

Staff Report

**NOVEMBER MODIFICATION  
FYs 2013-2016**

December 13, 2012



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## I. Overview

Historically, first quarter modifications to the city's financial plans have been technical documents adjusting the plan to deal with any changes that have occurred since the budget was adopted. For a number of years the city had chosen to use the first quarter modification to proactively deal with the next year's projected budget gap. Gap-closing actions were proposed, while not needed in the current fiscal year, to build up a budget surplus that would be used to help balance the next year's budget. Last year, FY 2012, we reported that for the first time in many years the city needed to use the gap-closing program to maintain budget balance in the current year and was unable to increase the budget stabilization account. FY 2013 continues that trend.

In the November modification, the city has proposed a \$555 million gap-closing program that is needed to keep FY 2013 in balance. The gap-closing program grows to \$1 billion in FY 2014, then drops to just over \$500 million in each of FYs 2015 and 2016. While there are numerous changes in the modification, the most significant is the deferral of \$635 million that was expected from the sale of 2,000 taxi medallions. The city shifted the receipt of these revenues to FYs 2014-16 due to a state Supreme Court decision striking down the state legislation authorizing the sales. The city is appealing the decision and, until there is a resolution, it is uncertain if the city will be able to count on these revenues in the outyears of the plan.

The modification relies on credible assumptions that the city's economic recovery is stronger than that of the nation. There has been strong job growth and the recovery of the financial sector can be seen through security industry profits that have reached \$17.6 billion through the third quarter of 2012. However, these assumptions, including the impact on property and business taxes, will have to be reconsidered in the midyear modification due to the October 29, 2012 occurrence of Hurricane Sandy, which caused extensive damage within the city.

The November modification does not incorporate any budgetary impact from Hurricane Sandy. The Governor, in consultation with the Mayor, has estimated the statewide cost for response, recovery, and lost revenues to total over \$42 billion. New York, New Jersey, and Connecticut have made a request to the President and Congress for federal assistance. The Mayor has estimated a \$5.7 billion loss of economic activity in the city. The Governor, in his request for federal disaster relief, estimates the damage to city homes and businesses will total \$4.7 billion and \$4.5 billion, respectively. These losses could result in a shortfall in property and business tax revenues. Additionally, expenditures for overtime pay in such departments as the Police, Fire and Sanitation could spike. Both the city and the state expect substantial federal assistance, the amount and timing of which are currently unknown.

The city has begun taking action with its recent announcement of a \$500 million emergency plan for additional capital spending related to the hurricane to repair public schools and hospitals. Furthermore, the city has kept its assumption in the November modification that it will undertake \$2.4 billion of short-term borrowing to meet cash-flow needs in the current fiscal year. The city has not had to undertake short-term financing in eight years, but includes such an assumption along with the corresponding interest costs in the financial plan. The city typically carries its lowest cash balance in the month of December, and thus far the cash balance is relatively stable even with adverse budgetary effects related to the hurricane. It is too early to determine what, if any, the direct impact on the city budget will be due to the hurricane but it is unlikely that the short-term borrowing will be needed. We expect that the midyear modification and Preliminary Budget for FY 2014 will start to quantify the budget implications.

In addition to the unknown effect of Hurricane Sandy on the city's budget and financial plan, it is also too early to quantify what impact, if any, the actions in Congress to deal with the so called "fiscal cliff" will have on the city's finances. The city's proactive approach to budget stress has allowed it to reduce the estimated budget deficit in FY 2014 to a manageable \$1.2 billion, and the gaps in FYs 2015 and 2016 to \$2.8 billion and \$2.6 billion, respectively. However, with the major uncertainties of the sale of taxi medallions, the impact of Hurricane Sandy, and the actions in Washington, the city will be faced both in the current fiscal year and beyond with having to continue to develop gap-closing programs that will reduce expenditures or raise revenues.

**NOVEMBER MODIFICATION:  
THE CITY'S OPERATING PROJECTIONS FOR  
FISCAL YEARS 2013-2016**

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

	FY 2013	FY 2014	FY 2015	FY 2016
<b><u>Revenues</u></b>				
Taxes:				
General Property	\$18,384	\$18,932	\$19,594	\$20,237
Other Taxes	24,571	25,444	26,798	28,021
Tax Audit Revenue	838	709	709	709
Sale of Property Tax Liens	46	38	38	38
Miscellaneous Revenues	6,506	7,105	6,724	6,581
Less: Intracity Revenues	(1,704)	(1,606)	(1,609)	(1,614)
Disallowances	(15)	(15)	(15)	(15)
Total City Funds	\$48,626	\$50,607	\$52,239	\$53,957
Other Categorical Grants	978	951	916	902
Interfund Revenues	538	509	508	509
Federal Categorical Grants	7,262	6,588	6,359	6,347
State Categorical Grants	11,566	11,703	12,042	12,521
<b>Total Revenues</b>	<b>\$68,970</b>	<b>\$70,358</b>	<b>\$72,064</b>	<b>\$74,236</b>
<b><u>Expenditures</u></b>				
Personal Service	\$37,356	\$37,832	\$39,638	\$40,861
Other Than Personal Service	29,217	28,606	29,289	29,765
General Obligation, Lease & TFA Debt Service	6,108	6,531	7,233	7,539
Budget Stabilization & Prepayments	(2,307)	(155)	--	--
General Reserve	300	300	300	300
Subtotal	\$70,674	\$73,114	\$76,460	\$78,465
Less: Intracity Expenditures	(1,704)	(1,606)	(1,609)	(1,614)
<b>Total Expenditures</b>	<b>\$68,970</b>	<b>\$71,508</b>	<b>\$74,851</b>	<b>\$76,851</b>
<b>Gap To Be Closed</b>	<b>\$0</b>	<b>(\$1,150)</b>	<b>(\$2,787)</b>	<b>(\$2,615)</b>

