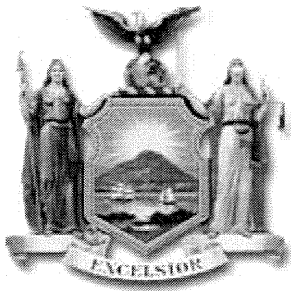


Staff Report

**REVIEW OF FYs 2013-2016
FINANCIAL PLAN**

July 19, 2012



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I. Overview

In June 2011, the city projected a balanced budget for FY 2012 and a \$4.6 billion budget gap for FY 2013. On June 28, 2012, the city presented a new four-year financial plan with a balanced budget for FY 2013 and gaps of \$2.5 billion in FY 2014 growing to about \$3.1 billion in each of FYs 2015 and 2016.

To close the projected \$4.6 billion gap in FY 2013 and accommodate over \$1 billion of agency new needs, as well as \$375 million in City Council initiatives, the adopted budget assumes increased revenues of \$276 million and gap-closing actions of \$5.8 billion, mostly of a nonrecurring nature. The largest piece of the city's gap-closing program was the creation of a \$2.4 billion surplus in FY 2012. All but \$155 million of this surplus will be used to prepay FY 2013 expenses, with the rest projected to be used in FY 2014. The city embarked on an additional agency reduction program that has decreased spending by \$988 million in FY 2013, reduced debt service costs further by \$304 million, and cut healthcare and senior care expenditures by \$83 million. In order to achieve a balanced budget in FY 2013, the city needed to rely on other large items, some of a nonrecurring nature.

In anticipation of recommendations by the City Actuary to change the methods and assumptions used to fund the city's pension systems, the city had created a \$1 billion reserve to fund expected increased costs. The City Actuary has made recommendations, which have been approved by the five pension boards, some of which await expected approval by the state legislature. On the whole these recommendations allowed the city to release \$500 million from the reserve, which is being used for gap-closing in FY 2013 and beyond. The Actuary's recommendations made revisions to the demographic assumptions including mortality rates, and the decrease of the assumed rate of return on investments to seven percent from eight percent. These changes significantly increased costs. The Actuary also recommended a change in the method used to calculate contributions, which will be consistent with new changes recently announced by the Governmental Accounting Standards Board. The change in methodology will create an unfunded liability that will be amortized over 22 years. While there is some concern over the length of time of the amortization, it was done to mitigate the substantial impact of the other changes, and spread the cost, including interest, over a longer period.

The city, in order to balance FY 2013, and reduce the FY 2014 gap, continues with its plan to deplete the Retiree Health Benefits Trust by \$1 billion in each year. As we have discussed in the past, we believe that this is shortsighted. The trust was created to start dealing with the unfunded liability produced by retiree health benefit costs. This liability now stands at \$84 billion as of FY 2011, and is growing at over \$5 billion a year. The city pays for this cost using a pay-as-you-go method and projects that cost to grow from \$2 billion in FY 2013 to \$2.7 billion by FY 2016. The city needs to develop a plan on how to deal with this growing cost.

The last large item needed to balance FY 2013 is for the city to implement its plan to sell 2,000 new taxi medallions. The new financial plan now assumes that the city will sell the medallions over a three-year period raising \$635 million in FY 2013, \$365 million

in FY 2014, and \$460 million in FY 2015. There are numerous lawsuits that have been started opposing the city's plan, and how and when they will be concluded is uncertain. For that reason we are holding this initiative at risk, and the city may need to develop a contingency plan to keep FY 2013 in balance.

In looking at the outyears of the financial plan, it is clear that the city will continue to face fiscal stress caused by an uncertain economy and continued higher costs in many areas. The increasing use of nonrecurring actions to balance FY 2013 has left large outyear gaps still to be dealt with. The likelihood that the outyear gaps can be solved with tax revenue gains is uncertain.

The national recovery has been disappointingly weak and unsteady, and despite all efforts to achieve a self-sustaining recovery this goal has proved elusive. Whenever the economy looks like it is reviving, news of troubles in Europe brings on a jittery stock market and fears of global economic weakness. The local economy is in better shape than the nation's because local jobs have been expanding steadily and tourism has been an important growth industry. Unfortunately, unemployment remains high despite the city's stronger job market. The finance sector remains mixed, with the securities industry showing a profits surge in the first quarter of 2012, following two quarters of losses at the end of 2011. The banking sector, which has suffered a wide-ranging ratings down-grade, will be forced to forego volatile high risk lines of business in favor of a less profitable but more stable business model to satisfy stricter bank regulators and more exacting rating agencies. The bright spots for the local economy are the housing market and the tourist industry. The housing downturn was less severe in the city than in other areas of the nation. Tourism, which had been a source of growth through the recession, continues to remain strong but is threatened by the weak recovery in the nation and by instability in Europe.

Total-funded expenditures are expected to grow 13.6 percent over the four-year financial plan. Two of the largest areas of growth are fringe benefits (excluding pensions) and debt service. Driven by the city's capital program, debt service costs are expected to grow by 36.8 percent between FYs 2012 and 2016, the affordability of which is discussed in this report. Fringe benefits, which are comprised of costs related to health and unemployment insurance, disability benefits and worker compensation, will rise by 40 percent from \$7.3 billion in FY 2012 to \$10.3 billion in FY 2016. The increase is mostly attributable to rising healthcare costs for both active and retired employees. The fact that pensions are excluded from this grouping is new. This is largely due to the changes made by the City Actuary already discussed, and the creation of a new pension tier for city employees approved by the state. Tier 6, for new employees only, will have the effect of starting to control the growth of pension costs and save the city \$21 billion over thirty years. While the financial plan shows little growth in pension costs over the four years, this may be short-lived. The city's investment earnings in FY 2012 have underperformed expectations and these losses will have to be phased in starting in FY 2014.

The city will need to continue its practice of developing agency actions during FY 2013 in order to help deal with the outyear budget gaps.

**JUNE FINANCIAL PLAN:
THE CITY'S OPERATING PROJECTIONS FOR
FISCAL YEARS 2013-2016**

TABLE 1

(\$ in millions)

	FY 2013	FY 2014	FY 2015	FY 2016
<u>Revenues</u>				
Taxes:				
General Property	\$18,371	\$18,918	\$19,579	\$20,221
Other Taxes	24,503	25,445	26,799	28,022
Tax Audit Revenue	724	706	706	706
Sale of Property Tax Liens	46	38	38	38
Miscellaneous Revenues	6,949	6,588	6,668	6,311
Less: Intracity Revenues	(1,631)	(1,597)	(1,600)	(1,605)
Disallowances	(15)	(15)	(15)	(15)
Total City Funds	\$48,947	\$50,083	\$52,175	\$53,678
Other Categorical Grants	924	919	916	902
Interfund Revenues	539	510	509	509
Federal Categorical Grants	6,661	6,471	6,371	6,370
State Categorical Grants	11,430	11,720	12,140	12,622
Total Revenues	<u>\$68,501</u>	<u>\$69,703</u>	<u>\$72,111</u>	<u>\$74,081</u>
<u>Expenditures</u>				
Personal Service	\$37,292	\$38,031	\$39,742	\$40,886
Other Than Personal Service	28,706	28,877	29,590	30,096
General Obligation, Lease & TFA Debt Service	6,118	6,755	7,196	7,474
Budget Stabilization & Prepayments	(2,284)	(155)	--	--
General Reserve	300	300	300	300
Subtotal	\$70,132	\$73,808	\$76,828	\$78,756
Less: Intracity Expenditures	(1,631)	(1,597)	(1,600)	(1,605)
Total Expenditures	<u>\$68,501</u>	<u>\$72,211</u>	<u>\$75,228</u>	<u>\$77,151</u>
<u>Gap To Be Closed</u>	<u>\$0</u>	<u>(\$2,508)</u>	<u>(\$3,117)</u>	<u>(\$3,070)</u>

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

TABLE 2

(\$ in millions)

	FY 2013	FY 2014	FY 2015	FY 2016
<u>Revenues</u>				
Taxes:				
General Property	\$34	(\$30)	(\$31)	(\$32)
Other Taxes	(248)	72	156	398
Tax Audit Revenue	0	0	0	0
Sale of Property Tax Liens	0	0	0	0
Miscellaneous Revenues	(109)	553	571	114
Less: Intracity Revenues	(100)	(64)	(63)	(63)
Disallowances	0	0	0	0
Total City Funds	(\$423)	\$531	\$633	\$417
Other Categorical Grants	11	10	10	10
Interfund Revenues	30	6	5	5
Federal Categorical Grants	69	(20)	(43)	(42)
State Categorical Grants	89	271	554	917
Total Revenues	<u>(\$224)</u>	<u>\$798</u>	<u>\$1,159</u>	<u>\$1,307</u>
<u>Expenditures</u>				
Personal Service	\$82	\$237	\$520	\$722
Other Than Personal Service	941	290	270	286
General Obligation, Lease & TFA Debt Service	(160)	(42)	33	38
Budget Stabilization & Prepayments	(987)	(155)	--	--
General Reserve	0	0	0	0
Subtotal	(\$124)	\$330	\$823	\$1,046
Less: Intracity Expenditures	(100)	(64)	(63)	(63)
Total Expenditures	<u>(\$224)</u>	<u>\$266</u>	<u>\$760</u>	<u>\$983</u>
<u>Gap To Be Closed</u>	<u>\$0</u>	<u>\$532</u>	<u>\$399</u>	<u>\$324</u>

RISKS TO THE FINANCIAL PLAN

TABLE 3

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

	FY 2013	FY 2014	FY 2015	FY 2016
Stated Financial Plan Gap	\$0	(\$2,508)	(\$3,117)	(\$3,070)
Estimation				
Uniformed Services Overtime	(\$32)	(\$130)	(\$166)	(\$201)
Police Overtime PEG	(50)	(50)	(50)	(50)
Subtotal	(\$82)	(\$180)	(\$216)	(\$251)
Not in Mayor's Control				
Sale of Taxi Medallions	(\$635)	(\$365)	(\$460)	\$0
Subtotal	(\$635)	(\$365)	(\$460)	\$0
Risk Total	(\$717)	(\$545)	(\$676)	(\$251)
Total FCB Estimated Surplus/(Gap)	(\$717)	(\$3,053)	(\$3,793)	(\$3,321)

II. Balancing the FY 2013 Budget

The June 2012 Financial Plan assumes a balanced budget for FY 2013 with projected revenues and expenditures totaling \$68.5 billion, which is \$462 million more than in the previous year. The year-over-year growth in revenues reflects a strong upturn in tax collections tempered by a third year of cutbacks in federal stimulus grants. Notwithstanding, the FY 2013 budget has been balanced with the use of a substantial amount of non-recurring revenues. For example, it includes such gap-closing measures as the net use of \$2.284 billion of a FY 2012 surplus for the prepayment of expenses, a \$1 billion drawdown to the Retiree Health Benefits Trust, and \$635 million of proceeds from the sale of taxi medallions. The city expects to end FY 2013 with a small surplus of \$124 million that, when combined with an additional \$31 million surplus generated in FY 2012, will serve to reduce the projected budget gap for FY 2014 to \$2.5 billion. Meanwhile, given the increasing use of nonrecurring resources, there are budget deficits estimated at \$3.1 billion for each of FYs 2015 and 2016.

