

Staff Report

**JANUARY MODIFICATION  
FYs 2013-2017**

March 14, 2013



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## I. Overview

The city in its January modification to the FYs 2013-17 Financial Plan presents balanced budgets for FYs 2013 and 2014 totaling \$70.4 billion and \$70.1 billion, respectively. The FY 2013 budget was originally balanced with the use of \$2.4 billion of prior-year surplus funds. In the November 2012 modification, the city closed a current-year deficit that arose since budget adoption with agency actions that totaled \$550 million and narrowed the projected gap for FY 2014 by \$1 billion. In this January modification, the city closed a \$1.2 billion budget gap remaining for FY 2014 in the November modification. The elimination of the gap was facilitated by the application of \$961 million of newly generated FY 2013 surplus funds that consist mainly of \$700 million of reserves not needed in FY 2013, a higher revenue forecast of \$239 million, and \$56 million of debt service savings. In total, the FY 2013 budget includes a surplus of \$1.1 billion that has been fully applied to balancing the FY 2014 budget.

At \$70.4 billion, the FY 2013 budget has been augmented with an allocation of \$1.4 billion in federal categorical aid to the city, largely for damages caused by Hurricane Sandy, that was partially offset by a loss of \$250 million in state aid due to the lack of a teacher evaluation agreement between the city and the United Federation of Teachers. At \$70.1 billion, the FY 2014 budget also reflects the \$250 million loss in state education aid but makes no provision for Sandy aid. In the January modification, total expenditures leap to \$74.5 billion for FY 2015, \$76.5 billion for FY 2016 and \$78.3 billion for FY 2017, outpacing total revenues to result in budget deficits of \$2.4 billion in FY 2015 and \$1.9 billion in each of FYs 2016 and 2017. At these levels, the outyear gaps have actually improved in the January modification compared to the November modification, when they were \$2.8 billion in FY 2015 and \$2.6 billion in FY 2016.

On balance, the city's budget presentation employs reasonable forecasting assumptions. In its economic plan, the city has taken a conservative stance to reflect its concerns with the federal budgetary impasse and economic difficulties in Europe. The city reduced its economic growth targets given the threat of a fiscal drag resulting from higher federal taxes and the severe spending cuts called for by the sequestration, which went into effect on March 1, 2013, as well as the European recession that could weaken tourism and the export market. Additionally, the city uses conservative interest rate assumptions in projecting its debt service costs on capital financing. In recent plans, the city has reaped the benefit of a historically low interest rate climate, and has used interest savings to offset new agency expenses. Debt service costs in the January modification are based on capital financing assumptions applied to the newly released preliminary ten-year capital strategy. The city is prudent to be conservative in its budget practices because while revenues tend to be volatile, the downsizing of expenditures is challenging. For now, local tourism is breaking records and securities industry profits are soaring, for an upside potential of \$250 million in FY 2013 revenues.

That being said, we have identified areas of budgetary risks for the city. The January modification reflects the city's expectation of a favorable ruling from the New York State Court of Appeals that would allow the city to sell 2,000 handicapped accessible taxi medallions during FYs 2014-16. While the city awaits the court's decision, it assumes the value of the proceeds from the sales will total \$600 million in FY 2014,

\$497 million in FY 2015 and \$363 million in FY 2016. We are holding these amounts at risk because it is uncertain when and how the court will rule. With these and other risks related to real property receipts and the overtime budgets, our evaluation indicates that the budget gaps could be larger by \$811 million in FY 2014, \$766 million in FY 2015, \$667 million in FY 2016 and \$304 million in FY 2017.

Moreover, a cloud of uncertainty hangs over the city's budget related to funding for future collective bargaining agreements. All of the 2008-10 round of labor contracts have expired. The current modification reflects a five-year contract that includes funding for annual wage increases at 1.25 percent in the last two years of the contract following a three-year wage freeze. For the city's contract with the United Federation of Teachers, which expired in 2009, a state fact-finding panel has been appointed to make nonbinding recommendations on what a settlement should contain. The Mayor has stated that the city cannot afford any retroactive raises. To the extent any contract settlement raises wages higher than that funded in the financial plan, the city will have to increase funding at a rate of over \$300 million for each additional one percent increase.

**JANUARY MODIFICATION:  
THE CITY'S OPERATING PROJECTIONS FOR  
FISCAL YEARS 2013-2017**

TABLE 1 (\$ in millions)

	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
<b><u>Revenues</u></b>					
Taxes:					
General Property	\$18,394	\$19,318	\$20,138	\$21,067	\$21,830
Other Taxes	24,793	25,368	26,639	27,773	29,015
Tax Audit Revenue	838	709	709	709	709
Sale of Property Tax Liens	46	38	38	38	40
Miscellaneous Revenues	6,586	6,875	6,758	6,715	6,458
Less: Intracity Revenues	(1,777)	(1,608)	(1,611)	(1,616)	(1,613)
Disallowances	(15)	(15)	(15)	(15)	(15)
Total City Funds	<u>\$48,865</u>	<u>\$50,685</u>	<u>\$52,656</u>	<u>\$54,671</u>	<u>\$56,424</u>
Federal Categorical Grants	8,655	6,543	6,361	6,349	6,346
State Categorical Grants	11,301	11,365	11,685	12,147	12,275
Other Categorical Grants	981	940	907	895	891
Interfund Revenues	<u>571</u>	<u>518</u>	<u>517</u>	<u>517</u>	<u>517</u>
<b>Total Revenues</b>	<b><u>\$70,373</u></b>	<b><u>\$70,051</u></b>	<b><u>\$72,126</u></b>	<b><u>\$74,579</u></b>	<b><u>\$76,453</u></b>
<b><u>Expenditures</u></b>					
Personal Service	\$37,593	\$37,721	\$39,505	\$40,716	\$41,981
Other Than Personal Service	29,793	28,429	29,122	29,553	29,929
General Obligation, Lease & TFA Debt Service	6,010	6,325	7,183	7,502	7,710
Budget Stabilization & Prepayments	(1,346)	(1,116)	--	--	--
General Reserve	<u>100</u>	<u>300</u>	<u>300</u>	<u>300</u>	<u>300</u>
Subtotal	<u>\$72,150</u>	<u>\$71,659</u>	<u>\$76,110</u>	<u>\$78,071</u>	<u>\$79,920</u>
Less: Intracity Expenditures	<u>(1,777)</u>	<u>(1,608)</u>	<u>(1,611)</u>	<u>(1,616)</u>	<u>(1,613)</u>
<b>Total Expenditures</b>	<b><u>\$70,373</u></b>	<b><u>\$70,051</u></b>	<b><u>\$74,499</u></b>	<b><u>\$76,455</u></b>	<b><u>\$78,307</u></b>
<b>Gap To Be Closed</b>	<b><u>\$0</u></b>	<b><u>\$0</u></b>	<b><u>(\$2,373)</u></b>	<b><u>(\$1,876)</u></b>	<b><u>(\$1,854)</u></b>

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

TABLE 2 (\$ in millions)

	FY 2013	FY 2014	FY 2015	FY 2016
<b><u>Revenues</u></b>				
Taxes:				
General Property	\$10	\$386	\$544	\$830
Other Taxes	222	(76)	(159)	(248)
Tax Audit Revenue	0	0	0	0
Sale of Property Tax Liens	0	0	0	0
Miscellaneous Revenues	80	(230)	34	134
Less: Intracity Revenues	(73)	(2)	(2)	(2)
Disallowances	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total City Funds	\$239	\$78	\$417	\$714
Federal Categorical Grants	\$1,393	(\$45)	\$2	\$2
State Categorical Grants	(265)	(338)	(357)	(374)
Other Categorical Grants	3	(11)	(9)	(7)
Interfund Revenues	<u>33</u>	<u>9</u>	<u>9</u>	<u>8</u>
<b>Total Revenues</b>	<b><u>\$1,403</u></b>	<b><u>(\$307)</u></b>	<b><u>\$62</u></b>	<b><u>\$343</u></b>
<b><u>Expenditures</u></b>				
Personal Service	\$237	(\$111)	(\$133)	(\$145)
Other Than Personal Service	576	(177)	(167)	(212)
Debt Service	(98)	(206)	(50)	(37)
Budget Stabilization & Prepayments	961	(961)	--	--
General Reserve	<u>(200)</u>	<u>0</u>	<u>0</u>	<u>0</u>
Subtotal	\$1,476	(\$1,455)	(\$350)	(\$394)
Less: Intracity Expenditures	<u>(73)</u>	<u>(2)</u>	<u>(2)</u>	<u>(2)</u>
<b>Total Expenditures</b>	<b><u>\$1,403</u></b>	<b><u>(\$1,457)</u></b>	<b><u>(\$352)</u></b>	<b><u>(\$396)</u></b>
<b><u>Gap To Be Closed</u></b>	<b><u>\$0</u></b>	<b><u>\$1,150</u></b>	<b><u>\$414</u></b>	<b><u>\$739</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	FY 2017
<b>Stated Financial Plan Gap</b>	<b>\$0</b>	<b>\$0</b>	<b>(\$2,373)</b>	<b>(\$1,876)</b>	<b>(\$1,854)</b>
<b>Estimation</b>					
Real Property Tax	\$50	(\$70)	(\$70)	(\$70)	(\$70)
Nonproperty Taxes	200	0	0	0	0
Uniformed Services Overtime	0	(91)	(149)	(184)	(184)
Police Overtime PEG	(50)	(50)	(50)	(50)	(50)
<b>Subtotal</b>	<b>\$200</b>	<b>(\$211)</b>	<b>(\$269)</b>	<b>(\$304)</b>	<b>(\$304)</b>
<b>Not in Mayor's Control</b>					
Sale of Taxi Medallions	\$0	(\$600)	(\$497)	(\$363)	\$0
<b>Subtotal</b>	<b>\$0</b>	<b>(\$600)</b>	<b>(\$497)</b>	<b>(\$363)</b>	<b>\$0</b>
<b>Risk Total</b>	<b>\$200</b>	<b>(\$811)</b>	<b>(\$766)</b>	<b>(\$667)</b>	<b>(\$304)</b>
<b>Total FCB Estimated Surplus/(Gap)</b>	<b>\$200</b>	<b>(\$811)</b>	<b>(\$3,139)</b>	<b>(\$2,543)</b>	<b>(\$2,158)</b>

## II. The FYs 2013-17 Financial Plan

The city in its January modification to the FYs 2013-17 Financial Plan presents balanced budgets for FYs 2013 and 2014 totaling \$70.4 billion and \$70.1 billion, respectively. Total expenditures leap to \$74.5 billion for FY 2015, \$76.5 billion for FY 2016 and \$78.3 billion for FY 2017, outpacing total revenues to result in budget deficits of \$2.4 billion in FY 2015 and \$1.9 billion in each of FYs 2016 and 2017. At these levels, the outyear gaps have actually improved in the January modification compared to the November modification, when they were \$2.8 billion in FY 2015 and \$2.6 billion in FY 2016. Furthermore, we see an upside potential in FY 2013 revenues of \$250 million.

