proposed in the executive budget, such as teacher layoffs and the elimination of fire companies.

The city projects higher expenses in FY 2012 for most budgetary areas. The city expects a return to the high historical levels in Medicaid after the phase-out of federal stimulus money. Growth in pensions and fringe benefits, including healthcare costs, as well as the escalating cost of debt service, which is a function of higher borrowing to support the capital program and the assumption that interest rates will rise, continue to drive the increase in expenditures. On a positive note, city-fund revenue increases by \$1.9 billion to \$46.5 billion in FY 2012 because of stronger tax collections and miscellaneous revenues. The local economic recovery is lifting the city's nonproperty taxes, which are in the second year of a broad-based collections upturn. However, this growth is insufficient to cancel out the fiscal stresses resulting from the depth of the recession and three years of revenue declines or stagnant growth for the nonproperty taxes. While our risk assessment shows a low level of concern in FY 2012, the lack of a projected surplus to help balance the outyears of the plan could be problematic. The city must also be wary of unidentified problems that could affect FY 2012 budget balance, such as additional reductions in federal and state aid, and the ripple effect if Congress fails to raise the debt ceiling.

Without the availability of any surplus budget resources beyond FY 2012, the city's financial plan contains budget gaps of \$4.6 billion for FY 2013, \$4.8 billion for FY 2014 and \$4.9 billion for FY 2015, as the growth in revenues lags that of expenditures. Total revenue increases 5.4 percent, over the four years of the plan, while total expenditure escalates by 12.8 percent. After a 0.8 percent decline in the FY 2012 budget, on the assumption that federal, state and private sources of categorical aid will fall sharply in FY 2012, total revenue growth improves to about two percent annually in FYs 2013-15, supported by an unsteady recovery in tax collections. In contrast, the average annual growth in expenditures doubled that of revenues at 4.4 percent for FYs 2013-15.

The nation's lethargic job growth is providing very little support to the local economic recovery. Fiscal stresses and cutbacks of federal aid are forcing government entities to shed jobs, weakening total job growth for both the nation and the city. The city's plan calls for tax collections growth to weaken in FYs 2013 and 2014 in response to the sluggishness of the economic recovery and a likely slowdown in the financial sector. The slow revenue growth in those years has made it difficult for the city to close the large budget gaps that are in its financial plan.

Similarly, the fast pace at which expenditures are growing relative to revenues has contributed to the budget imbalance. The expenditure area with the fastest growth

over the four-year period of FYs 2011-15 is debt service costs. While the city actively manages these costs, even with a new ten-year strategy that streamlines capital projects, debt service costs are projected to grow at a rapid pace. As in the past, in addition to debt service, growth in Medicaid, pensions, healthcare, and other fringe benefits continue to drive the outyear budget gaps. Hopefully, action will be taken in the next legislative session on the Governor's proposals for a new pension tier for new employees in order to start to control the growth in pension costs.

The task for the city will be to manage the FY 2012 budget in a way to start to build a surplus, close to the level achieved in FY 2011, that can deal with the projected \$4.6 billion gap in FY 2013. With the uncertainty in the economy and the likelihood of further federal and state aid reductions, the city's ability to avoid contentious expenditure reductions will be tested.

**JUNE FINANCIAL PLAN:  
THE CITY'S OPERATING PROJECTIONS FOR  
FISCAL YEARS 2012-2015**

TABLE 1

(\$ in millions)

	FY 2012	FY 2013	FY 2014	FY 2015
<b><u>Revenues</u></b>				
Taxes:				
General Property	\$17,543	\$18,157	\$18,592	\$19,022
Other Taxes	23,752	24,585	25,321	26,666
Tax Audit Revenue	660	659	666	666
Sale of Property Tax Liens	82	46	38	38
Miscellaneous Revenues	7,148	7,138	7,196	7,213
Unrestricted Intergovernmental Aid	37	12	12	12
Anticipated Federal & State Aid	0	0	0	0
Interfund Revenues	549	501	501	501
Less: Intracity Revenues	(1,549)	(1,526)	(1,523)	(1,523)
Disallowances	(15)	(15)	(15)	(15)
Total City Funds	\$48,207	\$49,557	\$50,788	\$52,580
Federal Categorical Grants	6,674	6,389	6,315	6,238
State Categorical Grants	11,030	11,090	11,163	11,180
<b>Total Revenues</b>	<b>\$65,911</b>	<b>\$67,036</b>	<b>\$68,266</b>	<b>\$69,998</b>
<b><u>Expenditures</u></b>				
Personal Service	\$37,239	\$38,225	\$38,734	\$39,526
Other Than Personal Service	27,846	28,016	28,691	29,352
General Obligation, Lease & TFA Debt Service	5,813	6,653	6,908	7,265
Budget Stabilization & Prepayments	(3,738)	--	--	--
General Reserve	300	300	300	300
Subtotal	\$67,460	\$73,194	\$74,633	\$76,443
Less: Intracity Expenditures	(1,549)	(1,526)	(1,523)	(1,523)
<b>Total Expenditures</b>	<b>\$65,911</b>	<b>\$71,668</b>	<b>\$73,110</b>	<b>\$74,920</b>
<b><u>Gap To Be Closed</u></b>	<b>\$0</b>	<b>(\$4,632)</b>	<b>(\$4,844)</b>	<b>(\$4,922)</b>

**CHANGES TO THE CITY'S OPERATING PROJECTIONS FOR  
FISCAL YEARS 2012-2015  
JUNE FINANCIAL PLAN COMPARED TO FEBRUARY MODIFICATION**

TABLE 2

(\$ in millions)

	FY 2012	FY 2013	FY 2014	FY 2015
<b><u>Revenues</u></b>				
Taxes:				
General Property	(\$60)	\$0	\$0	\$0
Other Taxes	121	265	(32)	(12)
Tax Audit Revenue	15	15	15	15
Sale of Property Tax Liens	42	6	(2)	(2)
Miscellaneous Revenues	223	167	162	154
Unrestricted Intergovernmental Aid	25	0	0	0
Anticipated Federal & State Aid	(600)	(600)	(600)	(600)
Interfund Revenues	49	8	8	8
Less: Intracity Revenues	(34)	(14)	(11)	(11)
Disallowances	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total City Funds	(\$219)	(\$153)	(\$460)	(\$448)
Federal Categorical Grants	737	594	554	477
State Categorical Grants	<u>(233)</u>	<u>(196)</u>	<u>(167)</u>	<u>(151)</u>
Total Revenues	<u>\$285</u>	<u>\$245</u>	<u>(\$73)</u>	<u>(\$122)</u>
<b><u>Expenditures</u></b>				
Personal Service	\$235	(\$151)	(\$267)	(\$403)
Other Than Personal Service	766	209	247	241
General Obligation, Lease & TFA Debt Service	(95)	(19)	(11)	(4)
Budget Stabilization & Prepayments	(587)	--	--	--
General Reserve	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Subtotal	\$319	\$39	(\$31)	(\$166)
Less: Intracity Expenditures	<u>(34)</u>	<u>(14)</u>	<u>(11)</u>	<u>(11)</u>
Total Expenditures	<u>\$285</u>	<u>\$25</u>	<u>(\$42)</u>	<u>(\$177)</u>
<b><u>Gap To Be Closed</u></b>	<u>\$0</u>	<u>\$220</u>	<u>(\$31)</u>	<u>\$55</u>



# RISKS TO THE FINANCIAL PLAN

TABLE 3

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

	FY 2012	FY 2013	FY 2014	FY 2015
<b>Stated Financial Plan Gap</b>	<b>\$0</b>	<b>(\$4,632)</b>	<b>(\$4,844)</b>	<b>(\$4,922)</b>
<b>Estimation</b>				
Miscellaneous Revenues	\$60	\$60	\$75	\$100
Uniformed Services Overtime	(\$167)	(\$221)	(\$225)	(\$225)
<b>Subtotal</b>	<b>(\$107)</b>	<b>(\$161)</b>	<b>(\$150)</b>	<b>(\$125)</b>
<b>Not in Mayor's Control</b>				
Pension Reform	\$0	\$0	(\$131)	(\$252)
<b>Subtotal</b>	<b>(\$0)</b>	<b>(\$0)</b>	<b>(\$131)</b>	<b>(\$252)</b>
<b>Risk Total</b>	<b>(\$107)</b>	<b>(\$161)</b>	<b>(\$281)</b>	<b>(\$377)</b>
<b>Total FCB Estimated Surplus/(Gap)</b>	<b>(\$107)</b>	<b>(\$4,793)</b>	<b>(\$5,125)</b>	<b>(\$5,299)</b>

## **II. Balancing the FY 2012 Budget**

The city has adopted a balanced budget of \$65.9 billion for FY 2012. The budget is \$509 million smaller than the FY 2011 budget. The contraction reflects an expected decline in total revenue resulting from the discontinuation of most federal stimulus aid programs. Meanwhile, expenses are projected to climb by a net \$3.3 billion. To balance the FY 2012 budget, the city prepaid certain expenses with the full use of a prior-year budget surplus of \$3.7 billion, which is \$92 million more than the surplus that was used to balance the FY 2011 budget.

The city projects higher expenses in FY 2012 for most budgetary areas. The largest increase, \$929 million, occurs in Other Than Personal Service (OTPS), which is driven by a high historical spending level in Medicaid after the phase-out of federal stimulus money. Additionally, spending for Personal Service (PS) jumps by \$903 million, spearheaded by increases in pension and fringe benefit costs of \$1.4 billion and \$361 million, respectively, being offset by lower labor costs of \$603 million and an increase of \$277 million in the drawdown of the Retiree Health Benefits Trust. Debt service cost escalates by \$865 million, which is a function of higher borrowing to support the capital program and the assumption that interest rates applied to the borrowing will rise. Other costs related to intra-city expenses climb by \$364 million, while the General Reserve is augmented by \$260 million, bringing its total to the normal level of \$300 million.

On a positive note, city-fund revenue increases by \$1.9 billion to \$46.5 billion in FY 2012 because of stronger tax collections and miscellaneous revenues. The local economic recovery is lifting the city's nonproperty taxes, which are in the second year of a broad-based collections upturn. However, this growth is insufficient to cancel out the fiscal stresses resulting from the depth of the recession and three years of revenue declines or stagnant growth for the nonproperty taxes.

### **TAXES LEAD THE RECOVERY IN CITY-FUND REVENUES**

The June 2011 Financial Plan contained \$305 million in additional city-fund FY 2011 revenue, compared with the May plan. The city is using this additional revenue to help balance the FY 2012 budget. The property tax gained \$30 million, while the nonproperty taxes increased by \$111 million. Audits yielded an extra \$89 million, and miscellaneous revenue increased by \$38 million. Federally funded unrestricted aid increased by \$37 million in FY 2011 and \$25 million in FY 2012, to cover city outlays for emergencies. Since the May plan, total revenues are up by \$443 million in FY 2011 because of the aforementioned increases in city funds and an additional \$138 million in categorical aid and interfund revenue.

