

Staff Report

**REVIEW OF FYs 2011-2015
FINANCIAL PLAN**

March 24, 2011



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I. Overview

In the November modification to the FYs 2011-14 Financial Plan, the city chose to take actions to start to deal with its projected FY 2012 budget gap. It started to implement agency reductions that would generate \$584 million in savings in FY 2011 and annualize to about \$1 billion in FY 2012. Using these savings, in addition to reserves not needed in FY 2011, the city projected a surplus of almost \$1.2 billion to be used to help balance FY 2012, and leaving a \$2.4 billion gap to be closed.

Between November and the submission of the February modification many changes occurred. The city's estimate of the FY 2012 budget gap increased to \$4.2 billion, with the identification of a reduction in state funding of almost \$1.4 billion, higher spending in city agencies of \$278 million, a timing adjustment of \$122 million for the projected receipt of federal funding, and higher pension costs of \$75 million.

To close the projected \$4.2 billion gap, the city identified almost \$2 billion in additional resources in FY 2011 that can be used to prepay FY 2012 expenses. The city raised its FY 2011 tax revenue forecast by \$993 million, received \$516 million in federal Medicaid funds earlier than expected, and reduced reserves not needed in FY 2011. The city also raised its city-fund revenue estimate by \$1.1 billion in FY 2012, identified savings of \$339 million in debt service, and reestimated the cost of healthcare premiums, as well as judgment and claims for a savings of \$175 million.

The combination of these actions would close all but \$600 million of the FY 2012 budget gap. The city has proposed that it would close the remaining deficit through three state actions, which include restoring \$200 million in state education aid and \$200 million in state Aid and Incentives for Municipalities funding, as well as making changes to the Variable Supplements Fund for police and fire unions saving the city \$200 million. Given the uncertainty of how much, if any, of these actions appear in an adopted state budget, the city has started the process to develop an agency reduction program, in time for the executive budget, in order to deal with the remaining gap.

The city was able to increase its estimates of city-fund tax revenues by \$993 million in FY 2011 and \$1.1 billion in FY 2012 because of rising tax collections stemming from a widening economic recovery. The national economy appears to be close to achieving a self-sustaining recovery. Federal payroll tax cuts are stimulating consumer spending and a bonus depreciation tax rule change could jump start business spending. The local economic recovery is widening its range to include job growth in the securities industry and several other sectors. Despite the stronger recovery, the city has concerns about the tepid pace of national economic growth, the impact of regulatory reform on Wall Street profitability, and the serious fiscal condition of New York State. Furthermore, the recent rise in energy prices could pose a serious risk to both the national and local economic recoveries.

On the expenditure side, it is important to note that the city has chosen to use city funds to offset the loss of \$853 million in federal stimulus funds and \$1 billion in state education aid, signifying its priority to education. FY 2012 operational funding for the Department of Education will total \$19.1 billion, with \$9.5 billion provided by the city. Despite this additional city funding, the \$350 million reduction called for in the November agency reduction program still stands and the city has chosen to achieve these savings using headcount reductions including 4,500 through layoffs, and 1,500 through attrition.

Despite all of the actions that the city has taken and an economic recovery underway, the city is still projecting outyear budget gaps of \$4.8 billion in each of FYs 2013 and 2014, and \$4.9 billion in FY 2015. If the risks we identified occur, the gap will range from almost \$5.7 billion in FY 2013 to over \$6 billion by FY 2015. These gaps continue primarily because of the high growth in debt service, pension and healthcare costs for both current and retired employees. In an attempt to contain the growth in debt service costs, the city has cut its capital program by 10 percent. This action generates debt service savings that, while relatively small in the years covered by the modification, grow to over \$100 million annually by FY 2020. In order to deal with the growth of pension costs, the city has also proposed that the state create a new pension tier for new employees, which would start generating savings in FY 2014. There are no plans in this modification to deal with the growth in healthcare costs, especially the unfunded liability of \$75 billion for retiree healthcare.

To deal with the large structural outyear budget gaps, it is time for all of the stakeholders--the city, state, labor and management--to come together and develop plans to reduce the growth in both pension and healthcare costs. If this is not successful, the city will be faced with having to develop deeper and deeper agency reduction programs year after year.

**FEBRUARY MODIFICATION:
THE CITY'S OPERATING PROJECTIONS FOR
FISCAL YEARS 2011-2015**

TABLE 1 (\$ in millions)

	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
<u>Revenues</u>					
Taxes:					
General Property	\$16,817	\$17,603	\$18,157	\$18,592	\$19,022
Other Taxes	22,267	23,631	24,320	25,353	26,678
Tax Audit Revenue	868	645	644	651	651
Sale of Property Tax Liens	30	40	40	40	40
Miscellaneous Revenues	7,476	6,925	6,971	7,034	7,059
Unrestricted Intergovernmental Aid	14	12	12	12	12
Anticipated State Actions	--	600	600	600	600
Interfund Revenues	559	500	493	493	493
Less: Intracity Revenues	(1,871)	(1,515)	(1,512)	(1,512)	(1,512)
Disallowances	(15)	(15)	(15)	(15)	(15)
Total City, IFA & Other Categorical Funds	\$46,145	\$48,426	\$49,710	\$51,248	\$53,028
Federal Categorical Grants	8,197	5,937	5,795	5,761	5,761
State Categorical Grants	11,565	11,263	11,286	11,330	11,331
Total Revenues	<u>\$65,907</u>	<u>\$65,626</u>	<u>\$66,791</u>	<u>\$68,339</u>	<u>\$70,120</u>
<u>Expenditures</u>					
Personal Service	\$36,392	\$37,004	\$38,376	\$39,001	\$39,929
Other Than Personal Service	26,735	27,080	27,807	28,444	29,111
General Obligation, Lease & TFA Debt Service	5,046	5,908	6,672	6,919	7,269
Budget Stabilization & Prepayments	(495)	(3,151)	--	--	--
General Reserve	100	300	300	300	300
Subtotal	\$67,778	\$67,141	\$73,155	\$74,664	\$76,609
Less: Intracity Expenditures	(1,871)	(1,515)	(1,512)	(1,512)	(1,512)
Total Expenditures	<u>\$65,907</u>	<u>\$65,626</u>	<u>\$71,643</u>	<u>\$73,152</u>	<u>\$75,097</u>
<u>Gap To Be Closed</u>	<u>\$0</u>	<u>\$0</u>	<u>(\$4,852)</u>	<u>(\$4,813)</u>	<u>(\$4,977)</u>

**CHANGES TO THE CITY'S OPERATING PROJECTIONS FOR
FISCAL YEARS 2011-2014
FEBRUARY MODIFICATION COMPARED TO NOVEMBER MODIFICATION**

TABLE 2 (\$ in millions)

	FY 2011	FY 2012	FY 2013	FY 2014
<u>Revenues</u>				
Taxes:				
General Property	\$70	\$210	\$494	\$792
Other Taxes	693	921	519	337
Tax Audit Revenue	240	0	0	0
Sale of Property Tax Liens	(10)	0	0	0
Miscellaneous Revenues	(31)	(25)	(22)	(22)
Unrestricted Intergovernmental Aid	0	(302)	(302)	(302)
Anticipated State Actions	--	600	600	600
Interfund Revenues	0	0	0	0
Less: Intracity Revenues	(47)	8	7	7
Disallowances	0	0	0	0
Total City, IFA & Other Categorical Funds	\$915	\$1,412	\$1,296	\$1,412
Federal Categorical Grants	326	100	70	49
State Categorical Grants	90	(1,055)	(1,232)	(1,605)
Total Revenues	<u>\$1,331</u>	<u>\$457</u>	<u>\$134</u>	<u>(\$144)</u>
<u>Expenditures</u>				
Personal Service	\$343	\$13	(\$4)	(\$440)
Other Than Personal Service	(447)	380	167	(439)
General Obligation, Lease & TFA Debt Service	(308)	(311)	(22)	(37)
Budget Stabilization & Prepayments	1,990	(1,990)	--	--
General Reserve	(200)	0	0	0
Subtotal	\$1,378	(\$1,908)	\$141	(\$916)
Less: Intracity Expenditures	(47)	8	7	7
Total Expenditures	<u>\$1,331</u>	<u>(\$1,900)</u>	<u>\$148</u>	<u>(\$909)</u>
<u>Gap To Be Closed</u>	<u>\$0</u>	<u>\$2,357</u>	<u>(\$14)</u>	<u>\$765</u>

RISKS TO THE FINANCIAL PLAN

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

	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
Stated Financial Plan Gap	\$0	\$0	(\$4,852)	(\$4,813)	(\$4,977)
Estimation					
Uniformed Services Overtime	(\$80)	(\$216)	(\$240)	(\$244)	(\$244)
Subtotal	(\$80)	(\$216)	(\$240)	(\$244)	(\$244)
Not in Mayor's Control					
State Foundation Aid for Education	\$0	(\$200)	(\$200)	(\$200)	(\$200)
State Aid & Incentives for Municipalities	0	(200)	(200)	(200)	(200)
State Reform of Variable Supp. Fund	0	(200)	(200)	(200)	(200)
Pension Reform	0	0	0	(131)	(252)
Subtotal	\$0	(\$600)	(\$600)	(\$731)	(\$852)
Risk Total	(\$80)	(\$816)	(\$840)	(\$975)	(\$1,096)
Total FCB Estimated Surplus/(Gap)	(\$80)	(\$816)	(\$5,692)	(\$5,788)	(\$6,073)

II. Balancing the FY 2012 Budget

The city has presented a balanced budget for FY 2012 of \$65.6 billion in the February modification to the FYs 2011-15 Financial Plan and Preliminary FY 2012 budget. In the earlier November 2010 modification, the city estimated a budget gap for FY 2012 of \$2.4 billion. Since then, that estimate increased to \$4.2 billion with the city's identification of a reduction in state funding of almost \$1.4 billion, higher spending in city agencies of \$278 million, a timing adjustment of \$122 million for projected receipt of federal funding and \$75 million in higher pension expense. In the February modification, the city used a combination of nearly \$2 billion of additional surplus funds from FY 2011 to prepay FY 2012 expenses, a higher revenue forecast of \$1.1 billion, city-funded debt service savings of \$339 million, and reestimates of healthcare premiums as well as judgment and claims totaling \$175 million to close all but \$600 million of the gap.

