

Staff Report  
**REVIEW OF FYs 2010-2013**  
**FINANCIAL PLAN**  
July 22, 2009

***New York State Financial Control Board***

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## I. Overview

A review of the FYs 2010-2013 Financial Plan shows that 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 order to balance the FY 2010 budget and knowing that the severe national recession and a local downturn centered in the financial sector would cause a large drop in nonproperty taxes, the city started as early as January 2008 to deal with the problem. The city started numerous agency reduction programs that ultimately will reduce expenditures by \$3.1 billion in FY 2010. Additionally, the city reduced \$2 billion of FY 2010 debt service costs by applying prior-year surplus funds to defease general obligation debt that is scheduled to come due. To buttress a loss of \$1.1 billion in city funds by a fall in tax revenue, the city also reimposed two property tax reductions, received state permission to raise the city sales tax rate and made some changes to the business taxes. These actions also have offset expenditure increases primarily due to growth in wages and fringe benefits, as well as debt service costs.

Over the four years of the financial plan, while FY 2010 is balanced, the city projects gaps of almost \$5 billion in each of FYs 2011 and 2012, growing to \$5.6 billion in FY 2013. Our analysis shows possible lower revenue collections in both nonproperty and property taxes, as well as additional expenditures related to overtime costs and pollution remediation not accounted for in the city's plan. Furthermore, the labor concessions in the plan, which need legislative action, are outside the city's control and, if not agreed to, will add to the city's budget imbalance. We estimate these risks to add \$74 million in FY 2010, \$1.2 billion in FY 2011, \$1.3 billion in FY 2012 and \$1.3 billion in FY 2013 to the city's projected multi-billion dollar budget gaps. Our risks bring the city's projected budget imbalance in the outyears of the financial plan to more than \$6 billion in each of FYs 2011 and 2012 and almost \$7 billion in FY 2013. With no prior-year surpluses left to be used, the city, as it has successfully done over the last two years, should develop actions that, while not needed to balance the budget in FY 2010, can be used to start to deal with the large FY 2011 problem.

The outyear gaps continue due to a slumping economy, and growing costs for wages, pensions, health coverage, and debt service. With the city and the nation in the midst of a severe recession, it appears that the path to economic recovery will be long and uneven. In the city's plan, the net effect of the revenue downturn followed by recovery is for total revenue to increase by \$5.1 billion, or 8.4 percent, over the four years of the plan, from \$61.1 billion in FY 2009 to \$66.2 billion in FY 2013. City-fund revenues, which fall by \$1.1 billion in FY 2010, begin to grow in FY 2011 with the recovery of the nonproperty taxes. A slowdown affecting the real property tax could weaken the revenue upturn in the outyears of the plan, even as most other taxes are staging a recovery. The nonproperty taxes plummet \$2.6 billion in FY 2010 and then recover, supported by a gradual economic upturn and by a tax program involving the sales and business taxes. To help restart the city's stalled economy, the federal government is

furnishing \$4.2 billion in economic stimulus grants, targeted mostly at medical assistance and education programs.

Meanwhile, the city projects that pension costs will climb vigorously over the life of the financial plan, accounting for nearly 11 percent of total expenditures by FY 2013. Among the more prominent causes for the rapid rise in pension costs is the funding of investment losses that occurred in FYs 2008 and 2009. Also pushing city pension contributions higher are wage increases and a CY 2008 arbitration award concerning salary increases for the Patrolmen's Benevolent Association. In addition to driving up pension costs, wage increases are also responsible for raising total expenditures over the four-year plan. The city expects employee wages to reach more than \$23.6 billion in FY 2013, up \$1.1 billion from FY 2010. The city has included in the labor reserve adequate funds to provide for these increases.

Another area of growth is the city's medical assistance costs that are expected to grow by three percent in each year of the financial plan, which is the maximum growth allowed under state rules. Though the city will be able to reap the benefit of a lower Federal Medical Assistance Percentage, which is funded by the federal economic stimulus program and will reduce the city's share of its medical costs, the savings will be short-lived since stimulus funding expires in FY 2011.

While not having a direct impact on the city's financial plan, the rapid pace in which the unfunded liability for Other Postemployment Benefits (OPEB) is likely to grow in the future is a concern. Our analysis of the OPEB liability projects that this unfunded liability will surpass \$96 billion by FY 2013 and will continue to grow in the future. The city created a trust fund by using prior-year surpluses to allocate \$2.5 billion to the trust to begin addressing this growing liability, but has not added any resources to the trust fund for the years covered by the financial plan. In fact, as the OPEB liability continues to grow, the city is planning to draw down funds that total more than \$1 billion over FYs 2010 to 2012 from the trust to deal with pension losses.

In addressing its budget imbalance, the city has acted to reign in the growth rate of debt service costs, one of its largest and fastest growing expenses. Given that debt service expenditures are mainly driven by capital spending, the city announced a reduction in the capital program one year ago. Specifically, the city reduced its four-year capital plan with the goal of containing the growth rate in projected debt service costs to be more in line with the rate of growth for tax revenues, the resource used to pay debt service costs. The city has now extended the capital program reductions over the period of FYs 2010-2019 in its final ten-year capital strategy that was released along with the executive budget in May.

**JUNE FINANCIAL PLAN:  
THE CITY'S OPERATING PROJECTIONS FOR  
FISCAL YEARS 2010-2013**

TABLE 1

(\$ in millions)

	FY 2010	FY 2011	FY 2012	FY 2013
<b><u>Revenues</u></b>				
Taxes:				
General Property	\$16,024	\$17,108	\$17,697	\$18,085
Other Taxes <sup>a</sup>	16,835	19,431	20,841	22,108
Discretionary Transfers	546	--	--	--
Debt Defeasance	382	--	--	--
Tax Audit Revenue	596	596	595	594
Tax Program	879	877	943	976
Sale of Property Tax Liens	48	40	40	40
Miscellaneous Revenues	7,026	6,744	6,783	6,823
Unrestricted Intergovernmental Aid	340	340	340	340
Interfund Revenues	486	453	443	443
Less: Intracity Revenues	(1,669)	(1,583)	(1,586)	(1,590)
Disallowances	(15)	(15)	(15)	(15)
Total City Funds	\$41,478	\$43,991	\$46,081	\$47,804
Federal Categorical Grants	6,600	6,389	5,355	5,344
State Categorical Grants	11,512	11,975	12,380	13,034
<b>Total Revenues</b>	<b><u>\$59,590</u></b>	<b><u>\$62,355</u></b>	<b><u>\$63,816</u></b>	<b><u>\$66,182</u></b>
<b><u>Expenditures</u></b>				
Personal Service	\$36,174	\$37,014	\$36,976	\$39,029
Other Than Personal Service	25,065	25,774	26,869	27,546
Debt Service	4,187	4,657	5,094	5,372
General Obligation & TFA Debt Defeasances	(2,313)	--	--	--
NYCTFA Debt Service	110	1,118	1,157	1,158
Budget Stabilization & Prepayments	(2,264)	--	--	--
General Reserve	300	300	300	300
Subtotal	\$61,259	\$68,863	\$70,396	\$73,405
Less: Intracity Expenditures	(1,669)	(1,583)	(1,586)	(1,590)
<b>Total Expenditures</b>	<b><u>\$59,590</u></b>	<b><u>\$67,280</u></b>	<b><u>\$68,810</u></b>	<b><u>\$71,815</u></b>
<b><u>Gap To Be Closed</u></b>	<b><u>\$0</u></b>	<b><u>(\$4,925)</u></b>	<b><u>(\$4,994)</u></b>	<b><u>(\$5,633)</u></b>
<sup>a</sup> Allocates NYCTFA debt service to expenditures.				

**CHANGES TO THE CITY'S OPERATING PROJECTIONS FOR  
FISCAL YEARS 2010-2013  
JANUARY MODIFICATION COMPARED TO JUNE FINANCIAL PLAN**

TABLE 2

(\$ in millions)

	FY 2010	FY 2011	FY 2012	FY 2013
<b><u>Revenues</u></b>				
Taxes:				
General Property	(\$188)	(\$39)	(\$39)	(\$39)
Other Taxes <sup>a</sup>	(613)	(785)	(950)	(1,195)
Discretionary Transfers	0	0	--	--
Debt Defeasance	0	0	--	--
Tax Audit Revenue	0	0	0	0
Tax Program	(15)	(43)	(29)	(47)
Sale of Property Tax Liens	14	9	9	9
Miscellaneous Revenues	266	(187)	(219)	(194)
Unrestricted Intergovernmental Aid	86	86	86	86
Interfund Revenues	41	16	9	10
Less: Intracity Revenues	(207)	(121)	(124)	(128)
Disallowances	0	0	0	0
Total City Funds	(\$616)	(\$1,064)	(\$1,257)	(\$1,498)
Federal Categorical Grants	1,274	1,066	21	10
State Categorical Grants	(117)	(152)	(10)	201
<b>Total Revenues</b>	<b><u>\$541</u></b>	<b><u>(\$150)</u></b>	<b><u>(\$1,246)</u></b>	<b><u>(\$1,287)</u></b>
<b><u>Expenditures</u></b>				
Personal Service	\$1,404	\$499	(\$274)	\$292
Other Than Personal Service	1,223	958	225	143
Debt Service	(166)	(126)	(117)	(124)
General Obligation & TFA Debt Defeasances	0	0	--	--
NYCTFA Debt Service	(106)	4	(1)	(4)
Budget Stabilization & Prepayments	(1,607)	350	--	--
General Reserve	0	0	0	0
Subtotal	\$748	\$1,685	(\$167)	\$307
Less: Intracity Expenditures	(207)	(121)	(124)	(128)
<b>Total Expenditures</b>	<b><u>\$541</u></b>	<b><u>\$1,564</u></b>	<b><u>(\$291)</u></b>	<b><u>\$179</u></b>
<b><u>Gap To Be Closed</u></b>	<b><u>\$0</u></b>	<b><u>(\$1,714)</u></b>	<b><u>(\$955)</u></b>	<b><u>(\$1,466)</u></b>
<sup>a</sup> Allocates NYCTFA debt service to expenditures.				



TABLE 3

**RISKS TO THE FINANCIAL PLAN**

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

	FY 2010	FY 2011	FY 2012	FY 2013
<b>Stated Financial Plan Gap</b>	<b>\$0</b>	<b>(\$4,925)</b>	<b>(\$4,994)</b>	<b>(\$5,633)</b>
<b>Estimation</b>				
Nonproperty Taxes	\$0	(\$150)	(\$75)	\$0
Property Tax	0	(100)	(200)	(300)
Miscellaneous Revenue	100	150	150	150
Uniformed Services Overtime	(104)	(82)	(81)	(81)
<b>Subtotal</b>	<b>(\$4)</b>	<b>(\$182)</b>	<b>(\$206)</b>	<b>(\$231)</b>
<b>Implementation</b>				
Pollution Remediation	\$0	(\$500)	(\$500)	(\$500)
<b>Subtotal</b>	<b>\$0</b>	<b>(\$500)</b>	<b>(\$500)</b>	<b>(\$500)</b>
<b>Not in Mayor's Control</b>				
10% Premium Contribution	\$0	(\$357)	(\$386)	(\$418)
Tier 5 Pension Legislation	0	(200)	(200)	(200)
Sales Tax Increase Program	(70)	0	0	0
<b>Subtotal</b>	<b>(\$70)</b>	<b>(\$557)</b>	<b>(\$586)</b>	<b>(\$618)</b>
<b>Risk Total</b>	<b>(\$74)</b>	<b>(\$1,239)</b>	<b>(\$1,292)</b>	<b>(\$1,349)</b>
<b>Total FCB Estimated Surplus/(Gap)</b>	<b>(\$74)</b>	<b>(\$6,164)</b>	<b>(\$6,286)</b>	<b>(\$6,982)</b>
Note: The city has set aside \$300 million in a general reserve in each of FYs 2010-2013.				