City funds increase by \$1.9 billion in FY 2012, to \$46.5 billion, compared with the previous year. City-fund revenues, which include taxes, intergovernmental aid, and miscellaneous revenue, are higher due to a \$2.1 billion upturn in tax collections. Despite this impressive tax growth, total revenue declines by \$509 million in FY 2012, to \$65.9 billion, due to a projected drop in categorical aid.

As shown in the figure to the right, the real property tax increases by \$764 million, to \$17.6 billion in FY 2012. The nonproperty taxes grow by \$1.3 billion to \$23 billion, in FY 2012, continuing the recovery that began in FY 2011 from the recessionary collections decline and stagnant growth of the preceding three years.

There are no tax program initiatives in the city's financial plan. The city's tax audit program declines by \$297 million in FY 2012, to \$660 million, following a six-year run of strong audit collections. Audits, which used to produce about \$500 million to \$600 million annually, have stayed within the \$750 million to \$1.1 billion range for each of the past six years.

FY 2012 City-Fund Revenues	
Increase by \$1.9 Billion	
(\$ in millions)	
Property Tax	\$764
Nonproperty Taxes	1,309
Audits	(297)
Tax Program	0
STAR Aid	80
Miscellaneous Revenue	199
Nonrecurring Revenue	(133)
Intergovernmental Aid	(14)
<b>City Funds</b>	<b>\$1,908</b>
Categorical Aid	(2,404)
Interfund Revenue	(13)
<b>Total Change in Revenues</b>	<b>(\$509)</b>

The city's share of the state's School Tax Relief (STAR) program is up \$80 million to \$792 million in FY 2012, since the previous year. Despite this increase, the STAR program has been scaled back from the peak aid of about \$1.2 billion that was paid out in each of FYs 2008 and 2009. The city's FY 2012 miscellaneous revenue projection of \$4.4 billion represents a net increase of \$66 million from the prior year.

Categorical aid declines by \$2.4 billion to \$18.9 billion. The largest aid reductions are to federal grant programs, which fell by \$1.8 billion, reflecting the discontinuation of most stimulus aid.

### **Property Tax**

The city expects the real property tax to yield \$17.6 billion in FY 2012, an amount that is \$764 million, or 4.5 percent, higher than the previous year. Growth improved slightly compared with the 4.2 percent growth of the previous year. The upturn in FY 2012 could prove to be a temporary respite from the trend toward weaker property tax growth. The improvement resulted from a 3.8 percent increase in real estate market values on the city's tax roll. This increase was the first substantial market value increase since FY 2008. Property tax revenue growth is likely to weaken in the outyears because market values had been mostly stagnant over the preceding five years and because further tax increases are not planned.

The city is raising its property tax contingency reserves to prepare for an upsurge in assessment complaints resulting from the many assessment increases on the FY 2012 tax roll. The city has set aside \$1.7 billion in reserves for FY 2012, an amount that is \$197 million higher than the reserves that were needed in FY 2011. The reserves set aside for the cancellation of tax bills increased by \$62 million to \$487 million. The city also enlarged its refund reserve by \$203 million to \$437 million.

The city kept property tax rates steady in FY 2012 at an average rate of \$12.283 per \$100 assessed value, which was fixed in December 2008 when tax rates were increased in the middle of FY 2009. As a temporary measure, the previous year's class

tax rates were used for the initial billing of FY 2012, since new tax rates had not yet been fixed when the bills were sent out.

The new tax rates that were enacted for FY 2012 would have caused individual class tax rates to have shifted by as much as seven percent, with private home owners paying more and commercial properties being favored with lower tax rates, even though the overall average tax rate would remain stationary. The city is therefore seeking legislative approval for a cap to ameliorate the swings in class tax rates. Given the legislative support for this measure both in the city and the state, it may be assumed that the property tax rates for FY 2012 will be adjusted retroactively, later in the fiscal year.

Once these adjustments are implemented, the new property tax rates would result in smaller increases for residential properties, balanced by smaller reductions for commercial properties. Owners of private homes will see their tax rate go up by 4.8 percent, to an estimated \$18.205, while the rate for residential apartment buildings increases by 0.6 percent, to about \$13.432. Offsetting these increases is a decline for the utility property tax rate of 1.3 percent, to \$12.473, and a 1.6 percent rate reduction for commercial properties to \$10.152.

### **Nonproperty Taxes**

The local economic recovery is lifting the city's nonproperty taxes, but fiscal stress continues to linger because the recession had induced tax collections to fall or stagnate for three consecutive fiscal years. The nonproperty taxes increase by \$1.3 billion in FY 2012, to \$23 billion. This projected six percent growth represents the second stage of a recovery that began in FY 2011 with a 12 percent rebound. Even with these two impressive growth increments, the FY 2012 tax yield will still fall short of the prerecession peak of \$23.4 billion that was collected in FY 2008.

The personal income tax improves by \$563 million or seven percent in FY 2012, down from an 11 percent increase in FY 2011. The general corporation tax increases by \$425 million or 19 percent, improving on the 16 percent gain in FY 2011. The unincorporated business tax rises by \$124 million, marking a second consecutive year of seven percent growth. The city sales tax grows by about \$270 million, an increase of five percent. Also growing are the mortgage recording tax, the utility and the commercial rent tax with respective gains of \$86 million, \$20 million and \$19 million.

Not all taxes participate in this broad-based revenue growth in FY 2012. The banking corporation tax drops by \$109 million or eight percent, slipping from the stellar 38 percent growth in FY 2011. Also declining are the real property transfer tax, the hotel occupancy tax and some smaller taxes.

### **EXPENDITURE HIGHLIGHTS IN FY 2012**

Since the May modification, the city has added \$521 million to the FY 2011 surplus, and for FY 2012, averted the layoff of nearly 4,300 teachers in the city's agency program. Further, the city has restored funding to previous spending cuts and added discretionary funding totaling more than \$386 million. These actions build upon early

ones taken by the city at the same time it addressed additional funding needs, the loss of almost \$1.7 billion in federal and state education aid, and the winding down of federal stimulus money.

The city has added \$521 million to the surplus since the May financial plan through a combination of increased revenue and lower spending of \$305 million and \$216 million, respectively. Much of the decrease in expenditures reflects the receipt of federal monies. The city will recognize \$75 million of Medicaid stimulus funds in FY 2011, which were budgeted to be received in FY 2012, and will also receive \$50 million in each of FYs 2011 and 2012 under the Patient Protection and Affordable Care Act of 2010.<sup>1</sup> Additionally, city-funded debt service is expected to be lower in FY 2011 by \$44 million and other spending decreases will total \$47 million.

In the FY 2012 adopted budget, the city plans to spend \$509 million less than the FY 2011 projection, as shown in the figure to the right. The decrease will lower total-funds spending to \$65.9 billion from \$66.4 billion. The effect of FYs 2010 and 2011 prepayments substantially lowers FY 2012 expenditures relative to FY 2011. The FY 2011 surplus funds of \$3.7 billion used to prepay FY 2012 expenses are \$92 million more than the FY 2010 funds that prepaid FY 2011 expenses.

<b>Change in Expenditures from FY 2011 to FY 2012 (\$ in millions)</b>	
Prepayments	(\$3,830)
OTPS	929
PS	903
Debt Service	865
Other	364
General Reserve	260
<b>Total Net Change</b>	<b>(\$509)</b>

Nonetheless, the city projects higher expenses in most budgetary areas in FY 2012. As shown in the figure, the largest increase occurs in Other Than Personal Service (OTPS), which is anticipated to rise by \$929 million. Most of the increase in this area reflects a return to a historical spending level in Medicaid after the phase-out of federal stimulus money. Medicaid costs are projected to climb by nearly \$1.4 billion from FY 2011 to FY 2012, but are offset by lower spending of \$172 million in Public Assistance and \$297 million in other OTPS areas.

Elsewhere, the city has budgeted for net higher spending of \$903 million in Personal Service (PS), with projected pension and fringe benefit costs increasing by \$1.4 billion and \$361 million, respectively. Pension costs have increased significantly due to the phase-in of investment losses and an anticipated change in actuarial assumptions and methods. However, the higher spending will be offset by lower labor costs of \$603 million and an increase in the drawdown of the Retiree Health Benefits Trust (RHBT) of \$277 million (the drawdown increases to \$672 million in FY 2012 from \$395 million in FY 2011). In addition to a rise in debt service costs of \$865 million, which results from a projected increase in outstanding debt and greater interest expenses, and other costs related to intra-city expenses of \$364 million, the adopted budget will recognize an increase in the General Reserve by \$260 million, bringing the total to the normal level of \$300 million.

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<sup>1</sup> This program bridges the health insurance changes due in 2014 by providing funding totaling \$5 billion. The money is distributed on a first come first serve basis nationwide for reimbursement at 80 percent of claims between \$15,000 and \$90,000 for retirees between 55 and 65 years of age.

## **Debt Service**

City debt service costs in the adopted budget, including that for the New York City Transitional Finance Authority (NYCTFA) and related lease agreements, are projected to total \$5.8 billion in FY 2012, net of prepayments. At this level, the FY 2012 debt service projection reflects an increase of \$865 million relative to FY 2011, for an annual growth rate of 17.5 percent. Notwithstanding the annual growth, debt service costs for both FYs 2011 and 2012 were trimmed incrementally since a year ago by a total \$404 million and \$481 million, respectively, largely reflecting the recognition of actual interest savings and the deferral of principal payments from refunding bond sales. The June financial plan contains \$89 million of the total debt service savings for FY 2011 and \$101 million for FY 2012, which have been applied to balancing the FY 2012 budget.

One of the challenges for budget balance is the rapid annual growth in debt service costs, which is a function of additional borrowing to support the capital program and the assumption that interest rates applied to the borrowing will rise. As illustrated in the figure to the right, more than half of the year-over-year increase is related to NYCTFA debt service cost, which is projected to rise by 47 percent. However, it should be noted that the debt service cost for FY 2011 reflects a reduction of roughly \$90 million that results from the use of surplus resources for the defeasance of NYCTFA bonds originally scheduled to mature in FY 2011. After an adjustment for the defeasance of FY 2011 bond maturities, the growth rate for NYCTFA debt service is 35 percent, which is still relatively high compared to eight percent for city general obligation (g.o.) bonds.