To close the remaining gap, the city has proposed state actions, including restoration of Aid and Incentives for Municipalities (AIM), education aid and reform of the Variable Supplements Fund, that provide a recurring benefit of \$600 million annually starting in FY 2012, for which state approval is uncertain at this time. Additionally, we have estimated that overtime expenses for the uniformed services could exceed the amount in the February modification by \$216 million in FY 2012.

The city increased its estimates of city-fund revenues by \$930 million in FY 2011 and \$1.4 billion in FY 2012 because of rising tax collections stemming from a widening economic recovery. The national economy appears to be close to achieving a self-sustaining recovery. Federal payroll tax cuts are stimulating consumer spending and a bonus depreciation tax rule change could jump start business spending. The local economic recovery is widening its range to include job growth in the securities industry and several other sectors. Despite the stronger recovery, the city has concerns about the tepid pace of national economic growth, the impact of regulatory reform on Wall Street profitability, and the serious fiscal condition of New York State. Furthermore, the recent rise in energy prices could pose a serious risk to both the national and local economic recoveries.

In the outyears of the February modification, the city projects expenditures will exceed revenues. The city has identified the fast growth in such expenditure areas as pension, health care and debt service costs to be the main contributor of the budget imbalance. In an attempt to contain the growth in debt service costs, the city has cut its capital program by 10 percent. This action generates debt service savings that, while relatively small in the years covered by the modification, grow to over \$100 million annually by FY 2020. Meanwhile, budget gaps of \$4.8 billion to \$5 billion continue to exist in each of FYs 2013-15 in the February modification. Moreover, we have identified additional budget risks of \$840 million in FY 2013, \$975 million in FY 2014 and \$1.1 billion in FY 2015.

REVENUES IMPROVE IN FY 2011

City-funded revenues expanded by \$930 million in the February modification for FY 2011 compared with the November plan, as shown in the figure to the right. Total revenue gained \$1.331 billion partly because \$401 million in additional categorical grants, mostly federally funded, were included in the plan. Tax collections improved by \$806 million, with the nonproperty taxes increasing \$746 million, and the property tax adding \$60 million. These gains flow through to enable the city to more easily balance FY 2012 and deal with the outyear budget gaps.

Improving FY 2011 Tax Outlook Increases City Funds by \$930 Million (\$ in millions, change since Nov. plan)	
Property Tax	\$60
Nonproperty Taxes	746
Tax Audits	240
STAR Aid	(53)
Miscellaneous Revenue	<u>(63)</u>
City Funds	\$930
Categorical Aid	<u>401</u>
Total Change in Revenues	\$1,331

The improvement in the nonproperty taxes was led by the business taxes, which are up \$375 million, and the sales tax which increased by \$224 million. The real estate related taxes and the hotel taxes also improved since earlier estimates. Moving against the trend, the personal income tax had a downward revision of \$56 million.

The real property tax is up \$60 million largely due to smaller refund payouts. The city raised its target for tax audits by \$240 million, indicating that this ongoing collections effort is continuing to produce strong results. The city's allocation of the state School Tax Relief (STAR) program is down by \$53 million.

Miscellaneous Revenue

In the February modification, the city's FY 2011 miscellaneous revenue estimate decreases by \$63.2 million to \$4.29 billion on a plan-to-plan basis largely because of a \$58.5 million drop in fine revenue to \$799.2 million. Out of the \$58.5 million negative variance, \$53.5 million refers to a reduction in parking ticket revenue due to the frequent snowfalls (one-time cost) and a recurring cut of \$27.4 million in each year of the plan to acknowledge the long-term downward trend in ticket issuance by the Police Department. Total parking fine revenue is expected to slide by 3.9 percent to \$580.4 million in FY 2011 from the prior year.

From FY 1991 to FY 2010, FY 2003 was the last year that there was positive year-to-year growth in the number of traffic-related summonses issued by the Police Department.¹ During the period of FY 1991 to FY 2010, total ticket issuance by city agencies for traffic infractions fell from a high of over 13 million in both FYs 1991 and 1992 to a low of 7.8 million in FY 2003, before new initiatives and hiring of traffic enforcement agents brought total issuance up to nine million tickets annually since FY 2004.

¹ In FY 2003, the Police Department issued 2.5 million tickets, which represents 3.2 percent growth over the prior year.

The city's FY 2012 miscellaneous revenue projection fell by \$17.1 million from the prior plan to \$4.25 billion and represents a decline of less than one percent from FY 2011. Among the plan-to-plan variances for FY 2012, higher charges for services revenue (e.g. hike in college tuition) was overshadowed by the decline in fines (e.g. lower parking violation receipts). Fines and charges for services are the largest sources of recurring revenue among the six core categories, at about \$800 million annually during the forecast period.² Core category revenue is forecast to grow moderately at 2.2 percent in FY 2012 to \$2.6 billion on a year-to-year basis and increase by \$128.1 million or 4.9 percent to \$2.7 billion by FY 2015.

REVENUE GAINS FLOW THROUGH TO FYS 2012-2015

The stronger tax collections in FY 2011 flow through to the city's plan for FY 2012, making budget balance more attainable. City funds are up by \$1.412 billion in FY 2012 compared with the November plan, as shown in the figure to the right. Total revenue increases by only \$457 million, because of large expected reductions to categorical grant programs. These program specific grants are down by \$955 million largely due to state aid cutbacks.

City Funds Rise \$1.4 Billion in FY 2012 (\$ in millions, change since Nov. plan)	
Property Tax	\$210
Nonproperty Taxes	909
STAR Aid	12
Unrestricted Aid	(302)
Anticipated State Aid	600
Miscellaneous Revenue	(17)
City Funds	\$1,412
Categorical Aid	(955)
Total Change in Revenues	\$457

The city has increased its tax collection plan for FY 2012 by \$1.119 billion. Just as in the previous year, the nonproperty taxes, which improved by \$909 million, gained the most additional revenue in FY 2012. The real property tax projection is higher by \$210 million due to a favorable assessment report.

In recognition of state cutbacks to its Aid and Incentives for Municipalities (AIM) program, the city has removed about \$300 million in unrestricted state aid from its plan. The city is seeking additional state aid, and has included \$600 million in anticipated revenue in its plan while it negotiates for these funds. We have included this aid request as a risk in Table 3 on page 5, because receipt of these funds is not in the Mayors control.

² Core category revenue consists of: licenses (with permits and franchises), charges for services, interest, rent, fines, and a miscellaneous category without major nonrecurring actions, tobacco proceeds, housing revenue, and HHC payments. Dedicated funds such as water and sewer charges are also excluded from core category revenue since the funds are unavailable for gap-closing assistance.

The city has increased its nonproperty tax collection plan for FY 2012 by \$909 million, as shown in the figure to the right. Most of the major taxes participated in the gains, save for the personal income tax, the utility tax and the cigarette tax, which were little changed. The strongest improvements were recorded for the sales tax, which gained \$422 million, and the business taxes, which are up \$296 million. The property transactions taxes increased by \$107 million and the commercial rent tax gained \$59 million, indicating that the downturn in real estate could finally be ending.

Nonproperty Tax Outlook for FY 2012 Improves by \$909 Million Since Nov. (\$ in millions)	
Nonproperty Taxes	\$909
Personal Income	7
General Corporation	148
Banking Corporation	50
Unincorporated Business	98
Sales	422
Property Transfer	85
Mortgage Recording	22
Commercial Rent	59
Utility	0
Hotel	20
Cigarette	(2)

Steadier National Growth Strengthens the Local Outlook

The city has upgraded the economic forecasts in its February modification and is now more moderate in its outlook than it was in its conservative November economic plan. The lagging and unsteady national growth had been raising questions about the sustainability of the city's upturn. Recent data suggesting that the nation's economy is closer to a self-sustaining recovery has given the city the assurance to increase its revenue projections. Also, new federal programs to stimulate the economy by cutting payroll taxes and providing bonus depreciation write-offs for business investments are designed to keep the economic recovery on track. The city nevertheless has concerns about the tepid pace of national economic growth, the impact of regulatory reform on Wall Street profitability, and the serious fiscal condition of New York State. Furthermore, the recent rise in energy prices could pose a serious risk to both the national and local economic recoveries.

In the city's outlook, national output growth as measured by real GDP accelerates to 3.2 percent in 2011 from 2.8 percent in 2010 after recovering from a decline of 2.6 percent in 2009. Growth eases back to 2.8 percent in 2012, after which GDP accelerates to a peak of 3.4 percent in 2014 before settling toward trend growth of 3 percent in 2015. This upgraded view of national output, contrasts sharply with the much weaker and more unsteady outlook, which the city presented in its November economic plan.