TAXES LEAD THE RECOVERY IN FY 2013 REVENUES

The June 2012 Financial Plan contained \$393 million in additional FY 2012 city-fund revenue, compared with the May plan. These last-minute revenue gains will be used to help the FY 2013 budget by prepaying some expenses before the close of FY 2012. Tax collections, which slipped by \$35 million, did not contribute to the year-end revenue gains. Instead, the city tapped unused reserves that had been set aside for grant disallowances to add \$180 million to FY 2012 revenue. Nonrecurring revenues contributed an extra \$171 million, which includes the city's \$150 million share of a federal settlement with ING Bank. Miscellaneous revenue increased by \$77 million. Since the May plan, total revenues are up by \$415 million in FY 2012 because of the previously mentioned city-fund increases and a net increase of \$22 million in categorical grants and interfund revenue. Even though grants improved slightly on a plan-to-plan basis, categorical aid has been dropping persistently for three consecutive years.

City-fund revenue increased by \$1.5 billion in FY 2013, compared with the previous year, to \$48.9 billion. City-fund revenues, which include taxes, intergovernmental aid, and miscellaneous revenue, are higher primarily due to a \$1.5 billion upturn in tax collections. Total revenue increases by \$462 million, to \$68.5 billion. Despite the strength of taxes, total revenue growth is relatively modest because it includes categorical aid which has been declining due to the cutback of federal stimulus grant programs.

As shown in the figure, the real property tax increases by \$500 million, to \$18.4 billion in FY 2013. The nonproperty taxes grow by \$1 billion to \$23.7 billion in FY 2013, marking a third year of growth since the end of the recession. There are

FY 2013 City-Fund Revenues	
Increase by \$1.5 Billion	
(\$ in millions)	
Property Tax	\$500
Nonproperty Taxes	1,033
Audits	24
Tax Program	0
STAR Aid	34
Miscellaneous Revenue	115
Nonrecurring Revenue	(2)
Intergovernmental Aid	(25)
Disallowances	(180)
City Funds	\$1,499
Categorical Aid	(\$1,025)
Interfund Revenue	(12)
Total Change in Revenues	\$462
Note: Numbers may not add due to rounding.	

no tax program initiatives in the city's financial plan. The city's tax audit program increases by \$24 million in FY 2013, to \$724 million.

The city's share of the state's School Tax Relief program (STAR) is up \$34 million to \$824 million in FY 2013, since the previous year. Despite this increase, the STAR program is still below \$1.2 billion that was paid out in each of FYs 2008 and 2009. Further suppressing this program, the state recently enacted a two percent growth limit on STAR assistance going to any property taxpayer. Thus, even though the city property tax was not included in the statewide two percent property tax cap, the cap will limit relief to city taxpayers.

The city's FY 2013 miscellaneous revenue projection of \$5.3 billion, which is up by \$113 million from the prior year, includes one-time revenue of \$713 million, consisting mostly of the planned sale of new taxi medallions. Categorical aid declines by \$1 billion to \$19 billion, continuing for a third year the downward trend that began with the curtailment of federal stimulus aid programs.

Nonproperty Taxes

The nonproperty taxes are growing slowly, in step with the disappointingly weak national economic recovery. The nonproperty taxes increase by \$1 billion in FY 2013, to \$23.7 billion. This increase represents the third year of rising nonproperty tax receipts since the start of the recovery. Unfortunately, the initial 13 percent growth spurt in FY 2011, at the start of the recovery, is not being replicated. Growth weakened to four percent in FY 2012 and the city expects growth to improve slightly to 4.6 percent in FY 2013. With these three years of growth, the nonproperty taxes will finally have exceeded the prerecession peak of \$23.4 billion that was collected in FY 2008. Despite this significant revenue milestone, fiscal stress continues to linger because the recession effectively set back the city's nonproperty tax growth path by five years.

The personal income tax increases by \$500 million or 6.3 percent in FY 2013, which is an improvement over the 4.3 percent growth rate of the preceding year. The city sales tax grows by \$229 million, an increase of 3.9 percent. The business taxes inch upward in FY 2013 with a projected gain of \$153 million, or weak growth of 2.9 percent, which is nevertheless an improvement over the 0.6 percent growth rate of the previous year. The stagnation of these taxes is a lingering aftereffect of the large securities industry losses in the second half of 2011. Another concern is the profit-making capacity of the banking industry, which is faced with more government oversight, shifts away from volatile and high risk lines of business, and downgraded ratings. Also growing are the mortgage recording tax, the property transfer tax and the commercial rent tax with respective gains of \$64 million, \$42 million and \$34 million. An indication that could lift nonproperty tax collections is the very strong securities industry report of \$7.3 billion in earnings in the first quarter of FY 2012.

EXPENDITURE HIGHLIGHTS IN FY 2013

The financial plan assumes a balanced budget for FY 2013 with projected total-fund spending of \$68.5 billion. This is \$462 million more than projected spending for FY 2012. At the start of FY 2012, the city had projected a budget shortfall of \$4.6 billion in FY 2013. While the city took a number of gap-closing actions for FYs 2012 and 2013, the majority of those measures, nearly \$4.2 billion, are nonrecurring, leaving the city to face structural imbalances in the outyears of the financial plan. Expressly, after building up more than \$2.4 billion of surplus funds in FY 2012, which were used to prepay FYs 2013 and 2014 expenses, most of the city's surplus resources have been used up. With limited amounts of recurring measures, there are budget gaps estimated at \$2.5 billion in FY 2014, and \$3.1 billion in each of FYs 2015 and 2016.

As shown in the figure to the right, the projected FY 2013 budget gap exceeded \$4.6 billion at the start of FY 2012. To close the gap, which increased by \$1.067 billion to support new agency needs and cover higher costs for Judgments and Claims, the FY 2013 adopted budget assumes increased revenues of \$276 million and gap-closing actions totaling nearly \$4.2 billion. Additionally, the city will be using \$1 billion of Retiree Health Benefits Trust (RHBT) funds as a gap-closing measure and has planned to sell additional taxi medallions that are expected to net \$635 million in extra revenue. Also, the labor reserve will be reduced by \$54 million.

Meanwhile, the City Council has identified initiatives totaling \$375 million and has restored the funding for 20 fire companies that were to be closed. Also, the Council restored funding to various programs totaling about \$24 million. These restorations reduce the projected FY 2013 agency program to \$988 million from \$1.012 billion.

FY 2013 Gap-Closing Actions	
City Funds (\$ in millions)	
Gap to be Closed	\$4,632
<u>Revenue Increase</u>	
Forecast	276
<u>Gap-Closing Actions</u>	
Net Surplus Funds	(2,284)
Agency Program	(988)
Pensions	(500)
Debt Service	(304)
HIP & Senior Care Savings	(83)
<u>Expenditures Increase</u>	
New Agency Needs	1,067
Judgments and Claims	50
<u>Other Actions (Decrease)</u>	
RHBT	(1,000)
Taxi Medallions	(635)
Labor Reserve	(54)
<u>Initiatives</u>	
City Council	375
Gap to be Closed	\$0

The largest of the city's gap-closing actions, \$2.284 billion, reflects the use of net surplus funds for the prepayment of expenses. Specifically, a FY 2012 surplus of \$2.439 billion was assigned to prepay expenses totaling \$2.408 billion in FY 2013 and \$31 million in FY 2014.¹ Meanwhile, a surplus of \$124 million is projected for FY 2013, which has been earmarked to prepay FY 2014 expenses. Accordingly, the net surplus funds eliminated almost half of the initial budget deficit for FY 2013 and are being used to reduce the gap for FY 2014 by a combined \$155 million.

¹ The FY 2012 surplus of \$2.439 billion represents an increase of \$711 million over the May modification. This surplus was used to prepay \$1.34 billion of debt service on city general obligation bonds; \$879 million of debt service on bonds issued by the New York City Transitional Finance Authority, including \$170 million of CityTime Settlement Funds used to defease related outstanding bonds; \$156 million of lease debt service; and \$64 million of subsidies.

Starting in FY 2008, the city has decreased expenditures in FY 2013 by more than \$5.1 billion by implementing consecutive agency programs that reduced departmental expenditures and increased revenue collections in certain agencies. As recognized in the June financial plan, the city expects to implement an additional \$988 million of agency actions as part of its Program to Eliminate the Gap (PEG), which will bring total cumulative savings in FY 2013 to \$6.1 billion. As shown in the figure to the right, more than half of the FY 2013 program, totaling \$534 million, is from Major Organizations, which includes the Department of Education (DOE), and debt service with savings of \$305 million and \$229 million, respectively.

FY 2013 Program to Eliminate the Gap (Expense and Revenue)	
City Funds (\$ in millions)	
<u>Agency Category</u>	
Major Organizations	(\$305)
Debt Service	(229)
Uniformed Services	(183)
Other Mayoral	(162)
Health and Welfare	(53)
Procurement Savings	(56)
Total Program Savings	(\$988)

Of the savings in Major Organizations, the DOE will produce nearly all of it, totaling more than \$301 million. A large portion of the PEG will be in the collection of higher Pre-K and Medicaid revenues amounting to \$62 million and \$50 million, respectively. Expenditure savings in Pre-K will total about \$36 million and cost reductions in facilities and food service add up to \$25 million. Also, \$28 million will be realized from leasing agreements and other actions. An additional \$100 million of the PEG for DOE is attributable to debt service savings related to school construction. Specifically, an assignment of \$100 million of state building aid to pay debt service costs related to school construction allowed the city to cut its funding for debt service by an equivalent amount, which the city chose to designate as a PEG for DOE.

The \$229 million reduction in debt service that is included in the city's gap-closing program represents a portion of a combined \$632 million in city-fund debt service savings for FY 2013 achieved over the past year. City-fund debt service costs in the adopted budget, including that for the New York City Transitional Finance Authority (NYCTFA) and related lease agreements, are projected to total \$5.7 billion in FY 2013, net of prepayments.² The \$632 million of combined savings were realized incrementally, largely as a result of actual interest rates being lower than originally forecasted and the deferral of principal payments from refunding bond sales.