City & NYCTFA Debt Service Net of Prepayments (\$ in millions)			
	FY 2011	FY 2012	Change
G.O Debt	\$3,668	\$3,968	\$300
NYCTFA Debt	1,066	1,565	499
Lease Debt	214	280	66
<b>Total Funds</b>	<b>\$4,948</b>	<b>\$5,813</b>	<b>\$865</b>

While the debt service cost for the NYCTFA is forecasted to grow at a much faster pace than for the city, currently the weight of NYCTFA debt service is not as heavy compared to the proportion of the amount of bonds outstanding. In FY 2012, the projected NYCTFA debt service cost at \$1.6 billion amounts to 39 percent of city g.o. debt service cost at \$4 billion. Meanwhile, the projected debt outstanding for the NYCTFA at \$21.2 billion amounts to 50 percent of city g.o. debt outstanding at \$42.6 billion, based on the adopted budget. The disproportionality of debt service cost to debt outstanding for the NYCTFA in relation to g.o. debt is reflective of the fact that NYCTFA bonds carry lower interest rates and have a longer maturity structure as a whole than city g.o. bonds. A longer maturity structure has the dual distinction of making the annual debt service cost relatively low by leaving more debt outstanding, which could result in higher total debt service costs over the life of the bonds. We discuss the city's debt burden in the section of the report titled "The Capital Program Profile and Associated Debt" beginning on page 26.

## **FY 2012 Program to Eliminate the Gap**

The Program to Eliminate the Gap (PEG) that began in FY 2008, with targeted savings (both expense and revenue) of \$985 million, grew substantially each fiscal year thereafter with additional savings of \$2.1 billion in FY 2009 and \$1.1 billion in each of FYs 2010 and 2011, reducing FY 2012 expenditures by a total of \$5.3 billion. In Table 4

on page 11, the most recent PEG for FY 2012 is presented, which encompasses those agency programs targeted in the November, February, May and June modifications to the financial plan.

TABLE 4

<b>FY 2012 PROGRAM TO ELIMINATE THE GAP</b>			
(\$ in millions, city funds)			
<b>Agency Categories</b>	<b>Expense</b>	<b>Revenue</b>	<b>Total</b>
<b>Uniformed Services</b>			
Police	(\$63)	(\$1)	(\$64)
Fire	(37)	(1)	(38)
Correction	(8)	(5)	(13)
Sanitation	(91)	--	(91)
<b>Health and Welfare</b>			
Children Services	(64)	--	(64)
Social Services	(53)	--	(53)
Homeless	(23)	--	(23)
Youth and Community	(12)	--	(12)
Health & Mental Hyg.	(45)	--	(45)
<b>Other Mayoral</b>			
Housing Preservation	(7)	(1)	(8)
Finance	1	(39)	(38)
Transportation	(26)	(30)	(56)
Parks and Recreation	(42)	--	(42)
Libraries	--	--	--
Cultural Affairs	--	--	--
Citywide Admin.	(13)	(10)	(23)
All Other Agencies	(83)	(31)	(114)
<b>Major Organizations</b>			
Education	(328)	--	(328)
CUNY	(4)	--	(4)
HHC	(7)	--	(7)
<b>Other</b>			
Procurement Savings	(56)	--	(56)
<b>Total PEG</b>	<b>(\$961)</b>	<b>(\$118)</b>	<b>(\$1,079)</b>
(Negative) numbers decrease the gap.			

As shown in the table, city agencies are categorized into four main groups, Uniformed Services, Health and Welfare, Other Mayoral and Major Organizations. As late as the executive budget, the city had planned for more than \$1.2 billion in agency savings that were expected to annualize over the life of the financial plan to almost \$1.2 billion in FY 2013 and to \$1.1 billion in each of FYs 2014 and 2015. About a third of the projected expenditure reductions in FY 2012 were to come from the Department of Education (DOE) with \$394 million in savings. The majority of those spending cuts in the DOE were to be achieved by reducing headcount, including the layoff of 4,278 teachers.

In the adopted budget, the city has restored funding of \$223 million to the DOE to avert the layoffs, which left targeted DOE savings at \$171 million. The city has funded \$157 million of these restored funds with other DOE actions, which brings total savings to \$328 million in FY 2012, as shown in Table 4. These measures include reforming the Absent Teacher Reserve Pool to accommodate greater flexibility, saving \$40 million; delaying sabbaticals in FY 2013, saving \$17 million; reducing transportation contracts, generating savings of \$21 million; transferring \$32 million of unused funds from the Education Construction Fund to the DOE's operating budget; and

implementing administrative efficiencies, which are expected to save \$47 million. Most of these actions, totaling nearly \$98 million, are recurring over the life of the financial plan. The remaining \$66 million of initially planned savings of \$394 million will be replaced from the city's operating budget.

The city's uniformed agencies have identified a total of \$206 million in targeted savings for FY 2012. The Police Department will save \$64 million with about half, or \$30 million, by way of the planned attrition of 350 civilian workers. Also, the Department plans to collect \$12 million in federal reimbursements from security associated with the United Nations and about \$11 million will be saved by delaying the replacement of its patrol car fleet. Although the Fire Department has been sorting through a staffing issue, it has targeted \$38 million in savings with \$15 million stemming from increased management of uniformed medical and light-duty leave. Also, the Department will find savings by eliminating administrative positions; however, the financial plan has restored funding to the 20 fire companies set to be closed in FY 2012. The Sanitation Department projects savings of \$91 million with surplus funds of \$35 million generated from the closure of the Fresh Kills landfill and \$22 million from the waste export budget (though these funds will phase out after FY 2013). The Department will also produce savings of \$21 million by redeploying supervisors.

In addition to the restored funding to avert teacher layoffs and the closure of 20 fire companies, the city also funded the restoration of more than \$336 million of PEGs for FY 2012. Most of these restorations occur in libraries, cultural organizations, education and children, health and social services. The adopted budget also assumes almost \$50 million in discretionary funding to cover the continuation of many citywide programs.

Over the four years of the financial plan, the city is likely to be forced to seek further spending reductions to address the budget gaps in FYs 2013 to 2015. While the agency program has helped to replace the nearly \$1.7 billion in lost federal and state education funding and balance the FY 2012 budget, further cuts could give rise to debate over the city's priorities.

### **Department of Education**

With student population projected to grow to over 1.12 million, the budget for FY 2012 is \$19.42 billion for the Department of Education (DOE) for operational purposes. Nonoperational pension and debt service costs, which are accounted for centrally, are not included. The total is an increase of just over \$518 million, or 2.7 percent, over the FY 2011 projection that is currently \$18.91 billion.

With the state facing fiscal constraints, the city share of the budget was the largest since mayoral governance took control of the schools in 2002. The city provided over 48 percent, or just over \$9.39 billion (including other-categorical and intra-city funds) of the FY 2012 operational spending. The city's increased funding, in conjunction with the concessions the teachers' union agreed upon, allowed layoffs to be averted in FY 2012.



With the major portion of the stimulus funding program having come to an end in FY 2011, the federal contribution in FY 2012 is projected at \$1.92 billion, a drop-off of one-third from the previous fiscal year which is forecasted at over \$2.87 billion.

State funding declined from a forecasted \$8.14 billion in FY 2011 to a projected \$8.11 billion in FY 2012. However, this small decline represents a relatively large drop in shared contribution from the past. Between FYs 2006-10 state average shared contributions equaled just over 46 percent, but in FY 2012 its share is just under 42 percent. The decrease was made up by the city.

### **Uniformed Agency Overtime**

In the current financial plan, the city plans to spend about \$963 million on uniformed overtime expenditures, including civilian personnel, in FY 2011. The finalized overtime budget projections represent an increase of more than \$240 million over projected spending at the start of the fiscal year. Much of that amount is due to additional funding needed in the Police Department, which usually requires extra funds during the fiscal year, but also in the Fire Department, which required extra funds to manage a staffing issue. In addition, the Sanitation Department's overtime budget more than doubled in response to severe winter weather. Based on our analysis of actual overtime spending generated by the four agencies, for both uniform and civilian personnel, in FY 2011, we anticipate no risks to the overtime budget but believe spending in the outyears of the financial plan are grossly underestimated. In Section III, in Risks and Offsets starting on page 26, we discuss overtime risks over the life of the financial plan.

### **Collective Bargaining and Pension Costs**

By the end of FY 2012, all of the city's collective bargaining agreements from the CYs 2006-2008 round of collective bargaining will have expired with the exception of the Sanitation Officers contract, which will expire on the first day of FY 2013. Notable is the United Federation of Teachers (UFT), which by the end of FY 2012, would be without a contract for nearly three years.<sup>2</sup>

The city has made provisions in the labor reserve for the funding of wage increases beyond the CYs 2008-2010 round of collective bargaining, which is expected to begin three years after that round. In the current plan, the city has assumed a wage freeze for FYs 2011 and 2012 and 1.25 percent salary increase for each of the remaining years of the financial plan.

The annual pension cost paid by the city consumes a large portion of its expenditures. On a total-fund basis, it will represent more than 12.8 percent of the city's budget in FY 2012. While the city's annual contribution to its pension system is meant to

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<sup>2</sup> On June 22, 2011, the Governor announced that a five-year labor agreement with the Civil Service Employees Association was reached. Upon ratification, the agreement will carry no salary increase in state fiscal years (SFYs) 2011- 2014 and a two percent increase in SFYs 2015 and 2016, as well as an increase in employee contribution for healthcare and mandated furloughs for the next two fiscal years.

fund future benefit payments for current workers at their retirement, the annual cost has climbed significantly in recent fiscal years due to investment losses, higher investment fees and changes (anticipated and actual) to actuarial assumptions and methods. The city estimates that since FY 2002 its city-funded pension cost will increase from \$1.3 billion to \$8.3 billion by FY 2012, or by 519 percent. Presented another way, pension costs as a percentage of salary have increased from nine percent to a projected 39 percent over the same period. This is a sizable increase and clearly illustrates the rapid growth of a cost that the city has little ability to control.

A priority for the city has been to address its pension costs. Likewise, the state has also taken up the pension issue on its own and the city's behalf. While the city recently proposed a reform plan, Governor Cuomo has introduced his own legislation that will cover newly hired state and city workers.<sup>3</sup> More specifically, the Governor's reform would impact new hires by the state and local governments (the city included), including school districts and uniformed services. Provisions in the legislation include:

- increase the retirement age from 62 to 65,
- eliminate early retirement,
- require employees to contribute six percent of salary for career duration,
- provide a 1.67 percent annual pension multiplier,
- increase vesting period from 10 to 12 years,
- exclude overtime from final average salary,
- employ a five-year final average salary calculation with an eight percent anti-spiking cap,
- exclude wages above \$179,000 from the final average salary calculation,
- eliminate lump sum payouts for unused vacation leave and
- prohibit the use of unused sick leave for additional service credit.<sup>4</sup>

This reform legislation, which introduces a Tier 6, builds upon a recently enacted Tier 5 for all new state and local employees outside of the city, and for teachers statewide. The new tier applied to all newly hired city teachers, which required a 10-year vesting period, contributions of 4.85 percent for the first 27 years of service and 1.85 percent thereafter. It also set an annual return of seven percent on annuity accounts. If the bill were to be signed into law, the state estimates savings of more than \$93 billion over a thirty-year period for the state and local employers outside of the city. The city would save about \$30 billion over the same period of time. While the Governor's proposal was not enacted in the current legislative session, it is expected to be considered next year.

