

Staff Report

REVIEW OF FY 2010

June 10, 2010



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TABLE OF CONTENTS

PAGE

I. Overview	1
II. Balancing the FY 2010 Budget.....	4
Changes in the Revenue Plan.....	4
As the Recession Eases, the City Gains Extra Revenue.....	5
Tax Revenues.....	6
Miscellaneous Revenue.....	10
Change in Expenditure Projections.....	10
Debt Service Savings	14
Glossary of Acronyms.....	17

LIST OF TABLES

	PAGE
1. MODIFICATION HISTORY OF THE CITY'S OPERATING BUDGET FOR FISCAL YEAR 2010	2
2. CHANGES TO THE CITY'S OPERATING BUDGET FOR FISCAL YEAR 2010 SINCE BUDGET ADOPTION.....	3
3. DEBT SERVICE SAVINGS GENERATED A PORTION OF THE FY 2010 BUDGET SURPLUS.....	14

I. Overview

In our July 2009 staff report, after the city adopted its FY 2010 budget, we said, "The city will be able to balance the budget in FY 2010 with the use of prior-year surpluses, agency reduction programs, tax increases and federal stimulus funds. With all of the prior-year surpluses now used and with the city projecting an almost \$5 billion gap, balancing FY 2011 will be much more difficult."

In fact, the city, due to conservative assumptions and proactively managing its budget, now projects a FY 2010 surplus of nearly \$3.3 billion, all of which is expected to be used to help balance the FY 2011 budget.

With the economy in transition from recession to recovery, the city has been able to augment its revenue plan. City funds increased by \$2.1 billion, since the start of FY 2010, primarily due to a \$1.6 billion improvement in tax collections. Despite the nascent economic recovery and a rebound in the finance sector, collections for many of the city's nonproperty taxes are still falling compared with the previous year. Nevertheless, the slide in tax collections has greatly eased, which has enabled the city to enhance its tax estimates since the FY 2010 budget was adopted. A strong audit program and improved miscellaneous receipts including nonrecurring resources contributed to the larger revenue budget. However, despite the improvement, we think that June tax collections might not be as robust as the city expects, and other actions may need to be taken to maintain the level of surplus resources now projected.

Additionally, the city undertook a number of expense budget measures that generated \$1.1 billion used to fund the Budget Stabilization Account. Namely, the city reduced prior-year payables, implemented an agency program that lowered spending, saved on debt service costs, changed its labor policy to reduce labor costs, and decreased the general reserve.

The challenge for the city as it ends FY 2010 and prepares to adopt a FY 2011 budget is to find ways to continue to actively manage its finances to further reduce its large outyear budget gaps. The uncertainty of what reductions in state aid will occur when the state finally adopts its budget makes this even more difficult. The city's recent announcements of changes to its labor policy are a start in that direction. With the adopted FY 2011 budget unlikely to contain any funds in the Budget Stabilization Account and the city projecting a FY 2012 gap of over \$3.7 billion, without any wage increases, further state aid cuts, or loss of federal stimulus funds, the city finds itself in the same challenging position that it successfully managed in FY 2010.

**MODIFICATION HISTORY OF
THE CITY'S OPERATING BUDGET FOR FISCAL YEAR 2010**

TABLE 1 (\$ in millions)

	Adopted Budget	November Modification	January Modification	Executive Budget
<u>Revenues</u>				
Taxes				
General Property	\$16,024	\$16,016	\$16,017	\$16,061
Other Taxes	16,835	19,183	20,063	20,210
Discretionary Transfers	546	0	0	0
Debt Defeasances	382	0	0	0
Tax Audit Revenue	596	746	890	890
Tax Reduction/Fairness Program	879	0	--	--
Sale of Property Tax Liens	48	48	18	48
Miscellaneous Revenues	7,026	7,298	7,655	7,660
Unrestricted Intergovernmental Aid	340	340	340	171
Interfund Revenues	486	486	497	583
Less: Intracity Revenues	(1,669)	(1,768)	(1,804)	(1,825)
Disallowances	(15)	(15)	(15)	(15)
Total City Funds	\$41,478	\$42,334	\$43,661	\$43,783
Federal Categorical Grants	6,600	7,256	7,943	8,193
State Categorical Grants	11,512	11,518	11,476	11,571
Total Revenues	\$59,590	\$61,108	\$63,080	\$63,547
<u>Expenditures</u>				
Personal Service	\$36,174	\$36,634	\$36,295	\$36,444
Other Than Personal Service	25,065	25,709	25,928	26,096
General Obligation, Lease, & TFA Debt Service	4,297	5,233	5,117	4,999
General Obligation & TFA Debt Defeasances	(2,313)	(2,726)	(2,726)	(2,726)
Budget Stabilization & Discretionary Transfers	(2,264)	(2,274)	70	459
General Reserve	300	300	200	100
Subtotal	\$61,259	\$62,876	\$64,884	\$65,372
Less: Intracity Expenditures	(1,669)	(1,768)	(1,804)	(1,825)
Total Expenditures	\$59,590	\$61,108	\$63,080	\$63,547
<u>Gap To Be Closed</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>

II. Balancing the FY 2010 Budget

One year ago, the city adopted a balanced budget for FY 2010 that relied on the full use of a \$2.9 billion budget surplus accumulated in prior years, and assumed no surplus would be generated to help future-year budget balance. In contrast, the city now expects to end FY 2010 with a budget surplus of nearly \$3.3 billion, which it has assigned to help balance the FY 2011 budget. The city was able to generate this surplus by applying conservative assumptions in proactively managing its budget.