**CHANGES TO THE CITY'S OPERATING PROJECTIONS FOR  
FISCAL YEARS 2013-2016  
JUNE FINANCIAL PLAN COMPARED TO NOVEMBER MODIFICATION**

**TABLE 2** (\$ in millions)

	FY 2013	FY 2014	FY 2015	FY 2016
<b><u>Revenues</u></b>				
Taxes:				
General Property	\$13	\$14	\$15	\$16
Other Taxes	68	(1)	(1)	(1)
Tax Audit Revenue	114	3	3	3
Sale of Property Tax Liens	0	0	0	0
Miscellaneous Revenues	(443)	517	56	270
Less: Intracity Revenues	(73)	(9)	(9)	(9)
Disallowances	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total City Funds	(\$321)	\$524	\$64	\$279
Other Categorical Grants	\$54	\$32	\$0	\$0
Interfund Revenues	(1)	(1)	(1)	0
Federal Categorical Grants	601	117	(12)	(23)
State Categorical Grants	<u>136</u>	<u>(17)</u>	<u>(98)</u>	<u>(101)</u>
<b>Total Revenues</b>	<b><u>\$469</u></b>	<b><u>\$655</u></b>	<b><u>(\$47)</u></b>	<b><u>\$155</u></b>
<b><u>Expenditures</u></b>				
Personal Service	\$64	(\$199)	(\$104)	(\$25)
Other Than Personal Service	511	(271)	(301)	(331)
General Obligation, Lease & TFA Debt Service	(10)	(224)	37	65
Budget Stabilization & Prepayments	(23)	0	--	--
General Reserve	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Subtotal	\$542	(\$694)	(\$368)	(\$291)
Less: Intracity Expenditures	<u>(73)</u>	<u>(9)</u>	<u>(9)</u>	<u>(9)</u>
<b>Total Expenditures</b>	<b><u>\$469</u></b>	<b><u>(\$703)</u></b>	<b><u>(\$377)</u></b>	<b><u>(\$300)</u></b>
<b>Gap To Be Closed</b>	<b><u>\$0</u></b>	<b><u>\$1,358</u></b>	<b><u>\$330</u></b>	<b><u>\$455</u></b>



## RISKS TO THE FINANCIAL PLAN

TABLE 3

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

	FY 2013	FY 2014	FY 2015	FY 2016
<b>Stated Financial Plan Gap</b>	<b>\$0</b>	<b>(\$1,150)</b>	<b>(\$2,787)</b>	<b>(\$2,615)</b>
<b>Estimation</b>				
Uniformed Services Overtime	\$0	(\$99)	(\$143)	(\$180)
Police Overtime PEG	(50)	(50)	(50)	(50)
<b>Subtotal</b>	<b>(\$50)</b>	<b>(\$149)</b>	<b>(\$193)</b>	<b>(\$230)</b>
<b>Not in Mayor's Control</b>				
Sale of Taxi Medallions	\$0	(\$790)	(\$447)	(\$223)
<b>Subtotal</b>	<b>\$0</b>	<b>(\$790)</b>	<b>(\$447)</b>	<b>(\$223)</b>
<b>Risk Total</b>	<b>(\$50)</b>	<b>(\$939)</b>	<b>(\$640)</b>	<b>(\$453)</b>
<b>Total FCB Estimated Surplus/(Gap)</b>	<b>(\$50)</b>	<b>(\$2,089)</b>	<b>(\$3,427)</b>	<b>(\$3,068)</b>
Note: Our risk assessment does not reflect the yet unquantified potential risk from Hurricane Sandy.				

## II. Review of the Modification

The November modification to the FYs 2013-16 Financial Plan incorporates recent efforts by the city to offset deferred revenues and new spending needs that created a budget gap of \$555 million for FY 2013, and to trim the projected budget deficits in the outyears of the plan. Based on responses to a letter sent to agency heads in September 2012, the city crafted a gap-closing program that included a combination of expenditure savings and increased revenues totaling \$555 million for FY 2013, \$1 billion for FY 2014, \$509 million for FY 2015 and \$521 million for FY 2016.

The budget for FY 2013, as presented in the November modification, totals \$69 billion and is balanced with the use of a \$2.3 billion prior-year surplus as well as the \$555 million of gap-closing measures. It excludes \$635 million in miscellaneous revenue to reflect the change in the city's timeline of selling 2,000 handicapped accessible taxi medallions from FY 2013 to FY 2014, because the legislation that enables sales of the taxi medallions was struck down by the State Supreme Court. The city is appealing the ruling, and expects the sales to go forward to yield \$790 million in FY 2014, \$447 million in FY 2015 and \$223 million in FY 2016. The November modification maintains the projection that FY 2013 will end with a modest \$155 million budget surplus.

It should be noted that the November modification does not incorporate any budgetary impact from the October 29, 2012 occurrence of Hurricane Sandy, which caused extensive damage within the city. The Mayor, in his request for federal disaster relief, estimates a \$5.7 billion loss of economic activity in the city. The Governor, in his request for federal disaster relief, estimates the damage to city homes and businesses will total \$4.7 billion and \$4.5 billion, respectively. These losses could result in a shortfall in property and business tax revenues. Additionally, expenditures for overtime pay in such departments as the Police, Fire and Sanitation could spike. Both the city and the state expect substantial federal assistance, the amount and timing of which are currently unknown.

The city has begun taking action with its recent announcement of a \$500 million emergency plan for additional capital spending related to the hurricane to repair public schools and hospitals. Furthermore, the city has kept its assumption in the November modification that it will sell \$2.4 billion of short-term borrowing to meet cash-flow needs in the current fiscal year. The city has not had to undertake short-term financing in eight years, but includes such an assumption along with the corresponding interest costs in the financial plan. The city typically carries its lowest cash balance in the month of December, and thus far the cash balance is relatively stable even with adverse budgetary effects related to the hurricane.