Beyond FY 2013, we have identified areas of budgetary risks for the city. The January modification reflects the city's expectation of a favorable ruling from the New York State Court of Appeals that would allow the city to sell 2,000 handicapped accessible taxi medallions during FYs 2014-16. While the city awaits the court's decision, it assumes the value of the proceeds from the sales will total \$600 million in FY 2014, \$497 million in FY 2015 and \$363 million in FY 2016. We are holding these amounts at risk because it is uncertain when and how the court will rule. With these and other risks related to real property receipts and the overtime budgets, our evaluation indicates that the budget gaps could be larger by \$811 million in FY 2014, \$766 million in FY 2015, \$667 million in FY 2016 and \$304 million in FY 2017.

### **CITY INCREASES REVENUE ESTIMATES IN FY 2013**

City-funded revenues increased by \$239 million in FY 2013 compared with the November modification, as shown in the figure to the right. Total revenue increases by \$1.4 billion, to \$70.4 billion, largely because federal aid is increasing in response to the destruction caused by Hurricane Sandy. Federal categorical aid rises by nearly \$1.4 billion to \$8.7 billion in the January plan. As of February 8, 2013, the federal government has released \$1.8 billion in storm damage aid to the city. State aid falls by \$265 million to \$11.3 billion. The largest reductions are to state education aid, which falls by \$304 million, of which \$250 million is linked to an unresolved teacher evaluation program.

<b>FY 2013 City Funds Improve by \$239 Million</b> (\$ in millions, change since Nov. plan)	
Property Tax	\$10
Nonproperty Taxes	217
STAR Aid	5
Miscellaneous Revenue	7
<b>City Funds</b>	<b>\$239</b>
Federal Categorical Aid	1,393
State Categorical Aid	(265)
Other Categorical Aid	3
Interfund Revenues	33
<b>Total Non-City Revenues</b>	<b>\$1,164</b>
<b>Total Change in Revenues</b>	<b>\$1,403</b>

Tax collections improved by \$227 million, led by the nonproperty taxes, which increased by \$217 million to \$24 billion in FY 2013. The property transactions taxes gained \$152 million, while the banking corporation and the general corporation taxes added \$53 million and \$16 million, respectively. The hotel tax also had a big gain, increasing \$25 million but utility tax collections are down by \$20 million. Also declining were the personal income tax and the unincorporated business taxes, which dropped by \$5 million and \$7 million, respectively.

The property tax, which yields \$18.4 billion in FY 2013, only increased by \$10 million in FY 2013 compared with the previous plan. Despite this small current-year increase, property taxes are scheduled to climb in FY 2014 and in the outyears because strong property values were reported on the tentative tax roll.

### **Miscellaneous Revenue**

Compared with the prior plan, the city's miscellaneous revenue forecast rose by \$7 million to \$4.8 billion in FY 2013, but fell by \$232 million to \$5.3 billion in FY 2014, primarily because of the shifting of nonrecurring resources between fiscal years. 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>1</sup> On a plan-to-plan basis, the projections for the core categories reflect declines of \$25 million in FY 2013 and \$18 million in FY 2014, on a base that remains at about \$2.8 billion in both years. Contributing to the slippage in the FY 2013 forecast is a loss of \$51 million from Hurricane Sandy that impacted collections of parking, health, and environmental fines, meters, and towing. In the financial plan period, core category revenue is expected to progress from FY 2013 to FY 2017 by 6.2 percent, or \$174.6 million, to \$3 billion.

The January modification reflects the city's expectation of a favorable ruling from the New York State Court of Appeals that would allow the city to sell 2,000 handicapped accessible taxi medallions during FYs 2014-16. If the court decides in the city's favor, it would overturn a ruling last August from the State Supreme Court that invalidated the legislation establishing borough taxis and the taxi medallion sales. While the city waits for the court's decision, it lowered the value of the proceeds expected from the sale in FY 2014 by \$190 million to \$600 million, since fewer medallions would be sold due to the delay. The funds expected from the sales of taxi medallions in FY 2015 and FY 2016 were raised by \$50 million to \$497 million and \$140 million to \$363 million, respectively.

The legal process involves the city, and the taxi medallion owners and financiers, filing briefs with the court, the city offering a rebuttal in March, and then oral arguments. The earliest time for a decision by the court would be at the end of FY 2013. We are holding at risk \$600 million in FY 2014, because it is uncertain when and how the court will rule. We are also holding at risk \$497 million in FY 2015 and \$363 million in FY 2016, because there is no way of knowing now what the ultimate outcome of the lawsuit will be. If the city loses on appeal it will have to start over with new legislation.

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<sup>1</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.

## **REVENUES LINKED TO PROPERTY ACHIEVE LARGE GAINS IN FY 2014**

The real property tax and the property transfer taxes are the major sources of strength in the city's revenue plan for FY 2014 and the outyears. However, weak nonproperty taxes, the ongoing loss of education aid, and delays in the taxi medallion sale bring down FY 2014 total revenue by \$307 million, compared with the November modification, to \$70.1 billion.

City funds are higher by \$78 million in FY 2014, lifted by a revenue plan with \$301 million in extra tax collections, as shown in the figure to the right. The property tax improved by \$386 million because the city's assessment report shows that real estate values have climbed for a third consecutive year. Nonproperty taxes are down by \$85 million and miscellaneous revenue, which includes the deferred taxi plan, is down by \$232 million.

<b>City Funds Rise \$78 Million in FY 2014</b>	
(\$ in millions, change since Nov. plan)	
Property Tax	\$386
Nonproperty Taxes	(85)
STAR	9
Tax Audits	0
Miscellaneous Revenue	(232)
<b>City Funds</b>	<b>\$78</b>
Federal Categorical Aid	(45)
State Categorical Aid	(338)
Other Categorical Aid	(11)
Interfund Revenues	9
<b>Total Non-City Revenues</b>	<b>(\$385)</b>
<b>Total Change in Revenues</b>	<b>(\$307)</b>

Categorical aid fell by \$394 million in FY 2014, compared with the previous plan, with state education aid reductions leading the downturn. State education aid falls by \$346 million in FY 2014, following the \$304 million cutback in FY 2013. The decline steepens to \$382 million in FY 2015 and \$387 million in FYs 2016 and 2017. The largest component of the state education aid reductions is the ongoing loss of \$250 million, in each year of the plan, of funds that are linked to the unresolved teacher evaluation program. Federal education programs are also involved in the cutbacks and fall by \$50 million in the city's plan for FY 2014.

The city has reduced its nonproperty tax collection plan for FY 2014 by \$85 million. Individual taxes moved inconsistently with large downward corrections partly offset by smaller upward adjustments, as shown in the figure to the right. The largest shifts affected the business taxes. The general corporation and the unincorporated business taxes are down by \$118 million and \$36 million, respectively, whereas the banking corporation tax gained \$43 million. The property transactions taxes added \$67 million reflecting the upturn in the real estate market, but the commercial rent tax declined by \$15 million. A strong tourism sector lifted hotel tax by \$15 million and the sales tax by \$10 million. The personal income tax is lower by \$27 million, the utility tax is down \$21 million and the cigarette tax is down \$3 million.

<b>Nonproperty Tax Outlook for FY 2014 Decreases by \$85 Million since Nov.</b>	
(\$ in millions)	
<b>Nonproperty Taxes</b>	<b>(\$85)</b>
Personal Income	(27)
General Corporation	(118)
Banking Corporation	43
Unincorporated Business	(36)
Sales	10
Property Transfer	41
Mortgage Recording	26
Commercial Rent Tax	(15)
Utility	(21)
Hotel	15
Cigarette	(3)
Numbers may not add due to rounding.	

## **City's Economic Targets Lowered Due to Federal Budget Concerns**

The city reduced its economic growth targets largely because of uncertainty emanating from the federal budget process. The city is concerned about the fiscal drag resulting from higher federal taxes and the severe spending cuts called for by sequestration, which went into effect on March 1, 2013. Other concerns emanate from the European recession that could weaken local tourism and the region's export market. Closer to home the news is more encouraging. Despite the problems in Europe, local tourism is breaking records and the stock market is reaching new highs. The securities industry reported strong profits of \$23.9 billion in 2012, up from \$7.7 billion in 2011. Furthermore, mergers and acquisitions, which had been dormant since the recession, are starting to warm up.

In the city's outlook, national output growth as measured by real gross domestic product (GDP) drops to 1.5 percent in CY 2013 from 2.2 percent in 2012. Growth returns to a subpar 2.2 percent in 2014, before strengthening to 3.4 percent in 2015 and 2016. These numbers tell of a sluggish national recovery that is noticeably weaker than the city's November economic plan. The need for a less optimistic plan was underscored by the report that GDP was virtually flat in the fourth quarter of 2012 increasing by only 0.1 percent. The city expects national job growth to remain static at 1.3 percent in 2013 and 2014, down slightly from 1.4 percent in 2012. Job growth improves to 1.8 percent in 2015 and 2.1 percent in 2016. According to this slow growth plan, national unemployment will not drop substantially below eight percent until 2015.