With the economy in transition from recession to recovery, the city has been able to augment its revenue plan. City funds increased by \$2.1 billion, since the start of FY 2010, primarily due to a \$1.6 billion improvement in tax collections. Despite the nascent economic recovery and a rebound in the finance sector, collections for many of the city's nonproperty taxes are still falling compared with the previous year. Nevertheless, the slide in tax collections has greatly eased, which has enabled the city to enhance its tax estimates since the FY 2010 budget was adopted. A strong audit program and improved miscellaneous receipts including nonrecurring resources contributed to the larger revenue budget.

Additionally, the city undertook a number of expense budget measures that generated \$1.1 billion used to fund the Budget Stabilization Account (BSA). Namely, the city reduced prior-year payables, implemented an agency program that lowered spending, saved on debt service costs, changed its labor policy to reduce labor costs, and decreased the general reserve fund. The city must continue to actively manage its finances to further reduce its large outyear budget gaps as well as to ensure that it is prepared to weather cyclical economic downturns.

CHANGES IN THE REVENUE PLAN

The city has increased its revenue forecast for FY 2010 by \$4 billion, to \$63.5 billion, since the budget was adopted last June. As shown in the figure to the right, city funds increased by \$2.1 billion, largely due to a \$1.6 billion improvement to the city's estimate for total tax collections. The nonproperty taxes, which are up nearly \$1.6 billion due to a more positive economic outlook, account for almost the entire increase to total tax revenue. Increasing marginally, the property tax gained \$38 million due to a rescheduled lien sale and favorable shifts in the city's contingency reserves.

FY 2010 City Funds Increase by \$2.1 Billion Since Adoption (\$ in millions)	
Property Tax	\$38
Nonproperty Taxes	1,561
Tax Program	(1)
Audit Revenue	294
STAR Aid	8
Miscellaneous Revenue	397
Intergovernmental Aid	(169)
City Funds	\$2,128
Categorical Grants	1,733
Other Revenue	97
Total Revenue Increase	\$3,958

The city tax program experienced several setbacks in FY 2010. The city expects that a proposed increase of \$1 per pack to the state cigarette tax would cost the city \$1 million in lost revenue in FY 2010. Although the negative impact on the city's sales and cigarette tax collections is initially small, the full-year cost rises to \$12 million annually

in FY 2011 and beyond. Another setback for the city's tax program affected the tax fairness proposals. In January, the city proposed two tax fairness programs that would have yielded over \$200 million annually, starting in FY 2011. These programs were to have extended the mortgage tax to cooperative apartments and broadened the city sales tax base to include aviation fuel. These tax proposals failed to gain state support and are no longer in the financial plan.

Despite these setbacks to its most recent tax programs, the city had a greater measure of success with several earlier tax programs. At the start of FY 2010, the city implemented a program of nonproperty tax increases that yielded an estimated \$809 million. Three sales tax increases and base broadeners yielded \$650 million and a business tax conformity package brought in \$159 million. Also, tax programs approved in FY 2009 became fully effective in FY 2010 and yielded \$1.5 billion. These tax programs include the rescission of a seven percent property tax cut to raise \$1.2 billion, the cancellation of the homeowner rebate program to yield \$256 million, and a \$46 million increase to the hotel tax.

A strong audit collection program added \$294 million to city funds. Miscellaneous receipts increased by \$397 million from a variety of sources, including nonrecurring resources, and water and sewer charges. The city is preparing for a \$169 million reduction in state intergovernmental aid, although the amount of this aid will not be known until the state budget is finalized.

Categorical grants increased by \$1.7 billion to \$20.9 billion, with most of the improvement being in federal grants. The state, which funded \$11.6 billion of these program-specific grants, is the largest source of categorical aid. The city also received \$8.2 billion in federal grants and \$1.1 billion in private grants.

Most of the major nonproperty taxes contributed to the \$1.6 billion improvement in tax receipts. The largest gains were for the personal income tax, the bank tax and the sales tax. Some taxes, however, failed to meet expectations and have weakened since adoption. These declining taxes include the general corporation tax, the mortgage tax and the utility tax.

As the Recession Eases, the City Gains Extra Revenue

With an economic recovery in its early stages, the city has been able to add \$1.6 billion to nonproperty taxes in FY 2010. Despite this noteworthy improvement, the nonproperty taxes are still down \$236 million, or one percent, compared with the recession-weakened collections of the previous year. The nonproperty taxes will yield an estimated \$19.3 billion in FY 2010, which represents a staggering two-year slide of \$4.1 billion, or 18 percent, from the \$23.4 billion collections peak reached in FY 2008. Thus, the nonproperty tax collections indicate that the city is in the midst of a transition between the downturn of the previous year and the growth anticipated for the future.