Additional PEG savings will come from uniformed services (Police, Fire, Correction, and Sanitation), which are budgeted to decrease spending by \$183 million. The majority of these spending reductions are expected to come from the Police and Sanitation Departments. The Police Department identified efficiencies in its operations, which upon achieving, will yield \$50 million annually. However, we are concerned as to whether these savings will materialize given past restorations of overtime cost-containment initiatives and the continued increase in annual overtime spending by the Department. The Department is expected to generate \$586 million in overtime expenditures for FY 2012 and almost \$500 million for FY 2013. This is about half the

² City-fund debt service excludes those costs that are paid directly from categorical revenues, such as state building aid, federal subsidies and swap receipts.

overtime costs for the uniformed services area combined. Given these conditions, we hold at risk this proposed savings initiative.

The Police Department also anticipates a reimbursement of more than \$15 million for security work related to protection of the United Nations. The Sanitation Department is projected to contribute agency savings of \$54 million by implementing a civilian hiring freeze, recognizing a waste export surplus, and delaying staffing at its marine transfer stations.

Additional PEG savings of \$162 million and \$53 million are expected to come from the city's Other Mayoral, and Health and Welfare agencies, respectively. The reductions in these two budget areas are diversified and spread over numerous departments. The individual agency PEG savings range from under \$1 million to about \$10 million. The city also has budgeted for reduced inflation estimates for Other Than Personal Service (OTPS) procurement expenditures, which is projected to save about \$56 million. In total, FY 2013 PEGs will cut spending by \$988 million.

In other gap-closing actions, the city adjusted down its annual pension expense by a net \$500 million. The projected downward adjustment is due to the release of a \$1 billion pension reserve that was initially funded to address proposed changes to how pension benefits are calculated and funded. The adopted budget assumes, based on the recommendation of the City Actuary and approval of the five pension system boards, that this reserve is not needed in its entirety.³

Further gap-closing help was produced from the recognition of lower debt service costs of \$304 million (as a part of total city-fund debt service savings of \$632 million) and reduced costs associated with the rates paid for the Health Insurance Plan of New York (HIP) of \$42 million and senior care rate savings of \$41 million. However, these gap-closing actions have been offset by a total of \$1.1 billion of newly needed spending. The city estimates it will need to fund additional agency spending by \$1.067 billion. Some of the more prominent needs are centered in the city's uniformed services with the Police Department accounting for \$127 million of the added spending to cover a budget deficit in Personal Service costs. Also, the Fire Department will need additional funding of \$76 million to deal with increased overtime expenditures resulting from a staffing issue and higher OTPS costs. The Fire Department is projected to spend \$278 million in overtime for FY 2012 and even higher in FY 2013 with estimated expenses totaling \$325 million, due to a court-ordered inability to hire new firefighters.

Elsewhere in the uniformed services area, the Sanitation Department's budget increased by about \$34 million for higher uniformed salary expenses and snow budget adjustments, and Corrections was given an extra \$17 million for the reopening of a jail and to replace the loss of federal funding.

³ While the City Actuary can implement a number of these changes, some of the changes still require state action and are likely to be addressed in the next legislative session.

Besides the uniformed services area, some of the larger funding allocations to cover new needs occur in the Department of Environmental Protection (DEP), requiring additional monies totaling \$64 million. Some of the larger of these funding needs in the DEP will be \$10 million to fund a toilet replacement program, \$9.6 million for upstate property taxes, about \$7 million for the Croton filtration plant, with the remaining funds to be used for various other purposes. Also, the Campaign Finance Board has needs of \$42 million to cover electoral matching funds, the Taxi and Limousine Commission will receive accessibility program funding of \$23 million, and Health and Welfare agencies are allocated \$28 million.

The city also restored prior PEGs. Of this amount, \$112 million will be used to fund the restoration of prior PEG initiatives budgeted for in the Police Department. The other three uniformed agencies will also need to have substantial funds allocated for the purpose of prior PEG restoration. In total, the city will restore \$95 million of planned savings to the Fire, Correction and Sanitation Departments. This is at the same time that the four uniformed departments are projected to spend more than \$1 billion for overtime activities in FY 2012. Our analysis indicates that it is likely that the four agencies will spend at least this amount in each fiscal year of the financial plan. The city projects lower spending of \$972 million in FY 2013, \$874 million in FY 2014, \$839 million in FY 2015, and \$803 million in FY 2016. While we estimate no risk to the overtime budget in FY 2012, we do risk FYs 2013 to 2016. We anticipate the city is under budget for overtime spending in the uniformed services area by \$32 million in FY 2013, \$130 million in FY 2014, \$166 million in FY 2015, and \$201 million in FY 2016, as shown in Table 3 on page 5.

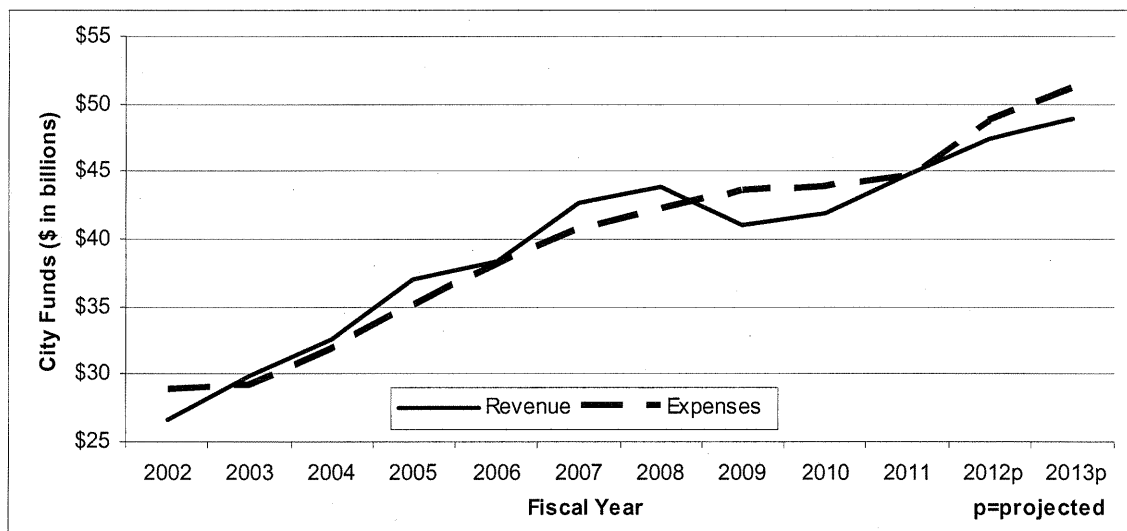
The city has also restored more than \$13 million to the agency program to fund library services and \$53 million to cover tuition adjustments and enrollment costs in the City University of New York (CUNY).

The city's gap-closing actions for FY 2013 rely mostly on the use of nonrecurring resources. As shown in the figure to the right, the city will employ \$4.2 billion of nonrecurring actions to close a more than \$4.6 billion budget gap. The largest of these actions is the use of \$2.3 billion of FY 2012 surplus funds. Over the last several fiscal years, the city has relied on surplus funds, which serve to prepay expenses in future fiscal years, as gap-closing resources. This is apparent after examining trends in city-fund revenue and expenditures over the last 11 fiscal years.

FY 2013 Nonrecurring Gap-Closing Actions City Funds (\$ in millions)	
Net Surplus Funds	(\$2,284)
RHBT	(1,000)
Taxi Medallions	(635)
Agency Program	(218)
FMAP	(32)
Total Nonrecurring	(\$4,169)

CITY-FUND REVENUE AND EXPENSES FROM FY 2002 TO PROJECTED FY 2013

CHART 1



In Chart 1, city-fund revenue and expenses for FYs 2002 through 2013 are depicted. As seen in the chart, revenues from FYs 2002 to 2013 will have increased from \$26.6 billion to an expected \$48.9 billion, or 84 percent. Meanwhile, city-fund expenditures will have increased from \$28.8 billion to an expected \$51.2 billion. Even more so, over this period, cyclical trending between the two is dramatically different. Expenditures have moved steadily upward from FY 2003 until FY 2011. However, in opposition to this steady path, a sharp increase in spending is projected between FYs 2011 and 2012. The city estimates expenses will increase by about \$4.2 billion between the two fiscal years, contrary to the \$1.8 billion average growth since FY 2002. The primary areas driving the spending growth are the Department of Social Services, the DOE, pension costs, debt service, and healthcare costs. Pension and healthcare costs have been particularly responsible for expenditure growth, not just between FYs 2011 and 2012, but since FY 2002.

However, between FYs 2009 and 2011, the pace of spending growth was relatively flat. This was due to cost reduction measures initiated by the city to address a sharp drop in revenue collections, which can be seen in the chart. While over the 11-year period revenue collections also trended upward, they have done so unevenly. The choppy pattern in revenue collections, as compared to the smoothed trend in expenditures, is most prevalent in FY 2009 where a significant revenue fall occurred due to the financial crisis. However, in the following fiscal year revenue resumed growth as economic conditions improved.

Back in FY 2002, in the aftermath of the September 11th attacks and a national recession, city revenue collections fell below expenditures. The city responded with gap-closing actions to produce a balanced budget for that fiscal year. In the following fiscal year, the economic problems faced by the city started to abate and economic recovery began. As the chart shows, FY 2003 revenue collections grew faster and higher than expenditures. This pattern would continue for the next five fiscal years, until FY 2008, when the financial crisis caused a severe economic downturn. As should be noted,

the economic recovery since FY 2009 has been slow and uneven largely impacting some of the most important industries the city relies on for financial activity.

Over the five-year period from FYs 2003 to 2008, the city produced annual budgets that did not rely on substantial use of surplus funds for balance. As shown in the figure to the right, the city had realized operating surplus funds (the difference between city-fund revenue and expenses) ranging from \$400 million to \$2 billion. A positive value is realized when revenue exceeds expenses producing an operating surplus and a negative value is produced when expenses exceed revenue, which results in an operating deficit. The positive surplus values are measured year-to-year as a cumulative amount.

Cumulative Surplus Funds City Funds (\$ in billions)		
Fiscal Year	Positive / (Negative)	Cumulative
2002		\$0.7
2003	\$0.7	1.4
2004	0.7	2.1
2005	1.9	4.0
2006	0.4	4.4
2007	2.0	6.4
2008	1.6	8.0
2009	(2.5)	5.5
2010	(1.9)	3.6
2011	0.1	3.7
2012p	(1.3)	2.4
2013p	(2.3)	0.1
Positive numbers add to cumulative surplus funds. (Negative) numbers reduce cumulative surplus funds.		

Starting from FY 2003, the city had recognized a \$700 million operating surplus, which added to a surplus recognized in FY 2002, bringing cumulative surplus funds to \$1.4 billion. In each fiscal year thereafter, until FY 2009, the city produced positive operating results. By FY 2008, the year-to-year cumulative surplus of funds summed to \$8 billion, which gave the city the ability to allocate funds for different uses. One of the largest of these allocations was to create the Retiree Health Benefits Trust (RHBT). The city allocated initial funding of the trust of \$1 billion in FY 2006 and followed with an additional \$1.5 billion in FY 2007.