For FYs 2014-16, the modification projects narrower budget gaps totaling \$1.2 billion, \$2.8 billion and \$2.6 billion, respectively, down from \$2.5 billion in FY 2014, and \$3.1 billion in each of FYs 2015 and 2016 in the June Financial Plan. Our evaluation indicates that the budget gaps could be larger by \$939 million in FY 2014, \$640 million in FY 2015 and \$453 million in FY 2016. We are holding the entire proceeds of the taxi medallion sales at risk because it is unknown when or how the appeals court will rule. Additionally, we believe that the city is at risk of exceeding its overtime budget for FYs 2014-16. Our risk assessment does not reflect any budgetary impact from Hurricane Sandy, which is not quantifiable at this time.

## **ECONOMIC OUTLOOK**

The city's economic plan assumes that the local economic recovery is stronger than that of the nation. Local job growth is presently strong but the plan indicates that growth is likely to edge down because of the insufficiency of national growth. Inconsistent and weak national job growth over the past year has brought only a slight improvement to the excessively high unemployment rate. However, the recent four-month run of higher job growth is a hopeful sign that the nation's anemic economic growth could be on the mend. Improving, along with the upturn in hiring, economic output growth increased to 2.7 percent in the third quarter of 2012, up from 1.3 percent in the second quarter.

For the city, strong job growth and a recovering financial sector have thus far failed to lift moribund income levels or push down stubbornly high unemployment. It is possible that job polarization in the regional labor market could be holding back the upward mobility of the labor force thereby depressing income growth. The city drew up its financial plan before Hurricane Sandy wrought its devastation upon the region. The storm could have far reaching implications for the city's economy and for its financial plan.

In its plan, the city had expected calendar year 2012 real gross city product (GCP) growth of 2.8 percent to exceed the nation's 2.1 percent output growth as represented by gross domestic product (GDP). This optimism stems in part from resurgent Wall Street profits, which reached \$17.6 billion by the third quarter of 2012, up from the \$7.7 billion earned in all of 2011. Aside from the financial sector, other reasons for optimism are strong job growth, a stronger real estate market and a vibrant hospitality sector.

Unfortunately, economic losses resulting from the hurricane will cause this optimistic GCP forecast to fall short. In his \$19 billion request for federal disaster relief, the Mayor quotes an estimate of \$5.7 billion in lost economic activity related to the storm. This loss, which is equivalent to one percent of GCP, causes 2012 GCP growth to drop to 1.8 percent instead of the originally projected 2.8 percent. The Governor reported that 305,000 housing units were damaged in the state and many of these were in the city. The damage costs to city homes amounted to \$4.7 billion, or nearly half of the statewide housing damage total of \$9.7 billion.

The damage sustained by city businesses amounted to \$4.5 billion, or 75 percent of the \$6 billion statewide business damage total. These losses could cause property and business tax revenues to fall short of plan targets.

The Federal Reserve Bank of New York's Beige Book reports a weakening of economic activity in the city in the post-storm period. Most of the factors cited appear to be of a temporary nature, such as power outages, transportation disruptions, and supply chain interruptions due to closure of trucking terminals and flooded warehouses. Destruction of loan collateral represents a more lasting effect of the storm, as this may hinder access to new loans for rebuilding. The Fed's survey could not yet evaluate whether there would be any long-lasting weakening of consumer demand or business hiring plans.

The city's plan projects that the local job market is expanding by 1.8 percent in 2012, exceeding the estimate of 1.4 percent for national job growth. Despite this impressive expansion, local unemployment remains stubbornly high at 9.2 percent, unchanged from the previous year. National job growth accelerated to an average of 158,000 new jobs per month over the five months ending in November, up from about 67,000 jobs per month during the April – June period. Even so, national unemployment improved by only one percentage point to 7.7 percent in November, from 8.7 percent the previous year. Despite robust local job growth for two consecutive years, the city's plan expects the local wage rate to remain flat with growth of only 0.5 percent in 2012, down from 2.7 percent in 2011. Similarly, local personal income growth drops to 2.5 percent from 3.7 percent the previous year. It is possible that structural changes in the labor market, such as job polarization, could be behind the disappointing income growth in the city.

In our December 2011 report, we reviewed a study by Federal Reserve economists of job polarization in the nation's workforce. In a recent follow up study, these economists report that job polarization is even more pronounced in this region than it is for the rest of the nation.<sup>1</sup> Among their findings is that for the past three decades most of the new jobs produced in this region have been for high-skill and low-skill workers, whereas upper-middle skill jobs expanded at a slower pace. Most surprising, the number of jobs in the lower-middle category actually underwent a decline. Most employment losses during recessions have been midlevel jobs, while few of these jobs get replaced during economic recoveries, opening up permanent gaps in the job mobility ladder.

The study also found that divergent compensation trends exacerbated the labor market polarization caused by the dearth of midlevel job creation. For the nation, real wages increased only marginally for midlevel jobs, whereas high-skill real wages increased 37 percent and low-skill wages increased by 17 percent from 1980 to 2010. The wage disparity was most extreme for the downstate New York area, where high-skill real wages increased by nearly 50 percent, while low-skill real wages increased by only five percent over this thirty-year period. We think that these findings explain why income growth has been lagging even when job growth has been so strong in the city.

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<sup>1</sup> Jaison R. Abel and Richard Deitz "Job Polarization and Rising Inequality and the New York – Northern New Jersey Region," Federal Reserve Bank of New York Current Issues in Economics and Finance, Volume 18, Number 7, 2012.

## **REVENUES**

The November modification removes \$635 million in taxi medallion revenue from FY 2013, postponing the expectation of these proceeds to future fiscal years. Several positive revenue adjustments since budget adoption helped to offset part of this large loss and FY 2013 city-fund revenues declined by \$321 million, to \$48.6 billion. Despite this sharp drop, the city increased its FY 2013 estimate for total revenue by \$469 million to \$69 billion due to an upward adjustment to categorical grants.