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<sup>3</sup> To read a complete analysis of the city's pension reform proposal, see the March 24, 2011 FCB Staff Report starting with "Fringe Benefit Costs" on page 23.

<sup>4</sup>Source: <http://www.governor.ny.gov/press/06082011PensionReformLegislation> (accessed June 2011)

### **Other Postemployment Benefits**

The New York City Health Benefits Program provides Other Postemployment Benefits (OPEB) to eligible retirees and beneficiaries. OPEB is comprised of Pre-Medicare and Medicare payments, Medicare Part B reimbursements and welfare fund contributions. Prior to a change in reporting standards (Statement No. 45) by the Government Accounting Standards Board (GASB) that requires governments to report OPEB benefits as a liability, the city reported its annual OPEB expense on a pay-as-you-go basis and financial statements did not reflect the effects of these costs until paid. The actual liability to the city for its OPEB was initially calculated as \$50.5 billion in FY 2006. The city's response was to form and fund the Retiree Health Benefits Trust (RHBT), which would serve as a means of funding the liability, with an initial funding of \$1 billion in FY 2006 followed by \$1.5 billion in FY 2007. Since that time, the city has not contributed any additional funds to the Trust. In fact, it has tapped the fund, which had appreciated to \$3.1 billion, by more than \$1.1 billion to fund investment losses to the pension system. The drawdown, which reduced the Trust to about \$2 billion, includes \$672 million drawdown in FY 2012.

It is unfortunate that the city has continued to reduce the Trust over the last two fiscal years to cover investment losses incurred in prior years while the OPEB liability continues to grow at a constant high rate. The city projects that the liability will grow to \$84.5 billion in FY 2012. We have repeatedly warned that rising healthcare costs will continue to push the OPEB liability higher. Our analysis indicates that the liability could approach \$100 billion by the end of the financial plan. While the city's pension system did suffer significant losses in FYs 2008 and 2009, the fund has made a remarkable comeback yielding 14.2 percent return in FY 2010 and a more than 20 percent return for FY 2011. Given the recent practice of drawing upon the RHBT to fund investment losses, the city should consider replenishing the Trust when there are investment gains that reduce its pension contributions.

### **III. The FYs 2012-2015 Financial Plan**

Without the availability of any surplus budget resources beyond FY 2012, the city's financial plan contains budget gaps of \$4.6 billion for FY 2013, \$4.8 billion for FY 2014 and \$4.9 billion for FY 2015, as the growth in revenues lag that of expenditures. Total revenue increases by \$3.6 billion or 5.4 percent, over the four years of the plan, from \$66.4 billion in FY 2011 to \$70 billion in FY 2015; while total expenditure escalates by 12.8 percent, from \$66.4 billion in FY 2011 to \$74.9 billion in FY 2015. After the 0.8 percent annual decline in the FY 2012 budget on the assumption that federal, state and private sources of categorical aid will fall sharply in FY 2012, total revenue growth improves to about two percent annually in FYs 2013-15, supported by an unsteady recovery in tax collections. In contrast, the average annual growth in expenditures doubled that of revenue at 4.4 percent for FYs 2013-15.

The nation's lethargic job growth is providing very little support to the local economic recovery. Fiscal stresses and cutbacks of federal aid are forcing government entities to shed jobs, weakening job growth for both the nation and the city. The city revenue plan calls for tax collections growth to weaken in FYs 2013 and 2014 in response to the sluggishness of the economic recovery and a likely slowdown in the financial sector. The slow revenue growth in those years has made it difficult for the city to close the large budget gaps that are in its financial plan.

Similarly, the fast pace at which expenditures are growing relative to revenue has contributed to the budget imbalance. The expenditure area with the fastest growth over the four-year period of FYs 2011-15 is debt service cost at 47 percent. The fiscal impact of the city's capital program is manifested in the form of annual debt service costs on the sale of bonds. The city actively manages debt service costs but, even with a new ten-year strategy that streamlines capital projects, debt service costs are projected to grow at this rapid pace. The city projects rapid growth in other areas such as Medicaid, fringe benefits and pension.

Adding to the increased pressure of rising expenditures are the potential risks to the city's financial plan. We estimate these risks would add to the city's projected multi-billion dollar budget gaps \$107 million in FY 2012, \$161 million in FY 2013, \$281 million in FY 2014 and \$377 million in FY 2015. Our additional risks bring the city's projected budget gaps to \$107 million in FY 2012, \$4.8 billion in FY 2013, \$5.1 billion in FY 2014 and \$5.3 billion in FY 2015.

#### **THE OUTLOOK FOR REVENUE GROWTH**

Total revenue increases by \$3.6 billion, or 5.4 percent, over the four years of the plan, from \$66.4 billion in FY 2011 to \$70 billion in FY 2015, as shown in Table 5 on page 17. At the start of the plan, total revenue edges down by 0.8 percent on the assumption that federal, state and private sources of categorical aid will fall sharply in FY 2012. Despite this early weakness, total revenue growth improves to about two percent annually in FYs 2013 through 2015, supported by an unsteady recovery in tax collections.

# CITY FUNDS INCREASE BY \$6.4 BILLION OVER THE NEXT FOUR YEARS

TABLE 5

(\$ in millions)

	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2011-15 % Change	FY 2011-15 \$ Change
Property Tax	\$16,860	\$17,625	\$18,203	\$18,630	\$19,060	13.0%	\$2,200
Nonproperty Taxes	21,652	22,960	23,724	24,462	25,807	19.2	4,155
Tax Program	0	0	0	0	0	--	0
Audit Revenue	957	660	659	666	666	(30.4)	(291)
Miscellaneous	4,171	4,370	4,431	4,497	4,530	8.6	359
Nonrecurring	169	36	23	20	7	(95.9)	(162)
STAR Aid	712	792	861	859	859	20.6	147
Unrestricted Aid	51	37	12	12	12	(76.5)	(39)
Disallowances	(15)	(15)	(15)	(15)	(15)	0.0	0
<b>Total City Funds</b>	<b>\$44,557</b>	<b>\$46,465</b>	<b>\$47,898</b>	<b>\$49,131</b>	<b>\$50,926</b>	<b>14.3%</b>	<b>\$6,369</b>
Categorical Aid	\$21,301	\$18,897	\$18,637	\$18,634	\$18,571	(12.8%)	(\$2,730)
Interfund Revenue	562	549	501	501	501	(10.9)	(61)
<b>Total Funds</b>	<b>\$66,420</b>	<b>\$65,911</b>	<b>\$67,036</b>	<b>\$68,266</b>	<b>\$69,998</b>	<b>5.4%</b>	<b>\$3,578</b>

Notes: Categorical Aid is the sum of state, federal and other categorical grants. Numbers may not add due to rounding.

City-fund revenues increase by \$6.4 billion, or 14 percent, over the city's plan, from \$44.6 billion in FY 2011 to \$50.9 billion in FY 2015. City fund growth starts out fast with 4.3 percent growth in FY 2012. Growth then slows to about 3.1 percent annually in FYs 2012 through 2015. The nonproperty taxes, which increase by 19 percent over the four years of the plan, are the primary impetus for the growth of city funds. The real property tax, which grows by 13 percent over the plan, is another support for the growth of city funds.

The nonproperty taxes are the fastest growing major revenue source in the city's plan. These taxes increase by \$4.2 billion, or 19 percent, from \$21.7 billion in FY 2011 to \$25.8 billion in FY 2015. The city plan has the nonproperty taxes growing most rapidly at the start of the plan and its conclusion, with a lull of weaker growth sandwiched in between. The nonproperty taxes increase by six percent in FY 2012, 3.3 percent in FY 2013, 3.1 percent in FY 2014, after which growth recovers to 5.5 percent in FY 2015. Previously, these taxes were recovering with a 12 percent growth surge in FY 2011 from a severe 17 percent decline during the recession.

The city is planning for the gradual restoration of some of the School Tax Relief (STAR) program reductions that were made during the recession. Over the three previous years, the state reduced the city's share of STAR aid by \$543 million to \$712 million in FY 2011 from \$1.255 billion in FY 2008. The city expects increased STAR aid by \$147 million, or 21 percent, to \$859 million by FY 2015.

Unrestricted aid declines from \$51 million in FY 2011 to \$37 million in FY 2012 and to \$12 million in each of the outyears. These allocations include assistance provided by the Federal Emergency Management Agency to reimburse the city for its outlays for two weather emergencies and the settlement of World Trade Center site cleanup costs. Previous revenue plans had generally included about \$300 million in state aid channeled through the Aid and Incentives to Municipalities program. The city has completely removed this source of revenue from its financial plan in recognition of the state's budgetary stress.

Categorical aid, which consists of federal, state and private program-specific grants, falls by \$2.7 billion during the plan, a decline of nearly 13 percent. The largest reductions are to federal aid programs, which decline by \$2.2 billion, or 26 percent. This reduction reflects the cessation of federal stimulus aid. The city is scheduled to lose about \$960 million in federal education grants in FY 2012. The city will also lose about \$240 million in federal health and social support grants in FY 2012. Additionally, about \$1 billion in Medicaid grants will be discontinued over the next two years.

### **Property Tax Growth**

The property tax increases by \$2.2 billion, or 13 percent, over the plan period, due to assessment growth at the start of the plan. The property tax grows by 4.5 percent in FY 2012, after which revenue growth drops to 3.3 percent in FY 2013 and to 2.3 percent in each of FYs 2014 and 2015. The plan's growth rates are consistent with the growth of four percent recorded for FY 2011, but are well below the 13 percent growth in FY 2010 when stronger assessment growth coupled with a tax rate increase had boosted growth.

Market values increased by 3.8 percent on the FY 2012 tax roll, providing a respite from the downward trend in property tax growth. That is why billable assessments increased 5.2 percent in FY 2012, improving from 4.2 percent growth in FY 2011. In the outyears of the plan, billable assessment growth continues to weaken to about two percent in FY 2015. Previously, market values had been virtually stagnant since FY 2008. Those flat market values will continue to depress billable assessments because assessments of most large properties are phased in over five years. Consequently, the weakening revenue growth in the plan is likely to persist until market values show improvement for several consecutive years.