However, in FYs 2009 and 2010 the full effects of the financial crisis were felt as a sharp drop in revenue collections occurred. At the same time, city expenditures continued to increase. The city was swift to adopt cost-reduction measures in FY 2008. In anticipation that its financial condition would worsen in FY 2009, the city started its agency program in FY 2008 to mitigate the impact of expected revenue losses. The mostly recurring savings have reduced spending in each fiscal year since. As shown in the figure to the right, PEGs implemented by the city for FY 2013, starting with the program in FY 2008, have cumulatively reduced expenditures by \$6.1 billion.

FY 2013 PEG Total City Funds (\$ in millions)	
Fiscal Year	
2008	(\$929)
2009	(2,063)
2010	(1,067)
2011	(1,079)
2012	(988)
Total PEG	(\$6,126)

Looking at FY 2009 in Chart 1 on page 12, city expenditures experienced moderate growth while revenue collections plunged. However, in the following fiscal year, the falloff in revenue would reverse and resume growth. Nonetheless, city-funded revenue continues to languish in growth relative to growth in expenditures. With that, the city has been relying heavily on the use of surplus funds to balance its budget but will face difficulty over the course of the financial plan as it addresses budget gaps in each of FYs 2014 to 2016. The economic events experienced by the city have eroded the amount of cumulative surplus funds tallied over fiscal years prior to FY 2009. As presented in the financial plan, the city is projected to use \$2.3 billion of FY 2012 surplus funds to balance FY 2013, leaving just \$155 million of cumulative surplus left to be rolled into FY 2014.

In other gap-closing actions with nonrecurring resources, the city plans to draw down the RHBT of its remaining \$2 billion over FYs 2013 and 2014, effectively depleting the fund. The fund had grown to more than \$3 billion after its initial funding of \$2.5 billion in FYs 2006 and 2007. The city plans to use \$1 billion of the trust fund's assets in each of FYs 2013 and 2014 as gap-closing actions. This follows the drawdown of \$1.1 billion of trust funds to offset the impact of pension fund losses that occurred during the financial crisis.

The RHBT was not created for these purposes. The trust was set up to address a change in reporting standards by the Governmental Accounting Standards Board (GASB). This change required governments to report their promised Other Postemployment Benefits (OPEB) expenses as a liability. Recently, GASB has changed the reporting rules for pension liabilities as well, and the city will have to follow similar reporting rules as it does with the OPEB liability.

Prior to this, the city reported its annual OPEB expense as a pay-as-you-go expense and financial statements did not reflect the effects of these costs until paid. However, governments are not required to fund their OPEB liability, unlike its pension liability, but only to report it on their balance sheet. Unlike other states and cities, the city recognized its full OPEB liability, totaling \$50.5 billion as of a FY 2005 actuarial valuation, and took the initiative to create and fund the RHBT. We viewed this action as a prudent first step in dealing with a significant and growing liability and advocated continued funding of the trust. We urged the city to replace the funds drawn initially to offset pension losses when, in the following fiscal years, the pension fund had strong investment gains. We are concerned to see that now the city will completely tap all of the RHBT funds, which leaves its OPEB liability, now a staggering \$84 billion as of June 30, 2011, completely unfunded. We project that the unfunded OPEB liability will continue to grow at about \$5 billion a year on average exceeding \$100 billion by the end of the financial plan period.

As an additional gap-closing action, the city expects to collect \$1.5 billion in extra revenue as part of a plan to sell 2,000 new yellow taxi medallions over the next three fiscal years from FY 2013 to FY 2015. The June financial plan assumes that the city will collect \$635 million in FY 2013, \$365 million in FY 2014, and \$460 million in FY 2015 from the sale. However, due to legal issues, this sale has been temporarily blocked by a court order. While this may be resolved during the financial plan period, we will hold the plan at risk. Also, as mentioned earlier, the city has implemented a PEG plan that will save \$988 million in agency spending. Of this amount, \$218 million will be of nonrecurring value over the life of the financial plan. Lastly, the city will recognize \$32 million for its final year of savings for the Federal Medical Assistance Percentages (FMAP) rate reduction. The FMAP reduction was enacted through the federal stimulus package and enabled the city to reduce expenditures for Medicaid.

The June financial plan reflects to a large extent the financial stress the city is experiencing. The plan reveals the city's heavy reliance on the use of nonrecurring resources and the drawdown of reserves to balance the FY 2013 budget. With spending continuing to escalate and revenues remaining unsteady, the city will need to take more drastic measures to address its future budget gaps.

III. The FYs 2013-2016 Financial Plan

The June 2012 Financial Plan reflects a mismatch between revenues and expenditures, with forecasts of budget deficits totaling \$2.5 billion in FY 2014 and growing to \$3.1 billion in each of FYs 2015 and 2016. Total revenues increase over the plan by \$6 billion, or nine percent, from \$68 billion in FY 2012 to \$74.1 billion in FY 2016. Revenue growth is weak at the start of the plan, and then picks up in the outyears. A major source of weakness is the five percent drop, in FY 2013, of categorical aid, which is in the third year of decline since federal stimulus grant programs were reduced in FY 2011. Total expenditures, meanwhile, increase by \$9.1 billion, or 13.4 percent, from \$68 billion in FY 2012 to \$77.2 billion in FY 2016. The main drivers of the projected expenditure growth are fringe benefits, debt service and operational support services. With their growth rates ranging from 19 percent to 40 percent over the plan years, compared to the nine percent unsteady revenue growth, these areas are the principal contributors to the city's budget imbalance, and would have to compete with the limited resources.

THE OUTLOOK FOR REVENUE GROWTH

Total revenue increases by \$6 billion, or nine percent, over the plan, from \$68 billion in FY 2012 to \$74.1 billion in FY 2016, as shown in Table 4. Revenue growth is weak at the start of the plan with stronger growth in the outyears. A major source of weakness in the plan is the five percent drop, in FY 2013, of categorical aid, which is in the third year of decline since federal stimulus grant programs were reduced in FY 2011. Even though some grant funding can be restored later in the fiscal year, the trend of grants is downward.

TABLE 4

CITY FUNDS INCREASE BY \$6.2 BILLION OVER THE NEXT FOUR YEARS

(\$ in millions)

	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2012-16 % Change	FY 2012-16 \$ Change
Property Tax	\$17,917	\$18,417	\$18,956	\$19,617	\$20,259	13.1%	\$2,342
Nonproperty Taxes	22,646	23,679	24,585	25,939	27,162	19.9	4,516
Tax Program	0	0	0	0	0	--	0
Audit Revenue	700	724	706	706	706	1.0	7
Miscellaneous	4,490	4,605	4,601	4,596	4,695	4.6	205
Nonrecurring	715	713	390	472	11	(98.5)	(704)
STAR Aid	790	824	859	859	859	8.7	69
Unrestricted Aid	25	0	0	0	0	(100.0)	(25)
Disallowances	165	(15)	(15)	(15)	(15)	(109.1)	(180)
Total City Funds	\$47,448	\$48,947	\$50,083	\$52,175	\$53,678	13.1%	\$6,230
Categorical Aid	\$20,040	\$19,015	\$19,110	\$19,427	\$19,894	(0.7%)	(\$146)
Interfund Revenue	551	539	510	509	509	(7.6)	(42)
Total Funds	\$68,039	\$68,501	\$69,703	\$72,111	\$74,081	8.9%	\$6,042

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

City-fund revenues increase by \$6.2 billion, or 13.1 percent, over the city's plan, from \$47.4 billion in FY 2012 to \$53.7 billion in FY 2016. City-fund growth starts out with moderate growth of 3.2 percent in FY 2013, but growth slows to 2.3 percent in FY 2014 because of a slowdown in nonproperty tax growth and a drop-off in one-time

revenue. Following this slowdown, city-fund growth picks up unsteadily to 4.2 percent in FY 2015 and 2.9 percent in FY 2016. Rising tax receipts are driving the revenue growth in the plan, with nonproperty tax collections increasing by \$4.5 billion or 19.9 percent and the real property tax growing by \$2.3 billion or 13.1 percent, over the next four years.

Nonrecurring revenue has become a major contributor to near-term budget balance. In FY 2012, the city received \$469 million from a settlement with CityTime and \$150 million from a federal settlement with ING Bank. The city also expects \$1.5 billion spread out over FYs 2013-15 from the sale of new taxi medallions.

The city is planning for the gradual restoration of some of the School Tax Relief (STAR) program reductions that were made during the recession. Over three previous years, the state reduced the city's share of STAR aid by \$543 million to \$712 million in FY 2011 from \$1.255 billion in FY 2008, due to across-the-board programmatic modifications. The city expects the state to restore part of this reduction and increase STAR aid by \$147 million, or 21 percent, to \$859 million by FY 2015. All the STAR growth is restricted to the state's subsidy for the city's personal income taxpayers, while the STAR allocation for city property taxpayers remains flat.

Categorical aid, which consists of federal, state and private program-specific grants, falls by \$146 million during the plan, a slight decline of 0.7 percent. The slight reduction in overall grants masks the major shifts in the plan between federal and state grant programs. Federal grants, which fall by \$1.3 billion or 17 percent, sustain the largest reductions. Most of these federal cuts occur in FY 2013 and follow the downward trend of the previous two years, which started with the curtailment of federal stimulus programs. Private grants fall by \$154 million, for a decline of 15 percent. Offsetting most of this shrinkage is a hoped-for state grant increase of \$1.3 billion, an 11 percent gain. But even if the state finds the resources for grant increases, programs will need to be cut back because the largest federal reductions occur at the start of the plan, while most of the offsetting state grant increases are scheduled for the outyears of the plan.

Property Tax Growth

Property tax revenue increases by \$2.3 billion, or 13 percent over the plan from \$17.9 billion in FY 2012 to \$20.3 billion in FY 2016. The property tax grows at a rate of under three percent in FYs 2013 and 2014, after which revenue growth improves to about 3.5 percent in FY 2015. These plan growth rates are substantially weaker than the 6.3 percent growth recorded for FY 2012, when revenues were still being lifted by the rapid growth of market values in FY 2008 just before the recession flattened market values.

Billable assessments increased 4.4 percent in FY 2013, slipping from 5.2 percent growth in FY 2012. In the outyears of the plan, billable assessment growth slows to about three percent. The billable growth plan was made possible by the 3.8 percent increase in market values on the city's FY 2013 tax roll. This increase, together with a 2.6 percent market value increase in FY 2012, indicates that the local real estate market is gradually emerging from the slump that hit in FY 2009. Despite this gradual rise in

market values, billable growth remains depressed as a lingering aftereffect of the downturn because assessments of most large properties are phased in over five years.