The March Blue Chip consensus projects 3.1 percent GDP growth in 2011, which is slightly below the city's estimate of 3.2 percent. However, the consensus survey gives a much more optimistic outlook for 2012, with GDP growth rising to 3.3 percent rather than dropping back to 2.8 percent, as the city has projected. The most recent GDP re-estimate shows that output actually increased by only 2.8 percent in the fourth quarter of 2010 rather than the advance estimate of 3.2 percent. Given the uncertainties regarding the pace of economic growth, the city is prudent to adopt the moderate outlook that is reflected in its financial plan.

The city's current forecast of national jobs is also more moderate than its previous employment projection. Despite the improved outlook, the job forecast still

appears sluggish with a very stretched-out recovery period. National jobs grow by 1.4 percent in the city's outlook for 2011, following a devastating six percent peak-to-trough slide in 2008 and 2009. Job growth rises to two percent in 2012 and reaches 2.1 percent in 2014. The Bureau of Labor Statistics reports that national employment increased by 192,000 jobs, in February, for an annual growth rate of 1.8 percent, which is painfully slow for a recovery but is still the best employment growth in nine months. This employment report also confirms that the city's employment forecast targets are attainable.

The local economy, which enjoyed an early growth spurt, levels off and then resumes a gradual recovery, in the city's economic plan. Real gross city product (GCP), surged by five percent in 2010, sustained by a stronger stock market and a reviving tourism sector. GCP sinks slightly by 0.3 percent in 2011, as Wall Street profits settle back from \$61 billion in 2009, to \$28 billion in 2010 and then to a forecast \$20 billion in 2011. The city expects weak GCP growth of 1.3 percent in 2012, with output increasing at the moderately faster pace of 2.3 percent in the outyears.

A revised labor market report indicates that the recovery in the city has been stronger than was previously reported, and that the recession was not as severe as initially feared. The job count for the city was revised upward by 31,600 in 2010 to 3,707,900 and now shows that the city gained 14,500 jobs in 2010, instead of losing jobs, as was previously reported. Additionally, the 2009 job loss is now reported as 100,900 rather than the much more grim loss of 106,800 that was reported earlier.

January, 2011 data indicate that private employment is advancing in the city at the rate of 53,000 jobs per year or 1.7 percent. Government employment is down by 15,400, or 2.8 percent. The report also indicates that the private sector recovery is widening to include not only financial services but is spreading to many other sectors. Finance jobs are up by 9,000, mainly because of hiring in the securities sector, which is growing by about six percent. Professional and business services are up by 18,000 jobs or 3.2 percent. Education and health services added 19,000 jobs, a 2.5 percent growth rate. Leisure and hospitality increased by 9,000 jobs or three percent.

AN UNSTEADY RECOVERY FOR REVENUE GROWTH

Total revenue increases by \$4.2 billion, in the city's plan, to \$70.1 billion in FY 2015 from \$65.9 billion in FY 2011, for growth of 6.4 percent over the four-year span. City-funded revenue grows by \$7.1 billion, or 16.1 percent, over the plan. City-fund growth achieves 5.6 percent in FY 2012, abruptly slows to 2.8 percent in FY 2013 and then climbs above three percent in the outyears, as shown in Table 4 on page 11.

PROPERTY TAX GROWTH AUGMENTS NONPROPERTY TAX RECOVERY

TABLE 4

(percent change, \$ in millions)

	FY 12	FY 13	FY 14	FY 15	FY 11	FY 15	FYs 11-15
Property Tax	4.7%	3.1%	2.4%	2.3%	\$16,847	\$19,062	13.1%
Nonproperty Taxes	5.9	2.7	4.4	5.4	21,540	25,793	19.7
Audits	(25.7)	(0.2)	1.1	0.0	868	651	(25.0)
STAR Aid	12.5	8.4	(0.2)	0.0	727	885	21.7
Miscellaneous	2.5	1.3	1.5	1.0	4,123	4,392	6.5
Nonrecurring	(86.2)	(21.7)	0.0	(72.2)	167	5	(96.9)
Unrestricted Aid	(14.3)	0.0	0.0	0.0	14	12	(14.3)
Anticipated State Aid	-	-	-	-	0	600	-
Disallowances	0.0	0.0	0.0	0.0	(15)	(15)	0.0
Total City Funds	5.6%	2.8%	3.2%	3.6%	\$44,271	\$51,385	16.1%
Categorical Aid*	(12.9%)	(0.7%)	0.0%	0.0%	\$21,077	\$18,242	(13.5%)
Interfund Revenue	(10.6)	(1.4)	0.0	0.0	559	493	(11.8)
Total Funds	(0.4%)	1.8%	2.3%	2.6%	\$65,907	\$70,120	6.4%

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

The property tax, which grows by 13.1 percent over the plan, increases from \$16.8 billion in FY 2011 to \$19.1 billion in FY 2015. The property tax grows by 4.7 percent in FY 2012 due to stronger assessments on the tentative tax roll. Growth nevertheless drops to about two percent by FY 2015, because market values had previously been stagnant since FY 2008, as discussed in "Property Values Revive" beginning on page 15.

While the real property tax slows, the nonproperty taxes stage a moderate and unsteady recovery. Nonproperty tax growth reaches 5.9 percent in FY 2012, down from 11.4 percent in FY 2011, which marked the start of the recovery. Growth dips to 2.7 percent in FY 2013, before climbing above five percent by FY 2015. Over the four-year plan period, the nonproperty taxes are projected to grow by 19.7 percent from \$21.5 billion in FY 2011 to \$25.8 billion in FY 2015.

Miscellaneous revenue increases by 6.5 percent from \$4.1 billion in FY 2011 to \$4.4 billion in FY 2015. Nonrecurring actions of \$167 million are projected for FY 2011 and drop rapidly thereafter. By their nature, the amount of nonrecurring actions will change during the course of a year and are front-loaded in the plan. In recognition of state cutbacks to its Aid and Incentives for Municipalities (AIM) program, the city has removed about \$300 million in unrestricted state aid from its plan. The city is still seeking additional state aid, and has included \$600 million in anticipated aid, including \$200 million in restoration of AIM funding, in its plan while it continues to negotiate for these funds.

Nonproperty Taxes Start to Recover

The nonproperty taxes recover by 11.4 percent in FY 2011 because of the extraordinary surge of securities industry profits, federal stimulus programs, and the Federal Reserve's efforts to encourage bank lending. The city's business taxes are leading the upturn, followed closely by the personal income and sales taxes. Revenue growth moderates to 5.9 percent in FY 2012 and dips to 2.7 percent in FY 2013, largely because of an expected drop in bank tax collections as financial market supports are

withdrawn. Moderate growth of about five percent returns by FY 2015, supported by a broadening economic recovery.

Tax collections reports through January indicate that the nonproperty taxes could be about \$100 million behind plan in FY 2011. The general corporation tax, the personal income tax and the real estate transactions taxes are not keeping pace with the city's new growth targets. Despite the slow start to FY 2011 tax collections, we think that the very positive local employment report indicates that the city's economic plan is on track to achieve its economic growth targets and its revenue collection goals.

Business Taxes

The city expects collections for this group of taxes to surge 19 percent in FY 2011, following three negative years when these taxes fell by 25 percent. During the recession, the business taxes slid by \$1.5 billion, from a high of \$6 billion collected in FY 2007 to a low of \$4.5 billion in FY 2010. Revenue growth moderates to 4.9 percent in FY 2012, drops to 2.3 percent in FY 2013, before climbing to 3.5 percent in FY 2014.

The banking corporation tax, which is the most volatile of the city's taxes, leads the upturn with a growth spurt of an estimated 28 percent in FY 2011, supported by the Federal Reserve's easy money policies. Once these supports are withdrawn, bank tax collections are projected to fall by 11 percent in FY 2012 and nine percent in FY 2013, before collections stabilize in FY 2014.

The general corporation tax (GCT) soars an estimated 22 percent in FY 2011, largely on the strength of Wall Street profits, which reached \$89 billion over the two-year period of CYs 2009 and 2010. Additional support for this tax comes from pretax corporate profits, which surged by 39 percent in CY 2010. A recently enacted federal bonus depreciation rule could jump start business spending but the city expects this tax rule change would cause profits to slip by 19 percent in CY 2011. A slowing securities sector combined with weaker business profits could bring down GCT growth from 13 percent to six percent in FY 2013, and to below four percent in the outyears.

The unincorporated business tax (UBT) grows by nine percent in the city's estimate for FY 2011. Growth drops to a more moderate pace of six percent in FY 2012, after which growth levels off at about four percent in FYs 2013-2015.

Property Transactions Taxes

The city has increased its estimates for the property transactions taxes by \$128 million in FY 2011 and by \$107 million in FY 2012. The city estimates that revenue for this group, consisting of the real property transfer and mortgage recording taxes will increase by 24 percent in FY 2011 to \$1.2 billion. This growth surge marks the start of a recovery from a three-year slump, during which revenue fell by 70 percent, to \$981 million in FY 2010 from the \$3.3 billion that was collected in FY 2007. The plan projects that growth will subside to about five percent in each of FYs 2012 and 2013, after which growth accelerates to 10 percent in FY 2014 and 14 percent in FY 2015.

Collections data indicate that the transactions taxes have indeed turned upward and are growing by about 20 percent in FY 2011 through January, which is slightly below the city's target of 24 percent growth. The mortgage recording tax is lagging behind the more rapid growth of the property transfer tax, indicating that the mortgage banking sector has not fully recovered from the mortgage crisis that set off the recession.