## **II. Balancing the FY 2010 Budget**

To balance the FY 2010 budget, the city is planning to use all of the \$1.3 billion in the Budget Stabilization Account (BSA) accumulated from prior-year surpluses. With this drawdown, there are no more funds in the BSA to address any current-year risks or to facilitate future-year budget balance.

The severe national recession and a local downturn involving the financial sector have caused city revenues to fall by a projected \$1.5 billion in FY 2010 compared to FY 2009. City funds, which are down by \$1.1 billion because of a steep slide in the nonproperty taxes, would have fallen much further were it not for two previously enacted property tax increases that helped lift the real property tax by \$1.7 billion.

The city is proactively managing the FY 2010 budget. It is preparing for the possibility of a slowdown in property tax collections by building up its reserves for contingencies such as rising delinquencies and assessment complaints. To help restore sinking nonproperty tax revenue, the city received state permission to enact a package of sales tax increases and a business tax conformity program. We believe that the city will receive \$70 million less from the sales tax program due to its delayed enactment by the state legislature, as discussed in "Nonproperty Taxes" on page 22.

Additionally, the city took proactive measures on the expenditure side of its budget. For example, the city reduced \$2 billion of current-year debt service costs by applying prior-year surplus funds to defease general obligation (g.o.) debt that is scheduled to mature in FY 2010. Expenditures are further lowered by \$1 billion in FY 2010 compared to FY 2009 because of the net impact of prepayments that were made with surplus revenues from prior years. Also, there is a reduction in Medical Assistance costs of \$285 million that is primarily due to the city's application of federal economic stimulus funds to support Medicaid costs.

These reductions in expenditures were partially offset by spending increases in certain areas. Specifically, spending is expected to escalate year-over-year for personal services as well as debt service. Personal service expenditures rose by \$1.1 billion, reflecting increasing wages as well as higher fringe benefit payments. For debt service, the costs have grown by \$646 million in FY 2010 compared to FY 2009. Most of the increase is attributable to the interest expense for the \$5.5 billion of g.o. debt incurred in FY 2009 and the \$6.5 billion of bonds projected to be sold in FY 2010, as well as conservative interest rate assumptions on existing variable rate products that have experienced market volatility over the last two years.

### **THE WEAKER REVENUE OUTLOOK**

Total revenue falls to \$59.6 billion in the city's plan for FY 2010, a decrease of \$1.5 billion from the previous year, as shown in the figure on page 7. City funds, which include taxes, intergovernmental aid, and miscellaneous revenue, are down by \$1.1 billion due to a precipitous fall in nonproperty tax collections.

The real property tax increases by \$1.7 billion, to \$16.1 billion in FY 2010. This extra property tax revenue is partly due to strong billable assessment growth on the tax roll and partly due to the implementation of two property tax increase programs. Even though the property tax base continued to grow, the extra revenue produced by tax increases proved to be needed to offset a major drop in the nonproperty taxes.

FY 2010 Revenues Fall by \$1.5 Billion (\$ in millions)	
Property Tax	\$1,701
Nonproperty Taxes	(2,589)
Audit Revenue	(384)
Tax Program	879
STAR Aid	(286)
Intergovernmental Aid	0
Miscellaneous Revenue	(403)
<b>City Funds</b>	<b>(\$1,082)</b>
Categorical Aid & Other Revenue	(394)
<b>Total Change in Revenues</b>	<b>(\$1,476)</b>

The nonproperty taxes are projected to fall by \$2.6 billion to \$16.9 billion because the personal income tax and most other major taxes are declining sharply. The steep drop in the nonproperty taxes is linked to the downward trajectory of the local economy, which is falling deeper and harder in this recession than the nation.

The personal income tax is down by over \$600 million in FY 2010, marking a second year of falling collections for this vitally important revenue source. The business income taxes, which are in a third year of decline, are down by \$1.1 billion in the city's plan for FY 2010. Additionally, property transactions tax collections are down by about \$170 million, indicating that the city's real estate market is continuing its downtrend for a third year. The softening of the local real estate market needs to be closely monitored, not only to estimate the shrinkage of transactions tax revenues, but because it could indicate the future direction of the real property tax, which is the largest of the city's tax revenue sources.

The city's tax audit program declines by about \$400 million in FY 2010, following a four-year run of strong audit collections. Audits, which used to produce about \$500 to \$600 million annually, have been yielding about \$1 billion in each of the last two years. The city expects that the weakened finance sector will be unable to support audit collections above \$600 million in FY 2010 and for the rest of the plan period. However, even if audit collections slow down, the success of the audit program may be measured in improved taxpayer compliance and enhanced baseline tax revenues.

The city is implementing a program of sales and business tax increases, which was originally scheduled to generate \$879 million in FY 2010. The delay in gaining state legislative approval, however, is likely to reduce the revenue yield of this tax program by \$70 million. The tax package consists of three sales tax increases that were to have raised \$720 million and a package of business tax conformity rule changes that would raise \$159 million, which are discussed in "Nonproperty Taxes" on page 22. This tax program would make city business tax rules conform more closely to existing state tax rules. Although this plan raises business tax revenue in the near term, businesses will see their taxes reduced when the conformity proposal is fully phased in.

Miscellaneous revenue declines by about \$403 million in FY 2010 largely because of fewer nonrecurring resources planned for FY 2010 as compared with FY 2009. The city's share of the state's School Tax Relief program (STAR) is down \$286 million in FY

2010. The state is cutting back on this taxpayer subsidy as it attempts to cope with its own budgetary difficulties. The cuts affect city taxpayers who are losing part of their STAR income tax credit.

Intergovernmental aid is unchanged in the financial plan because the state is restoring cuts to its Aid and Incentives for Municipalities (AIM) program. The financial plan assumes that unrestricted state aid will remain a constant \$340 million per year from FY 2010 through FY 2013. Categorical aid declines by about \$400 million. Most of the aid reductions are to state grant programs, which fell by \$700 million. Federal categorical aid expanded by \$330 million, partly as a result of the stimulus program.

### **Property Tax**

The city expects the real property tax to yield \$16.1 billion in FY 2010, an amount that is \$1.7 billion, or 12 percent, higher than the previous year. This extra property tax revenue is partly due to strong billable assessment growth on the FY 2010 tax roll and partly due to the implementation of two property tax increase programs. Despite this very robust growth in FY 2010, growth is likely to weaken in the outyears because further tax increases are not planned, and tax base growth could decline along with a weakening real estate market. The city is preparing for a collections slowdown and increased assessment complaints by enlarging its property tax reserve set-aside. The average property tax rate remains stationary in FY 2010, but individual class tax rates will shift slightly in favor of commercial properties, and result in a small increase for residential property owners.

The extraordinary 12 percent property tax growth was achieved with a combination of two tax increases on top of normal tax base growth. Property tax rates increased in the middle of FY 2009 when the seven percent rate reduction that went into effect in FY 2008 was cancelled. The full-year effect of this rate increase will produce \$1.2 billion in FY 2010. This rate increase adds 3.6 percent to FY 2010 property tax revenue growth, after having generated similar growth in FY 2009. Additionally, \$256 million in extra revenue results from the cancellation of the \$400 homeowner rebate program. This tax increase adds 1.8 percent to property tax growth. Also, the tax base, as measured by billable assessments, expanded by 6.7 percent.

Taken together, these three factors are responsible for the unusually strong 12 percent property tax growth in FY 2010. Despite this very strong showing, future growth will drop since no additional property tax increases are planned. Also, billable assessments are unlikely to repeat this year's strong performance because the economic slowdown is depressing property values.

The weakening of the property tax base is evident in the one percent decline in market values on the FY 2010 tax roll. This decline, which marks the first dip in market values in over a decade, follows the subpar two percent growth recorded in FY 2009. These weak results point to a coming slowdown in property tax revenue. The slowdown in current market values was offset by the flow-through of a "pipeline" of previously stored up market value increases. This pipeline, which can support tax base

growth in the early years of a stagnant market, as it did in the FY 2010 tax roll, can quickly dry up should market value growth turn negative.<sup>1</sup>

With the real estate market softening, the city is preparing for a collections slowdown by beefing up its property tax contingency reserves. The city has set aside \$1.6 billion in reserves for FY 2010, which is about \$270 million higher than the reserves that were needed in FY 2009, excluding the discontinued rebate reserve. For example, in FY 2010 the reserve for delinquency, or nonpayment of tax bills, increased by nearly \$70 million, to \$410 million. In order to prepare for a possible surge in assessment complaints, the city enlarged its cancellation reserve by nearly \$50 million to \$439 million and increased its reserve for refunds by about \$170 million to \$436 million. Lien sales, which increase by \$13 million to \$48 million in FY 2010, are one of the positive offsets to these negative reserve set-asides.

The city kept property tax rates steady in FY 2010 at an average rate of \$12.283 per \$100 assessed value, which was fixed in December 2008 when tax rates were increased in the middle of FY 2009. This is the same average tax rate that had been in effect in FYs 2004-2007, prior to the FY 2008 seven percent rate cut. As a temporary measure, the previous year's class tax rates were used for the initial billing of FY 2010, since new tax rates had not yet been fixed when the bills were sent out.

The new tax rates that were enacted for FY 2010 would have caused individual class tax rates to have shifted by as much as seven percent, favoring the commercial property classes at the expense of residential property owners, even though the overall average tax rate would remain stationary. The city has, therefore, obtained legislative approval for a cap to ameliorate large swings in class tax rates. Given the legislative support for this measure both in the city and the state, it may be assumed that the property tax rates for FY 2010 will be adjusted retroactively, later in the fiscal year.

Once these adjustments are implemented, the new property tax rates would result in relatively small increases in residential tax rates and a small decrease in the commercial tax rate. Owners of private homes will see their tax rate go up by 1.8 percent to \$17.088. The tax rate for residential apartment buildings increases by 1.4 percent to \$13.241, while the utility property tax rate is up 1.3 percent to \$12.743. Offsetting these increases is a 1.8 percent rate reduction for commercial properties to \$10.426.

### **Nonproperty Taxes**

The nonproperty taxes decline by \$2.6 billion in FY 2010 to \$16.9 billion. This projected steep 13 percent collections downturn follows the even steeper 17 percent nonproperty tax collections drop in FY 2009. The severe national recession and a local downturn involving the financial sector have resulted in falling receipts of the city's

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<sup>1</sup> For a more complete discussion of the flow-through of stored market value increases, see "Property Tax Growth" on page 19.

personal and business income and sales taxes. Moreover, the slowdown affecting the local real estate market will result in further declines of the property transactions taxes.