### **Economic Outlook**

With the national economy two years into an unsteady recovery, local economic growth could prove to be too anemic to deliver steady tax revenue growth over the four years of the plan. A reviving financial sector provided an initial lift to city revenues and the nonproperty tax collections surged by 12 percent in FY 2011. The city sees Wall Street profits weakening from \$28 billion in calendar year 2010 to \$20 billion in 2011 and \$14 billion in 2012. The slowing of this income stream will reduce nonproperty tax growth in the city's plan to six percent in FY 2012 and to about three percent in FYs 2013 and 2014. In FY 2015, nonproperty tax growth accelerates to six percent as the national economy steadies itself and begins to show stronger and more consistent growth.

Thus far, the nation has been recovering slowly and unsteadily, providing little impetus for local economic growth. Gross Domestic Product (GDP) increased at a 1.9 percent rate in the first quarter of 2011, dropping from 3.1 percent in the fourth quarter of 2010. The city sees GDP recovering with lackluster growth of 2.7 percent in 2011, weakening from 2.9 percent growth in 2010. GDP growth languishes at 2.8 percent in 2012 and 2.9 percent in 2013, before accelerating to 3.6 percent in 2014.

With the national recovery failing to gain traction until late in the plan, local economic growth weakens following a short-lived spurt, which marked the end of the

recession. A stimulus-led finance sector recovery sparked a 6.6 percent rebound in Gross City Product (GCP) in 2010, which followed a steep nine percent contraction over the recession in 2008 and 2009. Growth drops below one percent in 2011 and 2012, gradually accelerating to about two percent in 2013 and three percent in 2014. The economic growth spurts occurring in 2010 and in 2014 account for the relatively fast nonproperty tax collections growth in FYs 2011 and 2015, with a lull of falling growth in the intervening years.

The jobs recovery is disappointingly weak and unsteady, particularly for the nation. Employment began to turn around at the start of 2010 for both the nation and the city, but the city's unemployment rate is improving faster than the nation's. Through June 2011, the nation added 1.8 million jobs in the 16 months since the recessionary low point, lowering the national unemployment rate to a seasonally adjusted 9.2 percent from its peak of 10.1 percent. By comparison, the local unemployment rate has declined to 8.6 percent as of May 2011, from the recession's high point of 10 percent, showing that the city's economy is not getting adequate support from the lethargic national upturn.

Government jobs are disappearing in both the nation and the city, indicating that government entities are shedding jobs in response to fiscal stresses that are lingering even two years into the recovery. The nation produced a disappointing total of 18,000 jobs in June 2011, for a growth rate of 0.8 percent since the previous June. Private employment is stronger and produced 57,000 jobs, increasing by 1.6 percent. Government retrenched by 39,000 jobs in June, for a drop of 2.9 percent.

The same pattern of employment is evident in the city, with job growth being held down by a shrinking government sector. For the first five months of 2011, total job growth in the city averaged only 32,200, for a modest 0.9 percent increase over the previous year. A much stronger local private sector added an average 51,100 jobs, for robust growth of 1.6 percent. The weakest segment of the local jobs market is government, where employment fell by an average of 18,900 jobs, for a loss of 3.3 percent.

### **Nonproperty Taxes**

The city expects the nonproperty taxes to increase by \$4.2 billion, or 19 percent, over the next four years, from \$21.7 billion in FY 2011 to \$25.8 billion in FY 2015, as shown in Table 5 on page 17. However, because collections had fallen by 17 percent during the recession, nonproperty tax revenues will be only 10 percent higher in FY 2015 than they were in FY 2008 before the recession had brought down collections. These taxes started to recover in FY 2011 with a strong rebound of 12 percent. The plan calls for impressive growth of six percent in FY 2012, followed by weaker growth of about three percent in each of FYs 2013 and 2014. More substantive growth returns in FY 2015 with an increase of 5.5 percent. This pattern of weak revenue growth in the midyears of the plan reflects the city's view that the economic recovery will remain weak and unsteady until near the end of the plan period.

Among the fastest growing nonproperty taxes in the plan are the mortgage recording tax, which has a four-year increase of nearly 68 percent, and the general

corporation tax, which expands by almost 35 percent. The personal income tax, which increases by \$1.8 billion, or 23 percent, yields the most additional revenue. Also growing strongly are the unincorporated business tax, the real property transfer tax, and the sales tax. Not all of the city's taxes participate in the growth surge. The bank tax, which climbed 38 percent in FY 2011, is expected to weaken by 23 percent over the plan. Also declining over the plan are the cigarette tax, the hotel tax and the minor taxes.

**Property Transactions Taxes.** The city expects the two property transactions taxes (the real property transfer tax and the mortgage recording tax) to increase by about \$450 million, or 38 percent, from \$1.2 billion in FY 2011 to \$1.7 billion in FY 2015. The real estate transactions taxes increased by 23 percent in FY 2011, recovering a small portion of the collections drop that occurred over the preceding three years of the real estate downturn. Improved affordability for homes, low mortgage rates, stimulus tax credits for homebuyers, and an upturn in commercial real estate all contributed to the revival of FY 2011 collections. However, the city expects these taxes to grow at a much slower pace over the plan.

The growth rate of the transactions taxes falls to six percent in FY 2012, after which growth drops to three percent in FY 2013. Towards the end of the plan, growth accelerates to more than 12 percent in each of FYs 2014 and 2015. Previously, revenue had fallen by a staggering \$2.3 billion, or 70 percent, from a peak level of \$3.3 billion in FY 2007 to \$1 billion in FY 2010. The depth of this revenue loss and the very slow pace of the recovery are contributing to the fiscal stresses in the city's plan.

**Business Taxes.** The city's three business income taxes (the general corporation tax, the banking corporation tax and the unincorporated business tax) comprise another tax group that is recovering after three years of decline. These taxes bounced back with 18 percent growth in FY 2011, largely on the strength of bank profits. As bank tax revenues settle back to more normal levels, business tax growth drops to eight percent in FY 2012, slows to about two percent in FYs 2013 and 2014, and then increases by three percent in FY 2015. Previously, revenues had fallen by \$1.5 billion from the peak \$6 billion collected in FY 2007 to \$4.5 billion estimated for FY 2010. With the slow recovery in the revenue plan, business tax collections will not surpass the pre-recession high point until FY 2015.

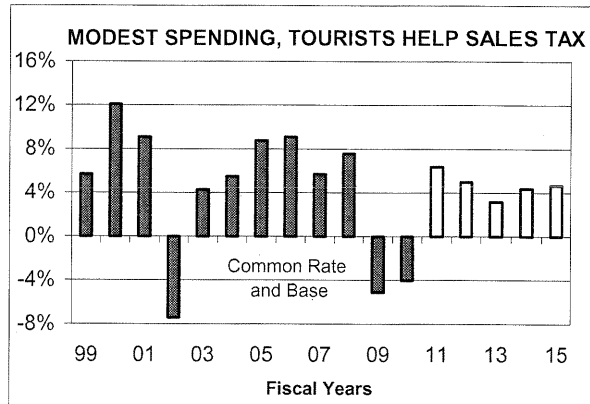
The city's business taxes had fallen over the previous three years because corporate profits and securities industry profits had severe setbacks in the recession. National pretax corporate profits are recovering from a three-year 28 percent slide, during which profits had fallen from \$1.823 trillion earned in 2006 to \$1.317 trillion in 2009. Profits soared 37 percent to \$1.801 trillion in 2010 and lifted the city's business taxes by 18 percent in FY 2011. Profit growth slowed to nine percent in the first quarter of 2011, indicating that the business tax growth slowdown projected in the city's plan is a realistic assumption.

**Sales Tax.** In its latest plan, the city expects sales tax revenue to grow 4.9 percent to \$5.8 billion in FY 2012 from the prior year, because of local job gains, higher wages, and tourism. Distinct from other economic recoveries, sales tax collections from FY 2012 to FY 2015 are unlikely to get a significant boost from Wall Street compensation or real estate-related consumption. Even though lower mortgage rates and home prices are



making real estate purchases more affordable, households still face tight credit conditions and sluggish wage growth. The pace of foreclosures has temporarily slowed due to legal issues, but there is still a backlog of homes that will enter the process. To a degree, consumers are still spending on necessities and some luxury items, but they are cautious because of the temporary lift to incomes from the cut in the payroll tax, weak employment growth, higher gas and food prices, and increased stock market volatility.

As seen in the figure to the right, the city expects sales tax revenue during FYs 2011-15, on a continuing base, to record over four percent annual growth except in FY 2013.<sup>5</sup> This forecast of a recovery in collections in FY 2011 and more moderate growth thereafter is conservative yet reasonable, given the revenue history and current economic conditions. Specifically, the city's latest sales tax projection reflects year-to-year increases of 6.4 percent in FY 2011, five percent in FY 2012, 3.2 percent in FY 2013, 4.4 percent in FY 2014, and 4.7 percent in FY 2015.



Supporting sales tax collections are the city's projection of steady employment gains that rise annually from 28,000 jobs in 2011 to 51,000 by 2015. After falling by 10.8 percent to \$263.3 billion in 2009, total wage income is forecast to exhibit annual increases from 2010 through 2015, largely from the influence of the nonfinancial sector of the economy. Last but not least, the city anticipates that sales tax collections during the plan period will continue to be augmented by the high volume of domestic and foreign travelers, some of whom will be attracted by new marketing campaigns such as "NYC I Do."

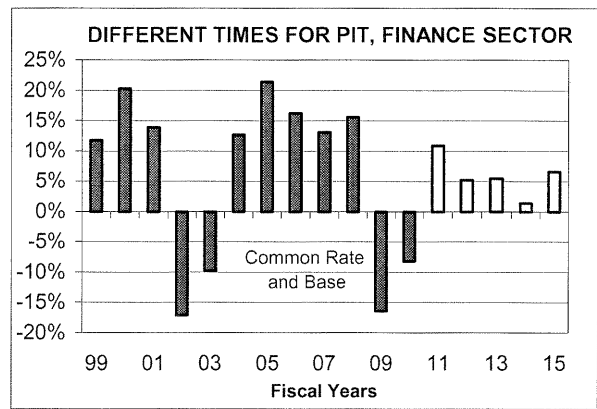
**Personal Income Tax.** For the first time in a long while, the city is not expecting a significant pick-up in finance sector compensation to propel both discretionary spending in the local economy and nonproperty tax collections in a financial plan. In its latest outlook, the city assumes that bonus payouts will decline in FY 2012 from the prior year and remain flat, along with employment in the financial industry, from FY 2012 to FY 2015. Consequently, personal income tax (PIT) revenue is anticipated to grow moderately by 7.4 percent on a year-over-year basis to \$8.2 billion in FY 2012.<sup>6</sup> The point is, going forward from FY 2011, the city is not expecting double-digit growth in finance sector earnings and PIT collections, where such growth rates defined past fiscal years and economic recoveries. The major players in the financial industry are facing a new

<sup>5</sup> "Continuing base" or "common rate and base" refers to tax collections that have been modified to remove the effects of tax programs and other adjustments to focus on the influence of the economy.