Sales Tax

By the last quarter of 2010, it was clear that consumer spending had resumed due to local job gains, a more positive outlook by households, and the record number of visitors to the city. The change in consumer behavior encouraged the city to increase its forecast of sales tax revenue, on a plan-to-plan basis, by \$224 million to \$5.5 billion in FY 2011 and \$422 million to \$5.8 billion in FY 2012 in the February modification. On a year-to-year basis, collections are expected to advance by 5.2 percent in FY 2012, slow to over two percent in both FYs 2013 and 2014, and reach 4.3 percent by FY 2015.

As FY 2011 progressed, households became more confident and optimistic regarding the labor market and business conditions, and were relatively wealthier due to the rise in the stock market. As a result, city sales tax collections (on a common rate and base, year-to-year basis) leaped 14.1 percent in the September quarter and advanced by 7.8 percent in the December quarter.³ To ensure that consumers would be willing to spend during the 2010 holiday season, retailers began to discount items early and heavily. Federal tax changes passed in December 2010, such as the cut in the employee portion of the payroll tax, will increase disposable income for individuals in 2011.⁴

The other mainstay in the recovery of local consumption is a new high of 48.7 million visitors to the city and the \$31 billion (city estimate) they spent in 2010. The previous record was 47.1 million visitors in 2008. Records were also set in 2010 in terms of the number of domestic and higher-spending foreign travelers. The ripple effects from the large number of tourists included more jobs in the leisure and hospitality industry and hotel rooms sold (even with a seven percent year-over-year increase in hotel room inventory), and higher daily room rates. While sales tax collections are enhanced by tourist-based spending, it is uncertain how long the dollar will remain low compared to the euro and other currencies when the Federal Reserve's quantitative easing program ends in June.⁵

³ "Continuing base" or "common rate and base" refers to tax collections that have been modified to remove the effects of tax programs and other adjustments to focus on the influence of the economy.

⁴ Besides reducing the employees' portion of Social Security taxes by two percentage points to 4.2 percent for one year, federal legislation also extended tax credits, unemployment benefits, and lower personal income tax rates for two years.

⁵ In addition to the possibility of a less-than-favorable exchange rate, foreign tourists may also reduce their spending in the city after dealing with higher food and energy costs at home, rebuilding their lives in Japan, and offsetting reduced government spending in certain euro zone countries.

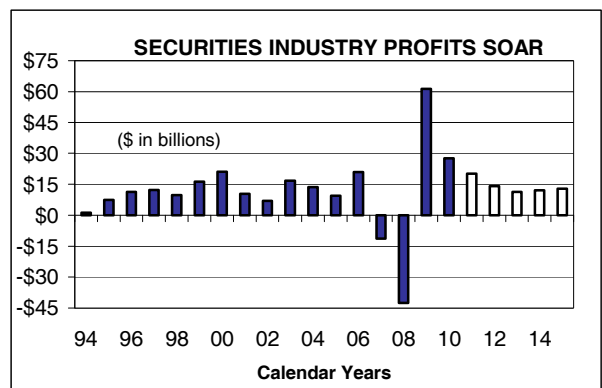
It is remarkable how quickly sales tax revenue has rebounded, but it may take longer than FY 2012 to realize the city's expectation that consumption will return to pre-recession levels, because of high unemployment and falling home prices. It remains to be seen if retailers will have to resort to price discounting to spur shopping during the year. The income boost from the cut in Social Security taxes is a one-shot in 2011 that households may use to address higher prices for food, energy and other commodities, and not for discretionary spending. Until there is a sustained improvement in jobs, incomes, and housing, households' behavior may continue to reflect lessons learned during the recession of paying down debt, limiting credit card use, and saving more, which will act to constrain sales tax revenue growth.

Personal Income Tax

Compared to the November modification, there are minor changes to the city's latest personal income tax (PIT) forecast for FY 2011 through FY 2015 in a context of a tax base that is expected to increase from \$7.5 billion in FY 2011 to \$9.5 billion in FY 2015. However, the adjustments to the components of the tax are relevant and reflect the city's view of more jobs and income growth in the nonfinance sector of the economy rather than in the finance industry. In this scenario, Wall Street compensation is likely to remain at a high level during the plan period, with little or no growth in the bonus payout.

The FY 2011 PIT estimate reflects nine percent year-to-year growth because of two tax law changes affecting high-income residents, an increase in the wage rate and employment, and a significantly larger final settlement that includes capital gains realizations from stock holdings. In FY 2012, PIT revenue is expected to rise by 9.3 percent to \$8.2 billion from the prior year, based on private sector job gains of 39,000 in 2011 and higher nonwage income from an appreciation in the value of stocks and commercial real estate, despite a decline in Wall Street bonuses. After FY 2012, PIT revenue is anticipated to slow to 3.2 percent in FY 2013, before achieving growth of 5.8 percent in FY 2014 and 6.7 percent in FY 2015 from a pickup in employment, wages, and nonwage income.

Despite a difficult trading environment and implementation of the Dodd-Frank financial reform law, New York Stock Exchange (NYSE) member firms earned \$27.6 billion in profits in 2010, as seen in the figure to the right. Besides trading, firms were able to reduce loan-loss reserves, make more business loans, and engage in investment banking activities such as advising on mergers and acquisitions, debt and equity underwritings, and



initial public offerings.⁶ After earning an unprecedented \$61.4 billion of profits in 2009 because of low interest rates and federal bailout programs, Wall Street firms made a phenomenal \$27.6 billion in profits in 2010. Prior to 2010, NYSE member firm profits had reached the \$20 billion mark only two times--in 2000 and 2006. The city expects securities industry profits to fall by \$8 billion to \$20 billion in 2011, drop by another \$6 billion to \$14 billion in 2012, and settle at a historically high level of \$12.9 billion by 2015.

As the profitability of NYSE member firms improved during 2010, an issue for the city was how well the relatively smaller Wall Street work force would be paid in FY 2011, and how the bonus payout would be structured. According to a study by the Wall Street Journal, total compensation and benefits at 25 publicly traded Wall Street banks and securities firms hit a record of \$135 billion in 2010, which is up 5.7 percent from \$128 billion in combined compensation and benefits by the same companies in 2009.⁷ In their analysis, on a per-employee basis, the average pay and benefits added up to about \$141,000, up from \$136,000 in 2009 and the previous high-water mark of \$138,000 in 2007.⁸

Pressure from shareholders, the public, and federal regulators interpreting the Dodd-Frank financial reform law forced Wall Street firms to change the structure of bonuses by reducing the amount of cash paid upfront and increasing the number of stock grants and options that vest over time. The purpose is to encourage employees to better manage risk and to focus on longer-term company performance. One estimate is that in 2010, deferred compensation increased to half of the total payout, up from about one-third in the prior year.⁹ This would help explain why withholding growth in the traditional bonus period has been respectable (on a year-to-year basis) but not spectacular.

The current PIT forecast for FYs 2011-15 is reasonable and benefits from many Wall Street firms that increased base salaries in 2010, which may incorporate the annual value of foregone cash bonuses. The other point is that the increasing use of stock-based deferred compensation in the financial sector offers an upside potential in future PIT revenues as deferred payments of stock become vested and sold. Depending on the benefit plan, the tax liability from a bonus payout or incentive award may be reflected in additional withholding or extension revenue years after the initial grant was bestowed.

⁶ In this case, the reduction in loan reserves refers to consumer debt, and not funds set aside for costs associated with mortgages originated or serviced by financial firms.

⁷ Aaron Lucchetti and Stephen Grocer, "On Street, Pay Vaults to Record Altitude," The Wall Street Journal online February 2, 2011.

⁸ Victoria McGrane and Aaron Lucchetti, "U.S. Seeks to Defer Portion of Bonuses," The Wall Street Journal online February 5, 2011.

⁹ Lucchetti and Grocer.

Property Values Revive

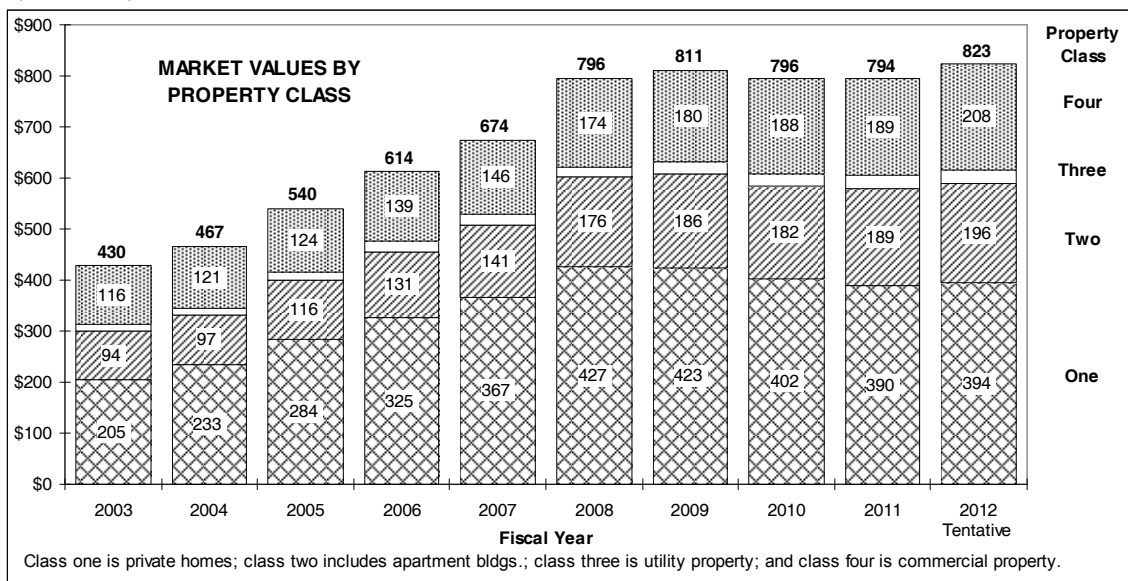
The local real estate market is starting to pull out of a prolonged slump. Market values increased by 3.75 percent to \$823 billion on the city's tentative FY 2012 tax roll. This fresh spurt of growth has enabled the city to raise its property tax growth forecast to 4.7 percent in FY 2012, up from 4.1 percent in the prior year. Assessment disputes often arise when the real estate market shifts into a new growth phase, so it is possible that the final tax roll in June could differ substantially from the preliminary estimates of the tentative roll. Additionally, any unresolved disputes could result in an enlarged refund risk in the future. The city is preparing for rising certiorari claims by expanding its refund reserve to \$437 million in FY 2012 from \$274 million in FY 2011 and to about \$380 million in each of the outyears.