The June plan added \$63 million to the property tax estimate for FY 2013 that was found during a review of property tax exemptions. This extra revenue indicates that the city could also increase outyear property tax revenues when it reevaluates this tax next January after having published the FY 2014 tentative tax roll. At this time, it is not apparent that all sectors of the property tax market will show strong increases. One concern is the office market, where vacancy rates hover around 10 percent. In its July economic report, the city noted that new hires are being deployed in smaller more efficient office spaces, resulting in softer leasing activity and stubbornly high vacancy rates. For these reasons, we will wait for the assessor's report in January to provide guidance as to future property tax revenue adjustments.

Economic Outlook

The national recovery has been disappointingly weak and unsteady, and despite all efforts to achieve a self-sustaining recovery, this goal has proved elusive. Whenever, the economy looks like it is reviving, news of troubles in Europe brings on a jittery stock market and fears of global economic weakness. The local economy is in better shape than the nation's because local jobs have been expanding steadily and tourism has been an important growth industry. Unfortunately, unemployment remains high despite the city's stronger job market. The finance sector remains mixed, with the securities industry showing a profits surge in the first quarter of 2012, following two quarters of losses at the end of 2011. The banking sector, which has suffered a wide-ranging ratings down-grade will be forced to forego volatile high risk lines of business in favor of a less profitable but more stable business model to satisfy stricter bank regulators and more exacting rating agencies.

Gross domestic product (GDP) increased at an annual rate of 1.9 percent in the first quarter of 2012, with growth dropping from three percent in the fourth quarter of 2011. The city sees weak GDP growth of 2.1 percent in 2012, which is a slight improvement on the dismal 1.7 percent growth in 2011. GDP growth languishes at 2.3 percent in 2013, before accelerating to 3.4 percent in 2014. Like the city, Blue Chip forecasters also predict weak growth for the next two years. In their June report, Blue Chip economists reduced their consensus growth targets so that their forecast is almost identical to the city's projections.

Similarly, the national job market has fallen into a rut. Job growth, over the last three months through June, has fallen to about 75,000 jobs per month, which is down from the average of 226,000 jobs produced in the preceding three months. The nation's job growth has been too weak to budge the unemployment rate, which has remained close to 8.2 percent since January 2012.

The local economy is benefitting from strong employment growth but remains beset by stubbornly high unemployment and weak income growth. Local jobs surged by 76,000 in May, with this being the third consecutive year of accelerating growth. Inexplicably, the local unemployment rate has failed to come down during these last three years and remains at 9.6 percent as of May. Even though the local job count has

fully recovered from the losses sustained in the recession, jobs in the finance sector have not yet reached this milestone partly due to the volatility of earnings in this sector and partly due to the relocation of many finance jobs to other locales. An extremely encouraging development is the expansion of the very remunerative business services sector because these job additions have the power to lift local wages and incomes, which had been dormant.

Other bright spots for the local economy are the housing market and the tourist industry. The housing downturn was less severe in the city than other areas of the nation. With housing markets finally recovering in the rest of the nation, the local market should continue on its upward path. Tourism, which had been a source of growth through the recession, continues to remain strong but is threatened by the weak recovery in the nation and by instability in Europe.

Nonproperty Taxes

The nonproperty taxes are the fastest growing major revenue source in the city's plan. These taxes increase by \$4.5 billion, or 19.9 percent, from \$22.6 billion in FY 2012 to \$27.2 billion in FY 2016, as shown in Table 4 on page 15. The city plan has the nonproperty taxes growing most rapidly at the start of the plan and its conclusion, with a lull of weaker growth in FY 2014. The nonproperty taxes increase by 4.6 percent in FY 2013, then growth weakens to 3.8 percent in FY 2014. More substantive growth returns in FY 2015 with an increase of 5.5 percent, after which growth dips to 4.7 percent in FY 2016. Previously, at the start of the recovery, these taxes recovered with a 13 percent growth surge in FY 2011. Unfortunately, tax growth dropped to four percent in FY 2012, and languishes near this level through the plan.

Among the fastest growing nonproperty taxes in the plan are the mortgage recording tax which has a four-year increase of nearly 60 percent, and the real property transfer tax, which expands by 44 percent. Also growing strongly are the personal income and sales taxes. The business taxes are mixed, with the bank tax lagging behind the faster growth of the general corporation and the unincorporated business taxes. Cigarette tax revenue falls over the plan due to the shrinking popularity of this highly taxed activity and difficult tax enforcement issues.

Property Transactions Taxes. The city expects the two property transactions taxes (the real property transfer tax and the mortgage recording tax) to increase by about \$707 million, or about 50 percent, from \$1.4 billion in FY 2012 to \$2.1 billion in FY 2016. These two taxes increased by 17 percent in FY 2012, continuing the robust growth trend of FY 2011 when these taxes grew 25 percent. Transactions tax growth moderates to seven percent in FY 2013, after which the city projects annual increases of between 10 and 13 percent in the outyears of the plan. Previously, revenue had fallen by a staggering \$2.3 billion, or 70 percent, from a peak level of \$3.3 billion in FY 2007 to \$1 billion in FY 2010. The depth of this revenue loss is a continuing source of fiscal stress in the city's plan.

The combination of improved affordability and low mortgage rates should continue to stimulate activity, despite the lapse of homebuyer stimulus incentives. Also the local market should continue to improve along with the nationwide upturn in the

housing sector. The commercial segment of the market is less secure. Office vacancy rates hover around 10 percent, imposing limits on rent levels and property values.

Business Taxes. This group of taxes, consisting of the general corporation tax, the banking corporation tax and the unincorporated business tax, increase by 19 percent, or \$1 billion over the next four years from \$5.3 billion in FY 2012 to 6.4 billion in FY 2016. Previously, these taxes failed to grow in FY 2012, following an all too brief one-year surge of 18 percent growth in FY 2011. With the gradual growth in the revenue plan, business tax collections will not surpass the pre-recession high point until FY 2015.

Business tax collections have been extremely volatile because securities industry profits have been unsteady with quarters of strong profits interspersed with quarters of severe losses. In the first quarter of 2012, the securities industry earned \$7.3 billion after having sustained a loss of \$3 billion in the third quarter of 2011 and another loss of \$2 billion in the fourth quarter of 2011. National pretax corporate profits have also been unsteady, with a strong gain of 14 percent in the first quarter of 2012 following lackluster growth of four percent in 2011.

Another reason for the volatility of the finance sector is that financial institutions have tended to pursue highly profitable but risky lines of business. The recent downgraded ratings of 15 major banks, coupled with increased regulatory scrutiny could force the finance industry to adopt a more stable but less profitable business model.

Personal Income Tax. In a remarkable turnaround from the market volatility and \$4.9 billion loss incurred by New York Stock Exchange (NYSE) member firms in the second half of 2011, the companies earned \$7.3 billion in the first quarter of 2012. The NYSE member firms' profits came largely from trading, investment banking, loan origination, and reducing reserves for problem loans. Yet, the same degree of profitability is unlikely to be repeated in the second quarter of 2012, because of renewed focus on euro-zone sovereign debt, domestic fiscal policy, and new regulations (e.g. capital requirements, proprietary trading). In addition, the recent downgrade by Moody's Investors Service of 15 global banks, including five of the six largest American banks by assets, may increase the cost of capital and limit business opportunities.⁴ The downgrade reflects the rating agency's unease over the profitability, risk management, and capital levels of the Wall Street operations of the banks.

The city is trying to navigate this fluid environment in the latest financial plan and, consequently, does not expect a significant pick-up in finance sector compensation and employment to propel discretionary spending and nonproperty tax collections. Personal income tax (PIT) revenue is projected to increase 6.3 percent on a year-over-

⁴ The five American banks downgraded by Moody's are Citigroup, Bank of America, Morgan Stanley, JPMorgan Chase, and Goldman Sachs. Several of the "companies have publicly estimated some direct costs of a downgrade, [in terms of] ... additional collateral ... or termination payments. But the biggest effect of the downgrade could be to deprive some firms of trading revenue [because] trading partners are expected to seek out higher-rated banks because of their perceived safety." Robin Sidel and Aaron Lucchetti, "Ratings Cuts for Giant Banks," The Wall Street Journal online June 22, 2012.

year basis to \$8.5 billion in FY 2013, where revenue growth in FY 2013 is, to a large extent, at the expense of FY 2014 as taxpayers shift capital gains realizations into 2012 from 2013 to avoid a higher federal capital gains tax rate.

With the exception of a decline in earnings and jobs in the finance industry in 2012, and limited growth thereafter in the securities sector bonus payout, the city projects moderate gains in total employment and wages from 2012 to 2016. It is possible that instead of increasing employment in the securities sector in 2013 and beyond, the industry will continue to slowly shrink and stabilize by the outyears of the financial plan. This may result from financial firms' attempts to right-size the level of employees given the demand for certain business services and the opportunity to near-shore mid-level employees to less expensive regions outside of New York.⁵

Compensation (bonuses and salaries) in the securities sector is projected to fall by \$7.3 billion to \$77.6 billion in 2012, and rise between three and four percent annually from 2013 through 2016 to \$88.3 billion. With this modest compensation forecast, it is probable that withholding revenue will exhibit a much smaller bell-shaped curve in the December to March bonus period than in prior years, and reflect the steadying influence of job and income gains from the nonfinance sector. For the tax as a whole, on a common rate and base, PIT collections are forecast to rise by six percent in FY 2013, 0.9 percent in FY 2014, 6.6 percent in FY 2015, and 3.8 percent in FY 2016.⁶

The city is expecting NYSE member firms to earn \$10 billion in 2012 and about \$12 billion in both 2013 and 2014, after recording profits of \$7.7 billion in 2011. After achieving a profit of \$7.3 billion for the first quarter of 2012, it is not assured that profits for NYSE member firms in 2012 will reach or exceed the city's forecast, if profitability in 2012 follows the 2011 pattern of decreasing strength as the year progresses. The city's PIT forecast for FYs 2013-16 is not aggressive, but may be undercut by an environment of uncertainty, volatile capital markets, and cautious investors. Some of the issues to be resolved for banks are: new rules related to the Dodd-Frank law and international capital requirements; automatic federal tax increases in 2013 due to an impasse between the President and Congress; stabilizing the banking systems of several euro-zone countries; and reducing mortgage-related liabilities.

Sales Tax. In its latest plan, the city expects sales tax revenue to advance 3.9 percent to \$6.1 billion in FY 2013 from the prior year, and to increase moderately thereafter, because of national economic growth, local job gains, higher wages, and tourism. In the city's outlook, there is steady improvement in jobs and income from the nonfinance sector of the local economy, such as in the professional and business services industry and the leisure and hospitality industry, and over 50 million tourists per year from 2012 through 2015. Sales tax collections in FYs 2013-16 will benefit, to a degree,

⁵ Nelson D. Schwartz, "Financial Giants Are Moving Jobs Off Wall Street," The New York Times online July 1, 2012.