The personal income tax declines by \$610 million, or nine percent, in FY 2010 following the even more severe 25 percent revenue loss in FY 2009. The business income taxes plummet by \$1.1 billion, or 21 percent, with each of the three taxes in this group falling by at least \$300 million. The real property transfer and the mortgage recording taxes are scheduled to fall by a combined total of about \$170 million or 14 percent, following the 50 percent revenue slide in FY 2009. The city sales tax, following along with this broad based revenue downtrend, falls \$606 million, a hit of 13 percent. The decline in tourism shrinks hotel tax receipts by \$30 million, despite the effort to stabilize this revenue source by raising the room tax rate from five percent to 5.875 percent.

## **EXPENDITURE HIGHLIGHTS**

Total city expenditures are projected to fall by almost \$1.5 billion between FYs 2009 and 2010, due mainly to the offsetting benefit of prior-year surpluses. The surpluses were used to prepay debt service and subsidies in addition to defeasing debt that is scheduled to come due in FY 2010. At the same time, expenditure increases are being fueled by employee wages, pension costs and debt service. As shown in the figure to the right, the city's debt defeasance of \$2 billion and increase in the net surplus roll of almost \$1 billion helped offset more than \$1.7 billion of higher expenditures in personal service and debt service.

<b>FY 2010 Expenditures Fall by \$1.5 Billion</b> (\$ in millions)	
Net Debt Defeasance	(\$2,036)
Change in Net Surplus Roll	(985)
Medical Assistance	(285)
Personal Service	1,068
Debt Service	646
General Reserve	260
Other Spending Decreases	(144)
<b>Total Expenditure Decrease</b>	<b>(\$1,476)</b>

The increase in the net surplus roll of \$985 million, including New York City Transitional Finance Authority (NYCTFA) grants, results from the net difference between the FY 2008 budget stabilization transfer into FY 2009 and the subsequent transfer from FY 2009 into FY 2010. Also, the city was able to lower medical assistance costs by \$285 million due to a change in the Federal Medical Assistance Percentages (FMAP) rates enacted by the federal government as a part of the stimulus package. Furthermore, lower costs in public assistance and expenditure reductions in other than personal services (excluding debt service) amounted to an additional \$144 million decrease.

Though the city was able to use surplus resources gained from previous fiscal years to reduce expenditures and bring FY 2010 into balance, the city is still experiencing growth in personal service (employee wages, pension costs, and fringe benefits) that exceeds \$1 billion. The city's wage costs have risen by almost \$600 million due mostly to collective bargaining settlements. Pension costs have grown by about \$300 million because of FY 2008 investment losses and a valuation update. Finally, fringe benefits such as health insurance, worker's compensation, employment insurance, and social security contributions have also risen and are projected to grow by almost \$200 million from FY 2009. Meanwhile, debt service costs are projected to grow by \$646 million from FYs 2009 to 2010 stemming from the city's large-scale capital financing program. The

city has also increased its general reserve by \$260 million to \$300 million as it customarily does at the beginning of a fiscal year.

### FY 2010 Agency Program

In September 2007, the city asked all agencies to reduce their expenditures by finding recurring spending cuts or revenue increases (if applicable for the agency) in order to address an impending budget shortfall induced by a steep decline in city tax revenues. In the January 2008 Modification, the initial rollout of the city's agency program or the Program to Eliminate the Gap (PEG), \$543 million in savings were produced in FY 2008 and nearly \$1.1 billion in savings were found for FY 2009, with much of those savings expected to stretch through FYs 2010 to 2012. As the economic downturn worsened, the city instructed agencies to continue to identify budget cuts in forthcoming modifications, in addition to those already made, to deal with projected budget gaps in FYs 2010 through 2013.

### **FY 2010 TOTAL AGENCY PROGRAM SINCE JANUARY 2008**

TABLE 4

(\$ in millions)

Agency Category	Jan 2008	May 2008	Nov 2008	Jan 2009	May 2009	Total
Uniformed Services	(\$77)	(\$137)	(\$192)	(\$184)	(\$45)	(\$635)
Health and Welfare	(81)	(60)	(98)	(127)	(72)	(438)
Mayoral	(101)	(51)	(85)	(108)	(89)	(434)
Major Organizations	(283)	(109)	(396)	(314)	(104)	(1,206)
Elected Officials	(20)	(3)	(12)	(3)	(5)	(43)
All Other	(305)	(49)	(84)	(13)	20	(431)
<b>Total Expense PEG</b>	<b>(\$867)</b>	<b>(\$409)</b>	<b>(\$867)</b>	<b>(\$749)</b>	<b>(\$295)</b>	<b>(\$3,187)</b>
<b>Total Revenue PEG</b>	<b>(79)</b>	<b>(52)</b>	<b>(216)</b>	<b>(168)</b>	<b>(28)</b>	<b>(543)</b>
<b>Total Program*</b>	<b>(\$946)</b>	<b>(\$461)</b>	<b>(\$1,083)</b>	<b>(\$917)</b>	<b>(\$323)</b>	<b>(\$3,730)</b>

(Negative) numbers decrease the gap. \*Before adjustments for restorations.

As shown in Table 4, the city had expected to save more than \$3.7 billion in FY 2010. The savings came primarily from expenditure PEGs totaling about \$3.2 billion and new or increased revenues, which totaled more than \$500 million. During negotiations leading to the adopted budget, the Mayor and City Council made some service restorations. As a result, as shown in the figure to the right, the city has restored almost \$314 million of planned spending cuts to its FY 2010 Adopted Budget. Since January 2008, the city has restored PEGs totaling \$639 million (including \$325 million of prior restorations), reducing the agency program for FY 2010 to \$3.1 billion. Also, the Council added about \$50 million for discretionary funding, as shown in the figure.

<b>FY 2010 Restorations and City Council Discretionary Funding</b>	
(\$ in millions)	
Senior, Health, and Social Services	\$121
Cultural and Recreational	73
Educational	53
Legal and Safety Services	50
Job and Business Services	9
Elected Officials	8
<b>Total Restorations</b>	<b>\$314</b>
Discretionary Funding (Various)	\$37
Discretionary Funding for Aging	5
Discretionary Funding for Youth	8
<b>Total Discretionary Funding</b>	<b>\$50</b>
<b>Total Restorations and Funding</b>	<b>\$364</b>

As shown in Table 4 on page 11, savings in FY 2010 were found in each of the city's six main agency categories with almost half of the total expected savings coming from the city's uniformed services (Police, Fire, Correction, and Sanitation Departments) and major organizations (the Department of Education, the City University of New York, and the Health and Hospitals Corporation). Of these savings, those identified in the Department of Education (DOE) come from mainly nonpedagogical cuts such as in administration and staffing with additional savings found from reducing costs associated with other than personal services in most city schools. The city had initially planned to reduce over 14,000 pedagogical positions because of a decrease in state aid, but federal stimulus funding allowed the city to save those positions.

Other significant savings are expected to come from the city's uniformed agencies. The city anticipates that it will be able to reduce expenditures in FY 2010 by more than \$600 million through a number of measures such as: headcount reductions in uniformed (through attrition and class cancellations) and civilian Police Department positions, a United Nations federal reimbursement, the elimination of a number of manned positions in certain fire companies (partially restored), a reestimate of waste export contracts, moving inmates from city jails to underutilized state jails (partially restored), an increase in Emergency Medical Services revenue, fleet related reduction savings, and a host of other cost-cutting initiatives. However, of the more than \$600 million (not including PEG restorations) in expected savings, city uniformed agencies have targeted only about \$51 million in overtime related savings or eight percent of the PEG total.

When the city initiated its agency program in January 2008, it urged agencies to find recurring actions. As shown in Table 5, the city expects to reduce expenditures in FY 2011 by more than \$3.6 billion and by about \$3.5 billion in each of FYs 2012 and 2013, with the bulk of the savings produced in DOE (as a component of major organizations) and in uniformed services.

TABLE 5

**AGENCY SAVINGS EXPECTED TO CONTINUE THROUGH FY 2013**

(\$ in millions)

Agency Category	FY 2011	FY 2012	FY 2013
Uniformed Services	(\$582)	(\$514)	(\$526)
Health and Welfare	(428)	(411)	(411)
Mayoral	(456)	(471)	(475)
Major Organizations	(1,101)	(1,089)	(1,089)
Elected Officials	(62)	(62)	(62)
All Other	(441)	(485)	(485)
<b>Total Expense PEG</b>	<b>(\$3,070)</b>	<b>(\$3,032)</b>	<b>(\$3,048)</b>
<b>Total Revenue PEG</b>	<b>(557)</b>	<b>(497)</b>	<b>(495)</b>
<b>Total Program*</b>	<b>(\$3,627)</b>	<b>(\$3,529)</b>	<b>(\$3,543)</b>
(Negative) numbers decrease the gap. *Before adjustments for restorations and reversals.			

**Uniformed Services Overtime**

In the FY 2010 Adopted Budget, the city estimates it will spend \$682 million on uniformed overtime expenditures (uniformed and civilian personnel). Over the last five



years, the four uniformed agencies (Police, Fire, Correction, and Sanitation Departments) have exceeded \$700 million in overtime expenditures. Based on current reported spending, our analysis indicates that uniformed agency overtime will again top \$700 million in FY 2009 and reach \$785 million, which represents about 78 percent of total overtime expenditures generated by all city agencies including uniformed agencies.

The city makes budget corrections during the fiscal year to keep pace with actual overtime spending. For example, in FY 2009, the city initially budgeted \$672 million in overtime spending but raised its estimate by \$95 million by fiscal-year end. The increased estimate of \$767 million is much more consistent with the growth in overtime spending seen over the past few fiscal years. As shown in Table 6, in June 2008, the city budgeted \$678 million in uniformed agencies' overtime spending for FY 2010. However, after decreasing its forecast to \$667 million in November, the city reestimated its forecast to \$713 million in January, and then again in May, forecasting \$688 million. After a further decrease of \$6 million to its FY 2010 Adopted Budget, the city now projects \$682 million to be spent in FY 2010. The decline reflects overtime savings related to the city's agency program. Nonetheless, we foresee the city adding additional funding later in FY 2010 to cover an overtime budget shortfall.

TABLE 6

**FY 2010 UNIFORMED SERVICES' OVERTIME BUDGET FORECAST**  
(\$ in millions)

Agency	FY 09 Adopted	FY 09 Nov Modification	FY 10 Jan Plan	FY 10 Exec Budget	FY 10 Adopted	FY 2009 Actuals*
Police	\$333.9	\$333.9	\$374.1	\$379.4	\$373.3	\$477.4
Fire	207.5	200.7	214.0	183.4	183.4	162.3
Correction	68.3	68.3	65.4	65.4	65.3	95.2
Sanitation	67.7	63.9	59.8	59.8	59.8	50.5
<b>Total OT</b>	<b>\$677.5</b>	<b>\$666.8</b>	<b>\$713.4</b>	<b>\$687.9</b>	<b>\$681.9</b>	<b>\$785.4</b>
Includes both uniformed and civilian personnel. *Actual spending recorded through June 2009. Totals may not add due to rounding.						

If overtime for the uniformed agencies follows historical trends, the city will make additional adjustments to its overtime budget during the fiscal year. Based on analysis of overtime expenditures for FY 2009 of \$785 million, we project that actual spending on overtime for FY 2010 will be nearly the same, a risk of \$104 million. Furthermore, we expect the city to end FY 2009 with projected overtime expenditures short of actual spending, leaving an overtime risk in the FY 2009 budget of approximately \$19 million.