<sup>6</sup> This is not to minimize the scale and impact of securities industry compensation on other industries and nonproperty tax collections. The city forecasts that annual finance sector earnings will remain in the \$80 billion range from 2010 to 2014, and exceed \$90 billion in 2015.

regulatory environment and higher interest rates in the years covered by the latest financial plan.

The figure to the right shows the city's latest PIT forecast on a year-to-year basis and on a common rate and base. After a strong rebound of 10.9 percent in FY 2011, collections are expected to grow modestly by 5.2 percent in FY 2012 and 5.5 percent in FY 2013, improve slightly by 1.4 percent in FY 2014, and advance by 6.6 percent in FY 2015. PIT revenue in FY 2014 is suppressed primarily because taxpayers are likely to shift capital gains realizations into FY 2013 from FY 2014 due to the expiration of the lower, Bush-era, capital gains tax rate.



Recently, lower interest rates that dramatically cut interest expenses for financial firms, and the absence of tougher regulations, enabled members of the New York Stock Exchange (NYSE) to earn \$61.4 billion in 2009 and \$27.6 billion in 2010. For the first quarter of 2011, NYSE member firm profits reached \$9.3 billion, primarily from a resurgence in mergers and acquisitions, technology initial public offerings, and commodities trading. However, they may earn less than the city's 2011 profit estimate of \$20 billion because of several new and long-standing issues, in addition to lower trading volume and sluggish revenue growth in the second quarter of 2011.<sup>7</sup>

Banks and bank holding companies still face issues with collateralized debt obligations or other mortgage-based securities sold to investors, inadequate servicing of mortgages and foreclosed properties, as well as possible defaults on euro-zone sovereign debt. The new issues include: (1) increased competition from unregulated firms in profitable areas such as commodities, (2) more supervision and larger capital requirements for "systemically important financial institutions," (3) higher fixed costs from raising salaries instead of offering annual cash bonuses, and (4) new rules and platforms for other profitable areas such as derivatives, proprietary trading, and consumer fees. In the short term, financial firms may resort to layoffs and other means to cut expenses. In the long term, they are waiting to adjust their business models based on regulators' efforts to flesh out the Dodd-Frank financial reform law.

### **Miscellaneous Revenue**

In the latest financial plan, the city's miscellaneous revenue forecast increases by 4.5 percent, or \$196.6 million, to \$4.5 billion from FY 2011 to FY 2015.<sup>8</sup> If we narrow the

<sup>7</sup> The city's outyear forecast of NYSE member firm profits is more likely to be achieved, and spans from about \$12 billion to \$14 billion during 2012 to 2015.

<sup>8</sup> The city's latest miscellaneous revenue forecast for FYs 2011-15 does not include proceeds from the sale of 1,500 taxi medallions over three years starting in FY 2013, as detailed in the state enabling

view to highlight the core categories, we can evaluate the potential for recurring revenue growth in the city's miscellaneous revenue forecast.<sup>9</sup> This is accomplished by negating the effects of the highly variable nature of asset sales and third-party payments, in addition to collections that are tied to agency expenditures. Core category revenue is expected to advance by 5.7 percent, or \$149.6 million, to \$2.8 billion from FY 2011 to FY 2015. Of the total variance of \$149.6 million, \$142.3 million can be traced to the city's expectation of higher interest income.

After reaching a historical low of \$22.2 million in both FYs 2010 and 2011, the city estimates that higher interest rates, rather than more funds for short-term investment, will cause interest earnings to reach \$164.6 million by FY 2015. The city's assumption is that during 2012 the Federal Reserve will promote a less accommodative monetary policy, which will cause the federal funds rate to rise from the current range of 0 to 0.25 percent. Based on a model used by the city, short-term interest rates will average 0.5 percent in FY 2012, 2.7 percent in FY 2013, 3.5 percent in FY 2014, and 4.2 percent in FY 2015.

The remaining plan variance of \$7.3 million among the other core categories represents more growth in licenses, charges, fines, and rent compared to an almost equal decline in the miscellaneous category from FY 2011 to FY 2015. Despite higher revenue projected in such areas as franchises and privileges in the Department of Transportation, tuition and other fees, parking fines, and rent from economic development projects, core category growth is limited by slippage in numerous agency activities in the miscellaneous category. Yet, it is likely that the projection for the miscellaneous category will be raised as the fiscal year progresses. Based on historical patterns of growth and the city's practice of developing new initiatives, the city's miscellaneous revenue forecast could be higher by \$60 million in FY 2012, \$60 million in FY 2013, \$75 million in FY 2014, and \$100 million in FY 2015.

## **SOURCES OF EXPENDITURE GROWTH IN THE FINANCIAL PLAN**

The city's expenses between FYs 2011 and 2015 are expected to rise by \$8.6 billion, or 13 percent, with total spending reaching \$74.4 billion in the final year of the financial plan from \$65.9 billion in FY 2011, as shown in Table 6. While total spending is projected to rise annually over the life of the financial plan, the city projects expenditures (excluding intracity expenses and interfund agreements) to fall by about \$500 million between FYs 2011 and 2012. The decrease in expenditures is primarily due to the prepayment of FY 2012 expenditures, which will reduce costs in the Other Than Personal Service (OTPS). Also, the city is projecting lower costs in Public Assistance and

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legislation. As preparatory work is completed prior to the sale, such as an environmental impact statement, this initiative will be included in a subsequent city modification to the financial plan.

<sup>9</sup> Core category revenue consists of six types of revenue: licenses (with permits and franchises), charges for services, interest, rent, fines, and a miscellaneous category without major nonrecurring actions, tobacco proceeds, housing revenue, and HHC payments. Dedicated funds such as water and sewer charges are also excluded from core category revenue since the funds are unavailable for gap-closing assistance.

wages. These reductions have been offset by the growth in fringe benefit, pension, Medicaid and debt service costs.

### PROJECTED EXPENDITURE GROWTH IN FYs 2011-2015

TABLE 6 (yr/yr percent change, \$ in millions)

	FYs 2011-12	FYs 2012-13	FYs 2013-14	FYs 2014-15	FYs 2011-15	Level in FY 2011	Level in FY 2015
<b>Total Expenditures</b>	<b>(0.8%)</b>	<b>8.9%</b>	<b>2.0%</b>	<b>2.5%</b>	<b>13.0%</b>	<b>\$65,859</b>	<b>\$74,419</b>
<b>Total PS</b>	<b>2.6%</b>	<b>2.8%</b>	<b>1.4%</b>	<b>2.1%</b>	<b>9.2%</b>	<b>\$35,404</b>	<b>\$38,660</b>
Salaries and Wages	(2.7%)	(0.9%)	0.5%	0.0%	(3.1%)	21,298	20,636
Fringe Benefits	1.2%	14.5%	6.3%	6.2%	30.8%	7,229	9,455
Pensions	20.7%	1.8%	(1.4%)	3.0%	24.6%	6,877	8,570
<b>Total OTPS</b>	<b>(4.7%)</b>	<b>16.5%</b>	<b>2.8%</b>	<b>2.9%</b>	<b>17.4%</b>	<b>\$30,455</b>	<b>\$35,758</b>
Public Assistance	(11.1%)	(1.4%)	0.0%	0.0%	(12.3%)	1,557	1,365
Medicaid	29.0%	1.8%	2.2%	2.8%	37.9%	4,819	6,643
Debt Service	17.5%	14.4%	3.8%	5.2%	46.8%	4,948	7,265
Other OTPS	(18.4%)	24.7%	2.8%	2.4%	7.1%	19,131	20,486

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

As shown in Table 6, Personal Service (PS) increases by 9.2 percent from FY 2011 to FY 2015 driven by a climb in fringe benefits and pension costs of 31 percent and 25 percent, respectively. Fringe benefits, which are comprised of such costs as health and unemployment insurance, disability benefits and worker compensation, grow particularly fast between FYs 2012 and 2013, a jump of more than \$1 billion, or 14.5 percent. The increase is mainly due to 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. The financial plan does, however, assume a drawdown of \$672 million in FY 2012 from the Trust following drawdowns of \$82 million and \$395 million in FYs 2010 and 2011, respectively. Pension costs are expected to increase by 21 percent between FYs 2011 and 2012, with a change in actuarial assumptions and methods, and mostly increase each year thereafter with the exception of between FYs 2013 and 2014. The increase includes \$1 billion in reserve to fund the anticipated changes. The growing costs in these areas are mitigated by savings in wage expense of \$662 million, or 3.1 percent, over the life of the financial plan. The city has assumed a wage freeze for FY 2012 and a 1.25 percent salary increase for each of the remaining years of the financial plan.

Other Than Personal Service expenditures are expected to increase by 17.4 percent from FY 2011 to FY 2015 due mainly to a jump in Medicaid and debt service costs, while spending for public assistance falls by about \$192 million, or 12.3 percent. Over the life of the plan, Medicaid and debt service expenditures are expected to grow by almost 38 percent and 47 percent, respectively. Most of the increase in Medicaid spending reflects the winding down of the Federal Medical Assistance Percentages (FMAP) rate reduction enacted through the federal stimulus package and the return to a historical level of spending. The FMAP enhancement reduced Medicaid costs by more than \$2.1 billion from FY 2010 through FY 2013 but, with its ending, will return spending to a historical level. The increase in debt service results from a projected rise in outstanding debt and greater interest expenses.

Expenditures that fall under Other OTPS, which include the impact of prepaid expenses but exclude public assistance, Medicaid and debt service costs, are expected to rise by almost 25 percent between FYs 2012 and 2013 after an 18 percent decrease between FYs 2011 and 2012. The decline between FYs 2011 and 2012 occurs as a consequence of a prepayment of FY 2012 expenses. The increase between FYs 2012 and 2013 are centered in areas such as libraries, the Department of Education, other mayoral agencies and miscellaneous budget areas.

### **Pension Costs in FYs 2012-2015**

As shown in Table 7, pension contributions for FYs 2012 to FY 2015 will cost the city \$8.4 billion in FY 2012 and grow to almost \$8.7 billion by FY 2015. The cost has risen sharply due to two main funding issues: investment losses suffered in FYs 2008 and 2009, and a projected change in the pension systems' actuarial assumptions and methods. The city has already allocated \$1 billion in each year of the financial plan in anticipation of the changes, which may include such factors as the mortality rates and a lower Actuarial Interest Rate (AIR) used to calculate the city's annual contribution.