The city's plan sees the local economy underperforming the sluggish national growth path. Real gross city product (GCP) growth, which drops to zero in 2013 from 3.6 percent in 2012, creeps up to 0.9 percent in 2014 before accelerating to 2.2 percent in 2015.

Local hiring, which had been a primary driver of the city's economy for the past two years, drops back in the city's plan. Employment growth retreats to about 40,000 new jobs per year in 2013-17, down from the supercharged expansion of 86,700 jobs in 2011 and 79,500 jobs in 2012. Despite this surge in hiring, local unemployment has failed to improve and has remained close to nine percent for the past four years. The city's Independent Budget Office (IBO) tackled the task of explaining this disparity by examining data from the American Community Survey. IBO's report restores confidence in the employment surveys by demonstrating that the stubbornly high local unemployment rate reflects the enlargement of the labor force due to the return of previously discouraged jobseekers.<sup>2</sup>

In its economic plan, the city has taken a conservative stance, which reflects its concerns with the federal budgetary impasse and economic difficulties in Europe. There could be some upside potential to tax collections in FY 2013 because of the strength of the city's job market, its financial sector, and tourism. The city is correct to be

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<sup>2</sup> Julie Anna M. Golebiewski, "Unraveling the Discrepancy Between City Job Growth & A High Unemployment Rate." NYC Independent Budget Office, February 2013.

conservative in its outlook, because revenue gains could be erased if volatility returns to the stock market due to concerns about the federal budget and the recession in Europe.

## **MODERATE TAX GROWTH SUPPORTS THE CITY'S REVENUE PLAN**

Total revenue increases by \$6.1 billion, in the city's plan, to \$76.5 billion in FY 2017 from \$70.4 billion in FY 2013, for growth of 8.6 percent over the plan. City-funded revenue grows by \$7.6 billion, or 15.5 percent, over the plan. City funds increase by 3.7 percent in FY 2014 and growth holds fairly steady until FY 2017 when growth drops to 3.2 percent, as shown in Table 4

### **PROPERTY AND NONPROPERTY TAXES LEAD REVENUE GROWTH**

TABLE 4

(percent change, \$ in millions)

	FY 14	FY 15	FY 16	FY 17	FY 13	FY 17	FYs 13-17
Property Tax	5.0%	4.2%	4.6%	3.6%	\$18,440	\$21,870	18.6%
Nonproperty Taxes	2.2	5.2	4.4	4.6	23,964	28,133	17.4
Audits	(15.3)	0.0	0.0	0.0	838	709	(15.3)
STAR Aid	4.7	0.5	0.6	0.5	829	881	6.3
Miscellaneous	0.8	(0.3)	1.6	2.3	4,626	4,830	4.4
Nonrecurring	230.1	(17.2)	(24.2)	(96.0)	183	15	(91.8)
Disallowance Reserve	0.0	0.0	0.0	0.0	(15)	(15)	0.0
<b>Total City Funds</b>	<b>3.7%</b>	<b>3.9%</b>	<b>3.8%</b>	<b>3.2%</b>	<b>\$48,865</b>	<b>\$56,424</b>	<b>15.5%</b>
Federal Categorical Aid	(24.4%)	(2.8%)	(0.2%)	0.0%	\$8,655	\$6,346	(26.7%)
State Categorical Aid	0.6	2.8	4.0	1.1	11,301	12,275	8.6
Other Categorical Aid	(4.2)	(3.5)	(1.3)	(0.4)	981	891	(9.2)
Interfund Revenue	(9.3)	(0.2)	0.0	0.0	571	517	(9.5)
<b>Total NonCity Funds</b>	<b>(10.0%)</b>	<b>0.5%</b>	<b>2.2%</b>	<b>0.6%</b>	<b>\$21,508</b>	<b>\$20,029</b>	<b>(6.9%)</b>
<b>Total Funds</b>	<b>(0.5%)</b>	<b>3.0%</b>	<b>3.4%</b>	<b>2.5%</b>	<b>\$70,373</b>	<b>\$76,453</b>	<b>8.6%</b>

Numbers may not add due to rounding.

The property tax, which grows by 18.6 percent over the plan, increases from \$18.4 billion in FY 2013 to \$21.9 billion in FY 2017. The property tax grows by five percent in FY 2014 sustained by three consecutive years of assessment growth. The property tax growth rate wavers unsteadily through the outyears, weakening to 3.6 percent in FY 2017.

The nonproperty taxes also grow unsteadily but growth is almost as strong as that of the property tax. The nonproperty tax growth starts off with slow growth of 2.2 percent in FY 2014. Growth climbs to 5.2 percent in FY 2015 and then slows to about 4.5 percent in the outyears. Previously, nonproperty tax growth hit 5.9 percent in FY 2013 because of a rush to realize capital gains in order to beat the tax increases that were expected to go into effect in CY 2013. Over the plan period, the nonproperty taxes grow by 17.4 percent from \$24 billion in FY 2013 to \$28.1 billion in FY 2017.

Miscellaneous revenue increases by 4.4 percent from \$4.6 billion in FY 2013 to \$4.8 billion in FY 2017. Nonrecurring actions of about \$180 million are planned for FY 2013 after which revenues climb to about \$600 million in FY 2014. These revenues drop to \$500 million in FY 2015 and then to about \$380 million in FY 2016. The nonrecurring actions consist primarily of the sale of taxi medallions, which is discussed in greater detail in "Miscellaneous Revenue" beginning on page 7.

### **Nonproperty Tax Growth Is Slow and Uneven**

As the tepid economic recovery drags on, the city's nonproperty tax collections remain unremarkable. The recovery of the nonproperty taxes started with a 12.6 percent surge in FY 2011, which reflected the recovery of securities industry profits, federal stimulus programs, and the Federal Reserve's efforts to encourage bank lending. Tax growth eased back to a more moderate four percent in FY 2012. Growth quickened slightly to an estimated 5.9 percent in FY 2013 because taxpayers rushed to sell homes and financial assets before the feared capital gains tax increase was enacted. The city expects that the resulting spin up in the income and property transfer taxes could be offset by a corresponding slowdown in FY 2014. The growth plan for the nonproperty taxes consequently falls to a very conservative 2.2 percent in FY 2014. There could be upside potential in the city's plan if the predicted spin down does not dampen growth as much as predicted. It is possible that FY 2014 growth could turn out to be stronger than the 2.2 percent projection in the plan.

### **Business Taxes**

The city expects collections for this group of taxes, consisting of the general corporation tax, the banking corporation tax and the unincorporated business tax, to grow unsteadily over the plan. Collections increase by a very slight two percent in FY 2014, down from the five percent growth in FY 2013. Revenue growth then turns upward to five percent in FY 2015, and remains near that growth rate in FYs 2016-17. If revenues stay close to the slow and unsteady growth path mapped out in the city's plan, collections could surpass the prerecession peak of \$6 billion by FY 2016.

The weakness in FY 2014 primarily reflects a projected six percent decline of the banking corporation tax, which follows a seven percent advance in FY 2013. A major difficulty for the banking industry is the large penalties that are owed to settle mortgage lending and foreclosure abuses. The city is also concerned that banks may have overpaid their tax bills in previous years. The city doubled its refund reserve for the bank tax to \$191 million in FY 2013 from \$96 million in FY 2012. The city then reduced its estimate of gross collections by \$73 million in FY 2014 to \$1.5 billion because banks are likely to reduce their future tax payments until the overpayments are worked off.

The banks have benefited greatly from the upturn in mortgage lending resulting from the Federal Reserve's policy to hold down interest rates. The banks could face a more difficult business environment once the Fed discontinues its monetary easing. Another concern is that new regulations may require banks to spin off or discontinue some high risk lines of business such as hedge funds, moderating future earnings. Federal Deposit Insurance Corporation (FDIC) data indicate that the profits picture of the banking industry is mixed. Whereas national bank earnings are up 19 percent in CY 2012, New York State bank profits are down by four percent.

The business taxes, which have a history of extreme volatility, can quickly shift from a negative outlook to a strong upturn. The securities industry reported strong profits of \$23.9 billion in 2012, up from \$7.7 billion in 2011. Also, mergers and acquisitions, which had been dormant since the recession, are starting to warm up.

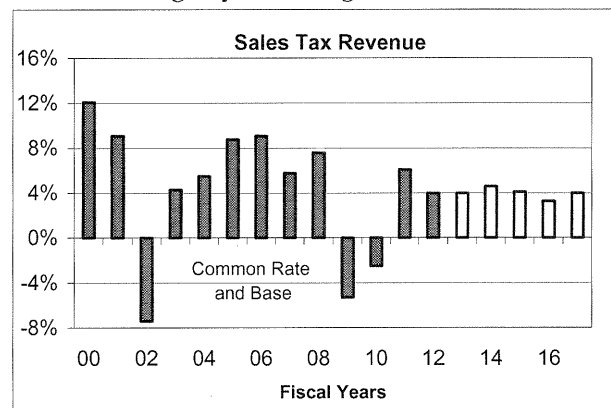
National pretax corporate profits through the third quarter of CY 2012 are up by 17 percent.

### Property Transactions Taxes

Since the November modification, the city has increased its estimates for the property transactions taxes by \$152 million in FY 2013 and by \$67 million in FY 2014. Similarly, the growth of this group of taxes, consisting of the real property transfer and mortgage recording taxes, is heavily front-loaded. Growth of 17 percent in FY 2013 drops to seven percent in FY 2014 because these taxes benefited from the rush to sell real estate (along with financial assets) to beat the expected capital gains tax increase that went into effect at the start of CY 2013. In FYs 2015 through 2017 growth averages nine percent. Despite this impressive uptrend, revenues reach only \$2.4 billion by FY 2017, falling short of the previous peak of \$3.3 billion that was reached in FY 2007.