An earlier-than-expected national recovery enabled the city to resume economic growth much sooner than had been projected in June 2009. The federal economic stimulus program provided relief to the city in its hour of need and helped lift the city-centered financial services industry from devastating losses to record-setting profits.

The city now projects that the national economy will recover with 2.9 percent growth in calendar year (CY) 2010 from the 2.4 percent decline in 2009. Although some recoveries are often stronger, the city's new projection represents a significant improvement over previous forecasts of lingering weakness. The city's outlook for national employment remains negative with a decline of 0.7 percent in 2010, but this is a considerable improvement from the 4.3 percent decline in 2009. Employment has been showing positive growth in every month since the start of 2010, with 982,000 jobs added through May. Temporary census workers, numbering 564,000 as of May, have dominated most of the recent hiring. The two-year downturn, which cost 8.4 million jobs, has apparently ended as of the end of 2009.

The local economy recovers with 3.6 percent growth in 2010, up from a decline of 4.5 percent in 2009. As recently as June 2009, the city was preparing for a three-year contraction of about 20 percent. Despite the economic upturn, local employment falls by 1.6 percent, which represents an improvement from the 2.8 percent job decline in 2009. With the local economy in transition between recession and growth, much of the extra \$1.6 billion in tax revenue in the city's FY 2010 budget is attributable to the recovery of the financial services industry, which earned \$61.4 billion in profits in 2009, a phenomenal rebound from the devastating losses of \$53.9 billion in 2008 and 2009.

Tax Revenues

Since adoption, the city increased its FY 2010 tax collection plan by \$1.6 billion, to an estimated \$35.4 billion. The nonproperty taxes accounted for nearly all of the improvement in total tax collections during the year, as shown in the figure to the right.

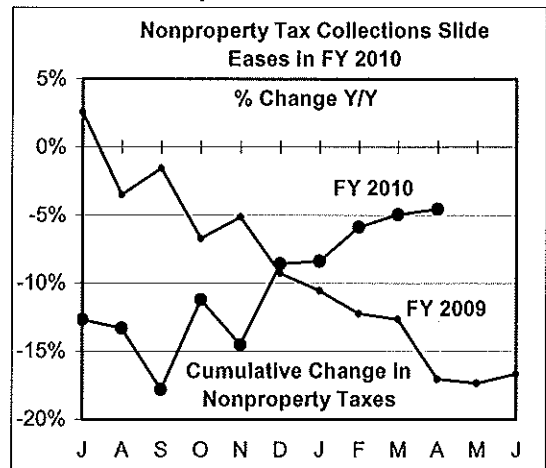
The real property tax improved slightly over the year by \$38 million to \$16.1 billion. To achieve its higher property tax target: the city raised its estimate of prior-year collections, trimmed unneeded funds from its contingency reserve for refunds, and advanced the date for its property tax lien sale. On the negative side, there were a larger than expected delinquency problem and smaller cash overpayments.

FY 2010 Tax Outlook Improves by \$1.6 Billion Since Adoption (\$ in millions)	
Property Tax	\$38
Nonproperty Taxes	\$1,561
Personal Income	\$872
Sales	203
General Corporation	(176)
Banking Corporation	467
Unincorporated Business	102
Commercial Rent	50
Property Transfer	15
Mortgage Recording	(90)
Utility	(14)
Hotel	35
Cigarette	(2)
Other	99
Tax Revenue Increase	\$1,599
Note: Excludes STAR and audit programs.	

The nonproperty taxes improved by nearly \$1.6 billion to \$19.3 billion in FY 2010. Large upward revisions were reported for the personal income tax, which gained \$872 million, and the sales tax, which increased \$203 million, reflecting the improved economic outlook. The business taxes present a mixed picture, with the banking corporation and the unincorporated business taxes increasing by \$467 million and \$102 million, respectively, and the general corporation tax dropping by \$176 million. The real estate related taxes also present a mixed picture, with the commercial rent tax up by \$50 million, the real property transfer tax increasing \$15 million, while the mortgage recording tax is down \$90 million. The hotel tax gained \$35 million, an indication of the strength of tourism. Other taxes are up \$99 million, primarily due to larger payments in

lieu of taxes from public benefit agencies such as Battery Park City Authority and the Economic Development Corporation.

The nonproperty taxes, while not yet in a recovery mode, are no longer falling as sharply as in the previous year. These taxes, which were sliding by 17 percent at the close of FY 2009, were falling by only five percent by April of FY 2010. The easing steepness of the collections decline in FY 2010 enabled the city to raise its tax collection targets as the year progressed by \$1.6 billion. The figure to the right, which shows the cumulative growth rates of the city's nonproperty tax collections for the past two fiscal years, indicates that the nonproperty taxes are emerging from a severe downturn. At the start of FY 2009, tax collections hovered close to the zero growth mark, seeming to follow the flat growth trend that had been previously set in FY 2008. Collections worsened, as the recession intensified, and ended FY 2009 with a severe decline of 17 percent.