The city's recent report on the tentative assessment roll for FY 2012 indicates that the market value of all taxable city property increased by 3.75 percent to \$823 billion. Previously, property values had been stagnant at about the \$800 billion level since FY 2008, as shown in Chart 1. As welcome as is any sign of recovery, this 3.75 percent growth is modest compared with the 13 percent average annual market value growth achieved from FY 2003 to FY 2008. Growth on the tax roll was extremely uneven, being much weaker for residential properties than for commercial properties. Private home values increased by one percent to \$394 billion. Residential apartment buildings grew by four percent to \$196 billion, while commercial properties increased by 10 percent to \$208 billion.

A 3.75 PERCENT MARKET VALUE INCREASE IN FY 2012 MARKS THE FIRST SUBSTANTIAL GROWTH SINCE FY 2008

CHART 1

(\$ in billions)



The residential apartment sector experienced unevenness in FY 2012 market value growth, with large buildings growing strongly, and small buildings showing decreases or slow growth. Large rental properties and cooperative apartment buildings increased by an average of 12 percent, and condominiums increased by 15 percent.

Among the smaller residential apartment properties, rental buildings declined in value by 18 percent, cooperative buildings increased by five percent, and condominiums in small buildings remained virtually unchanged. Some large residential buildings had increases of 50 percent or more, sparking protests and assessment challenges. The city has agreed to cap the increases in this sector at 50 percent, and has offered \$21 million in reductions to property tax bills. Unresolved disputes over these increases could present the city with a lingering risk to its property tax base.

Among the major sectors of the commercial market, offices increased in value by 12 percent and hotels grew by nine percent, while store buildings increased eight percent in FY 2012. Part of this growth reflects the addition of new properties to the tax roll, as the office and hotel sectors each expanded by about one percent.

Billable assessments increased 6.6 percent on the tentative roll for FY 2012. The city estimates that by June, corrections to the tentative roll will reduce the billable growth rate on the final tax roll to 5.6 percent, which represents acceleration from the 4.2 percent billable growth in the previous year. The city expects the property tax to yield \$17.6 billion and grow by 4.7 percent in FY 2012, up from 4.1 percent in the prior year. This renewed growth is scheduled to moderate to 3.1 percent in FY 2013 and drop to 2.3 percent by FY 2015.

The city has trimmed its refund reserve for FY 2011 by \$120 million to \$274 million. Thus far in the first five months of FY 2011, the city has issued only \$89 million in property tax refunds, an amount that is smaller than for most recent years. These results justify the relatively small refund reserve for FY 2011. Despite the favorable property refund trend, the city must exert caution before cutting its refund reserves, especially in the late stages of a real estate downturn, when assessment disputes tend to proliferate. It can take many years for over-assessment complaints to wind their way through Tax Commission hearings and Law Department reviews before ending up in court. Thus the city needs to monitor the outyear risk of a surge in assessment lawsuits and the possible resulting refund claims.

EXPENDITURES

In the February modification, the city projects that total funded expenditures will fall by \$659 million in FY 2011, excluding nearly \$2 billion in surplus funds to be used in the prepayment of FY 2012 expenses. With the inclusion of the surplus, total funded expenditures will increase from \$64.6 billion to \$65.9 billion, or \$1.3 billion, as shown in the figure to the right.

Much of the decrease in expenditures is attributed to the fact that the city is receiving federal stimulus funds related to Medical Assistance (MA) earlier than originally anticipated. The additional federal funds allow for a temporary decrease in the city share of Medical Assistance through an increase in the Federal Medical Assistance Percentage (FMAP)

FY 2011 Expenses November to February Modifications (\$ in millions)	
Personal Service	\$343
OTPS	64
Medical Assistance	(515)
Debt Service	(308)
General Reserve	(200)
Other	(43)
Total Net Change	(\$659)
FY 2012 Prepayments	1,990
Total Increase	\$1,331

under the American Recovery and Reinvestment Act. The FY 2011 budget was adjusted to reflect an additional \$516 million that was received earlier than anticipated, as a result of the enhanced FMAP, giving the city an expected total savings of \$999 million in FY 2011. The savings are projected to lower the total budget of Medical Assistance from \$5.4 billion in the November modification to \$4.9 billion in the February modification. The city is projecting to receive more than \$1.2 billion of federal funds through FY 2013, after which, the savings from the increased federal assistance will end. Thereafter, Medical Assistance costs will increase to \$6 billion annually starting in FY 2012, adjusted to the annual state-capped growth of three percent. All non-federal costs above the city's three percent cap are paid for by the state.

Additionally, a fall in the cost of debt service and a decrease in the general reserve, totaling \$508 million, offset higher costs of more than \$400 million in Personal Service (PS) and Other Than Personal Service (OTPS). The city has used the FY 2011 savings, along with other actions and increased revenues, to prepay almost \$2 billion more of FY 2012 expenses than previously expected in the November modification.

Elsewhere, in the February modification, the city increased spending for the Department of Education (DOE) in FY 2011, compared to the November modification. With more than fifty percent of the school year behind them, the city increased estimated spending for its public schools in FY 2011 by just over \$109 million, or 0.6 percent, for a net total in operational funding of nearly \$18.8 billion.

As shown in the figure to the right, the expected surplus (city funds) in FY 2011 has grown by nearly \$2 billion, from about \$1.2 billion to almost \$3.2 billion, between the November and February modifications. This is largely due to an increase of \$930 million (net of a decline in non-tax revenues of \$63 million) in forecasted FY 2011 tax revenues and cost reductions previously mentioned (FMAP funding, debt service savings, and reduction of the general reserve). Additionally, the city has also reduced the reserve for prior-year payables by \$500 million, identified miscellaneous budget savings of \$64 million pertaining to a reestimate in healthcare premiums, and judgment and claims expenditures. Also, after a reestimate of projected pension cost, the city will realize modest savings of \$12 million. However, the city will spend additional funds of \$453 million to address higher expected costs in its uniformed services, miscellaneous expenses, energy costs, health and welfare services, and other areas. Also, the city will have to replace lost state funds of \$48 million in health and welfare services.

Growth in Surplus City Funds from November to February Plan (\$ in millions)	
November Modification	\$1,161
Tax Revenue Forecast	\$993
FMAP	516
Prior Payables Reserve	500
Debt Service	269
General Reserve	200
Miscellaneous Budget	64
Pension Expense	12
Agency Spending	(453)
Non-Tax Revenue	(63)
State Impact	(48)
Surplus Increase	\$1,990
February Modification	\$3,151
Surplus Increase / (Decrease)	

From the November to February modifications, the city projects that total funded expenditures in FY 2012 will decrease by \$1.9 billion from \$67.5 billion to \$65.6 billion, which keeps FY 2012 spending about \$281 million less than FY 2011. As shown in the figure to the right, much of the decrease between the modifications is from the use of about \$2 billion in additional surplus funds rolled into FY 2012 from FY 2011 to prepay expenses. The city is also expecting lower costs in debt service, fringe benefits and Public Assistance (PA) of \$311 million, \$129 million and \$64 million, respectively. The nearly \$2.5 billion in cumulative expenditure reductions are offset by about \$600 million in higher projected costs in OTPS, PS, and MA of \$322 million, \$142 million and \$122 million, respectively. The city also estimates that intra-city expenditures will increase by \$8 million.

FY 2012 Expenses November to February Modifications (\$ in millions)	
Prepayment of Expenses	(\$1,990)
Debt Service	(311)
Fringe Benefits	(129)
Public Assistance	(64)
OTPS	322
Personal Service	142
Medical Assistance	122
Intra-city	8
Total Decrease	(\$1,900)

Also in FY 2012, operational funding for the DOE will total \$19.1 billion with \$9.5 billion being provided by the city. Signifying its priority to education, in the face of losing \$853 million in federal stimulus funds and \$1 billion in state aid, the city has chosen to use city funds to offset these reductions. Also, as identified in the November 2010 Agency Program, the DOE is reducing its budget by \$350 million, which the city has chosen to achieve through headcount reductions that consist mostly of layoffs, while other budget changes total \$141 million. This is the first time in recent years that the city's share of DOE operational funding has exceeded that of the state. In FY 2012, the city contribution to DOE's budget is projected to be \$1.6 billion more than state funding of \$7.9 billion.