The FY 2013 revenue changes in the November modification are summarized in the figure to the right. Tax collections improve by \$81 million, largely on the strength of the bank tax. The city's plan for audit revenue rises by a very substantial \$114 million, and miscellaneous revenues increase by \$51 million. These revenue improvements help offset the very large \$567 million downward adjustment to one-time revenues. This large decrease consists primarily of the \$635 million loss of taxi medallion sales revenue combined with upward revisions to several other one-time revenues.

<b>FY 2013 Revenue Changes Since the Adopted Budget</b> (\$ in millions)	
Taxes	\$81
Audits	114
One-Time Revenues	(567)
Miscellaneous Revenue	51
<b>City Funds</b>	<b>(\$321)</b>
Categorical Aid and Interfund Revenue	790
<b>Total Change in Revenues</b>	<b>\$469</b>

Categorical aid increased by about \$790 million, which is down from the \$1 billion upward adjustment at this time last year. Federal grants increased \$601 million, state grants increased \$136 million, while private grants declined by \$54 million. Disaster assistance could substantially lift categorical aid, but such grants will only serve to compensate the city for its losses. Aside from disaster grants, many other federal grant programs could be targeted for reductions whether or not the national budget impasse is resolved.

### **Tax Revenue**

The city increased its tax revenue estimate for FY 2013 by \$81 million, as shown in the figure to the right. The tax picture is very uneven, with some taxes improving and others falling. The mixed tax collection trend and uncertain economic conditions indicate that large surpluses are not likely to be generated from taxes.

The nonproperty taxes increase at the moderate pace of 4.9 percent in FY 2013 to yield \$23.7 billion. Nonproperty growth then eases back to 3.5 percent in FY 2014. At the start of the recovery in FY 2011, the nonproperty taxes grew at the relatively robust pace of 13 percent. Following this surge, growth slowed to 3.9 percent in FY 2012, resetting the trend for the moderate growth projected in the current nonproperty tax plan.

<b>Changes in the FY 2013 Tax Revenue Projections Since June</b> (\$ in millions)	
Real Property Tax	\$13
Personal Income	17
Sales	(3)
General Corporation	(53)
Banking Corporation	117
Unincorporated Business	5
Commercial Rent	(8)
Property Transfer	(2)
Mortgage Recording	(5)
Utility	(3)
Cigarette	(1)
Hotel	4
<b>Total Tax Changes</b>	<b>\$81</b>

Among the nonproperty taxes, the banking corporation tax, which gained \$117 million, had the largest upward revision. The personal income tax gained \$17 million, while the unincorporated business and the hotel occupancy taxes added \$5 million, and \$4 million, respectively. The general corporation tax, which fell by \$53 million, had the largest loss. Also

falling are the commercial rent tax, which is down \$8 million, and the two real estate transactions taxes, which together are down \$7 million. Slight declines were recorded for the utility tax and the cigarette tax.

### **Real Property Tax**

The real property tax improved by \$13 million, partly due to the city's effort to identify the exempt properties that should be restored to the tax rolls. This increase follows a \$63 million property tax improvement in the June plan, which was also largely due to the city's review of tax exemptions. These enhancements could have additional outyear benefits, which might not be fully reflected in the plan. In January, following the release of the FY 2014 tentative tax roll, the city will furnish a revised property tax plan. This new plan should reflect the effects of rising property values and the full impact of all the properties that were added to the tax rolls due to construction or the restoration of exempt properties.

A question remains as to how properties damaged in the storm will be treated on the tentative tax roll. The city might not have the resources to individually reassess all affected properties for physical damage. Even when the physical damage is restored, market values within the affected zones will not really be known until post-storm sales determine the desirability of real estate in waterfront communities.

The city expects the real property tax to increase by 2.7 percent to \$18.4 billion in FY 2013, after which growth increases slightly to 2.9 percent in FY 2014. These property tax growth estimates are much lower than the 6.4 percent growth rate recorded for FY 2012. Despite this very conservative growth plan, storm damage could cause a collections shortfall. Revenues could fall short in FY 2013 due to homeowner financial stress and a rise in delinquency. The revenue plan for FY 2014 could also be revised downward, depending on how the city's assessor treats storm damage losses. By way of comparison, the Governor's estimate of \$9.3 billion in storm damage to city homes and businesses represents 1.1 percent of all market values on the city's tax roll.

Recognizing the financial stresses affecting storm zone property owners, the Mayor has proposed legislation to ease some of the burden of paying property taxes. One proposal would offer a three-month interest-free grace period for payment of taxes due in January 2013. The second proposal would rebate a portion of the FY 2013 tax bills to reflect the post-storm value of damaged homes. The city estimates that more than 3,000 homes would be eligible for the grace period, resulting in the temporary delay of about \$1.5 million in tax payments. Additionally, more than 900 homeowners could receive refunds averaging \$794, for a total cost of less than \$1 million. The Finance Department is also working to ensure that the property tax assessments for FY 2014 would reflect the post-hurricane conditions.

### **Sales Tax**

There is essentially no change in the city's FYs 2013-16 sales tax forecast since the June financial plan. Collections are expected to grow steadily from \$6.1 billion in FY 2013 to \$6.8 billion by FY 2016, based on gains in local employment, income, and consumption (from residents and tourists).<sup>2</sup> For the quarter ending in September, on a common rate and base, sales tax collections are four percent higher than in the September 2011 quarter.<sup>3</sup> In the latest plan, on a continuing base, the city projects sales tax collections will climb about four percent annually from FY 2013 through FY 2016.

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<sup>2</sup> The sales tax forecast was prepared prior to Hurricane Sandy.