The collections data from the start of FY 2010 were indicating that the current year might be continuing on the same severe double-digit nonproperty tax loss trend that had been set at the end of FY 2009. Fortunately, the recession loosened its grip on the city and FY 2010 nonproperty tax collections started to climb out of the depths. These taxes, which were falling by a dismal 18 percent in September, improved to minus nine percent by December. The collections outlook continued to improve until April when the rate of decline slowed to minus five percent. So, even though tax collections are not yet in recovery, a decline of minus five percent represents a dramatic improvement over the minus 17 percent loss rate in FY 2009 that had threatened to persist into FY 2010. Despite this improvement, we think that June collections might not be as robust as the city expects, reducing the amount of surplus resources available to help balance FY 2011.

Business Income Taxes. Since the start of FY 2010, revenues for the general corporation tax (GCT) declined by \$176 million; while the banking corporation and the unincorporated business taxes improved by \$467 million and \$102 million, respectively. Taken together, revenue for this group of taxes has fallen by 13 percent in FY 2010, to \$4.5 billion and has been sliding for three consecutive years. Business tax collections are \$1.5 billion below the FY 2007 collections peak of \$6 billion.

The disappointing GCT collections are the result of the relatively slow recovery of business profits, which are lagging behind the speedier recovery of the financial sector. National pretax corporate profits fell by two percent in 2009 following a slide of 18 percent in 2008. This weakness was still present in 2009, while Wall Street firms were earning a record \$61.4 billion. Fortunately, business profits gained strength, and by the first quarter of 2010 profits stand 45 percent higher than the depressed first quarter of the previous year. It is therefore likely that the languishing GCT will recover at the end of FY 2010 or early in FY 2011.

The business tax recovery was also delayed by a three-year adverse trend in refund issuance that is weakening net revenues for all three business taxes. The city has set aside a refund reserve of \$908 million, which is \$24 million larger than the \$884 million paid out in FY 2009. The city has already issued \$708 million in business tax refunds in the first eight months of FY 2010. It is possible that a few more large payouts could deplete the reserve before the fiscal year has ended and necessitate an additional refund set aside in the next financial plan.

Real Estate Transactions Taxes. The three-year decline of the transactions taxes has had a severe impact on the city's revenue plan. The city has reduced its FY 2010 revenue plan for the transactions taxes by \$75 million, to just \$1 billion. The two taxes in this group, the real property transfer tax and the mortgage recording tax, have been diminished by the severe slowdown in the real estate market. The new revenue estimate represents a 19 percent decline from the actual collections of the prior year. Since the revenue peak of \$3.3 billion in FY 2007, the transactions taxes have fallen by \$2.3 billion, or about 70 percent. The city revenue plan sees a gradual upturn starting in FY 2011 with growth of seven percent.

Sales Tax. Despite another year of reduced local consumption from job losses and home foreclosures, sales tax collections in FY 2010 advanced by 8.7 percent over the prior year, because of a tax hike, more tourists, and a touch of Wall Street bonus payouts. By the end of calendar year 2009 and into 2010, consumers remained frugal due to sluggish wage growth, but began to spend more, while dealing with tight credit conditions and the need to pay down debt. From the restated adopted budget (as of November 2009) to the May modification, the FY 2010 sales tax revenue estimate grew by \$203 million to \$5 billion. One of the principal reasons for the growth, despite the recession, is a local tax rate increase and base broadeners that yielded \$650 million in FY 2010 and is projected to raise about \$800 million annually in FYs 2011-14.¹ Without the changes in tax law, sales tax revenue on a common rate and base would have ended FY 2010 down negative 5.8 percent after having recorded negative 5.5 percent in the prior year.²

One of the major supports to sales tax collections and the local economy in 2009 and 2010 is the record number of domestic and foreign visitors to New York City and the multiplier effect on retail sales, hotel occupancy and room rates, and employment in the leisure and hospitality industry. In 2009, the city became the most popular tourist destination in the country for the first time since 1990 with 45.3 million visitors, who spent about \$28 billion. International visitors, at 8.6 million, also made the city their first choice in 2009, which is important because it is estimated that they spend nearly five

¹ Effective August 1, 2009, the city received state permission to: (1) raise the local sales tax rate by 0.5 percent to 4.5 percent, (2) tax the transmission and distribution of electricity and natural gas from alternative energy suppliers, and (3) remove the local exemption on the purchases of clothing and footwear priced at and above \$110.

² "On a continuing base" or "on a common rate and base" refers to tax collections that have been adjusted to remove the effects of tax programs and other adjustments to focus on the influence of the economy.

times as much as domestic travelers. For the first quarter of 2010, the city is experiencing year-over-year gains in such areas as the number of visitors, international visitor spending, and hotel occupancies, and appears on its way to reaching its goal of 46.7 million visitors in 2010. Another support to the sales tax base in FY 2010 was higher bonus payouts sponsored by larger Wall Street firms after two years of industry losses in 2007 and 2008. The boost to local consumption from Wall Street compensation, though beneficial, was not as strong as in prior years since more employee compensation has shifted to deferred stock from predominantly cash.