In its November modification, the city had estimated a budget gap of \$2.4 billion for FY 2012. The projected shortfall in FY 2012 grew by about \$1.9 billion to \$4.2 billion as a result of reduced state funding of almost \$1.4 billion, projected higher spending in city agencies of \$278 million, a timing adjustment of \$122 million for the accounting of a quicker recognition of FMAP funding and \$75 million in higher pension expense, as the figure to the right shows. Nonetheless, the city used a combination of surplus funds from FY 2011 to prepay FY 2012 expenses, a higher revenue forecast of \$1.1 billion, city-funded debt service savings of \$339 million and reestimates of healthcare premiums and judgment and claims totaling \$175 million to close all but \$600 million of the gap. The city has proposed \$600 million of state actions including restoration of Aid and Incentives for

FY 2012 Budget Gap-Closing (\$ in millions)	
November Mod Gap	(\$2,357)
State Budget Reductions	(1,386)
Agency Spending	(278)
FMAP Timing	(122)
Pension Expense	(75)
Total Gap	(\$4,218)
FY 2012 Prepayment	1,990
Revenue Forecast	1,114
State Actions	600
Debt Service	339
HIP, J&C Reestimates	175
Total Gap-Closing	\$4,218
February Mod Gap	\$0
Gap (Increase) / Decrease	

Municipalities (AIM), education aid and reform of the Variable Supplements Fund to close the remaining gap.¹⁰

Agency Program and Expense Reestimate

In the February modification, the city has not asked for any additional agency cost reductions beyond those budgeted in the November modification, although after some adjustments, the program does increase by about \$900,000 in FY 2011. As shown in the figure to the right, all city agencies have found collectively more than \$585 million in savings and increased revenues. The full annualized savings from these actions over the life of the financial plan total more than \$1 billion in FY 2012 and about \$915 million in each fiscal year thereafter.

FY 2011 Agency Program (\$ in thousands)		
Agency Category	Expense	Revenue
Uniformed Services	(\$78,745)	(\$2,261)
Health and Welfare	(100,493)	--
Mayoral	(96,265)	(46,651)
Major Organizations	(232,995)	--
Elected Officials	(4,547)	(1,644)
All Other	(21,800)	--
Total PEG Components	(\$534,845)	(\$ 50,556)
Total Program		(\$585,401)
(Negative) numbers decrease the gap.		

The cuts in agency spending still include the headcount reductions totaling more than 8,200 positions by FY 2012. These reductions include the elimination of over 6,000 employees within the DOE, including 4,500 by way of layoffs, with the balance of 1,500 by way of attrition, in order to meet its spending reduction of \$350 million targeted in the November 2010 Agency Program. The city has not planned any further headcount reductions beyond those budgeted in the November modification.¹¹ Additionally, the city is asking the state to revisit its personnel layoff policy, which currently is centered on seniority (last-in first-out) rather than the proposed merit and performance basis.

The city has allocated \$731 million in funds to cover new spending needs in a number of city agencies and other budgetary areas. As shown in Table 5 on page 21, newly needed spending for FY 2011 of \$453 million will account for about two-thirds of the additional funding requirement and \$278 million will be needed in FY 2012. These new needs will not affect the agency program because alternative cuts and other savings have been identified to offset any restored funds or restorations.

¹⁰ On March 9, 2011, the city called for additional agency actions of two percent in uniformed agencies and the Department of Education, and four percent in all other agencies. The proposed savings of \$600 million are expected to insure that FY 2012 is in balance given the uncertainty of state actions. The agency proposals are due for review by March 24, 2011.

¹¹ A full explanation of the November agency program can be found in the December 16, 2010 FCB Staff Report starting on page 12 with "Program to Eliminate the Gap."

TABLE 5

AGENCY EXPENSE REESTIMATE FOR FYs 2011 and 2012

(\$ in thousands) City Funds

Agency	FY 2011	FY 2012	Total
Police	\$110,001	\$0	\$110,001
Fire	14,300	22,957	37,257
Correction	25,501	4,944	30,445
Sanitation	77,829	4,505	82,334
Total Uniformed Services	\$227,631	\$32,406	\$260,037
Juvenile Justice	\$27,701	\$0	\$27,701
DoITT	27,160	24,895	52,055
Parks and Recreation	20,029	13,892	33,921
Total Mayoral	\$74,890	\$38,787	\$113,677
Admin for Children Services	\$19,726	\$47,174	\$66,900
CUNY	6,000	12,000	18,000
Energy	29,693	21,010	50,703
Miscellaneous Budget	36,065	77,301	113,366
Other Agencies	58,500	49,500	108,000
Total Other	\$149,984	\$206,985	\$356,969
Total Reestimate	\$452,505	\$278,178	\$730,683

The largest allocation of new spending in FY 2011 was required by the city's uniformed services. In total, almost \$228 million of additional spending will be needed, with the Police and Sanitation Departments requiring the most funds. The city has also added funding to cover spending requirements in FY 2012 of \$32 million. For FY 2011, the Police Department will need \$79 million to fund overtime and longevity deficits plus another \$31 million to restore earlier proposed cost-saving initiatives such as attrition savings, citywide court efficiencies and a revised recruitment class schedule. The Sanitation Department's call for added funds of \$78 million in FY 2011, results mainly from unusually inclement weather events that have dumped record setting amounts of snow onto the New York City area. The deficit in the snow budget in FY 2011 and an incremental need for FY 2012 called for increased funding of \$77 million and \$4.5 million, respectively. Also, the city has added \$1.2 million for the removal of graffiti in FY 2011.

The Fire and Correction Departments will require additional funds in FY 2011 of almost \$40 million and \$28 million for FY 2012, collectively. In FYs 2011 and 2012, the Fire Department has asked for additional funds to cover overtime costs of \$14 million and \$15 million, respectively. Also in FY 2012, the Fire Department will address higher differential payments that have called for a \$7.3 million adjustment. The Department of Correction's requirements in FY 2011 result mostly from \$23 million in restorations for proposed savings in areas such as leasing beds to the federal government and housing efficiencies.

In addition to the added spending requirements in uniformed services, the city has budgeted extra funds to cover \$225 million of new needs in FY 2011 and about \$246 million in FY 2012 for a number of other agencies and budgetary areas. The Administration for Children Services will fund special education services by \$20 million in FY 2011 and \$18 million in FY 2012, and will require \$29 million in funds to cover

retroactive charges related to placement costs of juveniles in New York State facilities in FY 2012. These retroactive charges will also increase the spending requirements in the Department of Juvenile Justice by \$22 million in FY 2011. The Department of Information Technology and Telecommunications (DoITT) has a number of expense needs totaling \$27 million and \$25 million in FYs 2011 and 2012, respectively. Parks and Recreation required restorations of \$12 million in each of FYs 2011 and 2012, in addition to other new needs of \$7.6 million and \$2 million, respectively.

The city will require extra spending for energy of \$30 million in FY 2011 and \$21 million in FY 2012. In the city's miscellaneous budget area, additional spending will be allocated to account for new needs of \$25 million and \$72 million in FY 2011 and 2012, respectively, that is largely associated in the criminal justice area and also higher fringe benefit costs will add \$10 million and \$4 million in FYs 2011 and 2012, respectively.

Uniformed Overtime for FYs 2011 - 2015

Overtime spending in the city's four uniformed agencies is projected to reach nearly \$1 billion for FY 2011 but fall substantially to \$691 million in FY 2012, \$667 million in FY 2013 and \$663 million in each of FYs 2014 and 2015. The cost of funding overtime has been a particular concern to the city, nonetheless, initiatives to control the costs of this budgetary area have not materialized to their full cost-containment projections. For example, this fiscal year, savings proposed in the past have been restored or new spending required, as discussed in "Agency Program and Expense Reestimate" starting on page 20.

The February modification increases overtime spending over the November modification by \$146 million for FY 2011. In FYs 2012 to 2015, the projected budget remains mainly the same as estimated. About half the increase, or nearly \$69 million, since the November modification is due to higher funding needs in the Police Department. As analyzed in past FCB reports, the Department accounts for about half of uniformed overtime spending and as the cost to fund its overtime operations increase, so do overall spending in total uniformed overtime. The Police Department has identified cost-saving measures in the past but with each modification following such proposals, spending has either been restored or added to fund some other deficit in the Department. The Fire Department has also ramped up spending by \$31 million as it deals with an understaffing issue. Additionally, overtime costs in the Department of Sanitation, due to a number of back-to-back snowstorms, pushed costs up by \$46 million for FY 2011.

As shown in the figure to the right, we project the following cost and risk estimates for uniformed services overtime over the life of the financial plan. Based on fiscal-year-to-date actual spending of \$658 million through February 2011, the city is on track to spend \$987 million. We will hold at risk \$80 million in FY 2011, increasing to \$216 million in FY 2012, \$240 million in FY 2013 and \$244 million in each of FYs 2014 and 2015, as shown in the figure and in Table 3 on page 5. We believe that the risks will fall

Overtime Estimates and Risk (\$ in millions)		
Fiscal Year	City Estimate*	Budget Risk**
2011	\$907	(\$80)
2012	\$691	(\$216)
2013	\$667	(\$240)
2014	\$663	(\$244)
2015	\$663	(\$244)
* Uniformed and Civilian Personnel		
**(Negative) numbers increase gap		

over the life of the plan as the city increases its spending estimates.

Fringe Benefit Costs

The city estimates that fringe benefits (total funds), which encompass two of the city's most costly budget items of pension and healthcare costs, will rise from \$14.7 billion in FY 2011 to \$18.2 billion in FY 2015, an increase of \$3.5 billion, or about 24 percent. Taken separately, the city expects to contribute more than \$8.7 billion in FY 2015 to its pension system, or \$1.7 billion more than its \$7 billion FY 2011 contribution.