In October, on a year-to-year basis, local employment rose by 98,400 jobs, despite small losses in the financial activities sector (and securities subsector). Over 40 percent of the 98,400 new jobs originated in the high-paying professional and business services industry. The city expects 69,000 jobs to be added in 2012, and over 40,000 jobs annually from 2013 through 2016. Compared to the prior year, October withholding receipts are up 18.5 percent and 7.7 percent on a year-to-date basis, which is before the December to March bonus period. The city projects total wages will grow 2.4 percent to \$300.4 billion in 2012, and advance moderately thereafter during 2013-16.

It is too early to quantify the influence of Hurricane Sandy on holiday spending patterns and sales tax collections from just Thanksgiving through “Cyber Monday.” For those unaffected by the storm, consumer confidence was rising, in part due to improvements in the housing and labor markets. It remains to be seen if consumption weakens in the weeks proceeding Christmas, or if spending increases modestly from last year as people shift from mostly discretionary purchases to replacement of items lost in the hurricane.

### **Personal Income Tax**

After recording a \$17 million positive adjustment to the FY 2013 personal income tax (PIT) estimate of \$8.5 billion (to reflect September collections), the city left the PIT forecast for FYs 2014-16 unchanged from the prior plan. Despite the likely shift in income from FY 2014 to FY 2013 to take advantage of a lower federal capital gains tax rate, PIT collections are projected to increase annually and reach \$9.5 billion by FY 2016. On a continuing base, PIT revenue is expected to rise by 6.4 percent in FY 2013, 0.7 percent in FY 2014, 6.4 percent in FY 2015, and 3.6 percent in FY 2016.

The city’s latest PIT forecast suggests a holding pattern due to uncertainty over possible federal tax law changes related to the fiscal cliff, and whether Wall Street profits in the second half of 2012 would resemble the prior-year pattern of two quarters of profits (\$12.6 billion) and two quarters of losses (\$4.9 billion). The November modification tax forecast was prepared before the arrival of Hurricane Sandy and the release of third quarter New York Stock Exchange (NYSE) member firms’ profits. Wall Street firms are facing a challenging environment due to eurozone sovereign debt, higher capital requirements, new federal regulations, mortgage-related lawsuits, and investor caution. They are under pressure to increase revenue and profits from existing business lines (e.g. trading, investment banking, and loan origination) and cut costs (e.g. layoffs). Notwithstanding these headwinds, NYSE member firms earned a profit of \$7.1 billion for the third quarter of 2012, which brings the year-to-date total to \$17.6 billion. The city’s plan indicates securities industry profits of \$10 billion in 2012 and \$11.6 billion in 2013, which grows to \$14.3 billion by 2016.

Adding to the brighter outlook is anecdotal evidence that those who are still employed in the securities sector might see an increase in compensation, although it will probably still be weighted towards deferred stock and options, and not cash. Part of the cash bonus is now reflected in higher annual salaries. The benefit to PIT collections is that the performance of the stock market during the third quarter of 2012 might have encouraged individuals to cash in stock awards or exercise options from prior years, which may result in higher-than-expected withholding, final return, and extension revenues in FY 2013.

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<sup>3</sup> “Common rate and base” or “continuing 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.

## **Miscellaneous Revenue**

Compared with the June financial plan, the city's latest miscellaneous revenue forecast fell by \$516 million to \$4.8 billion in FY 2013 and rose by \$508 million to \$5.5 billion in FY 2014, largely due to nonrecurring resources. In the November modification, the city changed its timeline of selling 2,000 handicapped accessible taxi medallions from FY 2013 to FY 2014, and now expects to receive \$790 million in FY 2014, \$447 million in FY 2015, and \$223 million in FY 2016. The reason for the change in schedule is that on August 17, 2012 a State Supreme Court justice struck down the law that permitted the city to sell taxi medallions and establish borough taxis. The court ruled that the city violated the home rule clause in the state constitution when the Mayor turned to the state legislature and not the city council to draft the law changing the taxi industry. The city has appealed the ruling to the New York State Court of Appeals. We are holding this initiative at risk because it is unknown when or how the court will rule.

The dominance of nonrecurring resources in the city's miscellaneous revenue projections is one of the rationales for the concept of core category revenue, where the focus is on activities that promote recurring revenue growth and, thereby, assist in achieving budget balance.<sup>4</sup> In this way, the city's projections for the core categories reflect an overall increase of \$63 million to \$2.8 billion in FY 2013 and \$90 million to \$2.9 billion in FY 2014, despite cuts in the interest income forecast. The Federal Reserve's intention of keeping the federal funds rate low, at least through mid-2015, is the main reason for interest earnings projected below \$20 million annually during FYs 2013-15, and only reaching \$65 million by FY 2016. Among the other five core categories, the city projects higher revenue from: construction permits, cable franchises, fire department inspections, parking meters, garages and long-term parking, environmental and traffic fines, and legal settlements.

## **EXPENDITURES**

In its November modification, the city is relying on a combination of \$759 million in expenditure savings and increased revenues to offset both the deferred revenue from the sale of new taxi medallions and higher than expected spending in some city agencies. As the city addresses these FY 2013 budget needs, it must also look to close the budget gaps in the outyears of its financial plan. The city will mostly use the recurring value of its latest agency program to lessen those deficits, but this will still leave gaps of nearly \$1.2 billion in FY 2014, \$2.8 billion in FY 2015, and \$2.6 billion in FY 2016. Achieving budget balance in the outyears will likely call for additional actions to reduce expenditures or raise revenues, since other nonrecurring reserves have been mostly depleted (e.g. the Retiree Health Benefits Trust and surplus funds). It is likely that the FY 2014 projected gap will be higher due to risks associated with the sale of taxi medallions as well as the unknown impact on the city's budget due to Hurricane Sandy. These risks will have to be addressed in the midyear modification and preliminary budget for FY 2014.