### Department of Education

In its FY 2010 Adopted Budget, the city appropriated \$18.309 billion to the Department of Education (DOE) for operational purposes (not including other categorical and intracity funds). This amount exceeds the FY 2009 projected close by \$724 million. A significant factor in this increase is the federal funding from the American Recovery and Reinvestment Act of 2009 (the "stimulus" package). The money received from the stimulus package will be used to offset a decrease in state aid to

education and avoid a previously announced reduction of over 14,000 pedagogical positions.

Federal funds total \$2.756 billion for FY 2010 and provide 15 percent of the department's budget, which is five percentage points greater than the share in FY 2009. This significant jump in federal funding represents \$1.013 billion more than FY 2009, or an annual growth rate of 58.1 percent.

City funds in the current fiscal year budget total \$7.375 billion, not including other categorical and intra-city funds. This amount represents just over 40 percent of the total DOE budget and an increase of \$113 million from FY 2009.

State funds for DOE for FY 2010 make up almost 45 percent of the total DOE budget with the funding contribution estimated at \$8.178 billion, which is a reduction of \$402 million compared to FY 2009. State funding dips for the first time since FY 2004, where most of this drop is due to the state implementing a Deficit Reduction Assessment of \$426 million.

### **Pensions**

For FY 2010, planned contributions made by the city to its five actuarial pension systems will near \$6.7 billion (total funds), which is an increase of about \$300 million over the contributions planned for FY 2009. In estimating its pension cost for FY 2010, the city has provided funding for investment losses incurred in FY 2008 and delayed a proposed savings of \$200 million that was anticipated from the creation of a fifth pension tier. The city had anticipated in FY 2008 that the pension systems would produce a combined zero investment return on its assets and therefore allocated \$121 million to fund the loss, which would begin to phase-in in FY 2010. The city is able to lag by two years the phase-in of investment losses and gains. The zero return needs to be funded because the pension systems require a minimum return on its assets of eight percent.

As financial markets declined and the economy worsened, the value of the pension systems' assets fell further than the city had anticipated and the systems produced a combined negative return of 5.4 percent for FY 2008. The loss, which would begin to phase-in in FY 2010, added an additional \$82 million to the city's FY 2010 annual contribution. The city will drawdown, by that same amount, funds from the Retirement Healthcare Trust Fund (RHBT) to cover this further funding need.

Also, the city had proposed the creation of a Tier V in the pension systems for new city employees, which they had expected to yield recurring annual savings of \$200 million. In light of the uncertainty of this cost-saving initiative coming to fruition in FY 2010, the city has moved the initiative to FY 2011.

With the close of FY 2009, we project the pension systems will suffer substantial investment losses that will fall far below the systems' required rate of return or Actuarial Interest Rate of eight percent. Due to the recession and a highly volatile stock market, the city had projected investment losses of eight percent in its November modification

but subsequently changed its projection to a 20 percent loss in its January modification as the value of pension assets dropped by billions of dollars. In response, the city has provided resources to cover these losses once the phase-in period begins in FY 2011. Based on our analysis, we concur with the city's loss projections and find no risk to FY 2010 due to the lag of the phase-in period. Nonetheless, when those multi-billion dollar losses start to be phased-in in FY 2011, even though well-funded, the city will see its pension cost ramp up significantly at the same time it needs to address a very large budget imbalance in that fiscal year and in FYs 2012 and 2013. We will discuss this and other factors and our analysis of pension costs over the life of the city's financial plan in "Pension Costs," beginning on page 28.

### **Debt Service**

Debt service is one of the areas within the budget where costs are expected to increase from FY 2009 to FY 2010. City debt service costs, including that for the NYCTFA and related lease agreements, are projected to total \$4.7 billion in FY 2010, net of prepayments. At this level, the FY 2010 debt service projection leaps \$646 million above what it was in FY 2009, for a growth rate of 16.1 percent.

Most of the debt service increase is attributable to the interest expense for the tremendous amount of debt incurred in FY 2009 and projected to be incurred in FY 2010. Specifically, the city sold \$5.5 billion of city general obligation (g.o.) bonds to support its capital program in FY 2009 and plans to sell an additional \$6.5 billion in FY 2010. Also, both the city and the NYCTFA are using higher interest rate assumptions in FY 2010 for outstanding variable rate bonds than the actuals experienced in FY 2009. Given how volatile the variable rate bond market has been within the last two years, we believe this is a prudent approach to budgeting. On this point, the Dormitory Authority for the State of New York converted variable rate bonds it sold for municipal health facilities to fixed rate bonds to reduce payment volatility. This generated savings in FY 2009, but costs are higher thereafter compared to the prior assumptions for variable rate securities.

It should be noted that the NYCTFA had exhausted its statutory capacity to issue additional bonds for general capital purposes, which was capped at \$13.5 billion of issuances. Upon the city's request, the state legislature has passed and the Governor has signed legislation approving an increase in the NYCTFA borrowing cap. The legislation raises the statutory capacity to \$13.5 billion of debt outstanding and allows the issuance of bonds beyond that level to the extent that the additional debt, when combined with outstanding g.o. debt, does not exceed the constitutional debt limit for g.o. bonds. The city has maintained that given additional borrowing capacity, the NYCTFA will issue up to one half of the bonds that would otherwise have been sold in the form of g.o. debt by the city, with the rationale being that the NYCTFA has proven to be a cost-effective source of financing. It is assumed that the replacement of g.o. debt with NYCTFA debt could generate \$20 million of debt service savings in FY 2010.

Nonetheless, debt service will jump from absorbing a historically low share of tax revenues in FY 2009 at 11.2 percent to 13.2 percent in FY 2010. The debt service burden is projected to rise over the years covered by the plan to 15.6 percent in FY 2013. We provide a detailed discussion of the city's debt burden in the section of the report titled "The Capital Program Profile and Associated Debt" beginning on page 36.

### **III. The FYs 2010-2013 Financial Plan**

With the city and nation in the midst of a severe recession, it appears that the path to economic recovery will be long and uneven. In the city's plan, the net effect of the revenue downturn followed by recovery is for total revenue to increase by \$5.1 billion, or 8.4 percent, over the four years of the plan, from \$61.1 billion in FY 2009 to \$66.2 billion in FY 2013. City-fund revenues, which fall by \$1.1 billion in FY 2010, begin to grow in FY 2011 with the recovery of the nonproperty taxes. A slowdown affecting the real property tax could weaken the revenue upturn in the outyears of the plan, even as most other taxes are staging a recovery. The nonproperty taxes plummet \$2.6 billion in FY 2010 and then recover, supported by a gradual economic upturn and by a tax program involving the sales and business taxes. To help restart the city's stalled economy, the federal government is furnishing \$4.2 billion in economic stimulus grants targeted mostly at medical assistance and education programs.

Meanwhile, the city projects that pension costs will climb vigorously over the life of the financial plan, accounting for nearly 11 percent of total expenditures by FY 2013. Among the more prominent causes for the rapid rise in pension costs is the funding of investment losses that occurred in FYs 2008 and 2009. Also pushing city pension contributions higher are wage increases and a CY 2008 arbitration award concerning salary increases for the Patrolmen's Benevolent Association. In addition to driving up pension costs, wage increases are also responsible for raising total expenditures over the four-year plan. The city expects employee wages to reach more than \$23.6 billion in FY 2013, up \$1.1 billion from FY 2010. The city has included in the labor reserve adequate funds to provide for these increases. In fact, the city has reduced the reserve by \$200 million in FY 2010 and \$279 million in each of FYs 2011 and 2012 in anticipation of a reduced headcount.

Another area of growth is the city's medical assistance costs that are expected to grow by three percent in each year of the financial plan, which is the maximum growth allowed under state rules. Though the city will be able to reap the benefit of a lower Federal Medical Assistance Percentage, which is funded by the federal economic stimulus program and will reduce the city's share of its medical costs, the savings are to be short-lived since stimulus funding expires in FY 2011.

Of particular concern to us is the rapid pace in which the liability for Other Postemployment Benefits (OPEB) is likely to grow in the future. Our analysis of the OPEB liability projects that this unfunded liability will surpass \$96 billion by FY 2013 and will continue to grow in the future. The city created a trust fund by using prior-year surpluses to allocate \$2.5 billion to the trust to begin addressing this growing liability, but has not added any resources to the trust fund for the years covered by the financial plan. In fact, as the OPEB liability continues to grow, the city is planning to draw down funds that total more than \$1 billion over FYs 2010 to 2012 from the trust to deal with pension losses, which is a significant step-back in addressing this most serious issue.

In addressing its budget imbalance, the city has acted to reign in the growth rate of debt service costs, one of its largest and fastest growing expenses. Given that debt service expenditures are mainly driven by capital spending, the city announced a reduction in the capital program one year ago. Specifically, the city reduced its four-year capital plan with the goal of containing the growth rate in projected debt service costs to be more in line with the rate of growth for tax revenues, the resource used to pay debt service costs. The city has now extended the capital program reductions over the period of FYs 2010-2019 in its final ten-year capital strategy that was released along with the executive budget in May. In this section of the report, we analyze the new profile of the capital program and the associated debt.

Adding to the increased pressure of rising expenditures are the potential risks to the city's financial plan. Our analysis shows possible lower revenue collections in both nonproperty and property taxes, as well as additional expenditures related to overtime costs and pollution remediation not accounted for in the city's plan. Furthermore, the labor concessions, which need legislative action, are outside the city's control and, if not agreed to, will add to the city's budget imbalance. We estimate these risks to add \$74 million in FY 2010, \$1.2 billion in FY 2011, \$1.3 billion in FY 2012 and \$1.3 billion in FY 2013 to the city's projected multi-billion budget gaps. Our additional risks bring the city's projected budget imbalance in the outyears of the financial plan to more than \$6 billion in FYs 2011 and 2012 and almost \$7 billion in FY 2013.

## **THE OUTLOOK FOR REVENUE GROWTH**

In the city's plan, total revenue falls by \$1.5 billion in FY 2010, after which revenue growth resumes, helped by tax increase programs and a gradual economic recovery. The net effect of the revenue downturn followed by recovery is for total revenue to increase by \$5.1 billion, or 8.4 percent, over the four years of the plan from \$61.1 billion in FY 2009 to \$66.2 billion in FY 2013, as shown in Table 7 on page 18.

City-fund revenues, which fall by \$1.1 billion in FY 2010, begin to grow in FY 2011 with the recovery of the nonproperty taxes. A slowdown affecting the real property tax could weaken the revenue upturn in the outyears of the plan, even as the nonproperty taxes are staging a recovery. The nonproperty taxes plummet \$2.6 billion in FY 2010 and then recover, supported by a gradual economic upturn and by tax increases. The city's tax program increasing sales and business taxes will yield about \$1 billion annually by FY 2013; while two property tax measures, which were partially implemented in FY 2009, will yield \$1.6 billion annually by FY 2013. The net effect of these negative and positive growth trends is that over the next four years city funds increase by \$5.3 billion, or 13 percent, from \$41 billion in FY 2009 to \$46.3 billion in FY 2013.<sup>2</sup>

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<sup>2</sup> City-fund revenues represent funds produced by the local economy and include taxes, miscellaneous revenue (with nonrecurring resources), and unrestricted aid. However, city-fund revenues exclude categorical grants, which are payments from the state and federal governments and third-parties that are restricted in use to specific programs and cannot assist in achieving budget balance.