### Sales Tax

Fueled by strong gains in jobs and tourism, and a more modest improvement in income, the city's latest sales tax forecast calls for growth of four percent in FY 2013 and 4.6 percent in FY 2014, on a continuing base, with slightly slower growth thereafter.<sup>3</sup> As seen in the figure, the city's FYs 2013-17 sales tax forecast is reasonable and aligns with the lower-range of historical collections at four to five percent annually rather than at the higher-end of at least eight percent per year. In the January modification, revenues are expected to increase steadily from \$6.1 billion in FY 2013 to \$7.1 billion by FY 2017.<sup>4</sup> Currently, on a year-to-year and adjusted basis, sales tax collections were up four percent in the September 2012 quarter and 3.6 percent in the December 2012 quarter. These figures represent good, but not great results, in a context of conflicting trends.



A major factor underlying the sales tax base has been the expansion of private sector jobs, which increased by 85,000 in 2012 and 94,000 in 2011. The city projects employment gains to average a more sustainable 40,000 per year in 2013 to 2017. Another benefit to collections is the city's estimate of a new high of 52 million tourists in 2012, with direct spending of \$36.9 billion and a broader economic impact of \$55.3 billion. There were also concomitant positive effects on hotel occupancy, room rates,

<sup>3</sup> "On a continuing base" or "on a common rate and base" refers to tax collections that have been adjusted to remove the effects of tax programs and other technical changes to focus on the influence of the economy.

<sup>4</sup> The sales tax forecast for FYs 2013-17 in the January modification changed only slightly from the prior submission.



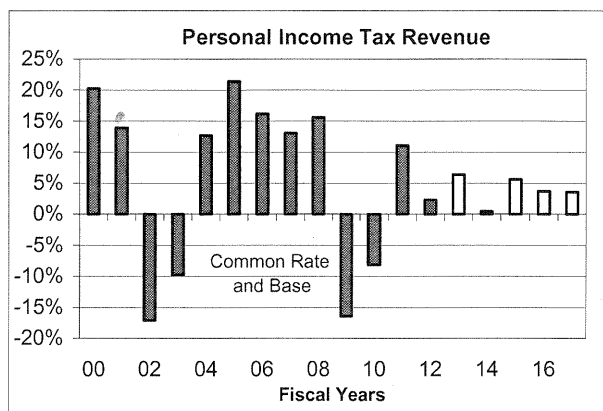
and employment in the leisure and hospitality industry. The city believes its share of the overseas tourist market in 2012 reached a record 33 percent, where each percentage point increase in market share represents an additional \$750 million in direct spending by tourists.

Yet, undermining consumption by residents is the ongoing fiscal stalemate in Washington and the uncertainty regarding further changes to taxes and the debt ceiling, along with sequestration-based cuts in expenditures that will have local ramifications. Households have become more pessimistic in 2013, particularly when the employees' share of Social Security returned to 6.2 percent of wages, after the rate was lowered to 4.2 percent in 2011 and 2012. This tax increase has overshadowed, to a degree, the gradual improvement in the housing market in terms of price appreciation. Compared to last winter, discretionary spending was restrained during the 2012 holiday season, and there is a temporary spike in energy prices. The pattern of spending primarily on necessities rather than luxuries exhibited so far by households will likely continue, because of the need to repair homes and replace items damaged in Hurricane Sandy, on reduced take-home pay.

### Personal Income Tax

In the January modification, the personal income tax forecast for FYs 2013-17 incorporates small changes from the prior plan relative to a tax base that rises from \$8.5 billion in FY 2013 to \$9.8 billion in FY 2017. The city projects that on a common rate and base personal income tax revenue will advance by 6.4 percent in FY 2013, 0.5 percent in FY 2014, 5.6 percent in FY 2015, 3.7 percent in FY 2016, and 3.6 percent in FY 2017, as shown in the figure. The city's tax projections largely reflect a financial industry that is in transition, in terms of employment, compensation, regulation, and business lines.

The figure also shows that, except for two times (FYs 2002-03, FYs 2009-10), personal income tax revenue on a continuing base regularly achieved annual growth of at least ten percent, led by high levels of finance sector compensation that was paid mostly in cash, with some restricted stock that was deferred.<sup>5</sup> The relatively lower rates of tax revenue growth that started in FY 2012 and continue in the forecast period represent a significant and possibly lasting change from the past. They are indicative of a more uncertain and challenging business environment marked by more federal regulations and mortgage-related settlements, higher interest



<sup>5</sup> The two events that led to revenue losses are the attack on the World Trade Center and the global financial meltdown triggered by the collapse of Lehman Brothers and Bear Stearns.

rates in the outyears of the plan, and an ongoing process to align headcount and compensation within units at financial firms with the revenue produced.

The city's personal income tax forecast for FYs 2013-17 reflects reasonable assumptions for finance sector compensation and jobs, nonwage income, along with federal tax and monetary policy. Securities industry profits are expected by the city to increase by \$11 billion to \$18.7 billion in 2012 from the prior year, but profitability slows to \$13.4 billion in 2013 and \$12.1 billion in 2014, before a pick-up in earnings in 2015 and 2016. After the city's tax forecast was released, it was announced that New York Stock Exchange (NYSE) member firms earned \$6.3 billion for the fourth quarter of 2012, compared with the city's estimate of \$1.1 billion. For 2012, NYSE member firms earned \$23.9 billion despite uncertainty regarding the fiscal cliff, and higher costs from mortgage settlements and hedging errors.

Wall Street compensation (including bonuses), while at a very high level, is expected by the city to stagnate as financial firms continue to lay off workers in 2013 and automate more functions. If it weren't for the city's assumption of stronger wage growth in the nonfinancial sector of the economy during 2012-17, from three to nearly five percent annually, personal income tax revenues would have been weaker in the forecast period. For example, estimated growth of 6.4 percent in FY 2013 comes at the expense of a 0.5 percent increase in FY 2014, as high income taxpayers shifted capital gains realizations, stock awards, bonuses, and dividend income into 2012 from 2013 to avoid higher federal taxes. It is possible that personal income tax collections could be higher in FY 2013 by \$200 million if extension and final return payments in April reflect more taxpayer liability.

Over the years, the financial industry has shown remarkable resiliency and ingenuity in varied economic and regulatory environments. Currently, higher revenues from mortgage refinancing, corporate debt issuance, and business lines such as trading and wealth management, and fewer employees, allowed Wall Street firms to lower their compensation ratio as a percent of revenue from historic highs. Going forward, it will be interesting to see how NYSE member firms' profitability adjusts to a setting of more regulations, higher capital requirements, and a less accommodative interest rate policy by the Federal Reserve.

### **Property Values Improve for a Third Year**

Market values increased by 4.3 percent on the city's tentative FY 2014 tax roll. These stronger market values have enabled the city to project that property taxes would grow by five percent, for a gain of \$916 million, to yield \$19.4 billion in FY 2014. The city has trimmed its collection target by more than two percent to allow for assessment disputes, particularly from taxpayers in Sandy-damaged communities. Even so, the property tax implications of the storm are not fully known. Aside from the largely unknown risks related to the hurricane, the Independent Budget Office has identified a \$70 million property tax risk related to the inclusion of several previously exempt properties on the tax roll.

The city's report on the tentative assessment roll for FY 2014 indicates that the market value of all taxable city property increased by 4.3 percent to \$874 billion. This

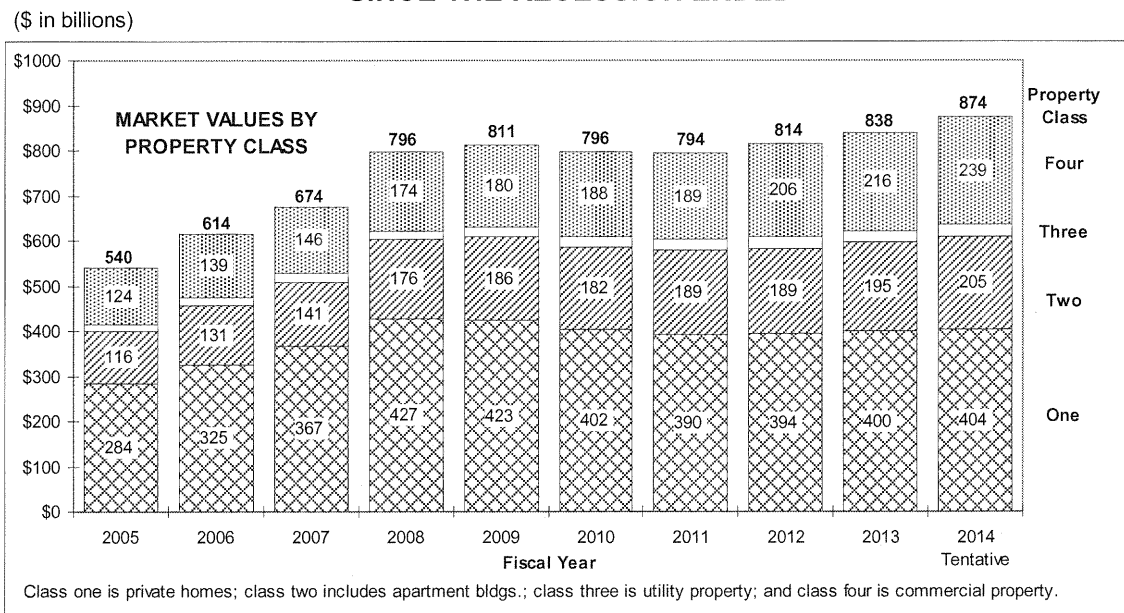
new increase follows a 2.9 percent increase in FY 2013 and the 2.6 percent market value increase in FY 2012. Previously, property values had been stagnant at about the \$800 million level since FY 2008, as shown in Chart 1. While the 4.3 percent upturn in property values in FY 2014 is a great improvement over the flat real estate market during the recession, the current increase is still subdued compared with the 14 percent average annual market value growth achieved prior to the recession from FY 2005 to FY 2008.