The November modification assumes FY 2013 will remain in balance with the implementation of the city's latest agency program, coupled with a higher revenue forecast. As shown in the figure to the right, the city anticipates it will collect \$204 million more in

<sup>4</sup> Core category revenue consists of: licenses (with permits and franchises), charges for services, interest, rent, fines, and a miscellaneous category that is stripped of major nonrecurring actions, tobacco proceeds, housing revenue, and HHC payments. Since water and sewer charges are dedicated to programmatic expenditures and therefore unavailable for gap-closing assistance, they are also excluded from the definition of core category revenue.

<b>November Modification to FY 2013</b> (\$ in millions) City Funds	
<b>Gap to be Closed</b>	<b>\$0</b>
<b>Revenue</b>	
Tax Audit	\$113
Tax Forecast	68
Non-Tax	23
Taxi Medallion Sale	(635)
<b>Total Net Decrease</b>	<b>(\$431)</b>
<b>Expenditures</b>	
New Agency Needs	\$123
Other Adjustments	1
<b>Total Increase</b>	<b>\$124</b>
<b>Gap to be Closed</b>	<b>(\$555)</b>
<b>Nov Mod PEG</b>	<b>\$555</b>
<b>Gap to be Closed</b>	<b>\$0</b>

revenue than estimated in the June financial plan. However, this higher collection is negated by the deferred sale of new taxi medallions, which would have earned the city \$635 million in FY 2013.

On the expenditure side, city agencies, mostly uniformed services and health and welfare, have increased their spending projections for the fiscal year by \$123 million. This new agency spending also includes restorations and substitutions, totaling \$16 million, which were part of prior-year agency programs. Of the \$107 million in actual increased spending, \$43 million is needed by uniformed services and \$39 million by health and welfare agencies, with the remaining \$25 million spread over other agencies in need. Some of this additional spending in uniformed services included about \$8.4 million by the Police Department to staff a fourth precinct in Staten Island and \$22 million to maintain a uniform operating level in the Department of Correction. In health and welfare, the Department of Homeless Services' reestimate of its capacity needs will add \$38 million to its budget. Also, other budget adjustments add another \$1 million, bringing the total spending increase to \$124 million.

Taken together, a net decrease in revenues of \$431 million accompanied by \$124 million of added expenditures opened a \$555 million gap in the FY 2013 budget. To close the gap, the city called for additional budget cuts by all city agencies. This latest agency program or Program to Eliminate the Gap (PEG), initially sought to produce savings of \$2 billion from mid FY 2013 through the end of FY 2014. The program nearly reached its goal with projected savings totaling almost \$1.6 billion over that same period, as shown in Table 4.

#### PROGRAM TO ELIMINATE THE GAP IN FYs 2013 - 2016

TABLE 4

(\$ in millions) City Funds

Agency Category	FY 2013	FY 2014	FY 2015	FY 2016
Uniformed Services	(\$65)	(\$148)	(\$21)	(\$22)
Health and Welfare	(145)	(143)	(87)	(104)
Mayoral Agencies	(189)	(182)	(135)	(129)
Department of Education	(127)	(298)	(266)	(266)
Debt Service	(29)	(230)	--	--
<b>Total Agency Program</b>	<b>(\$555)</b>	<b>(\$1,001)</b>	<b>(\$509)</b>	<b>(\$521)</b>
Includes both expense and revenue PEGs. (Negative) numbers decrease the gap.				

As shown in the table, city agencies have targeted \$555 million of savings in FY 2013. This includes both spending cuts and higher revenue collections. These savings will keep the city's FY 2013 budget in balance. Moreover, the recurring value of these PEGs increases significantly in FY 2014 to more than \$1 billion. This will help to mitigate the more than \$2.5 billion gap initially estimated in FY 2014. However, the value of the PEG declines to below the FY 2013 amount, saving just over \$500 million in each of FYs 2015 and 2016. This unfortunately only slightly reduces the gaps in these fiscal years.

The PEG actions taken by each agency vary widely, from reducing staff and collecting higher revenue, to recognizing operating efficiencies and recording surplus accruals. The city expects to reduce its headcount through the agency program by 627 positions in FY 2013, which increases to 1,338 positions by FY 2014. None of these positions will include teachers, police officers, or firefighters. The city will reduce the nonpedagogical and mostly nonuniformed positions (uniformed and civilian sanitation and correction workers are all included in this headcount reduction) mainly through attrition, however, the city does anticipate as many as 120 layoffs through FY 2014. The savings attributable to these staffing cuts account for just a small portion of the total PEG in each fiscal year of the financial plan. The headcount reduction in total is expected to reduce spending by \$33 million in FY 2013, but this will increase sharply in FY



2014 to \$119 million to reflect the full-year effect of the savings. For FYs 2015 and 2016, the savings from the headcount reduction are reduced to \$82 million and \$99 million, respectively.

One noteworthy aspect of the FY 2013 PEG is the reliance on nonrecurring actions, meaning many of the larger PEGs disappear after one or two fiscal years. PEGs that total at least \$5 million and last one to two fiscal years total \$231 million in FY 2013 and account for 42 percent of the PEG. In FY 2014, \$447 million of the \$1 billion PEG is comprised of nonrecurring actions. Of these \$447 million in nonrecurring actions, more than half is due to \$230 million in debt service savings. Due to the large amount of nonrecurring actions in both FYs 2013 and 2014, the agency program decreases by about half in each of FYs 2015 and 2016.

As shown in Table 4 on page 14, a major source of savings will come from the Department of Education (DOE). The DOE is expected to save \$127 million in FY 2013, but will increase this amount more than twofold to \$298 million in FY 2014 and to \$266 million in each of FYs 2015 and 2016. In the accompanying figure to the right, a detailed description of the DOE's PEGs for FYs 2013 and 2014 are given.