TABLE 7

**PROJECTED PENSION CONTRIBUTIONS IN FYs 2012-2015**  
(\$ in millions)

<b>Funding Source</b>	<b>FY 2012</b>	<b>FY 2013</b>	<b>FY 2014</b>	<b>FY 2015</b>
City	\$8,259	\$8,405	\$8,284	\$8,529
State	38	38	38	38
Federal	3	3	3	3
Intracity	124	124	124	124
<b>Total Contributions</b>	<b>\$8,424</b>	<b>\$8,570</b>	<b>\$8,449</b>	<b>\$8,694</b>

Changing the AIR will have a significant impact on pension costs for the city. The AIR is the rate of interest that pension fund assets are expected to gain in order to fund the benefits paid out to retirees. The city makes a pension contribution each fiscal year to fund the present value of benefits earned by each active city employee. The future value of those retirement benefits earned now are "discounted" to their present value today. The discount factor is the AIR, which is currently eight percent. For example, if an individual needed \$100 one year from now and earns simple interest at eight percent, he would need to deposit \$92.59 today. This is the present value of \$100 discounted at eight percent. At the end of the year with accumulated interest, the deposit would sum to \$100.

The pension system works in a similar fashion, except that the present value is a liability and is the amount that the city must contribute annually. If for example the AIR were to decrease from eight percent to 7.5 percent, the impact would be costly. Returning to the previous example, the present value increases as the discount rate becomes smaller, thus the present value of \$100 would rise from \$92.59 to \$93.02, meaning the city's required annual contribution would become higher. Some estimates suggest that a 50 basis point reduction, which would lower the AIR to 7.5 percent, could cost the city an extra \$750 million to \$1 billion annually.<sup>10</sup> As mentioned earlier, the city

<sup>10</sup> The 50 basis point reduction of the AIR is for illustration. The amount of any reduction, if any, is awaiting recommendation by the City Actuary.

had funded a reserve of \$1 billion annually to address such actuarial changes. Nonetheless, costs could be higher than anticipated and would require even more funding in future years.

### **Risks and Offsets**

Our risk evaluation of the city's financial plan is shown in Table 3 on page 5. We estimate that miscellaneous revenue will be above the city's plan by \$60 million in FYs 2012 and 2013, \$75 million in FY 2014 and \$100 million in FY 2015.

In the outyears of the financial plan, the city projects uniformed overtime spending of \$715 million in FY 2012, \$661 million in FY 2013 and \$657 million in each of FYs 2014 and 2015. Our analysis indicates that the city has underestimated its uniformed agency overtime budget. We project total annual overtime spending of \$882 million in each of FYs 2012 to 2015. As a result, we hold at risk \$167 million in FY 2012, \$221 million in FY 2013 and \$225 million in each of FYs 2014 and 2015. The city historically underestimates its overtime budget at the beginning of each fiscal year and increases it with each budget modification based on the current level of spending. As this action occurs, the risk to the city's budget is mitigated.

As mentioned in "Collective Bargaining and Pension Costs" starting on page 13, the city and state have recently proposed pension reform plans that create a new pension tier for newly hired workers. The city expects initial pension savings from the creation of the new pension tier to start in FY 2014 and yield savings of \$131 million in that fiscal year and increase to \$252 million in FY 2015. However, these savings are held at risk pending state legislative approval.

We now estimate that the city will have a possible budget gap of only \$107 million in FY 2012. The city also faces possible gaps of about \$4.8 billion in FY 2013, \$5.1 billion in FY 2014 and \$5.3 billion in FY 2015.

### **THE CAPITAL PROGRAM PROFILE AND ASSOCIATED DEBT**

The city has finalized its Ten-Year Capital Strategy for FYs 2012-21 at a level of \$54.1 billion of capital commitments. In accordance with its charter requirement, every two years the city presents a strategy that identifies the capital goals and anticipated sources of financing for the ensuing ten-year period. The strategy incorporates the city's four-year authorized capital commitments in the initial years, and extends the forecast for an additional six years. Over the past ten years, the size of strategies has varied considerably to reflect the city's current fiscal circumstances. The size of strategies has ranged from a low of \$49.3 billion for FYs 2004-13 to a high of \$83.7 billion for FYs 2008-17. The size of the strategy for FYs 2012-21 has been streamlined and is comparable to the \$54.4 billion contained in the strategy for FYs 2002-2011. It is expected that the scope of projects entered into may vary somewhat from the strategy, and that the actual costs, timing and funding sources may differ. Using the Ten-Year Capital Strategy for FYs 2002-11, we provide an example of actual commitments varying from the associated strategy, and the impact on debt service costs.

## **Profile of the FYs 2012-21 Capital Strategy**

The FY 2012 Ten-Year Capital Strategy calls for a total investment of \$54.1 billion in the city's capital stock over the period of FYs 2012-21. The investments are allocated for commitments classified into three main categories: state of good repair, which represents essential repair work needed largely because of deferred maintenance; programmatic replacement, which represents replacement of equipment and asset components at regular intervals at the end of their life cycle; and program expansion, which represents the addition of assets. There are more than two dozen functional areas within the city's capital strategy, but 78 percent of planned commitments are in five areas: education, environmental protection, housing, bridges and highways. Given the amount of commitments planned for these areas, the distribution among the three categories has a considerable impact on the profile of the entire strategy, as illustrated in Table 8.

The largest portion of commitments in the capital strategy, at \$23 billion or 42 percent, is classified as state of good repair projects.<sup>11</sup> Education projects make up \$9.7 billion, bridges \$3.4 billion, highways \$2.4 billion and housing \$1.8 billion. Meanwhile, commitments classified as program expansion total \$17.7 billion or 33 percent, with the largest allocation at \$10.4 billion for education, the second largest at \$4.1 billion for environmental protection and the third largest at \$1.6 billion for housing. Commitments for programmatic replacement projects amount to \$13.4 billion or 25 percent, with the majority allocated for environmental protection at \$7.7 billion.

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<sup>11</sup> The city in its FY 2011 Asset Information Management System (AIMS) Report recommends an investment of \$6.1 billion during FYs 2012-15 to bring certain physical assets up to a state of good repair. Only 48 percent, or \$2.9 billion, of the recommendations have been identified by individual agencies as being funded in the capital program for FYs 2012-15. This represents a continued slide in the funding proportion from the high of 60 percent identified in the FY 2008 AIMS Report. The city is required by charter to produce an annual maintenance report each October that details the recommended amounts of funding over the ensuing four fiscal years to maintain assets and asset systems with a replacement cost of \$10 million or greater and a useful life in excess of ten years. Additionally, the city produces a separate document, usually published around the time the executive budget is released, that reconciles the funding needs to the planned funding for each agency.

## THE FY 2012 TEN-YEAR CAPITAL STRATEGY

TABLE 8 (\$ in millions)

	State of Good Repair	Program Expansion	Programmatic Replacement	Total
<b>TOTAL</b>	<b>\$ 22,957</b>	<b>\$ 17,719</b>	<b>\$ 13,422</b>	<b>\$ 54,098</b>
<b>Percent of Total Program</b>	<b>42%</b>	<b>33%</b>	<b>25%</b>	<b>100%</b>
<b>Department of Education</b>	<b>9,745</b>	<b>10,363</b>	<b>13</b>	<b>20,122</b>
<b>Department of Environmental Protection<sup>a</sup></b>	<b>760</b>	<b>4,071</b>	<b>7,738</b>	<b>12,569</b>
Water Pollution Control	62	125	4,048	4,234
Water Mains	0	634	2,659	3,293
Water Supply	7	2,493	0	2,500
Sewers	691	820	268	1,779
Equipment	0	0	763	763
<b>Department of Transportation</b>	<b>6,552</b>	<b>0</b>	<b>479</b>	<b>7,031</b>
Bridges	3,438	0	39	3,477
Highways	2,406	0	0	2,406
Traffic	695	0	0	695
Ferries	12	0	402	413
Transportation Equipment	0	0	38	38
<b>Housing</b>	<b>1,827</b>	<b>1,573</b>	<b>0</b>	<b>3,400</b>
<b>All Others<sup>b</sup></b>	<b>4,073</b>	<b>1,712</b>	<b>5,191</b>	<b>10,976</b>

<sup>a</sup>These categories are funded by Water Authority revenue bonds.

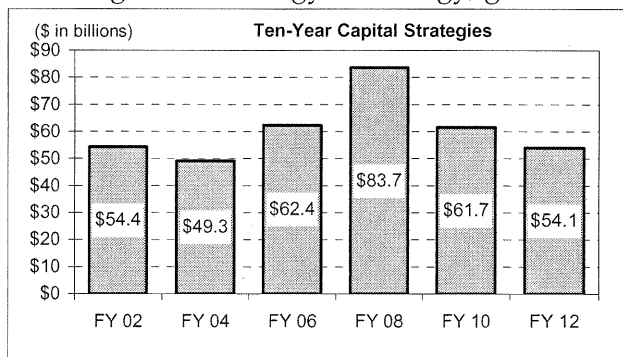
<sup>b</sup>All Others include Sanitation, Citywide Equipment, Correction, Parks, Public Buildings, Economic Development, Police, Transit Authority, Health and Hospitals Corporation, Fire, Courts, Cultural Affairs, Health, Human Resources, Administration for Children Services, Libraries, Homeless Service, CUNY, Real Estate, Aging, and Juvenile Justice.

Numbers may not add due to rounding.

The FY 2012 strategy reflects the city's current funding capacity. Funding levels for the city's long-range capital priorities change from strategy to strategy, given limited

resources and the completion of actual work. The figure to the right places the size of the current strategy into historical context. At a total \$54.1 billion, the FY 2012 strategy is the second smallest in size over the past ten years, larger than only the FY 2004 strategy, which was crafted during a recessionary period. The FY 2012 strategy is \$30 billion and \$8 billion

smaller than the FYs 2008 and 2010 strategies, respectively. The city has scaled down the size of its capital program incrementally since the FY 2008 strategy, which originated at the height of an economic boom when the city was the recipient of a record revenue windfall. Moreover, the FY 2008 strategy contained contracts for large new construction projects that represent a sizable portion of \$43 billion of commitments entered into during FYs 2008-11, which are not part of the FY 2012 strategy.