Comparing the property classes, market value growth was much stronger for commercial properties than for residential properties. Private home values improved by just 0.8 percent to \$404 billion. Residential apartment buildings grew by 4.8 percent to \$205 billion, while commercial properties increased by 10.5 percent to \$239 billion. This strong gain for commercial properties will tend to lift tax collections for the next five years because market value increases for commercial buildings and large apartment buildings are phased in over five years.

The city projects that property tax revenue growth will increase from 2.8 percent in FY 2013 to five percent in FY 2014. Growth then wavers unsteadily to 4.2 percent in FY 2015 and 4.6 percent in FY 2016 before weakening to 3.6 percent in FY 2017.

### MARKET VALUES GROW FOR A THIRD YEAR SINCE THE RECESSION ENDED

CHART 1



Complicating the city's effort to estimate tax revenue from the tentative roll is the not fully measured impact of Hurricane Sandy on assessments. Accordingly, the city has made a large downward adjustment of 2.2 percent to its estimate of taxable assessments in the final roll. Billable assessments increased 6.9 percent on the tentative roll for FY 2014. The city estimates that by June, corrections to the tentative roll (including the revaluation of Sandy-damaged properties) will reduce the billable growth rate on the final tax roll to 4.7 percent. Previously, billable assessments increased by 4.4 percent in FY 2013 and by 5.2 percent in FY 2012.

Even after the tax roll is finalized in June, Hurricane Sandy could have lingering effects on future tax collections. This is because it can take several years to settle assessment disputes, particularly if claims require adjudication in court. Another unknown is how future market values will be affected in the city's coastal zones. River and ocean views, and beachfront access, which always were big selling points, might now be considered less marketable features.

The city could offset these possible risks by reducing its property tax collection targets, and by increasing its reserves for tax bill cancellations and refunds in FYs 2014-17. The city has already set aside \$530 million for cancellations in FY 2014, which is \$38 million larger than the reserve of the previous year. However the refund reserve for FY 2014 is only \$380 million, which is \$55 million less than the refund set aside of \$435 million in FY 2013. Thus far in FY 2013, the city has paid out very little of its refund reserve. We think that the city can shift about \$50 million of unused reserves from FY 2013 to FY 2014 to pay for Sandy-related tax bill reductions.

The city's Independent Budget Office (IBO) has identified a property tax risk of \$70 million by combing through large properties listed on the tentative roll. IBO listed a half a dozen previously tax exempt properties that looked like they did not belong on the tax roll. IBO estimates that restoring the tax exempt status of these properties would cost the city \$70 million. This risk represents about eight percent of the \$916 million property tax growth scheduled for FY 2014 and could diminish the \$19.4 billion property tax by 0.4 percent. We think that this \$70 million risk carries through from FY 2014 to FY 2017 by diminishing the tax base in all four years of the plan, as shown in Table 3 on page 5.

## **EXPENDITURES**

The January modification for FY 2013 assumes the city's budget remains balanced and projects additional surplus funds of \$961 million. The city is relying on these additional surplus funds, along with a higher revenue forecast and other expenditure savings, to balance FY 2014. Although no new labor contracts have been agreed to, the financial plan presumes agreements that would include annual wage increases of 1.25 percent starting in FY 2013 for the majority of the city's unions. Still, fiscal challenges remain. In the November modification, the city faced a FY 2013 budget deficit due to the deferment of revenue to FY 2014 from the planned sale of new taxi medallions. This required the city to depend largely on new agency savings to keep the fiscal year in balance. In addition, the response to Hurricane Sandy required the deployment of city funds and resources to deal with the storm's aftermath.<sup>6</sup> In its current modification, the city is forced to address the significant loss of state education

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<sup>6</sup> The city estimates Hurricane Sandy caused almost \$4.5 billion in damage. Of this amount, more than \$1.4 billion is related to emergency work involving protective measures and debris removal. These expenditures will be covered by the expense budget. The city assumes that federal funding provided by FEMA will cover 90 percent of the total storm-related cost and plans to offset its 10 percent share using other Sandy-related federal funding. The long-term repair work, projected to cost about \$3.1 billion, is considered to be a capital expense and will be incurred over time in the capital budget. The city plans on seeking reimbursement for this cost.

aid for both FYs 2013 and 2014 and has once again deferred a portion of revenue expected from the taxi medallion sale in FY 2014 to FYs 2015 and 2016.

In its November modification, the city had projected \$124 million of surplus funds to prepay FY 2014 expenses. As shown in the figure to the right, the January modification assumes the addition of \$961 million of surplus funds, which will increase FY 2014 prepayments to almost \$1.1 billion. The total prepayment of expenses in FY 2014 is actually more than \$1.1 billion with the inclusion of \$31 million in prepayments from FY 2012. The largest portion of the additional surplus funds, \$700 million, comes from reserve funds not needed in FY 2013. This was possible even after having to deal with the emergency spending needs caused by Hurricane Sandy and the large loss of state education aid due to the inability of the city to reach an agreement with the teachers' union on a new evaluation plan. As shown in the figure, the city will reduce its reserve used for accrued claims funded in prior years by \$500 million and decrease its General Reserve from \$300 million to \$100 million. In other actions, the city revised upward its revenue forecast and is now expecting to collect \$239 million more than previously estimated and has also projected additional debt service savings of \$56 million. Further savings of \$13 million from miscellaneous expenses are expected, but offsetting the reserve reductions, higher revenue forecast, and expense savings are \$47 million of new agency needs.

<b>Growth in Surplus Funds from November to January Modification</b> City Funds (\$ in millions)	
<b>November Modification</b>	<b>\$124</b>
Prior Payables Reserve	\$500
Revenue Forecast	239
General Reserve	200
Debt Service	56
Miscellaneous	13
Agency Spending	(47)
<b>Surplus Increase</b>	<b>\$961</b>
<b>January Modification</b>	<b>\$1,085</b>
Surplus Increase / (Decrease)	

For FY 2014, the city had estimated a budget gap of nearly \$1.2 billion in its November modification, but has since closed the gap with the use of surplus funds from FY 2013, which will be used to prepay FY 2014 expenses. As shown in the figure to the right, the city will allocate \$961 million of surplus funds to prepay expenses, in addition to the \$124 million projected in the November modification. In addition, the city will realize other gap-closing measures to balance the FY 2014 budget. This includes a higher revenue forecast of \$268 million, the expectation of lower debt service costs totaling \$200 million, and reduced miscellaneous spending of \$36 million. Offsetting these gap-closing actions is another deferment of taxi medallion revenue. The sale of the medallions is still entangled in an ongoing court battle. The city has shifted \$190 million of this estimated revenue in FY 2014 to FYs 2015 and 2016 with collections of \$50 million and \$140 million, respectively. Also, new agency spending needs are expected to add \$125 million. While FY 2014 is projected to be balanced, the city still faces multi-billion dollar gaps in the outyears of the financial plan with \$2.4 billion in FY 2015 and \$1.9 billion in each of FYs 2016 and 2017.

<b>FY 2014 Gap-Closing Actions from November to January Modification</b> City Funds (\$ in millions)	
<b>November Mod Gap</b>	<b>(\$1,150)</b>
FY 2013 Prepayment	\$961
Net Revenue Increase	268
Debt Service	200
Miscellaneous	36
Taxi Medallion Sale	(190)
Agency Spending	(125)
<b>Total Gap-Closing</b>	<b>\$1,150</b>
<b>January Mod Gap</b>	<b>\$0</b>
Gap (Increase) / Decrease	

The city estimates in its January modification total-funded spending of \$70.4 billion in FY 2013. This is an increase of \$1.4 billion over projected spending reported in the November modification. Most of this growth is attributed to the increase in FY 2014 prepayments and costs incurred by Hurricane Sandy. As shown in the figure to right, the city projects increased spending in FY 2013 of \$813 million before budgetary savings are applied. Most of this increase, totaling \$544 million, is due to emergency spending needs related to Sandy, which has been expensed out as operational costs or Other than Personal Service (OTPS) expenditures, primarily in the Department of Environmental Protection and the Health and Hospitals Corporation. The city anticipates offsetting these charges with reimbursements from the Federal Emergency Management Agency (FEMA) as they become available.

<b>FY 2013 Expenses November to January Modifications</b>	
Total Funds (\$ in millions)	
<b>Spending Increases</b>	
Other OTPS	\$544
Salaries and Wages	156
Fringe Benefits	81
Medical Assistance	32
<b>Total Increases</b>	<b>\$813</b>
<b>Budget Savings</b>	
General Reserve	(200)
Debt Service	(98)
Intracity Funds	(73)
<b>Total Savings</b>	<b>(\$371)</b>
<b>Total Net Change</b>	<b>\$442</b>
FY 2014 Prepayments	961
<b>Total Increase</b>	<b>\$1,403</b>

Other spending increases are expected in labor costs. Although there are no new labor settlements, noncity grants are expected to increase salaries and wages by \$156 million during the fiscal year. Also, adjustments in fringe benefit costs will add \$81 million to spending and Medical Assistance expenditures are expected to increase slightly by \$32 million. These budget increases are anticipated to be offset by various savings. The city will decrease the General Reserve by \$200 million and also recognize \$98 million in debt service savings. Additionally, intracity funds, which account for the sharing of resources between agencies, will fall by \$73 million. Combined, these savings will total \$371 million. With the inclusion of \$961 million in expense prepayments for FY 2014, total-funded expenditures will rise by \$1.4 billion, as shown in the figure above.