Other fringe benefits paid by the city, such as healthcare and unemployment insurances, payroll tax (FICA) and workers' compensation, are expected to total \$7.7 billion in FY 2011 and grow to \$9.5 billion by FY 2015. The almost \$2 billion increase over the life of the financial plan, can be explained by the rising cost of healthcare premiums and other associated expenses paid by the city for active and retired city workers. The city has estimated that it will need to pay \$4 billion for these healthcare costs in FY 2011, increasing to \$6 billion by FY 2015.

In the November modification, the city had projected baseline growth of 9.5 percent in healthcare premiums paid to the Health Insurance Plan of New York (HIP) for FYs 2012 through 2014. However, in FY 2012, the city estimated it would need to increase that baseline rate to 11.5 percent. According to the February modification, the city has revised those growth estimates. The city now estimates a 9.77 percent increase in FY 2012 and nine percent in FY 2015, although it is keeping FYs 2013 and 2014 the same at 9.5 percent. The reestimate is expected to reduce costs by \$3.7 million in FY 2011 for the Department of Education (DOE) and by \$64 million in FY 2012, \$70 million in FY 2013, \$77 million in FY 2014 and \$85 million in FY 2015 citywide (including the DOE).

The annual pension cost paid by the city consumes a large portion of its expenditures. In FY 2011, total funded pension expense makes up about 48 percent of total fringe benefits and almost 11 percent of total city expenditures at \$65.9 billion (excludes intra-city expenses). Those proportions in FY 2015 grow slightly to almost 12 percent, with the ratio of pension expense to total expenditures increasing by approximately one percentage point.

To address this budget issue, the city recently presented to the Municipal Labor Committee details for a new employee benefit plan, which provides for major reform in how pension benefits will be collected in the future. The reform builds on a foundation of the creation of a new pension tier for some new employees. The pension system has a number of tiers and each offer different benefit structures. We present the latest employee tiers as the basis of comparison for the major points of the reform plan.

In Table 6 on page 24, some of the major details of the plan are presented. As the table shows, there are some variations as to current benefits offered to different groups of city workers. Most notable is that the proposed pension reform standardizes areas such as the age of retirement, years of service, vesting periods and contribution rates. Further, the city is proposing that overtime pay be excluded in final salary calculations and a special annual supplement be reformed.

MAJOR POINTS OF THE PENSION REFORM PROPOSAL

TABLE 6

Employee Group	Employee Contribution (%)	Vesting	Early Retirement	Overtime	Variable Supplements Fund ¹
Civilians					
Current	4.85 for first 10 yrs 1.85 for next 20 yrs	5 yrs payable at age 57	Unreduced at age 57 & 5 yrs	Pensionable	N/A
Proposed	5.00 for all yrs	10 yrs payable at age 65	Unreduced at 65/10 Early at 55/10 (5% reduction annually)	Not counted for pension	N/A
Teachers					
Current	4.85 for first 27 yrs 1.85 thereafter	10 yrs payable at age 62 or 55 with reduction	Unreduced at 62/10 & 55/27 Early at 55/10 (reduced 6% first 2 yrs, 3% to age 55)	Per session pensionable	N/A
Proposed	5.00 for all yrs	10 yrs payable at age 65	Unreduced at 65/10 Early at 55/10 (5% reduction annually)	Not counted for pension	N/A
Police/Fire²					
Current	3.00 for first 25 yrs	5 yrs payable at 20 service years	Early reduced at 42%	Can't top last 2 yr average by 10%	\$12,000 annual paid after 20 yrs of service
Proposed	Same	10 yrs payable at age 65	Same	Not counted for pension	No payment for future employees or current who aren't retirement eligible
Correction²					
Current	7.61 for first 10 yrs 4.61 next 10 yrs, then zero	5 yrs payable at 20 service years	None	Can't top last 2 yr average by 10%	Variable until 2019
Proposed	3.00 for first 25 yrs	10 yrs payable at age 65	Early reduced at 42%	Not counted for pension	No payment for future employees or current who aren't retirement eligible
Sanitation²					
Current	8.35 for first 10 yrs 5.35 next 10 yrs, then zero	5 yrs payable at 20 service years	None	Can't top last 2 yr average by 10%	N/A
Proposed	3.00 for first 25 yrs	10 yrs payable at age 65	Early reduced at 42%	Not counted for pension	N/A

Current pension benefits are based on the latest tier memberships.

¹ The specific provisions, in the table, related to the variable supplements fund are not contained in the February modification.

² Benefit paid after vesting is based on hypothetical 20 years of service and calculated by a benefit formula.

The city has requested that the state make some reforms to the Variable Supplements Fund (VSF) that would produce targeted savings of \$200 million annually starting in FY 2012. Currently, retired police and firefighters (correction officers would receive these payments starting in CY 2019) receive annual supplemental payments from the VSF of \$12,000 in addition to their annual pension payments. The VSF was created many years ago in return for the police and fire unions allowing the city to invest their pension funds in the equities market. Prior to the VSF, the pension funds' investments were in fixed-income or bonds, which are historically considered to be safer and less volatile. The city's allocation strategy to shift more assets into equities was meant to produce higher returns thus lowering pension contributions.

The city's pursuit of a more comprehensive reform plan is following recent changes passed by the state. Last fiscal year, the state enacted a Tier 5 for all new state and local employees outside of the city and for teachers statewide. The new tier applied to all newly hired city teachers, which required a 10-year vesting period, contributions of 4.85 percent for the first 27 years of service and 1.85 percent thereafter. It also set an annual return of seven percent on annuity accounts. As shown in the reform plan table on page 29, the new tier the city wishes to create will increase the contributions made by teachers to five percent of salary for the duration of their service and will eliminate the fixed minimum on their annuity accounts. The city expects initial savings from the creation of the new pension tier to start in FY 2014 and will yield savings of \$131 million in that fiscal year and increase to \$252 million in FY 2015.

On March 1, 2011, the Governor's Mandate Relief Redesign Team presented to Governor Cuomo a number of reform proposals aimed at reducing local government costs. Included in their recommendations was creating a Tier 6, which will, among other proposed ideas for new employees in the tier, increase contribution rates, raise the minimum retirement age, exclude overtime pay in pension benefit calculations and require a greater number of years before pensions can be collected.

Collective Bargaining and Labor Contracts

The city negotiates with 17 different unions, which represent about 300,000 city employees. As shown in the figure to the right, about two-thirds of the CYs 2006-2008 round of collective bargaining contracts have expired, leaving three active contracts in CY 2011 and four in CY 2012. The city has reserves for these remaining contracts for the funding of undistributed salary increases.

The reserve also contains funding for wage increases beyond the CYs 2008-2010 round of collective bargaining, which is expected to begin two years after this round and is assumed to be 1.25 percent. Hence, in the current plan, the city has assumed a wage freeze for FYs 2011 and 2012 and 1.25 percent salary increase for each of the remaining years of the financial plan.

In conjunction with pension benefit reform, the city has asked the state legislature to allow it to directly bargain with employee unions on pension benefits. Currently, the city bargains over employee salaries and the legislature sets the structure of benefits that the city pays out to retirees.

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

REDUCING THE CAPITAL PROGRAM TO CONTAIN DEBT SERVICE COSTS

The February modification recognizes \$308 million of debt service savings in FY 2011 that, as a component of the current-year budget surplus, is being applied to prepay FY 2012 expenses. Additionally, the city now forecasts that debt service costs will be lower in FY 2012 by \$311 million than previously estimated. The realization of these savings, which stem primarily from lower than previously projected interest costs on the city's debt, will reduce the FY 2012 expense budget by a combined \$619 million. With the savings, debt service costs for the city and the New York City Transitional Finance Authority (NYCTFA), net of prepayments, will total \$5 billion in FY 2011 and grow to \$5.9 billion in FY 2012.

The fact is debt service is a large and growing component of the city's budget. While there might be room for interest savings in the outyears of the plan, it is obvious that at the rate debt service is growing, it could crowd out spending for competing operating needs. To address the root cause of escalating debt service costs, the city has reduced its capital program for the period of FYs 2011-21 by 10 percent. This action generates debt service savings that grow to over \$100 million annually by FY 2020, as the cut in capital commitments accumulates. For the outyears of the financial plan, debt service is lower by \$22 million in FY 2013, \$37 million in FY 2014 and \$35 million in FY 2015, as it continues to grow from \$6.7 billion in FY 2013 to \$7.3 billion in FY 2015. In this section of the report, we will review the downsizing of the capital program and its impact on debt service costs.

Capital Program

In a memorandum to agency heads in December 2010, the city's budget director wrote, "We are actively seeking ways of diminishing City costs for pension and health benefits, and we are obliged to also address the amount of the budget going for debt service. To do so, we must reduce the plan for capital spending which drives borrowing and its resulting debt service cost on the City operating budget." In that memorandum, the budget director asked the agencies to identify a 20 percent reduction in capital commitments in each of FYs 2011-21. Using the proposals from each agency, the city ultimately downsized by \$4.1 billion, or 10 percent, the portion of the capital program that is supported with bond proceeds backed by tax revenues. For the five years of the financial plan, the cuts in authorized capital commitments amount to \$1.8 billion, with a reduction of \$1.8 billion in FY 2011 followed by an increase of \$1.1 billion in FY 2012 and cuts totaling \$1.1 billion in FYs 2013-15.