<b>Department of Education (\$ in millions) City Funds</b>		
<b>Expense PEGs</b>	<b>FY 2013</b>	<b>FY 2014</b>
Usage Trends & Services	(\$25)	(\$57)
Special Ed Contractual	(67)	(71)
Food Revenue from Tax Levy	--	(60)
Special Ed Pre-K Transportation	(13)	(13)
Administrative Efficiencies	(16)	(63)
Support & Tech Efficiencies	(2)	(6)
Operations Efficiencies	--	(19)
Increase in School Lunch Fees	(4)	(9)
<b>Total PEGs</b>	<b>(\$127)</b>	<b>(\$298)</b>

For the most part, from FYs 2014 to 2016, the DOE's PEGs are of recurring value. One of larger PEGs, valued at \$60 million in FY 2014, is the city tax levy savings from recognition of construction fund and food revenue. This initiative reduces in value in FYs 2015 and 2016 to \$28 million, hence reducing the DOE's PEG in each of FYs 2015 and 2016, to \$266 million. In addition, the DOE will recognize other large savings from its reestimate of usage trends, services and contractual expenses (in special education). These measures account for \$92 million of savings in FY 2013 and \$128 million in recurring savings starting in FY 2014. Elsewhere, the DOE has identified efficiencies, in both Personal Service (PS) and Other Than Personal Service (OTPS) costs, in its administrative, support, technology, and operational units that will have recurring value over the life of the financial plan starting in FY 2014. These savings total \$18 million in FY 2013 and grow to \$88 million in FY 2014. There is concern that additional DOE PEGs will be necessary if the city and the United Federation of Teachers do not reach an agreement on a teacher evaluation program. The receipt of \$293 million in FY 2013 state education aid is contingent upon such an agreement.

In other budgetary areas, for FYs 2013 and 2014, more than \$60 million of health and welfare savings will result from an increase in the federal reimbursement of fringe benefits, which will have no recurring value over the life of the financial plan. Other PEGs in this area are numerous, but mostly modest in size. A standout, though, is in the Administration for Children Services, which expects a one-time revenue settlement for prior-year claims for more than \$33 million in FY 2013.

Most of the savings in uniformed services is concentrated in FY 2014 with the majority of the reduced spending coming from the Department of Sanitation. Nearly \$76 million, or just about half of the total PEG, will be due to the recognition of a one-time waste export surplus totaling \$57 million, and almost \$19 million from staffing reductions due to the delay in opening four marine transfer stations.

In addition to the PEG, the city has also been able to reduce costs for health insurance. Health insurance represents a large part of city expenses and has been one of its highest growth areas. The city will be able to trim these costs with lower premium payments. While the city's financial plan assumed a 9.5 percent rate, the approved Health Insurance Plan of New York (HIP) Health Maintenance Organization (HMO) rate is 5.18 percent for FY 2014.<sup>5</sup> This rate reduction is expected to reduce health insurance premiums by \$11 million in FY 2013, all of which are savings for the DOE. For FY 2014, the savings will be spread citywide totaling \$191 million. Of this amount, the DOE will save \$76 million in reduced premium payments. A larger part of the savings, \$112 million, is allocated to the city's miscellaneous budget. The City University of New York (CUNY) will also share in this rate reduction, reducing its premium payments by \$3 million. The total insurance savings grow higher in each of FYs 2015 and 2016, to \$210 million and \$232 million, respectively. Of these amounts, the DOE's savings is \$84 million and \$93 million, respectively, with the rest, \$126 million and \$139 million, respectively, going to the city and CUNY (CUNY's portion, in each of FYs 2015 and 2016, remains at \$3 million).

Nonetheless, other budgetary areas are experiencing higher expenses. The city will have to spend more to cover higher pension costs. Starting in FY 2012, the city's annual pension cost is determined under revised actuarial assumptions recommended by the City Actuary. These revised assumptions include using a different cost method, a lower Actuarial Interest Rate (AIR), a market value restart (as of June 30, 2011), an actuarial asset value (as of June 30, 2010, which recognized FY 2011 investment results), and a method to amortize the payment of the Unfunded Actuarial Accrued Liability (UAAL). The November modification has included these actuarial change assumptions in the presentation of its projected pension costs over the life of the financial plan. Technically, there still remains the requirement of certain enabling legislation to be enacted by the state legislature, which is expected to occur in the next session.

Under the revised assumptions, the AIR has been reduced to seven percent from eight percent. The AIR is the required rate of return on assets held by the systems. In FY 2011, the pension systems' assets grew significantly with a combined return of 23.23 percent. However, the performance of the funds in FY 2012 fell sharply, returning just 1.37 percent. While this return is positive, it fell well short of the AIR, resulting in an unexpected actuarial loss of 5.63 percent (7 percent less 1.37 percent). Starting in FY 2014, this unexpected actuarial loss will begin to be phased in over a six year period. The city estimates it will require an additional \$98 million in FY 2014, \$197 million in FY 2015, and \$295 million in FY 2016 to fund these losses.

On October 29, 2012, one of the most devastating hurricanes in the last century hit the northeastern coast. The impact from the storm caused extensive damage to New York State and the surrounding region. The Governor has estimated total state damages close to \$42 billion, which includes \$33 billion in repair and restoration costs and \$9 billion in mitigation and prevention costs. Both the city and state estimate that the storm caused more than \$15 billion in damages to the city alone. Both the city and state expect substantial federal assistance in dealing with the aftermath of the storm. One of the budget areas that may be widely affected is citywide overtime expenditures. It is apparent that these additional overtime expenditures will be heavily tilted to uniformed services, mainly in the Police, Fire, and Sanitation Departments. Without accounting for the financial impact of Hurricane Sandy, the city expects to spend \$915 million to fund overtime expenditures in these three agencies and \$989 million when Correction is included, for FY 2013. The city expects to spend more than \$1.1 billion across all agencies.