**CITY FUNDS INCREASE BY \$5.3 BILLION OVER THE NEXT FOUR YEARS,  
RECOVERING FROM THE DOWNTURN EARLY IN THE PLAN**

TABLE 7

(\$ in millions)

	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2009-13 % Change	FY 2009-13 \$ Change
Property Tax	\$14,371	\$16,072	\$17,148	\$17,737	\$18,125	26.1%	\$3,754
Nonproperty Taxes	19,450	16,861	18,518	19,891	21,083	8.4	1,633
Tax Program	0	879	877	943	976	--	976
Audits	980	596	596	595	594	(39.4)	(386)
Miscellaneous	4,098	4,255	4,112	4,151	4,193	2.3	95
Nonrecurring	609	49	20	13	9	(98.6)	(600)
STAR Aid	1,188	902	913	950	1,025	(13.7)	(163)
Unrestricted Aid	340	340	340	340	340	0.0	0
Disallowances	(15)	(15)	(15)	(15)	(15)	0.0	0
<b>Total City Funds</b>	<b>\$41,021</b>	<b>\$39,939</b>	<b>\$42,609</b>	<b>\$44,605</b>	<b>\$46,330</b>	<b>12.9%</b>	<b>\$5,309</b>
Categorical Aid	\$19,577	\$19,165	\$19,393	\$18,768	\$19,409	(0.9%)	(\$168)
Interfund Revenue	468	486	453	443	443	(5.3)	(25)
<b>Total Revenue</b>	<b>\$61,066</b>	<b>\$59,590</b>	<b>\$62,355</b>	<b>\$63,816</b>	<b>\$66,182</b>	<b>8.4%</b>	<b>\$5,116</b>

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

The growth engine in the plan is the real property tax, which increases by \$3.8 billion or 26 percent from \$14.4 billion in FY 2009 to \$18.1 billion in FY 2013. Unfortunately, this source of growth is likely to weaken because the real estate downturn could linger even after other sectors have begun to recover from the recession. In contrast to the property tax, which weakens at the end of the plan period, the nonproperty taxes are already in a steep decline, and begin to recover in FY 2011. The net effect of a current decline followed by a later recovery is that the nonproperty taxes will generate projected growth of \$1.6 billion, or 8.4 percent over the four years, from \$19.5 billion in FY 2009 to \$21.1 billion in FY 2013.

The state's school tax relief (STAR) program is being cut by \$286 million in FY 2010. The city expects the state to gradually restore some of the STAR cuts beginning in FY 2011 so that by FY 2013 STAR aid will be down only \$163 million or 14 percent. The city plan assumes that unrestricted state aid will remain constant at \$340 million per year.

Categorical aid, which falls by about \$400 million in FY 2010, increases unevenly later in the plan. By FY 2013, categorical aid is expected to be restored to \$19.4 billion, which is nearly at the same level as at the start of the plan. Even though the total of categorical aid does not change significantly over the plan, the federal and state contributions do shift considerably. Federal aid, which increases by over \$330 million in FY 2010 largely as a result of stimulus-related medical assistance and education grants, declines in the outyears with the scheduled end of the stimulus program. The financial plan assumes that state aid will pick up starting in FY 2011 to compensate the city for diminished federal aid in the outyears.

**Miscellaneous Revenue**

From FY 2009 to FY 2013, the city projects miscellaneous revenue (including nonrecurring resources) will fall by 10.7 percent or \$505.6 million to \$4.2 billion. If we exclude those parts of the miscellaneous revenue forecast that do not foster long-term growth and budget balance, and focus on the remaining core categories, the projected

decline amounts to 0.5 percent or \$14.2 million to \$2.6 billion by FY 2013.<sup>3</sup> One of the major reasons for the significant difference in the plan variances from FY 2009 to FY 2013 is that the use of nonrecurring actions is expected to wane by FY 2013, as seen in Table 7 on page 18.

Of the six core categories, four of the six are poised for growth over the plan period and the standout is fine revenue. By FY 2013, fines are projected to gain 8.2 percent or \$65.4 million to reach \$863.8 million annually, due to improved enforcement of parking violations, more red light cameras, and higher ticket issuance.<sup>4</sup> From FY 2009 to FY 2013, the remaining two core categories--other miscellaneous and rent--are projected to slip by \$48.4 million and \$39.1 million, respectively. Most of the \$48.4 million plan variance in other miscellaneous arises from less legal settlements, and fewer agency actions and land sales (that may represent conservative forecasting rather than a shortfall). Rental income from several sources, including residential housing and commercial properties owned by the city, is projected to drop by 15.5 percent to \$213.7 million by FY 2013. We expect that as FY 2010 progresses, the projections for miscellaneous revenue will be increased by \$100 million in FY 2010 and \$150 million in each of FYs 2011 through 2013.

### **Property Tax Growth**

The property tax, which grows by \$3.8 billion or 26 percent over the plan period, produces most of the revenue growth shown in the plan. Even though the property tax is the city's main revenue growth engine, most of the growth occurs early in the plan with weak growth projected for the outyears. Property tax revenue growth declines from 12 percent in FY 2010 to seven percent in FY 2011, after which property tax growth slows to three percent in FY 2012 and to two percent in FY 2013. The plan assumes that the robust baseline growth of FY 2010 will continue in FY 2011, but that no property tax increases are in the plan, aside from the two increases that helped lift the current-year growth rate to 12 percent.

The city's property tax growth plan also rests on an assumption that overbuilding has not been a major factor during the boom years of the city's real estate cycle so that property values will not fall sharply. Another assumption is that the pipeline of unused real estate market value increases remaining from the strong growth of previous years will be phased in to support billable assessment growth over the next four years. Increases from past years, which had not been fully recognized in the tax base because of regulations limiting assessment increases with a system of assessment caps and phase-ins, can effectively boost assessment growth during periods of sluggish

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<sup>3</sup> The core categories are licenses, fees or charges, interest, rents, other miscellaneous and fines. It excludes such items as nonrecurring resources, tobacco proceeds, Health and Hospitals Corporation payments, and dedicated funds (e.g. water and sewer charges) that are tied to programmatic expenditures and not available for closing budget deficits.

<sup>4</sup> The other three core categories that are forecast to exhibit positive growth over the FY 2009 to FY 2013 period are licenses (\$0.6 million to \$488.2 million), fees (\$3.8 million to \$659.2 million) and interest (\$3.6 million to \$127.6 million).

market values. This flow-through effectively enabled FY 2010 billable assessments to grow by a very robust seven percent, even though market values recorded on the tax roll fell by one percent.

Much of the decline in market value recorded in the FY 2010 tax roll was confined to the residential property classes. Local realtors report that customer interest has been reviving following a prolonged lull in activity, with improved affordability and the prospect of federal income tax credits perking buyer interest. Prospective buyers, wishing to take advantage of a first-time homebuyer federal income tax credit of up to \$8,000, are finally realizing that they must make their selection soon so as not to miss the December 1, 2009 deadline for this program.

Commercial real estate values increased by seven percent in FY 2010, partly because many new properties, built during the boom years, were added to the tax roll. It is also possible that the substantial lead time needed to collect assessment data could have delayed the recognition of a down market. The FY 2011 tax roll may reveal that the real estate downturn is deeper and more broad based than had been previously measured. Furthermore, restrictions on credit availability and upward pressure on mortgage rates remain significant risks to the real estate market, and could extend the real estate downturn. Should these negative circumstances develop, the city may need to reevaluate its seven percent property tax growth target for FY 2011. For these reasons we hold the property tax at risk for \$100 million in FY 2011, \$200 million in FY 2012, and \$300 million in FY 2013.

### **Economic Outlook**

With the nation in the midst of a most severe recession, the national government has provided leadership and stimulus funds to get the economy back on track. While there are some indications that the recession is bottoming out, the nation's recovery could be a long drawn-out process. For the city, the recovery phase could be further delayed because the city's employment downturn has been lagging nearly one year behind the national downtrend, and because local economic activity is falling sharply.

To bolster its weakening economy and to help offset sagging revenues, the city is slated to receive \$4.2 billion in federal economic stimulus grants. Capital projects received \$378 million in stimulus funds in FY 2009. The city medical assistance program received \$447 million in stimulus grants in FY 2009, and this funding expands to \$850 million in FY 2010 and drops to \$295 million in FY 2011. The stimulus program includes an allotment of about \$1 billion in education funds in each of FYs 2010 and 2011, as well as \$223 million in other grants. While these stimulus funds are helping the city cope with shrinking tax collections while providing a much-needed boost to the local economy, the federal relief is slated to end in FY 2012. If the local economic recovery is indeed delayed, it is possible that city tax collections will not have recovered sufficiently by FY 2012 to offset the cutoff of federal stimulus aid.

A glimmer of hope that the recession was nearing its low point was that the nation's May job loss of 322,000 was about half of the average monthly decline for the preceding six months. Job losses accelerated to 467,000 in June, while the unemployment rate increased slightly to 9.5 percent, indicating that path to recovery



might be prolonged and uneven. Closer to home, New York Stock Exchange member firms earned record-setting profits of \$8.2 billion in the first quarter of 2009. Sadly, this stunning gain offsets only a small portion of the \$54 billion in losses accumulated over the previous two years. If the Wall Street rally is sustained it could pull the local economy out of the doldrums. However, even if the stock market has been on a rebound, this extremely volatile economic growth source cannot be counted on to produce the consistent steady growth needed to stabilize the city's finances.

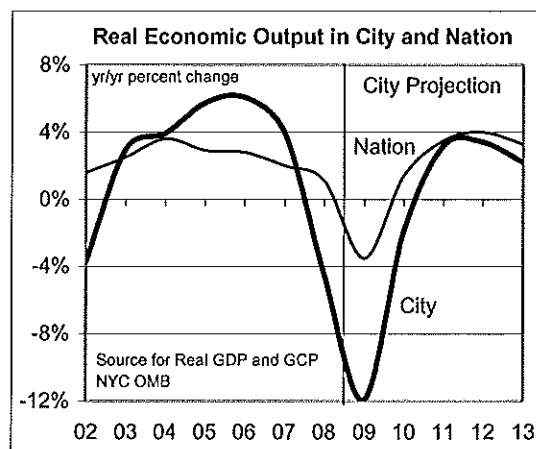
The local economy, which was still expanding even while the nation was in decline, is now experiencing severe job and income losses. The city did not see persistent job declines until November 2008, ten months after the nation's downturn had begun. It is therefore possible that the local economy will continue to fall even after the nation has begun to recover. Notwithstanding the delayed local downturn, by June the city's unemployment rate of 9.5 percent caught up to the nation's jobless rate.

Also as of June, the city had lost 96,000 jobs compared with the previous year, a loss rate of 2.5 percent. Although the local loss rate is not as severe as the nation's 4.2 percent year-over-year job loss rate, the city's job losses are concentrated in the high-paying securities sector, which is shedding jobs at a 12 percent rate. This hit to local finance jobs is causing a disproportionately severe drop in income, spending, and local tax collections. It now appears that the local job market will ebb even as the nation has started to recover and that the financial sector could sustain further shrinkage. These factors could extend the duration and the severity of the local downturn.

The city expects that the local downturn will be deeper and more severe than the nation's recession. The figure to the right, which shows the annual growth of real gross domestic product (GDP) along with real gross city product (GCP), compares the economic growth of the city to that of the nation.