On the other hand, for FY 2014, the city projects expenditures to decrease by about the same amount that FY 2013 expenses increase. In the January modification, the city projects that total-funded expenditures in FY 2014 will decrease from \$71.5 billion to \$70 billion, which is about \$1.5 billion less than estimated in the November modification. As shown in the figure to the right, much of the decrease between the modifications is from the use of \$961 million in additional surplus funds rolled into FY 2014 from FY 2013 to prepay mostly debt expenses. Also, debt service projections are expected to be lower by \$206 million and other OTPS costs will fall by \$177 million. Further savings in FY 2014 will come by way of lower-than-expected spending in labor and fringe benefit costs. While the city projects lower spending in FY 2014 between budget modifications, projected spending over the life of the financial plan will rise considerably.

<b>FY 2014 Expenses November to January Modifications</b>	
Total Funds (\$ in millions)	
Prepayment of Expenses	(\$961)
Debt Service	(206)
Other OTPS	(177)
Salaries and Wages	(79)
Fringe Benefits	(32)
Other	(2)
<b>Total Decrease</b>	<b>(\$1,457)</b>

TABLE 5

**PROJECTED GROWTH IN TOTAL-FUNDED EXPENDITURES IN FYS 2013 TO 2017**

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

	FYs 2013-14	FYs 2014-15	FYs 2015-16	FYs 2016-17	FYs 2013-17	Level in FY 2013	Level in FY 2017
<b>Total Expenditures</b>	<b>(0.4%)</b>	<b>6.4%</b>	<b>2.6%</b>	<b>2.4%</b>	<b>11.4%</b>	<b>\$69,802</b>	<b>\$77,790</b>
<b>Total PS</b>	<b>0.5%</b>	<b>4.8%</b>	<b>3.1%</b>	<b>3.2%</b>	<b>12.1%</b>	<b>\$36,655</b>	<b>\$41,093</b>
Salaries and Wages	(1.1%)	0.7%	1.4%	1.5%	2.6%	21,218	21,770
Fringe Benefits	3.5%	21.0%	7.6%	6.8%	43.9%	7,500	10,796
Pensions	1.9%	(0.1%)	2.4%	3.1%	7.4%	7,937	8,527
<b>Total OTPS</b>	<b>(1.4%)</b>	<b>8.2%</b>	<b>2.1%</b>	<b>1.6%</b>	<b>10.7%</b>	<b>\$33,147</b>	<b>\$36,697</b>
Public Assistance	0.1%	(0.2%)	0.0%	0.4%	0.3%	1,274	1,279
Medical Assistance	0.8%	1.3%	(0.5%)	0.0%	1.6%	6,314	6,415
Debt Service	5.2%	13.6%	4.4%	2.8%	28.3%	6,010	7,710
Other OTPS	(4.2%)	9.2%	2.3%	1.8%	8.9%	19,548	21,293

Note: Excludes interfund and intracity expenditures. Other OTPS adjusted for surplus funds.  
Numbers may not add due to rounding.

Over the financial plan period, the city has projected total-funded expenditures, excluding interfund and intracity expenditures, to grow from \$69.8 billion in FY 2013 to \$77.8 billion in FY 2017, which represents growth of nearly \$8 billion, or 11.4 percent, as shown in Table 5. Expenditures are comprised of two main categories, Personal Service (PS) and Other than Personal Service (OTPS). PS expenditures have three large components -- salaries and wages or labor costs, fringe benefits (healthcare, payroll tax, unemployment insurance, payments to Supplemental Welfare Funds, and workers' compensation), and pension costs. These three budgetary areas account for about 53 percent of the expense budget. The city is expecting growth of 12.1 percent, or about \$4.4 billion, in these combined areas. Most of this growth is driven by higher fringe benefit costs, which will increase by 44 percent, or \$3.3 billion, over the financial plan period.

Healthcare cost represents not only the largest item for the city's fringe benefits expense, but also one of the fastest growing areas in its total budget. These expenses are paid annually on a pay-as-you-go basis. The financial plan reflects estimated spending in healthcare costs for active and retired city workers, including payments to Supplemental Welfare Funds, to increase from about \$5.3 billion in FY 2013 to \$8.3 billion in FY 2017. This accounts for a \$3 billion increase, or more than 57 percent, and is responsible for a larger spending increase than any other budgetary item that is experiencing growth. A large portion of this rapid increase is explained by the drawdown of the Retiree Health Benefits Trust (RHBT). In each of FYS 2013 and 2014, the city is drawing down \$1 billion of RHBT funds. This technically amounts to a 21 percent spike in fringe benefit costs between FYS 2014 and 2015.

By depleting the RHBT, the city leaves the Other Postemployment Benefits (OPEB) liability, totaling more than \$88 billion as of June 30, 2012, completely unfunded. We have projected that the unfunded OPEB liability will continue to grow at about \$5 billion a year on average and will easily top \$100 billion in just three fiscal years. The cost of providing pay-as-you-go funding for OPEB expenses and healthcare premiums for retired and active city workers will, over time, become unsustainable without the allocation of more city resources to fund them.

In a recent report from the Citizens Budget Commission (CBC), an examination of the growing fiscal impact of healthcare costs on the city's budget is presented. The report states "currently, more than 90 percent of the [city's] municipal workforce is enrolled in health insurance plans that require no employee contribution toward the cost of the premium for basic individual and family coverage." It is the recommendation of the CBC in this study that, "[city] employees and retirees should share the premium cost of their health insurance."<sup>7</sup> We believe that the rising costs of healthcare benefits and the recommendations, like those presented by CBC to ameliorate these costs (e.g. member copay), be examined ever more closely by both labor and management.

Elsewhere in Personal Service, salaries and pension costs are also expected to increase over the financial plan period. The January modification assumes an increase in labor costs of 2.6 percent for FYs 2013 to 2017, or \$552 million. The city's annual pension cost will increase significantly more on a relative basis at 7.4 percent, but close to the same as labor in absolute terms, for an increase of \$590 million over the same period.

As of the January modification, labor contracts between the city and its unions settled in the 2008-2010 round of collective bargaining have all expired. The United Federation of Teachers (UFT) and Council of Supervisors and Administrators (CSA) have not settled contracts since the 2006-2008 round of collective bargaining. While no new bargaining agreements exist, the labor reserve in each of FYs 2013 to 2017 reflects funding for a five-year contract deal, which assumes a wage freeze for the first three years of the contract followed by 1.25 percent annual wage increases in the last two years of the contract. The funding in each fiscal year of the financial plan reflects the expected start and expiration dates for each of the union contracts. To the extent collective bargaining results in contracts that are higher than currently funded, the city will need to increase its funding with each additional one percent increase costing about \$308 million (includes related pension costs and payroll taxes).<sup>8</sup>

The standouts among collective bargaining issues are the contracts for the UFT and CSA as they remain one bargaining round behind the city's other unions. The UFT's contract expired in 2009 and CSA's in 2010. The bargaining for the next round for these unions resulted in an impasse, which has not yet been resolved. The New York State Public Relations Board has appointed a fact-finding panel in an effort to resolve the UFT impasse. It is important to note, however, that any recommendation from the panel is nonbinding and may only serve, as in past panel findings, as a possible framework for an agreement. The Mayor has stated that the city cannot afford any retroactive wage increases. The city has estimated that the cost of a retroactive increase, based on what other unions settled for, would increase the city's budget by almost \$2.6 billion in FY 2013 and \$900 million annually, over the life of the financial plan, starting in FY 2014.

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<sup>7</sup> "Everybody's Doing It: Health Insurance Premium-Sharing by Employees and Retirees in the Public and Private Sectors," Citizens Budget Commission January 2013 <<http://www.cbcny.org>>.

<sup>8</sup> The cost of a one percent increase is based on city estimates from December 31, 2009.



As shown in Table 5 on page 19, pension costs are projected to increase from \$7.9 billion in FY 2013 to \$8.5 billion in FY 2017. Much of this increase is for funding an unexpected actuarial investment loss experienced in FY 2012. The city reported an investment return of just 1.37 percent, which is far short of the required seven percent return set for the fund. The financial plan accounts for the six year phase-in of this actuarial loss starting in FY 2014. In other pension developments, the state legislature passed and the Governor signed into law (January 2013) the recommended pension changes in actuarial assumptions and methods proposed by the City Actuary.<sup>9</sup>

The city's OTPS is expected to increase by 10.7 percent, or \$3.6 billion, from FYs 2013 to 2017. This budget area comprises Public and Medical Assistance, debt service costs, and operational expenses for city agencies. The city does not project substantial growth in Public and Medical Assistance costs with just 0.3 percent and 1.6 percent increases, respectively. Much of the modest growth in Medical Assistance is due to the state's initiative to take over the growth in the city's share of Medicaid costs, which had been previously capped at three percent. This was part of the SFY 2012-13 state budget and will incrementally reduce the city's Medicaid growth, starting in SFY 2013-14, from three to two percent followed by an additional one percent reduction annually over the next two fiscal years. In addition, the state instituted a Medicaid administration cap, in which the city (and other localities) is responsible for administration costs above the cap. The state also plans a phased takeover of Medicaid administration.

The growth in OTPS expenditures is mostly attributed to an increase in debt service expenditures and other OTPS spending. These two budget areas are projected to increase by 28.3 percent and 8.9 percent, respectively.

The January modification assumes the continuation of the Program to Eliminate the Gap (PEG) that was initiated in the November modification. The program is mainly the same with only minor downward adjustments. The city expects to reduce its FY 2013 PEG to \$540 million, which is just \$15 million lower than the November modification. The agency savings are still expected to grow on an annualized basis to more than \$1 billion in FY 2014, but are reduced substantially in FY 2015 to \$508 million and \$521 million in each of FYs 2016 and 2017.<sup>10</sup> The city's PEG, which started in FY 2008, has produced significant annual savings. The city projects these agency savings to total more than \$6.3 billion in FY 2013 and rise in FY 2014 to almost \$6.6 billion.