Personal Income Tax. One way to characterize FY 2010 is that it was a time when larger banks and bank holding companies took advantage of very low interest rates, billions of dollars in federal aid, hardly any new federal regulations, and fewer competitors that allowed them to slash their interest expenses and earn revenue through trading and investment banking to the degree that New York Stock Exchange (NYSE) member firms' profits reached \$61.4 billion in 2009. Securities industry profits in 2009 more than made up for the \$53.9 billion in losses suffered by NYSE member firms in 2007 and 2008.³ In the past, when securities industry profits reached a new threshold, as in 2000 and 2006 when profits exceeded \$20 billion annually, the city increased its withholding and overall personal income tax (PIT) forecasts for the following fiscal year in anticipation of a surge in collections from bonus payouts from December to March. From the restated adopted budget forecast to the May modification, the FY 2010 PIT forecast increased by \$872 million primarily from expectations of higher withholding and installment payments, and fewer refunds due to the expiration of a credit. On a continuing base, PIT collections in FY 2010 are expected to have fallen by less than one percent on an annual basis, after the severe decline of negative 21.4 percent in FY 2009.

While the extreme profitability of the securities industry in 2009 allowed the city to expect positive finance sector earnings that would boost total wage income in 2010 versus the estimated sharp drop in 2009, the bounce-back in withholding and in PIT revenues overall was not as large as one would historically expect for several reasons. Pressure from the public and politicians influenced large Wall Street firms to change the structure of employee compensation to higher base salaries and stocks (and options), which vest over time and have clawback provisions, from mostly cash. Compensation was also reduced from about 50 percent of net revenues at major Wall Street firms and bonuses were sometimes given out later in the year. Withholding revenue was also constrained to just flat growth in FY 2010 after slipping negative 4.9 percent in FY 2009, because of continuing year-over-year job losses in the finance and non-finance sectors, which have only recently decreased in magnitude. Estimated declines in nonwage income also negatively affected FY 2010 PIT revenue. The volatility and downward pressure on stock prices in the market, along with the depressed residential and commercial housing markets, led to the city's assumption that capital gains realizations fell in 2009. Nonwage income, in the form of dividends, interest, and rent, is also estimated to have dropped in 2009 on a year-to-year basis.

³ The city anticipates that profits will fall by \$40.8 billion to \$20.6 billion in 2010 as financial firms deal with slightly higher interest rates and new federal regulations.

Miscellaneous Revenue

Over the course of FY 2010, the city's estimate of miscellaneous revenue was augmented by a total of \$397 million to \$4.7 billion by the time of the May modification. The city's FY 2010 projection of \$4.7 billion represents growth of 1.6 percent over the prior year. The \$397 million plan-to-plan variance incorporated, among other actions, a proposed labor settlement and other changes in the estimate for water and sewer charges, a reduction in the payment from the Health and Hospitals Corporation (HHC) to the city, and more nonrecurring resources that involved fund transfers from third parties.

If we exclude those parts of the city's miscellaneous revenue projection that do not foster long-term growth and budget balance, and focus on the remaining core categories, revenue was projected to fall by \$12 million since budget adoption.⁴ Among the forecasts for the six core categories, it was surprising that a large gain in fees was offset by slippage in fines and that there were small negative plan-to-plan variances among most of the remaining categories. Charge revenue increased by \$57 million during FY 2010 to \$730.6 million mainly because of higher tuition at community colleges and housing fees. Fine revenue declined by \$58 million to \$841.4 million from the start of FY 2010 due to greater compliance with parking regulations and by less-than-optimal locations for a number of red light cameras.

Nonrecurring Resources

In each fiscal year, the city generates and utilizes a number of nonrecurring actions that include asset sales and payments from third parties that are designed to support general operating expenditures. In FY 2010, the city expected to receive and use three distinct fund transfers that are each valued at over \$100 million. They encompass a legal settlement with Credit Suisse, a refund of prior-year medical expenses, and excess reserves from the Battery Park City Authority (BPCA) that is anticipated to yield \$133.8 million in FY 2010 and \$66.2 million in FY 2011. Under an agreement signed on March 29th between the BPCA, the Mayor, Governor, and City Comptroller, \$861 million of residual funds of the authority will be transferred over time as follows: (1) \$200 million in city budget relief, (2) \$200 million in state budget relief, (3) \$261 million in city pay-as-you-go capital funds, and (4) \$200 million to partially fund city affordable housing programs involving the Housing Development Corporation and Department of Housing Preservation and Development.

CHANGE IN EXPENDITURE PROJECTIONS

Since adopting a balanced budget for FY 2010, the city has generated more than \$1.9 billion of city-funded expenditure savings. The city has applied \$802 million of

⁴ The six core categories are licenses, fees or charges, interest, rent, fines, and miscellaneous (less nonrecurring resources, tobacco proceeds, and payments from the HHC). Dedicated funds such as water and sewer charges are also excluded because they offset city expenditures and do not assist in achieving budget balance.

these savings to fund new needs. The remaining \$1.1 billion of expenditure savings has been allocated, along with \$2.1 billion of increased city-funded revenues, to build up the surplus to almost \$3.3 billion during the fiscal year, which will prepay FY 2011 expenses.