Following the recession of 2001, GDP recovered to a peak growth of 3.6 percent in 2004. Since that high point, national output growth gradually weakened and slid to 1.1 percent in 2008, indicating that the recession was taking its toll on national output growth. The city's forecast sees GDP falling by a very hard 3.5 percent in 2009, before staging a weak recovery of 1.4 percent in 2010. National growth accelerates to 3.5 percent in 2011 and reaches a peak of four percent in 2012, before growth eases back toward the long-term trend of three percent.

The figure indicates that local economic growth reached a peak in 2006 with extraordinary growth that topped six percent. Local economic growth slipped to 3.9 percent in 2007 as securities industry profits evaporated and turned into an \$11 billion loss by the end of that year. Wall Street losses worsened to \$43 billion in 2008 and by the third quarter finance wage earnings had fallen 3.7 percent. These falling incomes are



reflected in the decline of GCP by an estimated 4.5 percent in 2008. The city sees GCP falling by 12 percent in 2009 and by two percent in 2010, for a three-year decline of 18 percent. Evidence that the city's dire outlook could be realized is in the 12 percent decline in securities industry jobs and the 3.7 percent drop in finance wages. The city outlook sees GCP recovering in 2011, with local growth lagging behind the more vigorous national economic recovery.

In an independent report, the New York City Comptroller indicates that the downturn in local economic output is not quite as severe as the nation's, with GCP falling at an annual rate of 4.1 percent in the first quarter of 2009 versus a 5.5 percent decline for GDP.<sup>5</sup>

### **Nonproperty Taxes**

The city expects the nonproperty taxes to increase by \$1.633 billion, or 8.4 percent, over the next four years, from \$19.5 billion in FY 2009 to \$21.1 billion in FY 2013, as shown in Table 7 on page 18. The recession is dragging down the city's nonproperty tax receipts by \$2.6 billion, or 13 percent in FY 2010. This drop follows the more severe decline of 17 percent in FY 2009. The plan anticipates that these taxes will recover with projected growth of 10 percent in FY 2011, seven percent in FY 2012, and six percent in FY 2013. The near term revenue losses reflect the weakness of the personal income, sales, and business taxes as well as the slumping real estate transactions taxes.

**Property Transactions Taxes.** With the transactions taxes in the third year of a severe downturn, this badly weakened revenue source could be nearing its low point. The city expects the two property transactions taxes (the real property transfer tax and the mortgage recording tax) to fall 14 percent in FY 2010. This decline follows the far more severe revenue losses of 51 percent in FY 2009 and 23 percent in FY 2008. Revenue is down by a staggering \$2.2 billion, or 67 percent, from a peak level of \$3.3 billion in FY 2007 to \$1.1 billion in FY 2010. Revenues begin to recover, in the city's plan, with annual growth of about 10 percent in FYs 2011-2013.

Improved affordability for homes and apartments and tax incentives for first-time homebuyers is starting to revive the residential real estate market. However, even if transactions volume starts to improve, lower home prices will hold down transaction tax revenue. Furthermore, the stalled commercial market would have to revive before tax collections could begin to improve. The city's plan for the commercial rent tax reflects its long term view that commercial real estate may not yet be poised for recovery. Revenue from this tax on commercial renters is scheduled to fall moderately in FYs 2010-2012, with no recovery in sight before FY 2013.

**Business Taxes.** The city's three business income taxes (the general corporation tax, the banking corporation tax and the unincorporated business tax) are in a third year of a revenue decline. These taxes, which fell by 10 percent in FY 2008 and by seven

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<sup>5</sup> See "New York City Recession Moderates" Office of the New York City Comptroller *Economic Notes* vol. XVII. No.2 (July 2009).

percent in FY 2009, drop 21 percent in the city's plan for FY 2010. Revenues are down by \$2 billion from the peak \$6 billion collected in FY 2007 to \$4 billion estimated for FY 2010. The plan calls for revenues to recover with annual growth exceeding 12 percent in FYs 2011-2012, followed by more modest growth of seven percent in FY 2013. However, even with the robust recovery projected for the outyears, growth would be insufficient to fully offset the steep decline occurring in FYs 2008-2010, leaving FY 2013 revenues below the peak achieved in FY 2007.

Part of the revenue loss in FY 2010 is attributable to federal business tax increases associated with the national stimulus program. The city expects to lose \$145 million in FY 2010 business tax revenue as local businesses adopt tax avoidance strategies to limit exposure to new federal tax rules. Additionally, the city is implementing a business tax conformity program that will raise about \$150 million annually from FY 2010 through FY 2013. This program would make city business tax rules conform more closely to existing state tax rules. Although this plan raises business tax revenue in the near term, businesses will see their taxes reduced when the conformity program is fully phased in.

The city's business taxes remain weak because of a downturn in national pretax corporate profits and securities industry profits. Corporate profits, which fell by 15 percent in CY 2008, recovered to \$1,352 billion earned in the first quarter of 2009, from \$1,195 billion earned in the final quarter of 2008. Despite this auspicious upturn, profits are still down by 23 percent in the first quarter, compared with the comparable period of the previous year. The city's economic outlook sees corporate profits falling 17 percent in 2009, before recovering with 20 percent growth in 2010. The securities industry, which achieved near-record earning of \$21 billion in 2006, reported losses of \$11 billion in 2007 and an even more severe loss of \$43 billion in 2008. Securities profits staged an impressive recovery, with record-setting earnings of \$8.2 billion in the first quarter of 2009. If these upturns in corporate and Wall Street profits prove to have staying power, they could hasten the recovery of business tax revenues.

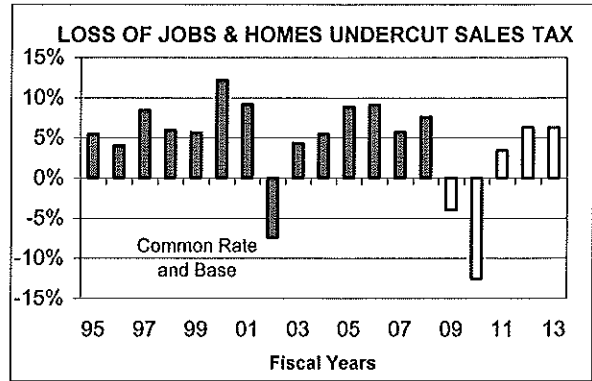
**Sales Tax.** In response to more layoff announcements (locally and nationally), lower income (e.g. reduced weekly work hours and bonus payouts), and loss of wealth from falling home prices and low stock valuations in retirement accounts, consumers have increased their savings to historically high rates.<sup>6</sup> This change in consumer behavior is reflected in lower personal expenditures, which now reflect purchases of necessities, paying down of debt, and rising gas prices. Complicating matters for the city (and sales tax collections) is that while the local economy is reeling from the loss of higher-paying jobs in the securities and related industries, it is also negatively impacted by fewer tourists.

In this environment, the city's latest sales tax forecast (on a continuing base) reveals two years of negative growth in FYs 2009 and 2010 before a recovery in

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<sup>6</sup> In "May Incomes Surge, But Savings Outpace Spending," by Martin Crutsinger of the Associated Press (online) on June 26, 2009, the Commerce Department reported that the household savings rate was 6.9 percent in May (up from 5.6 percent in April), which represents the highest rate since December 1993. In the most recent period of economic growth and rising home prices from 2005 to 2007, the savings rate was under one percent.

employment and income in 2011 propels sales tax revenue. As seen in the figure to the right, collections are expected to sink by a negative four percent and a negative 12.6 percent (on a continuing base) in FYs 2009 and 2010, respectively. By FY 2011, sales tax collections are anticipated to bounce back by 3.4 percent, and leap 6.3 percent in both FYs 2012 and 2013.<sup>7</sup>



The sales tax data in the figure for FYs 2010 through 2013 does not include the city's latest tax program, which was recently passed by the state legislature. As part of the city's gap-closing program, the local sales tax rate will increase by 0.5 percent to 4.5 percent on August 1<sup>st</sup> and the repeal of the exemption on purchases of clothing and footwear priced at and above \$110 will be in effect on September 1<sup>st</sup>. (The exemption would continue on purchases of clothing and footwear priced under \$110 to mitigate the regressivity of the sales tax). Also, the exemption from local taxation on the transmission and distribution of electricity and natural gas from alternative energy suppliers will end on August 1<sup>st</sup>. Originally, the city expected the sales tax program to raise \$720 million in FY 2010, if it was implemented at the beginning of the year. Due to the delayed enactment of the tax law changes, the yield may be \$70 million lower than projected by the city.

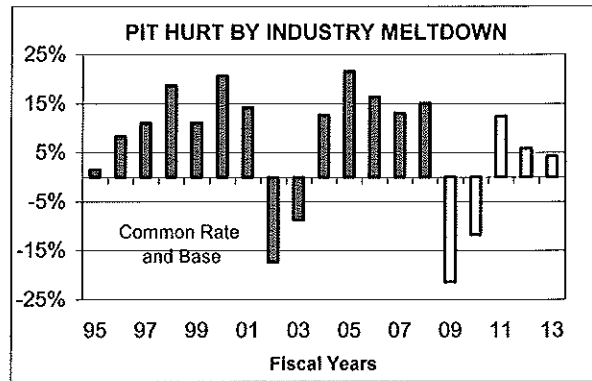
Setting the city's tax package aside for a moment, the figure above illustrates the city's view of the consequences to sales tax revenue of a national recession and local economic downturn in 2009 and 2010 and a recovery beginning in 2011. Recent forecasts by the Federal Reserve and private economists have raised the possibility of an easing of the recession or weak positive growth in the gross domestic product by the end of 2009, although it might take longer for a rebound in the labor market. The city estimates that nationally job losses will reach five million in 2009 and one million in 2010, before job gains of 1.9 million in 2011. Local employment is estimated by the city to fall by 172,000 in 2009 and 129,000 in 2010, and advance by only 9,000 in 2011. During this time, wage earnings are estimated to fall by a negative 10.7 percent in 2009 and a negative 4.8 percent in 2010, and rise by 3.3 percent to \$259.5 billion in 2011. While reasonable, the city's outyear sales tax forecast is dependent upon the timing of the end of the local economic downturn, the strength of the national recovery, and if there is a permanent (frugal) change in consumer spending. These concerns are mitigated by the new sales tax package that is expected to raise about \$800 million annually.

**Personal Income Tax.** FY 2009 was a tough year for the personal income tax (PIT) and the city's initial outlook for FY 2010 is for a continuation of the same adverse conditions--declining profits on Wall Street leading to reduced finance sector compensation, steep local and national job cuts, and falling nonwage income from

<sup>7</sup> "On a continuing base" or "on a common rate and base" refers to tax collections that have been adjusted to remove the effects of tax programs and law changes to focus on the influence of the economy.

shrinking capital gains realizations--until an economic recovery in FY 2011. There are signs that the national recession is easing and some degree of stability is returning to the stock, credit, and housing markets, but there is no evidence yet of a sustained period of positive economic and employment growth. Also, one of the wildcards in any outlook for the PIT and the financial industry are the new federal regulations, e.g. management and compensation practices, which may extend past the time when the Federal Reserve adopts a less interventionist role in the financial markets. The other wildcard is whether the recent report of profitability in the securities industry will extend to subsequent quarters in 2009.<sup>8</sup>

As seen in the figure to the right, the city forecasts PIT revenue to sink in FYs 2009 and 2010 by a negative 21.4 percent and a negative 11.8 percent (on a continuing base), respectively. One of the reasons, apart from economic conditions, for the plunge in FY 2009 PIT revenue is that the state took nearly \$600 million from the city as reimbursement for overdistributions in offset payments from tax years 2001 to 2007.<sup>9</sup> After facing steep declines in income (wage and nonwage) and employment because of the local and national economic downturns, and the implosion in the financial sector (including the securities industry), the city expects a strong rebound in PIT revenue growth of 12.4 percent in FY 2011 (on a common rate and base), and that growth will moderate in the outyears to 5.8 percent in FY 2012 and 4.3 percent in FY 2013. The turnaround in PIT revenue starting in FY 2011 is illustrated below in the city's assumptions for the following indicators.