⁶ "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.

from very modest increases in finance sector compensation, and signs of stabilization in the housing market. Consequently, sales tax revenue (on a continuing base, year-to-year basis) is forecast to increase by four percent in FY 2013, 4.3 percent in FY 2014, 4.4 percent in FY 2015, and 3.8 percent in FY 2016.

The city assumes total wages will remain essentially flat from 2011 to 2012 at about \$296 billion due to an 8.6 percent decline in finance sector earnings (including bonus payouts) in 2012. Thereafter, finance sector earnings increase 3.7 percent in 2013 to \$80.5 billion and remain in the \$80 billion range through 2016. From 2013 to 2016, nonfinance sector wages are projected to accelerate 13 percent to \$256.3 billion in 2016, which provides steady support to taxable consumption. Despite the likelihood of further Wall Street layoffs in the near term, which may include higher-paying senior positions, the city anticipates total job gains of 50,000 in 2012 and over 40,000 per year in 2013-16.

Overall, the sales tax forecast for FYs 2013-16 is reasonable, but there are factors outside of the city's control that might pose a risk to the forecast. Tourist-based consumption might weaken if bookings from the euro zone start to slow and are not offset with foreign visitors from other markets, or if there is a sustained appreciation in the value of the dollar. Households are becoming more cautious and pessimistic, because of stagnant wages and volatile capital markets, and may return to the frugal behavior exhibited during the recession - even if gas prices fall. Also, households may have less disposable income in 2013 if certain federal tax provisions are not extended (e.g. payroll tax, long-term capital gains, and alternative minimum tax) and automatic spending cuts are triggered.

Miscellaneous Revenue

It has not happened for a while, but miscellaneous revenue is again dominated by nonrecurring resources that are being used to help close budget deficits, in this case aiding FYs 2012 and 2013. In the past, the city created surpluses within a year from very strong nonproperty tax revenues and nonrecurring resources, among other means, which were used to prepay recurring expenses due in the following fiscal year. In the current plan, after leaping 18.6 percent to \$5.2 billion in FY 2012, miscellaneous revenue declines 11.5 percent or \$611.5 million from FY 2013 to FY 2016, largely because of the transitory nature of nonrecurring actions.

In the latest submission, some of the larger nonrecurring actions include the CityTime settlement of \$468.6 million and the ING Bank settlement of \$150.3 million in FY 2012 and the sale of 2,000 yellow taxi medallions valued at \$1.5 billion over three years -- \$635 million in FY 2013, \$365 million in FY 2014, and \$460 million in FY 2015. Of the nonrecurring actions described in the financial plan, we are holding the taxi medallion sale at risk in FYs 2013-15, because it is unknown when and how the State Supreme Court will rule concerning the three lawsuits filed by medallion owners and taxi lenders against the city's plan to establish borough taxis. In this case, the scale of the taxi medallion sale at \$1.5 billion is indicative of how far apart recurring revenues are from recurring expenditures, even with nearly \$6 billion in expenditure savings for FY 2013 from 11 rounds of deficit-closing actions taken by city agencies since 2007.

If we condense our view of miscellaneous revenue to focus on the core categories, we can evaluate the potential for recurring revenue growth in the city's miscellaneous revenue forecast. This is accomplished by negating the affects of the highly variable nature of asset sales and third-party payments, in addition to collections that are tied to agency expenditures.⁷ In this way, core category revenue is expected to advance 5.7 percent in FY 2012 and rise 3.3 percent, or \$93 million, to \$2.9 billion from FY 2013 to FY 2016. Within the total variance of \$93 million, \$72.3 million can be traced to the city's expectation of higher interest income. The remaining \$20.7 million variance reflects higher license and rent with minor slippage in charges for services, fines, and other miscellaneous.

Nonrecurring Actions

Over the years, the city has generated and used a diverse group of nonrecurring resources that include: land sales (e.g. Coliseum site, garages, buildings), asset sales (e.g. taxi medallions, mortgages), FEMA and NYCTFA financing related to the World Trade Center attack, legal settlements, refunds from prior-year expenses, airport rental arrears, and excess resources from other governmental entities (e.g. Municipal Assistance Corporation, Battery Park City Authority). This is not to imply that nonrecurring actions represent bad policy or should be restricted to a certain size. In some instances, nonrecurring payments reflect reimbursement to the city for expenses it already incurred, or a policy of selling buildings to private groups to increase the housing stock instead of letting the properties remain in-rem. One-time proceeds can be used to cover unexpected revenue shortfalls, which would mitigate deep cuts in services. The deciding factor for nonrecurring resources is how they are used; whether there is a risk associated with realizing the proceeds in the year as planned is another issue.

The preferred course, which the city has successfully accomplished in the past, is to use nonrecurring resources as part of surplus generated within a fiscal year that could address both unforeseen events that would negatively impact the budget and long-term expenses. Billions of dollars provided by the state and federal governments helped the city deal with the budget impact of the World Trade Center attack in FYs 2002 and 2003. In addition, the combination of nonrecurring revenues along with superlative nonproperty tax collections built billion-dollar surpluses that provided long-term benefits over numerous fiscal years. This included, but was not limited to, prepaying debt service due in subsequent years or starting a fund to pay healthcare costs for retirees. Unfortunately, the billions of dollars of surplus funds generated in prior years and the Retiree Health Benefits Trust will be exhausted in FY 2014.

⁷ Core category revenue consists of six types of revenue: licenses, 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.

SOURCES OF EXPENDITURE GROWTH IN THE FINANCIAL PLAN

The city projects total-funded expenditures, excluding intracity expenses and interfund agreements, to grow by about \$9.1 billion over the life of the financial plan from \$67.5 billion in FY 2012 to \$76.6 billion in FY 2016, or an increase of 13.6 percent. The financial plan for FY 2013 assumes costs in fringe benefits (excluding pension costs), debt service, and operational support services (other OTPS) to be the main drivers of growth.⁸ The city estimates that Personal Service (PS) costs related to salaries and pensions will grow as well, but at a substantially reduced rate when compared to fringe benefits, debt service, and other OTPS costs. Also, while Medicaid spending is expected to increase, Public Assistance expenditures are expected to fall.

PROJECTED EXPENDITURE GROWTH IN FYs 2012-2016

TABLE 5

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

	FYs 2012-13	FYs 2013-14	FYs 2014-15	FYs 2015-16	FYs 2012-16	Level in FY 2012	Level in FY 2016
Total Expenditures	0.7%	5.5%	4.2%	2.6%	13.6%	\$67,488	\$76,642
Total PS	0.3%	2.1%	4.6%	2.9%	10.3%	\$36,287	\$40,009
Salaries and Wages	(0.5%)	0.8%	1.0%	1.7%	3.1%	21,110	21,762
Fringe Benefits	1.2%	7.6%	20.0%	7.0%	39.9%	7,338	10,268
Pensions	1.3%	0.7%	(1.3%)	1.2%	1.8%	7,838	7,979
Total OTPS	1.2%	9.4%	3.8%	2.2%	17.4%	\$31,201	\$36,633
Public Assistance	(6.8%)	0.4%	0.0%	0.0%	(6.5%)	1,367	1,279
Medicaid	(0.1%)	1.3%	1.3%	(0.5%)	2.0%	6,289	6,416
Debt Service	12.0%	10.4%	6.5%	3.9%	36.8%	5,462	7,474
Other OTPS	(1.0%)	12.5%	3.9%	2.6%	18.7%	18,083	21,464
Note: Includes city, state, and federal funds. Excludes intracity expenses and interfund agreements. Numbers may not add due to rounding.							

As shown in Table 5, projected expenditure growth from FY 2012 through FY 2016 is presented and there are three budgetary areas that stand out as the main drivers of growth. Fringe benefits, which are comprised of costs related to health and unemployment insurance, disability benefits and worker compensation, are projected to grow by the largest amount. The June financial plan estimates that benefit costs will rise by 40 percent from \$7.3 billion in FY 2012 to \$10.3 billion in FY 2016. The elevated spending is due mostly to higher health insurance costs, which are the largest component of fringe benefit employee compensation. The city's employee healthcare costs represent one of its largest annual expenditures. Health insurance spending for active and retired employees is expected to reach \$6.8 billion in FY 2016 from \$4.1 billion in FY 2012, or an increase of 65 percent. The city is adjusting for most of this increase between FYs 2014 and 2015.

Another large source of growth is in the city's debt service expense (net of prepayments). The city projects a 36.8 percent increase between FYs 2012 and 2016 with

⁸ Operational support services are Other Than Personal Services (OTPS) that excludes Public Assistance, Medicaid, and debt service.

most of the increase in the early part of the financial plan, as shown in the Table 5 on page 23. Debt service costs in FY 2013 are higher by \$704 million compared to FY 2012, for an annual growth rate of 14.1 percent, as actual interest costs for FY 2013 have yet to be reflected. Over the entire plan period, the city expects to see its debt costs rise from \$5.5 billion to \$7.5 billion. We discuss the debt service costs stemming from capital program financing in the section of the report titled "The Affordability of the Capital Program," beginning on page 27.

Other OTPS expenditures are expected to increase by 18.7 percent from FYs 2012 to 2016. This budget area, which serves to support city operations such as technical and facility needs, also accounts for the impact of prepaid expenses in debt service and library subsidies. Rising OTPS costs are centered in areas such as libraries, the Department of Education, other mayoral agencies and miscellaneous budget areas.

Elsewhere, the costs associated with salaries, pensions, Public Assistance (PA) and Medicaid are expected to grow only modestly except for PA spending, which is projected to fall by 6.5 percent or \$88 million. The city expects its wage cost to grow by 3.1 percent over the plan period, reflecting planned salary increases of 1.25 percent in the next round of collective bargaining. As of July 2012, the start of FY 2013, all city labor contracts will have expired. The city has determined it can reduce its labor reserve by \$42 million in FY 2012, \$54 million in each of FYs 2013 and 2014, \$70 million in FY 2015, and \$56 million in FY 2016.⁹

Over the course of FY 2012, the city's pension system went through significant changes with state enacted pension reform that added a Tier 6 for new employees. For FY 2012 and after, it is likely that the state legislature will approve major changes to actuarial assumptions and methods recommended by the City Actuary and approved by the five pension systems' Boards. Also, with an approval by the Governmental Accounting Standards Board (GASB) of two new accounting and financial reporting statements, the city will have to report its unfunded pension liability, much like it does with its unfunded OPEB liability, on its financial statement for the first time. The city projects hardly any increase in its pension costs over the life of the financial plan, increasing by just \$142 million, or 1.8 percent, over the period. Nevertheless, at close to \$8 billion, the city's annual pension contribution represents 12 percent of projected total-funded spending in FY 2013.

The projected annual pension costs over the life of the financial plan include the impact of proposed changes to actuarial assumptions and methods. This package was recently presented and approved by the pension systems' five independent Board of Trustees. However, the package is in the process of implementation, effective with employer contributions for FY 2012, although some of the proposals require state

⁹ The labor reserve 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. The city had assumed a wage freeze for FYs 2011 and 2012.

legislative enactment that is expected to occur by the end of 2012 and be effective retroactively.