As shown in the figure to the right, the city undertook a number of expense budget measures that generated the resources to fund the Budget Stabilization Account (BSA). The city reduced prior-year payables, implemented an agency program that lowered spending, saved on debt service costs, changed its labor policy to reduce labor costs, decreased the general reserve and adjusted the Interfund Agreement (IFA) rate. After applying \$802 million of additional funds to address new operational needs, the city was able to allocate the expense savings, along with additional revenues, to build the surplus.

The City Generates Nearly \$3.3 Billion of Surplus Funds In FY 2010 (\$ in millions)	
Prior-Year Payables	\$800
Expense PEGs	413
Labor Actions	248
Debt Savings	211
General Reserve	200
IFA Adjustment	74
Total Expense Savings	\$1,946
New Funding Needs	(802)
Funds Available for BSA	\$1,144
Additional Revenues	2,128
Total Surplus Funds	\$3,272

Throughout FY 2010, the city was able to lower expenditures in a number of ways. For example, prior-year payables were reduced by \$800 million, which is about \$300 million more than usual. Historically, the city usually reduces these accruals by about \$500 million each year. However, the city has anticipated that because of lower labor costs, the prior-year payables can be reduced by a larger amount to reflect lower expenditures in this area. Also, the city continued to seek spending reductions citywide by asking all department managers to find expenditure savings and new or enhanced revenues, if applicable to their agency. The new agency program or Program to Eliminate the Gap (PEG) for FY 2010 is in addition to previous gap-closing measures that, since being implemented, have generated savings and extra revenues of almost \$2.9 billion in FY 2010. The new program expects to be able to save nearly \$489 million more, comprised of \$413 million in agency expenditure reductions and \$76 million in additional revenues in FY 2010, to reach cumulatively about \$3.4 billion since January 2008.

A major portion of the savings from the new PEG came from the Department of Education (DOE), which intended to eliminate 2,500 teaching jobs. The city has proposed to reduce this loss of teachers by modifying its contract proposal. The new contract proposal would cap the increase in salaries for teachers as well as school supervisors and administrators to two percent, thus allowing the city to rescind the plan to eliminate those pedagogical positions. This new proposal is a change in the pattern of collective bargaining from the four percent increase other unions received in the most recent round of settlements. The city is now in nonbinding arbitration with the United Federation of Teachers (UFT) and the Council of School Supervisors and Administrators (CSA).⁵ Although these projected labor savings have been removed from the budget,

⁵ On June 2, 2010, the city announced its intention to eliminate the two percent wage increase in both FYs 2010 and 2011 for the UFT and CSA members. The removal of more than \$400 million over the two years would offset the expected reduction in state education aid, when a state budget is adopted. This would allow for the city to forgo the planned layoff of over 4,400 teachers.

the DOE projects additional spending of \$76 million, raising its budget to almost \$18.5 billion, due primarily to an increase in federal aid.

Also, as part of its agency program for FY 2010, the city has planned headcount reductions of 891 positions in various other agencies. The majority of the reductions are expected to be through attrition with projected departures of 544 agency personnel. The remaining personnel decrease will be through layoffs totaling 347 positions coming mostly from city libraries.

In addition, because of a change in its labor policy for all unions, the city expects to save \$35 million from a two-year wage freeze and has reestimated its labor reserve, reducing it by \$213 million. The savings, totaling \$248 million, are the result of the removal of reserves funding a 1.25 percent wage increase for most city employees and the two percent cap on salaries for the UFT and CSA. Because planned productivity savings, which included health insurance contributions and a fifth pension tier, were eliminated entirely from the city's budget, the city's new labor policy is that all collective bargaining agreements must be funded by either productivity improvements or savings in pension and health costs.⁶

Elsewhere, a reduction in the city's debt service costs, which will be discussed later in the section titled "Debt Service Savings" beginning on page 14, produced savings of \$211 million and the city has reduced its general reserve by \$200 million, as it customarily does at the end of each fiscal year. Finally, savings of \$74 million were found through a reestimation of the IFA reimbursement rate used to fund city agencies that make use of personnel working on capital projects. The IFA serves as a mechanism for the city to reimburse the operating budget with capital funds for payment of those human resources.

As mentioned, the city has allocated \$802 million of surplus funds to address new funding needs. The city projects that \$219 million of these new needs will be allocated for additional agency expenditures in areas such as social services and uniformed services. The Department of Homeless Services and the Department of Social Services account for more than \$95 million of the allocation and uniformed services (Police, Fire, Correction and Sanitation) required an additional \$69 million.