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<sup>5</sup> The financial plan assumes nine percent growth in health insurance premiums for each of FYs 2015 and 2016.

Since the city has not included any costs associated with the storm in its November modification, we are uncertain as to the direct impact on the budget. The city anticipates that the financial impact will be heavily supplemented by federal disaster funds. Based on actual spending through October 2012, the city is not currently at risk in FY 2013 to exceed its planned overtime budget. However, we must hold at risk \$99 million in FY 2014, \$143 million in FY 2015, and \$180 million in FY 2016.

### **Debt Service Costs**

When debt service costs paid from all funding sources are compared on a plan-to-plan basis, the forecast in the November modification to the financial plan is lower than the June Financial Plan by \$10 million in FY 2013 and \$224 million in FY 2014, but higher by \$37 million in FY 2015 and \$65 million in FY 2016. The city's gap-closing program considers only the city-funded portion of debt service costs, and as such reflects plan-to-plan reductions in debt service costs for the city and the New York City Transitional Finance Authority (NYCTFA) totaling \$29 million in FY 2013 and \$230 million in FY 2014. These reductions were achieved primarily through bond refundings, which restructured maturities and extracted interest savings.

The refunding savings are derived from a combined \$1.55 billion of bonds that the city and NYCTFA sold in the first half of FY 2013. In August, the NYCTFA sold \$950 million of refunding bonds at a premium that replaced \$1.06 billion of outstanding bonds and generated debt service savings of \$13 million in FY 2013 as well as \$120 million in FY 2014 without raising costs in any year over the life of the bonds. In all, the sale produced \$130 million in net present value savings, which represent a sizable 12 percent of the \$1.06 billion of refunded bonds. Meanwhile, in October, the city sold \$600 million of refunding bonds at a premium that when combined with a \$7 million equity contribution replaced \$662 million of existing bonds to generate debt service savings of \$12 million in FY 2013 and \$89 million in FY 2014, without augmenting costs in any year over the life of the bonds. There were \$98 million in net present value savings on the refunding bonds, which represent an impressive 15 percent of the \$662 million of refunded bonds.

While the refunding savings provide budgetary relief for FYs 2013 and 2014, the projection for total debt service costs increases by \$37 million in FY 2015 and \$65 million in FY 2016. Debt service cost is primarily a function of financing the city's capital program. The plan-to-plan increases largely reflect the acceleration of infrastructure improvements. Specifically, the debt service forecasts incorporate the city's recent announcement of its plan to fast track \$1 billion of infrastructure investments as a means to stimulate the economy and create jobs. This involves an acceleration of expenditures for specific capital projects, including repairs to roadways, bridges, schools, and the waterfront, that were already included in the commitment plan. Subsequent to the release of the current financial plan, the city announced a \$500 million emergency plan for additional capital spending to repair public schools (\$200 million) and hospitals (\$300 million) damaged by Hurricane Sandy. We expect that these new commitments will be reflected in the next financial plan submission. It is possible that the capital commitment plan could experience a shortfall in other projects, as has been common for the last several years, so that total commitments do not swell. Additionally, an increase in debt service costs corresponding with the new commitments could be partially offset by interest savings the city could realize on actual bond sales, given the current low interest rate environment. Moreover, the city plans to apply to the Federal Emergency Management Agency for reimbursement of these capital costs related to Hurricane Sandy. It would be financially prudent for the city to use any such reimbursement to pay off the related bonds, which would serve to contain the rapidly growing debt service costs.

Debt service costs in the November modification are projected to increase from \$6.1 billion in FY 2013 to \$6.5 billion in FY 2014, \$7.2 billion in FY 2015 and \$7.5 billion in FY 2016, for an average annual growth rate of 7.3 percent.<sup>6</sup> Such escalating debt service costs are contributing to the projected budget deficits of \$1.15 billion in FY 2014, \$2.8 billion in FY 2015 and \$2.6 billion in FY 2016, as the share of resources needed to make the annual debt service payments is on the rise. The plan assumes that the city will realize a budget surplus of \$124 million in FY 2013 that will be used to prepay FY 2014 debt service costs. As illustrated in the figure to the right, debt service, net of prepayments, has been estimated to grow as a percent of tax revenues from 13.9 percent in FY 2013 to 15.4 percent in FY 2016, as the 7.3 percent average annual growth for debt service is almost double the 3.8 percent rate for tax revenues. For debt service to be contained to growing by the 3.8 percent rate projected for tax revenues it would have to shed \$708 million of the current forecast for FY 2016 to settle at \$6.831 billion.

City and NYCTFA Debt Service as Percentage of Tax Revenue (\$ in millions)			
FY	Debt Service	Tax Revenue	Debt Service as Percent of Tax Revenue
2013	\$6,108	\$43,839	13.9%
2014	6,531	45,123	14.5%
2015	7,233	47,139	15.3%
2016	7,539	49,005	15.4%

<sup>6</sup> The relatively small noncity-funded component of debt service costs, comprised of swap receipts, state budget aid, and federal subsidies, decreases from \$408 million in FY 2013 to \$310 million in FY 2014, \$307 million in FY 2015 and \$304 million in FY 2016.

## **Glossary of Acronyms**

<b>AIR</b>	Actuarial Interest Rate
<b>CUNY</b>	City University of New York
<b>CY</b>	Calendar Year
<b>DOE</b>	Department of Education
<b>FCB</b>	Financial Control Board
<b>FY</b>	Fiscal Year
<b>GCP</b>	Gross City Product
<b>GDP</b>	Gross Domestic Product
<b>HHC</b>	Health and Hospitals Corporation
<b>HIP</b>	Health Insurance Plan of New York
<b>HMO</b>	Health Maintenance Organization
<b>NYCTFA</b>	New York City Transitional Finance Authority
<b>NYSE</b>	New York Stock Exchange
<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>UAAL</b>	Unfunded Actuarial Accrued Liability