**Securities Industry Profits.** After three years of losses for New York Stock Exchange (NYSE) member firms in 2007 (\$11.3 billion), 2008 (\$42.6 billion) and 2009 (city estimate of \$14.3 billion), NYSE member firms are expected to earn \$6.9 billion in 2010 and \$8.1 billion in 2011. After 2011, securities industry profits are forecast to grow on average by \$1.6 billion annually to reach \$11.2 billion in 2013.

**Finance Sector Compensation.** After achieving a high of \$97.1 billion in 2007, finance sector compensation (including bonuses) is projected to reach a low of \$57.6 billion in 2010, which represents a loss of \$39.5 billion or 40.7 percent over three years. The city expects finance sector compensation to grow by 4.6 percent to \$60.3 billion in 2011 and remain at the \$60 billion level through 2013.

<sup>8</sup> First quarter 2009 profits for New York Stock Exchange member firms totaled \$8.2 billion, which is a record high and even surpasses the first quarter results for 2000.

<sup>9</sup> An offset payment from the state to the city occurs when a high-income taxpayer fails to accurately allocate his liability between the city and state in the extension payment on the April final return, which is later reconciled by the state. This kind of error can also occur in a taxpayer's quarterly installment payment.

**Employment.** From peak-to-trough, the city projects national job losses will reach 7.3 million from the fourth quarter of 2007 to the first quarter of 2010; local job losses may climb to 328,000 from the third quarter of 2008 to the third quarter of 2010. Within the local job cuts, the securities industry is expected to lose 47,000 jobs from the fourth quarter of 2007 to the second quarter of 2010.<sup>10</sup>

**Capital Gains Realizations.** From a peak of \$57.8 billion in 2007, capital gains realizations are estimated to fall by \$35.9 billion or 62.1 percent to a plan low of \$21.9 billion in 2009, because of the lack of credit to facilitate residential and commercial property purchases and the decline in stock valuations. This nonwage income source is projected to improve and average \$30.1 billion annually from 2010 to 2013.

Historically speaking, it is not unusual for PIT revenues to quickly turnaround and soar when the nonfinance sectors of the local economy are adding jobs, the finance sector (particularly the securities industry) is profitable with some job growth, and the national economy is expanding. In this scenario, credit is available for residential and commercial real estate transactions (in a functioning housing market), and the equity market, while volatile, is on an upward trend (leading to capital gains realizations).

However, despite some promising signs, such as \$8.2 billion recorded as first quarter 2009 profits for NYSE member firms, the current environment is still far from normal. Several of the investment and commercial banks that were able to promote a boom period after the last downturn in FYs 2002-03, are either out of business, re-emerged as bank holding companies, or are still in the Troubled Asset Relief Program (TARP). One reason for the recent uptick in market activity is related to financial institutions raising private capital without government guarantees to leave TARP and the restrictions on executive compensation.

While the Federal Reserve reports some signs of easing in the severity of the national recession and is developing an exit strategy, it is still heavily involved in promoting liquidity in the banking sector and the credit markets, e.g. accepting risky collateral from financial services firms and purchasing mortgage and consumer debt. Also, the federal impetus to restructure the financial sector (e.g. banking and investments) continues and includes new proposals for increased oversight, linking employee compensation with long-term company performance, and limiting bonuses for executives to one-third of annual salaries.<sup>11</sup> In this time of transition, it is unclear how compensation in the financial sector (particularly the securities industry) will be structured (e.g. base salary, bonus payout, and stock options) and what the industry will look like by the outyears of the forecast period in FYs 2011-13. For these reasons, we

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<sup>10</sup> The financial sector, of which the securities industry is a part, is forecast to lose 75,000 jobs from the fourth quarter of 2007 through the first quarter of 2011.

<sup>11</sup> "Salaries Safe, Bonuses Hit" by Deborah Solomon of the Wall Street Journal (online) on June 10, 2009.

believe that PIT revenues will be lower by \$150 million in FY 2011 and \$75 million in FY 2012.

## **SOURCES OF EXPENDITURE GROWTH**

Our projections for total expenditures between FYs 2009 and 2013 rise by more than \$10 billion, or 16.7 percent, with total spending reaching \$71.4 billion in the final year of the plan from \$61.1 billion in FY 2009, as shown in Table 8. Personal service increases by 12 percent, which is driven mainly by an almost 20 percent increase in pension costs. The more than \$1.2 billion increase in the city's pension bill is the result of investments losses of 5.4 percent in FY 2008 and about 20 percent in FY 2009. The city's other than personal service expenditures are expected to increase by 15.3 percent. The primary cause of the growth in this area is debt service, which is projected to increase by 62.5 percent.

### **THE CITY'S EXPECTED TOTAL EXPENDITURE GROWTH BETWEEN FYs 2009 AND 2013**

**TABLE 8** (yr/yr percent change, \$ in millions)

	FYs 2009-10	FYs 2010-11	FYs 2011-12	FYs 2012-13	FYs 2009-13	Level in FY 2009	Level in FY 2013
<b>Total Expenditures</b>	<b>(2.3%)</b>	<b>11.8%</b>	<b>2.3%</b>	<b>4.4%</b>	<b>16.7%</b>	<b>\$61,144</b>	<b>\$71,371</b>
<b>Total PS</b>	<b>2.9%</b>	<b>3.1%</b>	<b>(0.1%)</b>	<b>5.7%</b>	<b>12.0%</b>	<b>\$34,105</b>	<b>\$38,206</b>
Salaries and Wages	2.3%	3.4%	(1.9%)	3.8%	7.7%	21,345	22,991
Fringe Benefits	3.0%	0.2%	1.1%	13.8%	18.7%	6,493	7,708
Pensions	4.9%	5.1%	4.7%	3.8%	19.8%	6,268	7,507
<b>Total OTPS</b>	<b>(2.4%)</b>	<b>9.1%</b>	<b>5.1%</b>	<b>3.0%</b>	<b>15.3%</b>	<b>\$28,762</b>	<b>\$33,165</b>
Public Assistance	(1.0%)	0.0%	0.0%	0.0%	(1.0%)	1,313	1,299
Medicaid	(5.5%)	14.6%	8.3%	3.0%	20.8%	5,192	6,271
Debt Service	16.1%	23.8%	8.2%	4.5%	62.5%	4,018	6,530
Other OTPS	(5.7%)	4.3%	3.5%	2.7%	4.5%	18,239	19,064

Note: Includes city, state, and federal funds. Excludes interfund agreements and intra-city funds.  
Numbers may not add due to rounding.

Between FYs 2009 and 2013, fringe benefit expenses increase 18.7 percent from approximately \$6.5 billion to just over \$7.7 billion. As shown in the table, fringe benefits growth remains relatively flat between FYs 2010 and 2012 but increases significantly from FY 2012 to FY 2013 by \$934 million, or 13.8 percent. The increase is due to a technical adjustment for the restoration of a planned drawdown of the Retiree Healthcare Benefits Trust in FY 2013 to help fund pension systems losses. As a result of collective bargaining agreements, salaries and wages are projected to increase by 7.7 percent over the life of the financial plan.

While the city expects that public assistance costs will remain constant for the entirety of the financial plan at about \$1.3 billion, medical assistance spending will revert to its historical growth level of three percent (costs are capped at three percent annually with the state financing any costs above the cap) after FY 2011 when federal stimulus funding ends. The changes in the Federal Medical Assistance Percentages (FMAP) rates enacted by the federal government as part of its stimulus package enabled

the city to reduce expenditures for Medicaid from October 2009 to December 2011 by \$1.6 billion. After receiving \$447 million in FY 2009, the city will see further savings of \$850 million in FY 2010 and \$295 million in FY 2011.

As mentioned in "FY 2010 Agency Program" starting on page 11, the city had restored \$314 million in initiatives and added \$50 million for discretionary spending to the FY 2010 Adopted Budget. Also, the city has used \$225 million of surplus funds to prepay health insurance costs for FY 2010. Further, the city has postponed the start of annual planned savings of \$200 million from the creation of a Tier V in the pension systems until FY 2011. To allocate resources to these areas for FY 2010, the city has put off a planned debt defeasance of \$530 million and performed a technical adjustment to reduce labor reserve by \$200 million due to a planned decrease in headcount. The city has also planned to reduce the labor reserve by a further \$279 million in each of FYs 2011 and 2012.

### **Pension Costs**

In its FY 2010 Adopted Budget, the city reports a projected FY 2010 pension cost (total funds) of almost \$6.7 billion, which is expected to be about \$300 million higher than in FY 2009. As shown in Table 9, over the life of the financial plan, pension costs are projected to rise by about \$300 million annually from \$6.7 billion in FY 2010 to \$7.6 billion in FY 2013.

TABLE 9

#### **PROJECTED PENSION CONTRIBUTIONS FOR FYs 2010-2013**

(\$ in millions)

<b>Funding Source</b>	<b>FY 2010</b>	<b>FY 2011</b>	<b>FY 2012</b>	<b>FY 2013</b>
City	\$6,535.0	\$6,853.1	\$7,175.8	\$7,447.0
State	37.9	54.1	55.1	57.1
Federal	2.5	2.5	2.5	2.5
Intra-City	124.3	124.3	124.3	124.3
<b>Total Contributions</b>	<b>\$6,699.6</b>	<b>\$7,034.0</b>	<b>\$7,357.6</b>	<b>\$7,630.9</b>
Note: Numbers may not add due to rounding.				

The city's pension contribution covers contributions made to five primary systems and an additional number of noncity and nonactuarial systems, as shown in Table 10 on page 29. The New York City Retirement Systems (NYCRS) is comprised of the New York City Employees' Retirement System (NYCERS), the Teachers' Retirement System of the City of New York (TRS), the New York City Police Pension Fund, the New York City Fire Department Pension Fund, and the New York City Board of Education Retirement System (BERS).



TABLE 10

**RECONCILIATION OF PROJECTED CONTRIBUTIONS FOR FYs 2010-2013**

(\$ in millions)

<b>Plan Adjustments</b>	<b>FY 2010</b>	<b>FY 2011</b>	<b>FY 2012</b>	<b>FY 2013</b>
NYCERS	\$1,200.0	\$1,223.9	\$1,196.8	\$1,166.7
TRS	2,409.8	2,324.2	2,354.6	2,377.6
Police	1,980.1	1,984.5	2,000.6	1,945.5
Fire	874.1	855.4	858.1	827.3
BERS	125.0	133.6	137.2	139.5
NonCity Systems	64.9	69.9	71.9	76.9
NonActuarial Systems	45.8	49.8	50.8	52.8
Financial Plan Adjustments	0.0	592.7	887.7	1,244.5
Tier V Proposal Savings	--	(200.0)	(200.0)	(200.0)
<b>Total Pension Contributions</b>	<b>\$6,699.6</b>	<b>\$7,034.0</b>	<b>\$7,357.6</b>	<b>\$7,630.9</b>
Numbers may not equal those in Table 9 on page 28 due to rounding.				