A large portion of these savings is due to budget cuts, as part of the November PEGs in the Department of Education (DOE), which total \$122 million in FY 2013 and \$298 million in FY 2014. In spite of these cuts, the DOE did not identify the loss of any pedagogical positions. In addition to these budget cuts, the DOE has lost \$250 million of state aid, due to the failure of the city and the UFT to reach agreement on a state-

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<sup>9</sup> The changes to the pension systems' actuarial assumptions and methods recommended by the City Actuary are detailed in the March 15, 2012 FCB Staff Report, starting on page 19.

<sup>10</sup> For a detailed review of the Program to Eliminate the Gap, see the December 13, 2012 FCB Staff Report, starting on page 13.

mandated proposal for teacher evaluations by a January 17, 2013 deadline. The loss of state aid for the current fiscal year or school CY 2012-2013, represents what would have been an approximate four percent increase in state education funding. The loss of aid in FY 2013 is expected to be baselined annually over the life of the financial plan.

The circumstances that surround the loss of funding date back to CY 2010 when the state passed legislation to advance key areas in its Race to the Top application. Race to the Top (RTTT) is a federal program created to push for improvement and reforms in state and local school districts nationwide and is a component of the American Recovery and Reinvestment Act. The centerpiece of the state's legislation is a comprehensive evaluation system for teachers and principals based on a number of different measures like student achievement and classroom observations. The legislation specified that after the state legislature approved an outline of the plan for each school district, it was up to each district to come to an agreement concerning the details of the plan with its teachers' union. With the legislation in place, the state was one of 24 other states to win a total of \$5 billion in awards, with the state receiving almost \$697 million.

As a consequence to the loss of funding, the January modification reflects cost cutting actions by the DOE. In Table 6, the actions taken in response to the reduction contain a large number of one-time actions that are expected to occur in FY 2013 to offset the loss in that fiscal year, such as the attrition of 697 pedagogical positions. The DOE's budget also reflects further actions to replace the baseline loss over the life of the financial plan. In recurring actions starting in FY 2014, teacher attrition is projected to reduce the DOE budget by \$128 million in each year of the plan balancing more than half of the loss. This measure is expected to increase total teacher attrition to 1,842 positions by the end of FY 2014. Other actions like cutting spending on operations and reducing use of substitute teachers will fill in the rest of the loss.

#### DOE ACTIONS IN RESPONSE TO STATE FUNDING LOSS

TABLE 6 (\$ in thousands)

	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
<b>FY 2013 Actions</b>					
Elimination of Undisbursed School Funds	\$59,884	--	--	--	--
District 75 Reestimate	50,000	--	--	--	--
Attrition of Pedagogical Staff	33,059	--	--	--	--
SCA Revenue Offset	22,148	--	--	--	--
Reduction in Nonmandated Contracts	16,801	--	--	--	--
Administrative OTPS Reductions	16,338	--	--	--	--
Transportation Revenue Offset	15,050	--	--	--	--
Elimination of Central Vacancies	8,918	--	--	--	--
Reduction of School Aide Work Schedule	8,600	--	--	--	--
Title I Revenue Offset	7,809	--	--	--	--
Reduction in Use of Substitute Teachers	5,000	--	--	--	--
UI Efficiencies	4,000	--	--	--	--
EduJobs Revenue Offset	2,809	--	--	--	--
<b>Financial Plan Actions</b>					
Teacher Attrition	--	\$128,063	\$128,063	\$128,063	\$128,063
School OTPS Funding	--	66,763	66,763	66,763	66,763
Per Session Reduction	--	31,469	31,469	31,469	31,469
Reduction in Use of Substitute Teachers	--	18,985	18,985	18,985	18,985
School Nonpedagogical Attrition	--	4,720	4,720	4,720	4,720
<b>Total Actions</b>	<b>\$250,416</b>	<b>\$250,000</b>	<b>\$250,000</b>	<b>\$250,000</b>	<b>\$250,000</b>

There also exists the possibility that the city could lose an additional \$1 billion of funding. As delineated by the State Education Department, the DOE is likely ineligible for a number of funding sources and grants. According to the Department, the DOE will not meet the requirements for funding through the Systemic Supports Grant, and the Supporting Teacher and Leader Effectiveness Grant. Additionally, because of the city's inability to implement a teacher and principal evaluation plan, the State Education Department may also not approve eligible competitive federal grants that total \$194 million and noncompetitive federal grants that amount to \$830 million for school CY 2012-2013. These federal noncompetitive grants are formally known as Title I and Title IIA, respectively.

It is still unclear what the ultimate impact on the city's budget and financial plan will be given possible state legislative action and the results of pending lawsuits.<sup>11</sup> As part of the Governor's 30-day amendments to his SFY 2013-2014 Executive Budget released on February 21, 2013, legislation was introduced that will initiate an expedited arbitration process, led by the State Education Department. It is intended by June 1, 2013, following the arbitration and review process, a structure of a teacher evaluation system will be finalized. This legislation is a positive step in avoiding an additional loss of \$224 million in state aid in FY 2014 contained in the Governor's executive budget.

In another budgetary area, the city projects its four uniformed agencies (Police, Fire, Correction, and Sanitation) will generate \$992 million of overtime expenditures, which exclude expenses related to Hurricane Sandy, for FY 2013. The estimated spending in FYs 2014 through 2017 declines to \$901 million in FY 2014, \$844 million in FY 2015, and \$808 million in each of FYs 2016 and 2017. These figures include both uniformed and civilian personnel.

The combined uniformed agencies' overtime expenditures related to Sandy have been estimated to total about \$138 million. The majority of these expenditures were produced in the Police Department, which accounted for about \$85 million of storm related overtime costs. The Sanitation Department also had a large share, totaling \$42 million. A much smaller portion was recorded in the Fire Department with \$9.3 million and Correction had \$2.4 million of the total cost. The city expects these overtime costs to be fully reimbursed by federal funds.

After the east coast storm hit, the representatives of the tri-state area asked the federal government for more than \$80 billion of aid, but that figure was decreased to about \$60 billion. In early January, congress authorized \$9.7 billion in borrowing authority for the National Flood Insurance Program. On January 29, President Obama signed into law the remaining \$50 billion emergency appropriation of funds. The first round of aid for the city was made available in early February with a \$1.8 billion Community Development Block Grant. The city plans to use \$720 million of this

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<sup>11</sup> On February 22, 2013, the Campaign for Fiscal Equity was successful in petitioning the State Supreme Court in Manhattan to issue a preliminary injunction to stop the state from withholding \$250 million in state education aid from the DOE. The state is expected to appeal this order.

amount for housing recovery, \$185 million for business recovery, and \$140 million for infrastructure, with the remaining funds being spent on other grants and loans.

We estimate that the city's projected overtime costs, adjusting for costs associated with Sandy, pose no risk to the FY 2013 budget. Based on fiscal-year-to-date actual spending of \$496 million through December 2012, the city is on track to spend \$992 million. Accordingly, we will hold at risk \$91 million in FY 2014, \$149 million in FY 2015, and \$184 million in each of FYs 2016 and 2017. We believe that the risks will be reduced over the life of the plan as the city increases its spending estimates.

## **ANALYSIS OF THE CAPITAL STRATEGY AND DEBT SERVICE COSTS**

The city has released its Preliminary Ten-Year Capital Strategy for FYs 2014-23. Produced biennially, the preliminary strategy identifies the city's capital program goals, anticipated sources of financing, and projected debt service costs for the ensuing ten-year period. The strategy incorporates the city's four-year authorized capital commitments, or contracts, in the initial years, and extends the forecast for an additional six years. During the two-year interval between strategies, modifications are made regularly to the immediate four years of capital contracts to reflect programmatic realisms and fiscal circumstances, with commitment levels fluctuating from plan to plan. Indeed, while the Preliminary Ten-Year Capital Strategy for FYs 2014-23 shrank relative to the Ten-Year Capital Strategy for FYs 2012-21, commitments have expanded in the current plan compared to the October 2012 Capital Plan. Moreover, projected debt service costs continue to grow on a fast pace during the plan years.

The January modification includes \$98 million of debt service savings in FY 2013 as a component of the current-year budget surplus, which is being applied to prepay FY 2014 expenses. Additionally, the January modification forecasts that debt service costs will be lower by \$206 million in FY 2014 than previously estimated in the November 2012 modification. The realization of these savings, which have been facilitated mostly by the low interest yield climate, will reduce the FY 2014 expense budget by a combined \$304 million. With the savings, debt service costs for the city and the New York City Transitional Finance Authority (NYCTFA), net of prepayments, will total \$6 billion in FY 2013 and grow to \$6.3 billion in FY 2014, increasing in total expenditure share from 8.5 percent to nine percent. For the outyears of the financial plan, debt service is lower than in the November 2012 modification by \$51 million in FY 2015, \$38 million in FY 2016 and \$20 million in FY 2017, as it continues to grow from \$7.2 billion in FY 2015 to \$7.7 billion in FY 2017, when it will represent 9.8 percent of total expenditures. In this section of the report, we will review the capital program in broad terms and the resulting debt service costs.

### **Capital Strategy**

The preliminary strategy includes a total \$51 billion of authorized capital commitments, \$38.3 billion of which are city-funded while \$12.6 billion are supported

with noncity funds.<sup>12</sup> Of the preliminary city-funded commitments, the city and the NYCTFA will finance a combined \$26.1 billion by issuing tax-supported bonds; and the New York City Municipal Water Finance Authority will finance \$12.2 billion by issuing revenue bonds backed by user fees levied on city rate payers to fund environmental protection capital projects.