As part of these new needs, the city expects to spend about \$186 million more in uniformed services overtime than it had initially budgeted at adoption. Initial estimates for FY 2010 overtime expenditures in the Police, Fire, Correction and Sanitation

⁶ The state legislature has passed the Governor's pension reform bill, which contains provisions that implement a Tier 5 agreement between the city and the United Federation of Teachers. The new tier will apply to all new hires and will require a 10-year vesting, employee contributions of 4.85 percent for the first 27 years of service and 1.85 percent thereafter, and set an annual return of seven percent on annuity accounts, which is 1.25 percent lower. In addition, there may be future savings in the Police and Fire pension systems due to the Governor's veto of legislation allowing new hires to join the more lucrative Tier 2 of the pension system.

Departments were \$684 million for both uniformed and civilian personnel. The May modification reports that projected expenditures have jumped to nearly \$870 million, an increase of 27 percent from adoption. Part of the increase is due to significant snowfalls this winter that dumped record amounts of snow on the city. Also, the overtime budget for the Department of Correction was amended to reflect historical spending patterns. Additionally, the Police Department restored \$25 million in anticipated savings from a pilot program meant to reduce overtime spending.⁷ The Department says that additional time is needed in order to implement the program. However, the Fire Department's overtime spending budget is expected to be less due to a lower sick rate among firefighters, which is currently below the allowed 7.5 percent sick rate. We expect that the city will be within its targeted spending of \$870 million for FY 2010, based on fiscal year-to-date actual expenditures.

Elsewhere, \$187 million was required to compensate for the reestimate of planned savings expected from the reduction in the Federal Medical Assistance Percentages (FMAP). Also, \$394 million was needed to reduce the deficit in the Health and Hospitals Corporation (HHC) budget. The city anticipates additional funds of \$92 million will be required in FY 2010 to address the impact of the pending state budget. Lastly, \$136 million is expected to be needed to fund added costs in budgetary areas such as pension costs and other fringe benefits, requiring \$60 million and \$76 million, respectively.

The city has projected that it will reduce its Medicaid expenditures considerably more than previously estimated. Initially, the city had anticipated that it will be able to reduce its share of Medicaid costs by a total of \$1.6 billion from FY 2009 through FY 2011, due to the change in the FMAP, as part of the federal stimulus package. However, the city has increased the total savings projected to about \$2.8 billion and has extended the savings through FY 2013. About half of the \$1.2 billion of additional savings is due to the recently enacted healthcare reform that has changed the methodology of how the FMAP is calculated in favor of the city. The other \$600 million is the assumption that the FMAP stimulus will be extended by two quarters. Yet, considerable concern remains. The House of Representatives recently approved legislation that dropped the FMAP provision but the outcome of the bill still remains uncertain as it heads to the Senate for debate. Also, because of a timing issue, the city has reestimated as to when the FMAP savings would actually be fully recognized and in doing so, reduced the initially planned savings for FY 2010 by \$187 million and reallocated that money mainly to FY 2011.

The city was also able to help address a shortfall in the operating budget of the HHC by providing \$349 million of financial support. Through other actions worth \$246 million, HHC will close FY 2010 with a net operating surplus of \$434 million. The corporation has mainly operated as a self-sustained entity, but the economic downturn imposed a large increase in the number of uninsured patients seeking medical attention at HHC facilities. The city's action may be viewed as a "Bridge Plan" over the next few

⁷ For a complete description of the initiative, refer to the FCB March 2010 Staff Report in the section titled "Uniformed Overtime for FYs 2011-2014" starting on page 32.

fiscal years that will shore up the corporation's financial operations. However, if this plan is not successful and HHC continues to need support, the city may need to reevaluate this policy.

FY 2010 pension costs for the city are projected to be about \$6.8 billion. During the fiscal year, the estimated contribution increased modestly by \$60 million from adoption. The increase stems from the transfer of funds from the labor reserve. Subsequently, the pension systems are on course to yield returns exceeding the expected return on assets for the first time in two fiscal years. The last time the systems performed above the eight percent assumed actuarial rate was in FY 2007 with a yield of 18.2 percent. Following that stellar year, the pension fund's return fell precipitously by 5.4 percent and 18.3 percent in FYs 2008 and 2009, respectively. The markets have bounced back considerably since the start of CY 2010, although they have fallen sharply in the last few weeks due to fears that the European economy could weaken further due to an ongoing debt crisis, damping an already slow recovery in the United States. Our analysis indicates that through the end of May 2010, the pension fund has earned 12.99 percent, which is 4.99 percent better than the expected rate of return. The return to-date has added about \$11.2 billion to the market value of the assets held by the fund, bringing the total asset value to nearly \$97 billion.

Debt Service Savings

Since the FY 2010 budget was adopted, the city and the New York City Transitional Finance Authority (NYCTFA) achieved \$258 million in debt service savings, \$211 million of which is city-funded, mainly as a result of interest expenses being lower than originally forecasted. In fact, interest savings on floating rate instruments alone produced a \$270 million reduction in debt service, which was partially offset by higher outlays for other items, as captured in Table 3.