The package reflects the review by the City Actuary of an independent audit of the system. The Actuary has advised the following changes:

1. Revise demographic assumptions to reflect future expected changes in mortality and other causes of separation from the pension systems (e.g. disability).
2. Reduce the Actuarial Interest Rate (AIR) assumption from eight percent per annum (gross of investment expenses) to seven percent per annum (net of investment expenses), which will amount to an effective reduction of approximately 0.8 percent. Currently, investment expenses are recovered in the second year after they occur, which is comparable to an AIR assumption to 7.8 percent (net of investment expenses). The seven percent AIR assumption reflects an expected real rate of return of 4.5 percent and inflation expectation of 2.5 percent.
3. Replace the actuarial cost method currently being used. The City Actuary currently employs the "Frozen Initial Liability" method and has advised replacing it with the "Entry Age Actuarial Cost" method. The change in the actuarial cost method provides a means to lessen the impact to the city's annual pension contribution from the changes to actuarial assumptions and methods, particularly for the changes in demographic and AIR assumptions.
 - a. The new actuarial cost method recognizes an explicit initial Unfunded Actuarial Accrued Liability (UAAL) that is attributable to all historical benefit changes, actuarial investment gains/losses and all other actuarial experience of the pension systems.
 - b. The initial UAAL is then amortized over a fixed period of time.
 - c. This actuarial cost method is the most widely used of all actuarial cost methods available to public pension funds and will now be a required element of determining obligations in FY 2015 under the newly-issued GASB Statements Number 67 and 68.
 - d. The old actuarial cost method entailed funding benefit changes and actuarial investment gains/losses as part of the city's annual pension contribution. Any UAAL was implicit and was effectively financed over the working lifetimes of active employees.
4. Establish an amortization method and period for the explicit initial UAAL developed in the use of the new actuarial cost method.

- a. A rough approximation of the average remaining working lifetimes of active employees in the pension systems is 10 to 15 years.
 - b. The Actuary has determined that due to the potential cost of the proposed changes to the city, the UAAL amortization can be lengthened to a 22-year period.
 - c. The UAAL has been developed using an "Increasing Dollar Payments" schedule. Payments (including interest) will increase each period in accordance with the overall general wage increase assumption, which is projected at three percent.
 - d. Any future UAAL will be financed using a "Level Dollar Payment" schedule.
5. Setting the Actuarial Asset Value to the Market Value of Assets, known as a "Market Restart," as of June 30, 2011. This action will further smooth the impact of the changes to actuarial assumptions and methods.
 6. Retain the six-year phase-in period for investment gains/losses for FY 2012 and after, the one-year lag methodology and the reimbursement of administrative expenses.

In anticipation of these changes, the city set up an annual \$1 billion reserve to fund the financial impact. As shown in the figure to the right, the change in cost method significantly mitigates the financial impact to the city. Nonetheless, there is some concern over the 22-year amortization period pushing off costs for too long a period of time. The proposed change in assumptions for the AIR, demographics and market restart would have cost \$2.3 billion, which would have added an additional \$1.3 billion to the city's annual pension cost in addition to the \$1 billion reserve already budgeted for. However, the new actuarial cost method reduces the financial impact by \$1.7 billion, to about \$600 million, enabling the city to release the remainder of the reserve it had set up.

Change Impact to City (\$ in billions)	
AIR	\$1.4
Demographics	0.7
Restart	0.2
Cost Subtotal	2.3
Method Savings	(\$1.7)
Revised Cost	\$0.6

In other developments, GASB approved two new standards, Statement No. 67 and Statement No. 68, to improve the accounting and financial reporting of public pension funds. Statement No. 67 replaces and builds upon the foundation of an existing statement referring to pension reporting. Statement No. 68 requires governments for the first time to recognize long-term obligations pertaining to pension benefits as a liability on their balance sheets. It also requires the revised and different methodology for measuring annual costs of pension benefits for accounting purposes. These annual costs will likely differ, possibly significantly, from the pension costs (i.e. pension contributions) determined for the ongoing financing of the pension systems.

The new GASB statement will require the city to report the UAAL developed under the new actuarial cost method discussed earlier. While the GASB rules do not

affect the city's pension cost (i.e. the pension contributions) any further than they have been with the proposed changes in actuarial assumptions and methods, it is likely that in the November modification, the city will revise up its pension cost projections. Through March 31, 2012, the pension systems' investment returns have performed poorly, gaining only about three percent, which is well under the expected return.

THE AFFORDABILITY OF THE CAPITAL PROGRAM

The city has outlined a four-year capital plan for FYs 2013-16 that totals \$27.6 billion in commitments. The capital program provides the infrastructure, facilities, equipment and technology that strengthen the city's economic viability. In sizing its capital program, the city attempts to balance the need to preserve and expand its physical assets for the enhancement of economic growth against the confines of limited financial resources. In this section of the report, we will discuss the city's capital program, expounding on the economic advantages of investing in capital improvements while assessing the related debt service costs that compete with other critical services for limited operating funds.

The Capital Plan

While New York City is an old American municipality with an aging infrastructure, it also serves as a global center for finance and is expanding in such business areas as media, arts, entertainment and communications. Its population has been growing in recent years and is projected to continue expanding through 2030, increasing in density given the limitation of land scarcity. Moreover, the demographic make-up of the city is shifting, with a growing affluent and educated population who generates tax revenues for the city's coffers coming to expect a high quality of life. The scope of the capital program addresses these quantitative as well as qualitative changes in the city's population and to employment, as the city seeks to maintain a competitive edge through investment that restores the existing physical stock, expands infrastructure in categories sensitive to growth, and improves the quality of life.

The city's capital plan is separate from but related to the expense budget. The expense budget uses current resources to support services provided by the city such as public safety, sanitation, education, social services, etc. The capital plan funds outlays for the repair, replacement and expansion of such traditional infrastructure areas as streets, highways, bridges, mass transit, and the water and sewer systems; as well as facilities, equipment, vehicles and technology for the areas of education, housing, parks, corrections, hospitals, courts, police, fire, libraries, and economic development. The city receives some noncity funds from the state and federal government to support its capital program. Additionally, environmental protection projects are financed by the sale of bonds by the Water Finance Authority that are backed by city water and sewer user fees. However, the vast majority of the capital program is financed by the sale of general obligation (g.o.) bonds by the city and revenue bonds by the New York City Transitional Finance Authority (NYCTFA), both of which are backed by city tax revenues. The annual debt service costs on these tax revenue bonds are included in the operating budget and must compete with services provided by the city for limited resources. Indeed, the city projects that revenues will fall short of expenditures in each of FYs 2014-16.

THE DISTRIBUTION OF FYs 2013-16 CAPITAL COMMITMENTS BY FUNCTIONAL AREAS

TABLE 6

(\$ in millions)

	City Funds	NonCity Funds	Total Funds	Percent of Total Funds
Infrastructure				
DEP Total	\$6,494	\$135	\$6,628	\$25.0%
Water Pollution Control	2,173	30	2,204	8.3
Water Mains	1,840	104	1,944	7.3
Water Supply	1,033	0	1,033	3.9
Sewers	996	0	996	3.8
Equipment	451	0	451	1.7
Transportation & Transit				
Total	\$2,775	\$1,423	\$4,198	15.8%
Bridges	1,060	598	1,658	6.2
Highways	1,153	325	1,478	5.6
Traffic	111	239	350	1.3
Ferries	83	258	341	1.3
Equipment	28	4	31	0.1
Transit Authority & SIRT OA	340	0	340	1.3
Infrastructure Total	\$9,268	\$1,558	\$10,826	40.8%
Non-Infrastructure				
Education	4,133	3,661	7,794	29.4
Public Safety ^a	2,712	0	2,712	10.2
Housing & Economic Development ^b	1,553	323	1,876	7.1
Cultural & Recreation ^c	1,086	14	1,100	4.1
Citywide Equipment ^d	986	0	986	3.7
Citywide Administrative Services ^e	634	0	634	2.4
Health, HHC, Social Services, & CUNY ^f	582	39	622	2.3
Non-Infrastructure Total	\$11,687	\$4,037	\$15,725	59.2%
Total Program	\$20,955	\$5,595	\$26,551	100%
^a Public Safety includes Sanitation, Police, Fire, Corrections, Courts and Juvenile Justice.				
^b Housing & Economic Development include Housing Preservation and Development, Housing Authority and Economic Development.				
^c Cultural & Recreation include Parks, Cultural Affairs and Libraries.				
^d Citywide Equipment includes Department of Information, Technology and Telecommunications, and Equipment Purchases.				
^e Citywide Administrative Services include Public Buildings and Real Estate.				
^f Health, HHC, Social Services & CUNY include Health and Mental Hygiene, Hospitals, Human Resources, Children's Services, Aging, Homeless Services and Higher Education.				
Note: Numbers may not add due to rounding.				

The amount of capital commitments (or contracts) the city is authorized to enter into during FYs 2013-16 totals \$26.6 billion. Additionally, over \$3 billion of contracts that were authorized to be entered into during FY 2012 are expected to slip into FY 2013. The targeted level of commitments—the amount the city realistically expects to enter into, given programmatic as well as scheduling issues that often arise—totals \$27.6 billion for the four-year period. Of that amount, \$16.1 billion is funded with tax supported bonds sold by the city and the NYCTFA. The city itemizes its capital plan by functional areas based on the authorized levels. Table 6 provides this breakdown of authorized commitments.

For traditional infrastructure work, the Department of Environmental Protection (DEP) was earmarked \$6.6 billion (or 25 percent) of commitments. DEP ensures that the water and sewer systems are safe, maintained and adequate to meet the needs of New York City residents. Commitments include replacement activities for wastewater treatment in compliance with state and federal mandates; replacement and expansion of the facilities that protect and maintain the water supply sources and water distribution systems; expansion of water supply conveyance; repair, replacement and expansion of the sewer system; and equipment for water conservation and the automatic meter reading system.

Also under the traditional infrastructure category, commitments for transportation and transit projects total \$4.2 billion (or 15.8 percent). To facilitate safe and efficient movement of people and goods in the city, the capital plan includes funds to build and maintain roadways, bridges and municipal parking facilities; maintain the ferry system; provide traffic signs as well as streetlights; purchase automotive and data processing equipment; and improve and rehabilitate subway tracks.

Almost half of the non-infrastructure commitments, at \$7.8 billion (or 29 percent of total commitments), is allocated to the Department of Education (DOE). DOE has the tremendous task of educating over one million students, with a network of approximately 1,500 school buildings and support facilities. The primary objective of DOE's capital program is to halt and reverse the deterioration of school buildings as well as provide state-of-the-art technology and additional capacity to relieve overcrowding. The remaining \$7.9 billion of non-infrastructure commitments are spread among many functional areas.