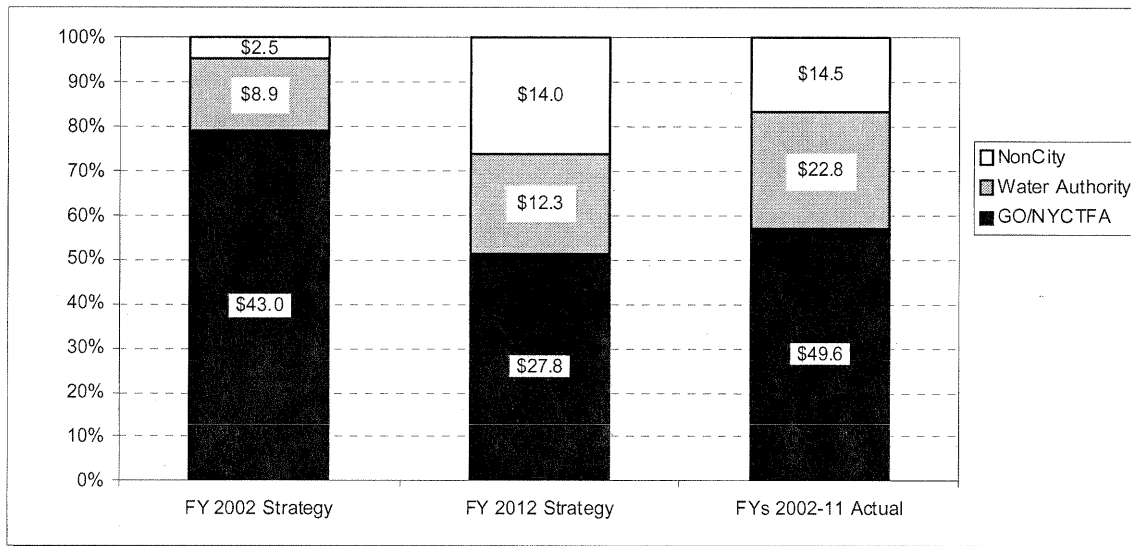


While the overall size of the current capital strategy is comparable to that of the FY 2002 strategy, the FY 2012 strategy reflects a significant shift in the funding



distribution.<sup>12</sup> As illustrated in Chart 1, the FY 2002 strategy assumed a hefty 79 percent (\$43 billion) of the commitments would be funded by bonds that are backed by city tax revenues, 16 percent (\$8.9 billion) by bonds sold by the Water Authority and secured by water and sewer user fees, and only five percent (\$2.5 billion) by noncity sources. In contrast, the current strategy assumes a more diversified funding distribution, with 51 percent (\$27.8 billion) of the commitments funded by bonds that are backed by city tax revenues; 23 percent (\$12.3 billion) by bonds that are backed by water and sewer fees; and 26 percent (\$14 billion) by noncity sources, led by the state with \$10 billion for school construction projects.<sup>13</sup>

**CHART 1** **FUNDING FOR THE CAPITAL PROGRAM IS MORE DIVERSIFIED**  
(\$ in billions)



This shift in the funding distribution is more in line with what the city has been experiencing in recent years, as it has actively sought support for its capital program from the state and federal governments and has augmented its environmental protection program, which is backed by water and sewer user fees. Indeed, over the ten-year period of FYs 2002-11, 57 percent of the commitments entered into were funded with city tax-supported debt; 26 percent with revenue bonds sold by the Water Authority; and 17 percent with noncity resources.<sup>14</sup> The redistribution in funding proportions is reflective of the fact that the city received an additional \$12 billion of noncity support beyond its projection in the FY 2002 strategy mostly to fund school projects, and it

<sup>12</sup> When inflation is accounted for by adjusting to FY 2011 dollars, the FY 2012 strategy is lower at \$50 billion than the FY 2002 strategy at \$63 billion.

<sup>13</sup> The FY 2012 strategy assumes parity between city and state funding for city education projects.

<sup>14</sup> The city has not published the actual commitment level for FY 2011. In calculating the ten-year total, we use the targeted level for FY 2011 taken from the executive budget.

enlarged commitments supported by water and sewer fees by \$13.8 billion to comply with mandates and augment the water supply system. City tax-supported commitments were increased to a lesser extent by \$6.7 billion. Accordingly, actual commitments entered into during FYs 2002-11 were approximately \$32.5 billion larger than the forecast in the FY 2002 strategy.

### **Debt Profile**

The fiscal impact of the capital program on the city is manifested in the form of annual debt service costs on the sale of bonds. The city actively manages debt service costs with consideration to the proportion of tax revenues absorbed. For a comprehensive analysis of the debt resulting from the city's capital program for the years covered by the financial plan, we use the framework of the annual Statement of Debt Affordability that was released by the city at the time of the executive budget. The Statement of Debt Affordability presents the aggregate debt and debt service levels for all bonds backed by tax revenues sold to support the city's capital program, including city and New York City Transitional Finance Authority (NYCTFA), as well as city lease agreements. Table 9 displays measures used in the Statement of Debt Affordability.

TABLE 9

### **DEBT AFFORDABILITY MEASURES**

(\$ in millions, except per capita)

	FY 2012	FY 2013	FY 2014	FY 2015	Average Annual Growth
City & NYCTFA Debt Service	\$ 5,914	\$ 6,669	\$ 6,922	\$ 7,279	7.2%
Debt Service Per Capita	705	795	825	867	
<b>Debt Service as Percentage of:</b>					
Tax Revenues	14.0%	15.3%	15.5%	15.7%	
Total Revenues	9.0%	10.0%	10.2%	10.4%	
Local Personal Income	1.3%	1.4%	1.4%	1.4%	
City, NYCTFA & Conduit					
Outstanding Debt	\$ 65,834	\$ 67,692	\$ 69,501	\$ 70,736	2.4%
Outstanding Debt Per Capita	7,845	8,066	8,282	8,429	
<b>Outstanding Debt as Percentage of:</b>					
Local Personal Income	14.5%	14.4%	14.1%	13.6%	
Tax Revenues	\$ 42,097	\$ 43,447	\$ 44,617	\$ 46,392	3.3%
Total Revenue	65,715	66,933	68,174	70,054	2.2%
Local Personal Income	455,240	469,580	491,440	518,820	4.5%

The Statement of Debt Affordability covers the plan years of FYs 2011-15; we start with FY 2012, the first year of the current strategy. Debt service is projected to climb from \$5.9 billion in FY 2012 to \$7.3 billion in FY 2015, for an average annual

growth rate of 7.2 percent.<sup>15</sup> The rising debt service costs will absorb an increasing share of tax revenues, from 14 percent in FY 2012 to 15.7 percent in FY 2015. As can be seen in the figure to the right, the projected debt service burden for each of FYs 2012-15 falls within the range of 11.2 percent and 17.4 percent that was actually experienced between FYs 2002 and 2011, corresponding with the economic boom and recessionary times, respectively.<sup>16</sup> Moreover, the current projected debt service burden is well below the forecast for each of FYs 2002-11 based on the FY 2002 strategy, where the levels ranged from 17.6 percent to 19.2 percent. The forecast for the debt service burden based on the FY 2012 strategy compared to the FY 2002 strategy assumes a longer maturity structure for the bonds and higher tax revenues.

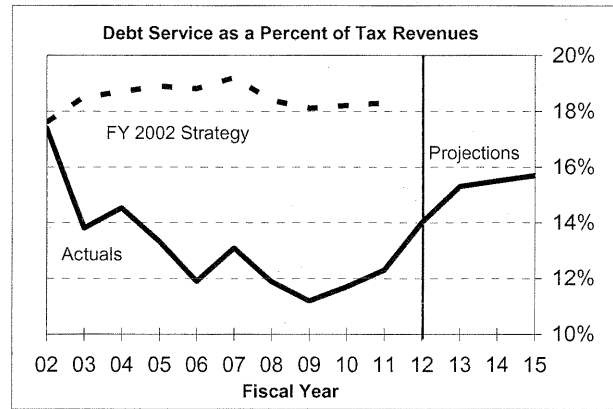


Table 9 on page 30 also measures debt service costs using other indicators. Debt service costs per capita based on the FY 2012 strategy are projected to increase from \$705 in FY 2012 to \$867 in FY 2015. Furthermore, debt service payments are forecasted to consume a larger share of total revenues and local personal income. Debt service rises from 9.0 percent in FY 2012 to 10.4 percent in FY 2015 as a percentage of total revenues, and from 1.3 percent in FY 2012 to 1.4 percent in FY 2015 as a percentage of local personal income. At 7.2 percent, the average annual rate of growth for debt service is outstripping the rates for tax revenues at 3.3 percent, total revenues at 2.2 percent, and local personal income at 4.5 percent.

Separately, Table 9 on page 30 reveals that from the high base of \$65.8 billion at the end of FY 2012 the combined outstanding debt is forecasted to increase to \$70.7 billion at the end of FY 2015, for an average annual growth rate of 2.4 percent. Outstanding debt per capita is expected to rise from \$7,845 in FY 2012 to \$8,429 in FY 2015. Meanwhile, the debt to income ratio is forecasted to decrease from 14.5 percent in FY 2012 to 13.6 percent in FY 2015, as the growth rate for personal income is anticipated to outpace that of outstanding debt.

The Statement of Debt Affordability does not include the debt service and outstanding debt associated with the Water Authority bonds that are sold to finance city environmental protection projects. The Water Authority projects the annual debt service on its bonds will grow at an average annual rate of 7.9 percent, from \$1.6 billion in FY

<sup>15</sup> Debt service projections are based on long-term financing assumptions in the executive budget and are net of prepayments. Debt service estimates based on assumptions in the adopted budget amount to \$5.813 billion in FY 2012, \$6.653 billion in FY 2013, \$6.908 billion in FY 2014 and \$7.265 billion in FY 2015, for a growth rate of 7.7 percent.

<sup>16</sup> The city has not published the actual debt service cost for FY 2011. We use the level for FY 2011 from the June 2011 Financial Plan.

2012 to \$2 billion in FY 2015, based on the forecast for outstanding bonds increasing at a rate of 3.5 percent from \$28.9 billion at the end of FY 2012 to \$32 billion at the end of FY 2015. The New York City Water Board levies user fees on city rate payers to fund the debt service on Water Authority bonds.

## **Glossary of Acronyms**

<b>AIMS</b>	Asset Information Management System
<b>AIR</b>	Actuarial Interest Rate
<b>BSA</b>	Budget Stabilization Account
<b>CUNY</b>	City University of New York
<b>CY</b>	Calendar Year
<b>DEP</b>	Department of Environmental Protection
<b>DOE</b>	Department of Education
<b>FCB</b>	Financial Control Board
<b>FEA</b>	Financial Emergency Act
<b>FMAP</b>	Federal Medical Assistance Percentages
<b>FY</b>	Fiscal Year
<b>GASB</b>	Government Accounting Standards Board
<b>GCP</b>	Gross City Product
<b>GDP</b>	Gross Domestic Product
<b>G.O. Bonds</b>	General Obligation Bonds
<b>HHC</b>	Health and Hospitals Corporation
<b>NYCTFA</b>	New York City Transitional Finance Authority
<b>NYSE</b>	New York Stock Exchange
<b>OPEB</b>	Other Postemployment Benefits
<b>OTPS</b>	Other than Personal Service
<b>PEG</b>	Program to Eliminate the Gap
<b>PIT</b>	Personal Income Tax
<b>PS</b>	Personal Service
<b>RHBT</b>	Retiree Health Benefits Trust
<b>SFY</b>	State Fiscal Year
<b>STAR</b>	School Tax Relief program
<b>UFT</b>	United Federation of Teachers