The proposal from each agency provides the basis for the Preliminary Ten-Year Capital Strategy for FYs 2012-21 that the city released along with its financial plan in February.¹² The preliminary strategy includes a total \$47 billion of authorized capital

¹² 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.

commitments, \$38.4 billion of which are city-funded while \$8.6 billion are supported with noncity funds. Of the preliminary city-funded commitments, the city and the NYCTFA will finance a combined \$26.5 billion by issuing tax-supported bonds, with 58 percent occurring in the first five years; while the New York City Municipal Water Finance Authority will finance \$11.9 billion by issuing revenue bonds backed by user fees levied on city rate payers to fund environmental protection capital projects, with 63 percent occurring through FY 2016.

When compared to the Ten-Year Capital Strategy for FYs 2010-19, the preliminary strategy is slimmer by \$14.7 billion, including a \$7.7 billion decline in tax-supported city-funded commitments, as illustrated in Table 7. In constructing the preliminary capital strategy, the city assumes the largest annual amount of tax-supported city-funded commitments will occur in FY 2012 at \$4.35 billion, which is \$2.9 billion less than the largest amount included in the prior capital strategy. The amount in the prior strategy, \$7.2 billion, was actually undertaken in FY 2010, the financing for which will contribute to the escalating debt service costs that the city is attempting to contain.

**THE PRELIMINARY STRATEGY FOR FYs 2012-21 IS ALMOST \$15 BILLION
SMALLER THAN THE PRIOR STRATEGY**

TABLE 7

(\$ in billions)

Ten-Year Capital Strategy	FYs 2010-19	FYs 2012-21	Change
Commitments by Funding Sources:			
Tax-Supported Bonds	\$34.2	\$26.5	(\$7.7)
Water Authority Bonds	12.8	11.9	(0.9)
Total City Funds	\$47.0	\$38.4	(\$8.6)
Federal Funds	\$3.1	\$2.8	(\$0.3)
State Funds	11.5	5.5	(6.0)
Other NonCity Funds	0.1	0.3	0.2
Total NonCity Funds	\$14.7	\$8.6	(\$6.1)
Total Financing	\$61.7	\$47.0	(\$14.7)

Meanwhile, city-funded commitments in the preliminary strategy that are financed by the Water Authority are lower by \$900 million compared to the Ten-Year Capital Strategy for FYs 2010-19. However, these commitments have been accelerated, with the 63 percent slated to occur in the first half much faster than the 56 percent in the prior ten-year strategy. Given that environmental protection projects have a different funding source, they were not subject to the directive given by the budget director. However, the burden of making user fee payments to secure Water Authority bonds falls on the same economic base that pays the taxes securing city and NYCTFA bonds.

The preliminary strategy also reflects a \$6.1 billion reduction in noncity-funded commitments relative to the Ten-Year Capital Strategy for FYs 2010-19, \$6 billion of which are attributable to a proposed cap on education capital projects eligible for state building aid. The original proposed legislation by the Governor placed an annual ceiling of \$2 billion on the amount of education construction eligible statewide for

building aid reimbursement. Moreover, the proposed legislation limited the amount the city could receive as a locality with a population of one million or more to a maximum of 50 percent of the funds available, or \$1 billion. Based on its interpretation of the legislation and historical funding proportions, the city has reduced state-funded commitments for education to \$500 million annually for a total of \$5 billion in FYs 2012-21. At this level, the preliminary strategy does not maintain the parity between city and state funding for city education projects that had been previously assumed. City-funded education projects in the preliminary capital strategy total \$10.1 billion, twice the amount of the noncity-funded commitments for education even with city-funded education projects being cut.¹³

Debt Service Costs

The budget director's memorandum calling for a reduction in tax-supported capital commitments came on the heels of debt service in the November 2010 modification reaching 16 percent of tax revenues by FY 2014. The city council speaker, commenting that a 20 percent cut to the capital program would hurt the construction industry, called for replacing an annual \$1 billion of bond financing with pay-as-you-go financing.¹⁴ Ultimately, the city contained debt service costs to less than 16 percent of tax revenues during the years covered by the current financial plan with the 10 percent cut in capital commitments coupled with an assumption that tax revenues will climb annually by \$1 billion to \$1.2 billion in each of FYs 2011-15. As illustrated in Table 8 on page 29, the portion of tax revenues paid by the local economy that will be consumed by the combined debt service costs for the city and the NYCTFA is expected to grow from 12.6 percent in FY 2011 to a high of 15.7 percent in FY 2015.

¹³ The initial building aid proposal was subsequently amended, and the new language could result in somewhat higher state funding for education. The final outcome will be known upon adoption of a state budget.

¹⁴ Pay-as-you-go financing involves the use of current resources from the operating budget to pay for capital projects. As an example, every \$1 billion of pay-as-you-go financing used to fund ten-year projects could reduce city debt service costs by \$130 million annually, assuming a five percent interest rate.

THE DEBT SERVICE BURDEN IMPROVED PLAN-TO-PLAN

TABLE 8

(\$ in millions)

	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
<u>Debt Service</u>					
November 2010	\$5,350	\$6,219	\$6,694	\$6,956	\$7,303
February 2011	<u>5,042</u>	<u>5,908</u>	<u>6,672</u>	<u>6,919</u>	<u>7,269</u>
Reduction	(\$308)	(\$311)	(\$22)	(\$37)	(\$35)
<u>Tax Revenues</u>					
November 2010 ^a	\$38,989	\$40,788	\$42,148	\$43,507	\$45,204
February 2011	<u>39,982</u>	<u>41,919</u>	<u>43,161</u>	<u>44,636</u>	<u>46,391</u>
Increase	\$993	\$1,131	\$1,013	\$1,129	\$1,187
<u>Debt Service as a % of Tax Revenues</u>					
November 2010	13.7%	15.2%	15.9%	16.0%	16.2%
February 2011	12.6%	14.1%	15.5%	15.5%	15.7%
Note: Numbers may not compute due to rounding.					
^a In FY 2015, the tax revenue amount is a FCB projection since one was not provided in the November 2010 Financial Plan for FYs 2011-14.					

While debt service costs on city and NYCTFA bonds have been trimmed, debt service payments on Water Authority bonds will be higher. The current financial plan increases the capital financing program for the Water Authority over the amount in the November 2010 modification by a total \$1.1 billion for FYs 2011-15, with \$865 million of that slated for FY 2011. Estimates of Water Authority debt service costs become higher by \$39 million in FY 2012, \$47 million in FY 2013, \$56 million in FY 2014 and \$67 million in FY 2015, effectively acting to negate the easing of city and NYCTFA tax-supported debt service costs on the local economy.

The reduction in state funding for the city's education capital projects is reflected in the city's capital financing program in that the NYCTFA sells the bonds that are supported by state building aid. The NYCTFA is authorized to sell bonds in an amount outstanding of up to \$9.4 billion to be secured by state building aid payable to the city and assigned to the NYCTFA. The related debt service cost is a noncity obligation and is not included in the debt service on NYCTFA bonds for general capital projects, which is paid from city personal income tax revenues. Since November 2006, the NYCTFA has held nine sales of Building Aid Revenue Bonds (BARBs) totaling \$4.62 billion, of which \$4.5 billion is still outstanding. With the proposal to cut state funding for education construction costs, the current financial plan reflects a significant reduction in the sale of BARBs totaling \$2 billion for FYs 2012-15. It should be noted that bonds sold to finance school construction costs typically have long maturities of 30 years that require payment of higher interest rates than on shorter bonds. Due to the long maturity, a replacement of BARB financing with tax-supported city or NYCTFA debt could have the heaviest impact on the city's debt service costs.

The city should be commended for taking steps to contain its escalating debt service costs. Typically, the city increases the capital program when its revenue forecast improves, working under the assumption that higher debt service costs would be

manageable. With the volatility in tax revenues, the city then abruptly cuts its capital program when tax revenues plummet. We urge the city, as it finalizes the capital strategy for FYs 2012-21, to consider additional means to maintain a sustainable debt service burden. Specifically, the city should give consideration to fully funding timely maintenance of its assets, as this will serve to minimize extensive work that can ensue from delaying maintenance; and allocating portions of incremental increases in its tax revenues for pay-as-you-go capital financing. The final strategy is expected to be released with the executive budget and we will provide a detailed analysis of the nature of the capital projects.

Glossary of Acronyms

AIM	Aid and Incentives for Municipalities
BARBs	Building Aid Revenue Bonds
BSA	Budget Stabilization Account
CSA	Council of School Supervisors and Administrators
CUNY	City University of New York
CY	Calendar Year
DOE	Department of Education
DoITT	Department of Information Technology and Telecommunications
DC 37	District Council 37
EMS	Emergency Medical Service
EMTS	Emergency Medical Technical Service
FCB	Financial Control Board
FICA	Federal Insurance Contributions Act
FMAP	Federal Medical Assistance Percentage
FY	Fiscal Year
GCP	Gross City Product
GCT	General Corporation Tax
GDP	Gross Domestic Product
G.O. Bonds	General Obligation Bonds
HHC	Health and Hospitals Corporation
HIP	Health Insurance Plan of New York
IFA	Interfund Agreements
J&C	Judgment and Claims
MA	Medical Assistance
NYCTFA	New York City Transitional Finance Authority
NYSE	New York Stock Exchange
OT	Overtime

OTPS	Other than Personal Service
PA	Public Assistance
PBA	Patrolmen's Benevolent Association
PEG	Program to Eliminate the Gap
PIT	Personal Income Tax
PS	Personal Service
STAR	School Tax Relief program
UBT	Unincorporated Business Tax
UFT	United Federation of Teachers
VSF	Variable Supplements Fund