Even at the sizeable \$26.6 billion, there are other projects that merit inclusion in the city's current capital plan. The city recently released its FY 2012 Asset Information Management System (AIMS) Report, which revealed that investments recommended to bring significant portions of its assets up to a state of good repair within the four-year period of FYs 2013-16 are not adequately funded in many areas.¹⁰ The state of good repair needs identified in the FY 2012 AIMS Report total \$6.4 billion, but only \$3.3 billion (or 52 percent) are recognized as being funded within four years. The fact of the matter is the city has limited resources. Accordingly, the city has prioritized the funding of some expansion and improvements to meet changes in its population and to employment over the funding of capital maintenance that extends the life of existing assets. It should be pointed out, however, that while expanding and improving the capital stock may well facilitate economic growth resulting in the increase of tax revenues that could ultimately support capital spending, the delay of full funding for timely maintenance leads to premature and more extensive deterioration of the existing assets that is more costly to restore.

The size of the capital program often fluctuates from plan to plan for various reasons. Sometimes the plan is cut substantially in response to an economic downturn,

¹⁰ State of good repair projects include corrective maintenance, encompassing extensive reconstruction and rehabilitation of the city's physical assets.

then ratcheted up again as the revenue forecast or the cost of financing improves, or as other funding sources are secured. Other times, current-year commitments have to be deferred to future years. For instance, commitments undertaken in FY 2011 fell short of the target by \$2.7 billion. Moreover, it appears that there will be a substantial shortfall in FY 2012 capital contracts. The shortfalls follow four years where the city undertook record high levels of new capital contracts totaling \$43.5 billion. With such high levels of outstanding contract liabilities, which will take years for the projects to be completed, capital spending and the supporting financing are advancing on the city's target. Indeed, the city and the NYCTFA have sold the second and third largest amount of tax revenue bonds for capital purposes in FYs 2011 and 2012, at \$5.8 billion and \$5.5 billion, respectively.

Debt Affordability

Table 6 on page 28 illustrates that \$5.6 billion or 21 percent of the capital plan is noncity funded, while \$6.5 billion or 24 percent is funded with bonds backed by water and sewer user fees. The remaining \$14.5 billion is supported by city tax revenue bonds, the debt service for which is a component of the operating budget. The city actively manages debt service costs with consideration to the proportion of tax revenues absorbed.

For a comprehensive analysis of the debt resulting from the city's capital program, we use the framework of the annual Statement of Debt Affordability that was released by the city at the time of the executive budget. The Statement of Debt Affordability presents the outstanding debt and debt service levels for FYs 2013-16 on all bonds backed by tax revenues sold to support the city's capital program, including city and NYCTFA, as well as city lease agreements. Table 7 on page 31 displays these measures.

In its Statement of Debt Affordability, the city projects that debt service will climb from \$6.13 billion in FY 2013 to \$7.45 billion in FY 2016. This reflects an average annual growth rate of 6.7 percent, with the vast majority of the debt service derived from bond sales undertaken prior to the plan years.¹¹ Meanwhile, the city projects tax revenues will increase from \$43.6 billion in FY 2013 to \$49 billion in FY 2016, predicated on a slower average annual growth rate, relative to debt service, of four percent over the plan years.¹² As a result, the share of tax revenues that debt service will consume is forecasted to grow from 14.1 percent in FY 2013 to 15.2 percent in FY 2016.

¹¹ Debt service projections are based on long-term financing assumptions in the executive budget and are net of prepayments. Debt service estimates based on assumptions in the adopted budget amount to \$6.118 billion in FY 2013, \$6.755 billion in FY 2014, \$7.196 billion in FY 2015 and \$7.474 billion in FY 2016, for an average annual growth rate of 6.9 percent.

¹² A detailed discussion on revenue growth can be found in the section titled "The Outlook for Revenue Growth," beginning on page 15.

DEBT AFFORDABILITY MEASURES

TABLE 7

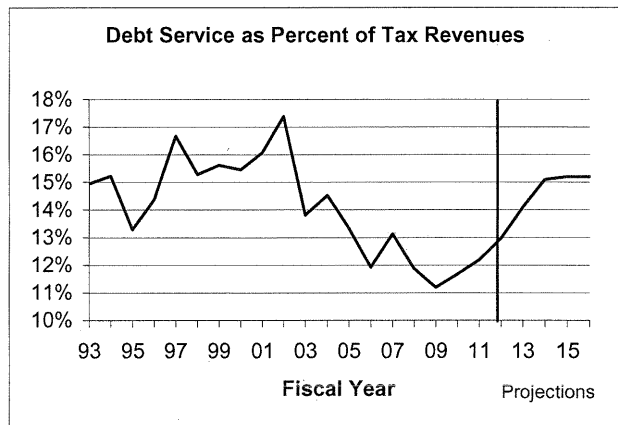
(\$ in millions, except per capita)

	FY 2013	FY 2014	FY 2015	FY 2016	Average Annual Growth
City & NYCTFA Debt Service	\$ 6,129	\$ 6,799	\$ 7,172	\$ 7,450	6.7%
Debt Service Per Capita	\$ 750	\$ 832	\$ 877	\$ 911	
Debt Service as Percentage of:					
Tax Revenues	14.1%	15.1%	15.2%	15.2%	
Total Revenues	8.9%	9.8%	10.0%	10.1%	
Local Personal Income	1.3%	1.4%	1.5%	1.5%	
City, NYCTFA & Conduit Outstanding Debt	\$ 67,389	\$ 69,501	\$ 71,035	\$ 71,917	2.2%
Outstanding Debt Per Capita	\$ 8,243	\$ 8,501	\$ 8,689	\$ 8,797	
Outstanding Debt as Percentage of:					
Local Personal Income	14.8%	14.7%	14.5%	14.1%	
Tax Revenues	\$ 43,581	\$ 45,107	\$ 47,122	\$ 48,987	4.0%
Total Revenue	\$ 68,717	\$ 69,333	\$ 71,632	\$ 74,089	2.5%
Local Personal Income	\$456,050	\$472,820	\$491,300	\$510,490	3.8%

At a projected 15.2 percent, the debt service burden will exceed the levels experienced during FYs 2003-12, when they ranged from 11.2 percent to 14.5 percent, as illustrated in figure to the right.

During this most recent ten-year period, tax revenues grew at a robust average annual rate of 6.5 percent, exceeding that for debt service at 5.8 percent.¹³ Tax revenue collection soared by double digits in four of those ten years, substantial amounts of which were used to defease outstanding bonds scheduled to mature in future years. The FY 2016 debt service burden of 15.2 percent is predicated on an

average annual tax revenue growth of four percent. The realization of a faster 6.5 percent average annual growth in tax revenues for the FYs 2013-2016 period would add \$3.6 billion of taxes in FY 2016, lower the debt service burden to 14.2 percent and eliminate the budget deficit, which was projected at \$3.15 billion.



¹³ The city has not published actual debt service and tax revenues for FY 2012. We use the levels for FY 2012 from the June 2012 Financial Plan.

In contrast, at a projected 15.2 percent in FY 2016, the debt service burden will nearly climb back to the average level experienced during the ten-year period of FYs 1993-2002, which was 15.4 percent, when debt service as a percent of tax revenues ranged from 13.3 percent to 17.4 percent. The high debt service burden for that earlier ten-year period is largely a product of the more sluggish average annual growth for tax revenues at 2.6 percent compared to debt service at 4.3 percent. In times of slumping tax revenues, the city resorted to debt restructuring to alleviate the immediate burden. A slower 2.6 percent average annual growth in tax revenues for the FYs 2013-2016 period would have a distressing impact on the city's operating budget, adding a \$1.9 billion revenue shortfall in FY 2016 on top of the projected \$3.15 billion deficit and resulting in a more burdensome debt service of 15.8 percent if nothing is done to reduce the cost.

Table 7 on page 31 also provides measures of debt service costs using other indicators. Per capita debt service is projected to increase from \$750 in FY 2013 to \$911 in FY 2016. Furthermore, debt service payments are forecasted to consume a larger share of total revenues and local personal income. Debt service rises from 8.9 percent in FY 2013 to 10.1 percent in FY 2016 as a percentage of total revenues, and from 1.3 percent in FY 2013 to 1.5 percent in FY 2016 as a percentage of local personal income. At 6.7 percent, the average annual rate of growth for debt service is outstripping the rates for tax revenues at four percent, total revenues at 2.5 percent, and local personal income at 3.8 percent.

Separately, Table 7 on page 31 reveals that from the high base of \$67.4 billion at the end of FY 2013 the combined outstanding debt is forecasted to increase to \$71.9 billion at the end of FY 2016, for an average annual growth rate of 2.2 percent. Outstanding debt increases as the amount of new bond issuances exceeds annual principal redemption. Outstanding debt per capita is expected to rise from \$8,243 in FY 2013 to \$8,797 in FY 2016. Meanwhile, the debt to income ratio is forecasted to decrease from 14.8 percent in FY 2013 to 14.1 percent in FY 2016, as the growth rate for personal income is anticipated to outpace that of outstanding debt.

The Statement of Debt Affordability does not include the debt service and outstanding debt associated with the Water Authority bonds that are sold to finance city environmental protection projects. At the time the Statement of Debt Affordability was released, the Water Authority projected the annual debt service on its bonds will grow at an average annual rate of seven percent, from \$1.7 billion in FY 2013 to \$2 billion in FY 2016, based on the forecast for outstanding bonds increasing at a rate of 2.6 percent from \$29.4 billion at the end of FY 2013 to \$31.7 billion at the end of FY 2016. The New York City Water Board levies user fees on city ratepayers to fund the debt service on Water Authority bonds.

Glossary of Acronyms

AIMS	Asset Information Management System
AIR	Actuarial Interest Rate
BSA	Budget Stabilization Account
CUNY	City University of New York
CY	Calendar Year
DEP	Department of Environmental Protection
DOE	Department of Education
FCB	Financial Control Board
FEMA	Federal Emergency Management Agency
FMAP	Federal Medical Assistance Percentages
FY	Fiscal Year
GASB	Governmental Accounting Standards Board
GCP	Gross City Product
GDP	Gross Domestic Product
G.O. Bonds	General Obligation Bonds
HHC	Health and Hospitals Corporation
HIP	Health Insurance Plan of New York
NYCTFA	New York City Transitional Finance Authority
NYSE	New York Stock Exchange
OPEB	Other Postemployment Benefits
OTPS	Other than Personal Service
PA	Public Assistance
PEG	Program to Eliminate the Gap
PIT	Personal Income Tax
PS	Personal Service
RHBT	Retiree Health Benefits Trust
SIRTOA	Staten Island Rapid Transit Operating Authority

STAR	School Tax Relief program
UAAL	Unfunded Actuarial Accrued Liability