### THE PRELIMINARY STRATEGY FOR FYs 2014-23 IS \$3 BILLION SMALLER THAN THE PRIOR STRATEGY

TABLE 7

(\$ in billions)

Ten-Year Capital Strategy	FYs 2014-23	FYs 2012-21	Change
Commitments by Funding Sources:			
Tax-Supported Bonds	\$26.1	\$27.8	(\$1.7)
Water Authority Bonds	12.2	12.3	(0.1)
Total City Funds	\$38.3	\$40.1	(\$1.8)
Federal Funds	\$2.2	\$3.0	(\$0.8)
State Funds	10.3	10.6	(0.3)
Other NonCity Funds	0.1	0.4	(0.3)
Total NonCity Funds	\$12.6	\$14.0	(\$1.4)
<b>Total Financing</b>	<b>\$50.9</b>	<b>\$54.1</b>	<b>(\$3.2)</b>

The capital strategy is a ten-year rolling commitment plan, where each new strategy drops the first two years of the prior strategy and adds two years on the back end, with adjustments made for projects that have been undertaken, deferred or eliminated. The Preliminary Ten-Year Capital Strategy for FYs 2014-23 is \$3.2 billion smaller than the one it replaced for FYs 2012-21, with \$1.7 billion less of tax-supported city-funded commitments, \$100 million less of Water Authority financed commitments and \$1.4 billion less of noncity-funded commitments, as illustrated in Table 7. When the annual distribution of commitments is compared between the two strategies, the \$3.2 billion reduction in the preliminary strategy is taken in the first five years. The preliminary strategy reflects commitments that continue to be front loaded, but to a smaller degree, with 58 percent authorized to occur in the first five years, compared to 60 percent in the FYs 2012-21 strategy. Table 8 on page 26 shows the front loading is driven by city-funded commitments. With 58 percent of total commitments slated for the first five years in the preliminary strategy, there is an average of \$5.9 billion of contracts, compared to a much lower average of \$4.3 billion for the 42 percent of commitments in the second five years.

<sup>12</sup> The city is required by its charter to produce a ten-year capital strategy biennially. A preliminary version is submitted with this financial plan and a final version is issued along with the executive budget. We will review the programmatic content of the final strategy when it is released with the executive budget.

## THE \$51 BILLION TEN-YEAR STRATEGY IS FRONT LOADED

TABLE 8

(\$ in billions)

<u>First Half</u>								
FY	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>5-Year Sub-total</u>	<u>Percent of Total</u>	<u>5-Year Average</u>
City Funds	\$7.9	\$4.8	\$3.7	\$3.4	\$3.1	\$22.9	45%	\$4.6
Noncity Funds	<u>1.8</u>	<u>1.1</u>	<u>1.0</u>	<u>1.4</u>	<u>1.1</u>	<u>6.4</u>	<u>13</u>	<u>1.3</u>
Total	\$9.7	\$5.9	\$4.7	\$4.8	\$4.2	\$29.3	58%	\$5.9
<u>Second Half</u>								
FY	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>5-Year Sub-total</u>	<u>Percent of Total</u>	<u>5-Year Average</u>
City Funds	\$3.5	\$3.3	\$3.0	\$3.0	\$2.6	\$15.4	30%	\$3.1
Noncity Funds	<u>1.0</u>	<u>1.4</u>	<u>1.6</u>	<u>1.0</u>	<u>1.2</u>	<u>6.2</u>	<u>12</u>	<u>1.2</u>
Total	\$4.5	\$4.7	\$4.6	\$4.0	\$3.8	\$21.6	42%	\$4.3

It is important to note, however, that the city entered into \$7.5 billion of total-funded capital contracts in FY 2012 and is authorized to enter into another \$19 billion in FY 2013, which when combined is \$9 billion more than was projected for those years in the FYs 2012-21 strategy. The substantial \$19 billion of contracts for FY 2013 is part of the city's FYs 2013-16 authorized commitment plan totaling \$39.3 billion, which incorporates \$5 billion of additional contracts over the prior four-year plan that was published in October.<sup>13</sup> So while relatively speaking the ten-year strategy shrank, overall the city's capital program has been augmented.

A component of the expansion is \$3.1 billion of additional commitments allocated to address the damage done to the city's transportation system, hospitals, beaches, boardwalks, housing and schools by Hurricane Sandy in October 2012. The capital plan presumes federal funding for the hurricane related repairs and replacements. Moreover, the city announced in October 2012 that it will accelerate spending on \$1 billion of contracts that were already in its plan, as a means to stimulate the economy and create jobs. To accelerate the work, the capital financing has been fast tracked, the merit of which the city rationalized given the low interest yield climate.

### Debt Service Costs

The portion of the city's capital program that is financed by tax-supported debt is represented in the operating budget in the form of annual debt service costs. Debt service projections have been updated with each submission of the city's financial plan since the FYs 2012-21 capital strategy to reflect terms of actual sales of city general obligation and NYCTFA revenue bonds, actual rates on variable rate debt, and changes in borrowing assumptions. To their credit, the city and the NYCTFA used conservative interest rate assumptions in projecting debt service costs, which yielded substantial savings in FYs 2012 and 2013 for their variable rate debt, as well as savings in each of

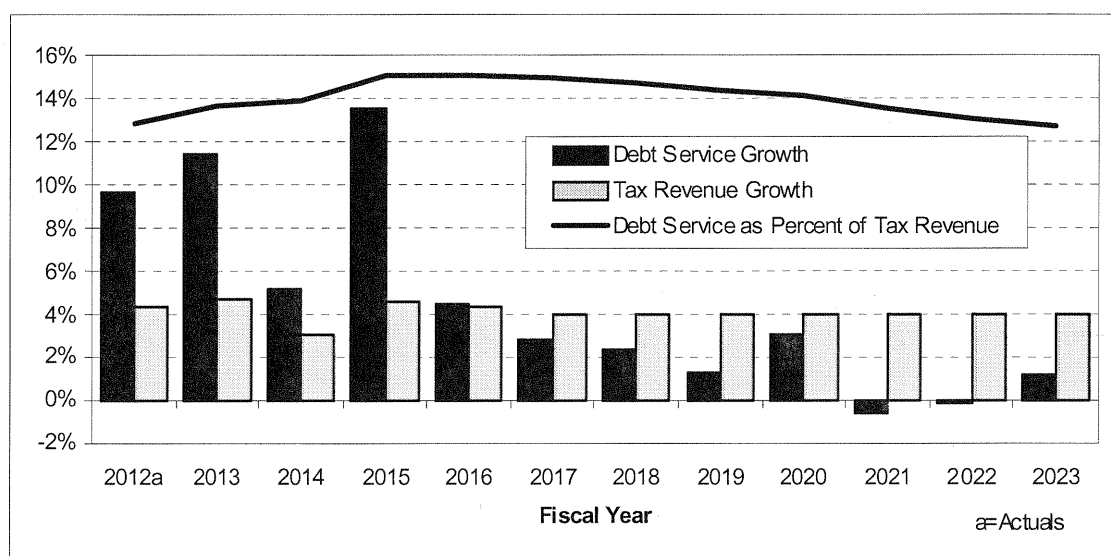
<sup>13</sup> The highest annual amount of commitments that the city has ever entered into was \$12.1 billion in FY 2010. Typically, whatever amount of authorized commitments is not entered into in a given fiscal year is rolled into the following fiscal year.

FYs 2012-16 on actual sales.<sup>14</sup> However, by FY 2017, interest savings are more than offset by the costs related to the higher borrowing required to support the burgeoning and accelerated capital program.

After totaling \$5.4 billion in FY 2012, debt service for the city and NYCTFA is projected to climb from \$6 billion in FY 2013 to \$7.7 billion in FY 2017, for an average annual rate of 6.4 percent. An extended analysis of debt service based on the preliminary ten-year strategy reveals a much slower growth to \$8.2 billion in FY 2021 and \$8.3 billion in FY 2023, for an annual average rate of 1.2 percent from FYs 2017-23. The tapered debt service growth rate from FY 2017 is predicated on the capital program contracting in the second half of the ten-year strategy.

## THE DEBT SERVICE GROWTH RATE IS EXPECTED TO SLOW AFTER FY 2015

CHART 2



The city actively manages debt service costs with consideration to the proportion of tax revenues absorbed during the plan years. The rising debt service costs will absorb an increasing share of tax revenues, from 13.6 percent in FY 2013 to peak at 15.1 percent in FYs 2015 and 2016, beyond which the burden begins declining to 14.9 percent in FY 2017. For those years in which the debt service burden hovers around 15 percent, the city is projecting budget gaps of \$2.4 billion in FY 2015, and \$1.9 billion in each of FYs 2016 and 2017.

To extend the analysis of the debt service burden to cover the outyears of the preliminary strategy, we assume a growth rate for tax revenues of four percent through FY 2023, which is the same as the growth rate the city assumed for FY 2017. In so doing, the projected debt service costs shrink as a percentage of tax revenues in each year, dropping to 12.7 percent in FY 2023. As can be seen in Chart 2, at 12.7 percent, the debt

<sup>14</sup> There is room for the realization of additional debt service savings in FY 2013 on approximately \$11 billion of combined outstanding variable rate obligations for the city and the NYCTFA with the continuation of historically low market-wide interest rates.

service burden would be just below the manageable 12.8 percent experienced in FY 2012, a year in which the city balanced its budget and was able to set aside excess resources to help close a budget gap projected for the current fiscal year. Essential to this assumption of an improvement in the debt service burden is the tapering of the capital program, as currently projected in the preliminary strategy, to restrain debt service growth to the average annual 1.2 percent, while tax revenues grow concurrently at the assumed four percent rate.



## **Glossary of Acronyms**

<b>CBC</b>	Citizens Budget Commission
<b>CSA</b>	Council of Supervisors and Administrators
<b>CY</b>	Calendar Year
<b>DOE</b>	Department of Education
<b>FDIC</b>	Federal Deposit Insurance Corporation
<b>FEMA</b>	Federal Emergency Management Agency
<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>IBO</b>	Independent Budget Office
<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>PS</b>	Personal Service
<b>RHBT</b>	Retiree Health Benefits Trust
<b>RTTT</b>	Race to the Top
<b>SCA</b>	School Construction Authority
<b>SFY</b>	State Fiscal Year
<b>STAR</b>	School Tax Relief program
<b>UFT</b>	United Federation of Teachers