**DEBT SERVICE SAVINGS GENERATED A PORTION
OF THE FY 2010 BUDGET SURPLUS**

TABLE 3

FY 2010 Debt Service Projections			
	May 2010	June 2009	Change
G.O./Lease Debt Service	\$3,492	\$3,566	(\$73)
NYCTFA Debt Service	808	755	53
G.O. Floating Rate Costs	107	376	(270)
G.O. Interest Earnings	(1)	(32)	32
Total-Funded Debt Service	\$4,406	\$4,665	(\$258)
Less: NonCity Funding	(84)	(131)	47
City-Funded Debt Service	\$4,322	\$4,533	(\$211)
Tax Revenues	\$37,209	\$35,310	\$1,899
City-Funded Debt Service As a Percent of Tax Revenue	11.6%	12.8%	
Note: Numbers may not add due to rounding.			

During FY 2010, the city reaped the benefit of market low short-term interest rates for floating rate debt, where rates averaged 0.20 percent and 0.55 percent for tax-exempt and taxable floating rate debt, respectively. Having experienced great turmoil in

the variable rate market only two years ago when auction rates jumped to double digits, the city judiciously employed conservative assumptions in estimating interest costs on its variable rate debt, and was positioned to realize these interest savings. Over the course of the fiscal year, the city recognized the interest savings in its projections by incrementally lowering the rates that it applies to these tax-exempt and taxable instruments from a high of 3.86 percent and 5.61 percent, respectively. On the flip side, these savings were partially offset by a corresponding \$32 million reduction in interest earnings on bond proceeds, which are used to pay debt service costs.

FY 2010 debt service for the city and NYCTFA, before prepayment, is expected to total \$4.4 billion, reflecting an annual increase over FY 2009 of \$376 million. It should be noted that in July 2009, the NYCTFA received legislative authorization to issue additional debt to support the city's general capital program, after exhausting its statutory bonding capacity in FY 2007. The legislation permits the NYCTFA to have outstanding \$13.5 billion of future tax secured bonds, which are backed by the city's personal income and sales taxes. In addition, the NYCTFA is authorized to exceed this threshold providing the overage is within the remaining debt incurring power for city general obligation (g.o.) bonds under the state constitutional debt limit.

The resulting effect of this new authorization is that the NYCTFA has resumed selling revenue bonds to support the city's general capital program, with the current assumption being that going forward the city and the NYCTFA will sell equal amounts of bonds each fiscal year. At the time the FY 2010 budget was adopted last June, it was assumed that the city would sell all the bonds to meet these capital needs. Given the NYCTFA's new ongoing authorization to execute bond sales, the city began including in the November 2009 Financial Plan Modification debt service costs on prior and future NYCTFA bond sales. We have always incorporated these costs in our assessment of the full debt service to be paid from tax revenues. Hence, our analysis shows interest costs on NYCTFA bonds are higher than projected a year ago but correspondingly lower on g.o. bonds.

The reasoning behind having the NYCTFA resume issuance of debt to support the city's capital program is that NYCTFA revenue bonds have a higher credit rating than city g.o. bonds, which has led to interest savings on past sales. All NYCTFA bonds are rated AAA by the Standard and Poor's Corporation, and recently have been elevated one notch higher to AAA by Fitch Ratings due to its recent recalibration of state and local government bond ratings to a global scale. Similarly, Moody's Investors Service undertook a ratings overhaul and has increased its ratings one notch on NYCTFA senior bonds to Aaa and subordinate bonds to Aa1. This compares to the AA rating for city g.o. bonds from Standard and Poor's, and the recalibrated Aa2 and AA ratings from Moody's and Fitch, respectively. Standard and Poor's ratings had already been based on a global scale that allows for comparability of municipal bond credit ratings to those of national governments, corporate entities and structured securities.

City and NYCTFA debt service is paid primarily from tax revenues, with noncity funds projected to provide additional support in FY 2010 totaling \$84 million. As illustrated in Table 3 on the previous page, the portion of debt service that is city-funded, at \$4.3 billion, will consume 11.6 percent of tax revenues in FY 2010. This is equal to the 11.6 percent and below the 12.5 percent experienced in FYs 2008 and 2009,

respectively. The FY 2010 debt service burden has been trimmed from an estimated 12.8 percent since the start of the fiscal year due to the debt service savings combined with \$1.9 billion of additional tax revenues that have materialized since the budget was adopted.

Glossary of Acronyms

BPCA	Battery Park City Authority
BSA	Budget Stabilization Account
CSA	Council of School Supervisors and Administrators
CY	Calendar Year
DOE	Department of Education
FCB	Financial Control Board
FMAP	Federal Medical Assistance Percentages
FY	Fiscal Year
GCT	General Corporation Tax
G.O. Bonds	General Obligation Bonds
HHC	Health and Hospitals Corporation
IFA	Interfund Agreements
NYCTFA	New York City Transitional Finance Authority
NYSE	New York Stock Exchange
OT	Overtime
OTPS	Other than Personal Service
PEG	Program to Eliminate the Gap
PIT	Personal Income Tax
PS	Personal Service
STAR	School Tax Relief program
UFT	United Federation of Teachers