Every fiscal year, the city makes a required contribution to its pension systems. As shown in Table 10, the city's annual contribution is comprised of separate contributions to each pension system, noncity systems and nonactuarial systems. In addition, the city often makes financial plan adjustments to its budgeted projections. When necessary, the pension systems need additional funding to meet obligations, such as in the case of a new collective bargaining agreement or the funding of an investment loss. Each system invests its portfolio of assets in a variety of investments such as common stocks, bonds and other alternative investments such as real estate, with the goal of attaining a return of eight percent (the required rate of return) or above. A gain on investments above this required rate of return or Actuarial Interest Rate (AIR) increases the value of assets; a loss depreciates their value. A return under eight percent is considered to be an investment loss. The city manages the ebbs and flows of investment gains and losses by using a six-year phase-in policy. This phase-in method allows the city to manage severe losses at the time that they are incurred. Investment gains are also phased in over time and offset the phase-in of investment losses. This process smoothes investment returns and reduces fluctuations over a long-term investment horizon.

As mentioned, the city routinely makes financial adjustments to its pension costs to compensate for additional funding needs. As shown in Table 10, in its FY 2010 Adopted Budget, the city expects to make no additional financial plan adjustments to its FY 2010 projected pension cost, but it is expected to add \$592.7 million in FY 2011, \$887.7 million in FY 2012, and \$1.245 billion in FY 2013.

As mentioned in "Pensions" starting on page 14, the city made necessary funding available for FY 2010 to cover such items as: the first year phase-in of an investment loss incurred in FY 2008, a valuation update made by the city actuary, and a PBA settlement. The adjustments made in FY 2011 to FY 2013 reflect the same funding needs, but in addition to the phase-in of losses from FY 2008, the city must also begin to fund an almost \$30 billion unexpected investment loss suffered by the pension systems in FY 2009, which begins to be phased-in in FY 2011.

The city has provided a substantial amount of resources to cover an expected 20 percent investment loss in FY 2009. Since the FY 2009 Adopted Budget, the city has allocated substantial funding (with offsets for reserve adjustments) to cover the phase-in of FY 2008 and FY 2009 losses in FYs 2011-2013. To provide these resources, the city is reducing the funding allocated to the Retiree Health Benefits Trust (RHBT) by \$82

million in FY 2010 that is used to pay annual healthcare insurance for current and retired city workers. It plans further reductions to the RHBT of \$395 million in FY 2011 and \$672 million in FY 2012, to offset the phase-in of pension losses in those fiscal years. The city had planned to draw down an additional \$957 million in FY 2013; however, this plan has been reversed and deemed unnecessary. In addition to the use of RHBT resources to offset investment loss funding, the city is also relying on the creation of a Tier V for newly hired city employees that will yield recurring annual pension cost savings. The city estimates that it will be able to reduce its annual pension costs by \$200 million annually contingent upon state legislative approval starting in FY 2011. A similar bill has been put together by the Governor in order to produce recurring annual state pension savings. Though the bill has not become law, two of the largest state unions have backed the measure. Additionally, support has come from the United Federation of Teachers, having conceptually agreed with the city for a Tier V for new teachers. The city had planned for the savings to begin in FY 2010; however, it has delayed this initiative given that state legislative approval has not occurred.

As discussed, the city has projected and funded for an investment loss of 20 percent for FY 2009. We believe that the losses to the systems will be slightly less than what the city has projected, about 19.6 percent. We believe that the city has provided adequate funding over the life of the financial plan for the phase-in of investment losses stemming from FYs 2008 and 2009 and find no risk of deficit funding. However, the city will need to fund the phase-in of both FY 2008 and FY 2009 losses in future years at a much higher phase-in percentage rate. Our analysis, for example, estimates that the city will have to fund FY 2009 investment losses of \$2.5 billion annually in addition to FY 2008 losses by FY 2016.

The expected rise in pension costs over the life of the financial plan, driven mainly by investment losses that occurred in FYs 2008 and 2009, are pushing up total city expenditures. The city's expenditures are expected to outpace revenue forecasts over this period. The city's projection of pension costs is expected to grow by nearly 20 percent from FY 2009 to FY 2013 with average annual growth of 4.6 percent. This puts the city in a precarious situation as it contends with projected budget gaps for FYs 2011 through 2013 that hover around \$5 billion or more. With little control over pension obligations that need annual funding, and while contending with multi-billion dollar investment losses and no surplus resources to draw from (though the city may opt to use the RHBT again as a resource), the city is facing even higher pension costs beyond the financial plan. We expect that pension costs will likely rise to more than \$10 billion by FY 2016. Additionally, the city's use of RHBT funding in FY 2010 to FY 2012, to fund investment losses, will require a total drawdown of more than \$1.1 billion. While monetarily, the use of the RHBT serves as a resource to pare down the impact of pension losses to the city's budget, the use of the RHBT is a departure from the initial steps taken in FY 2006 to deal with this growing unfunded liability.

#### **Unfunded Other Postemployment Benefit Liabilities to Grow Substantially**

Health insurance benefits provided to eligible city retirees and their beneficiaries are known as Other Postemployment Benefits (OPEB) and are funded through the New York City Health Benefits Program. OPEB is comprised of health insurance payments, as well as payments related to dental and vision care, prescriptions, Pre-Medicare and

Medicare, welfare fund contributions and Medicare Part B reimbursements. The city follows a pay-as-you-go policy for OPEB payouts, meaning that the costs are paid each year as they are claimed or distributed. Prior to 2004, OPEB payouts were reported as annual health cost expenditures, but the reporting process changed when the Governmental Accounting Standards Board (GASB) established a set of standards for governments to follow for reporting OPEB costs much like the standards set forth for pension reporting.

As stated by the GASB requirement, the city is not required to fund the OPEB liability. However, the city decided that it would be prudent to address the GASB issue and the New York City Retiree Health Benefits Trust (RHBT) was legally formed and funded in June 2006 with \$1 billion. In FY 2007, the city made an additional \$1.5 billion payment to the trust.

The city's OPEB liability is comprised of the promised benefit payments to city workers at retirement. Those promised payments are the Unfunded Actuarial Accrued Liability (UAAL) or present value of those future benefit payments. The UAAL was initially \$50.5 billion, as reported in FY 2006. The amount represents the required allocation of funds needed to fully fund the RHBT at that time. The liability has grown each fiscal year since then and remains significantly under funded. As of FY 2008, the UAAL has grown to \$63.7 billion and would require as much to be considered properly funded.

As shown in Table 11, beginning with FY 2009, the UAAL of \$64.4 billion is the value at the end of FY 2008 after adding for the projected annual growth in healthcare payments for pre-Medicare, Medicare, welfare funds and Part B premiums. After adjustments for the normal cost or required annual contribution of \$3.2 billion that would be paid if the city had fully funded the plan, interest income of \$2.7 billion that would have been collected on the fully-funded assets held by the trust, and \$1.5 billion (includes \$460 million prepayment) for the pay-as-you-go OPEB expenses that are paid through the trust fund, the OPEB liability is expected to grow to almost \$68.8 billion in FY 2009 or almost \$20 billion higher than when the OPEB liability was initially recognized on the city's balance sheet in FY 2006.

**TABLE 11** **SUMMARY OF PROJECTED UNFUNDED ACTUARIAL ACCRUED LIABILITY**  
(\$ in millions)

	FY 2009p	FY 2010p	FY 2011p	FY 2012p	FY 2013p
UAAL at Beginning of Year	\$64,402	\$69,966	\$76,201	\$83,197	\$91,057
Normal Cost	3,235	3,364	3,498	3,638	3,784
<b>Subtotal</b>	<b>\$67,637</b>	<b>\$73,330</b>	<b>\$79,700</b>	<b>\$86,836</b>	<b>\$94,840</b>
Interest @ 4%	2,705	2,933	3,188	3,473	3,794
Pay-As-You-Go OPEB*	(1,506)	(1,655)	(1,833)	(1,966)	(2,142)
RHBT Contribution	0	0	0	0	0
<b>UAAL at End of Year</b>	<b>\$68,836</b>	<b>\$74,608</b>	<b>\$81,055</b>	<b>\$88,343</b>	<b>\$96,492</b>
*Includes prepayments of \$460 million in FY 2009 and \$225 million in FY 2010, and RHBT drawdowns of \$82 million in FY 2010, \$395 million in FY 2011, and \$672 million in FY 2012.					
Note: Numbers may not add due to rounding. <span style="float: right;">p=projected</span>					

As discussed in "Pensions" starting on page 14, the pension systems' total investment loss was 5.4 percent. To mitigate the budget impact of financing the loss,

which begins to phase-in in FY 2010, the city has planned to draw down \$1.1 billion from the RHBT. The city plans to reduce the trust fund by \$82 million in FY 2010, \$395 million in FY 2011 and \$672 million in FY 2012. As shown in the table, our analysis projects that the OPEB liability is expected to climb to more than \$96 billion by FY 2013 or approximately double the size of what it was in FY 2006. No further contributions to the RHBT are in the city's financial plan.

The city is facing considerable fiscal strain in the years ahead with multi-billion dollar budget gaps that must be closed. It is clear from our analysis that the OPEB liability is likely to grow in the future beyond FY 2013 to well above \$100 billion, which is substantially more than the market value of the assets held by the city's pension systems. The city needs to address this serious growing liability. Given few options, it has two possible ways, within its control, that it can approach the issue. One is to reduce healthcare costs to retirees through collective bargaining and, in conjunction with or alternatively to, increase contributions to the RHBT dramatically on a sustained year-to-year basis. The city has made strides in one of these areas with the modification of the New York City Health Benefits Program. The city and the Municipal Labor Committee have tentatively agreed on a proposal to charge covered employees' and retirees' co-payments for certain medical services, which are expected to produce savings of \$200 million in each of FYs 2010 and 2011 and recurring annual savings of \$150 million thereafter. The city has also proposed and presented in the financial plan a 10 percent premium health insurance contribution. The savings of \$357 million were originally scheduled for FY 2010 but are now projected to start in FY 2011. The savings are expected to continue in subsequent fiscal years but no agreement has been made with city employees on this cost-containment initiative.

### **Citywide and Uniformed Services Overtime**

In FY 2009, total citywide overtime expenditures will exceed \$1 billion for the second consecutive fiscal year and are likely to be even higher for FY 2010. Our analysis of overtime spending reveals that the average annual growth rate over the past five fiscal years (FYs 2005 to 2009) for total citywide overtime is 3.2 percent. Based on this number, we expect overtime spending for all city agencies to top \$1 billion for FY 2010. Also, we observe that total overtime expenditures for nonuniformed agencies grew 32 percent or \$54 million from FYs 2005–2009, while total overtime expenditures for uniformed agencies (Police, Fire, Correction, and Sanitation Departments) have grown by nine percent or \$65 million over the same period. Still, the main component of total citywide overtime spending is the uniformed agencies, which account for about 78 percent or \$785 million of total citywide overtime expenditures.

The percentage of overtime costs in the PS budget for uniformed agencies over the life of the financial plan is shown in Table 12 on page 33. As shown in the table, over the life of the financial plan, a sizable portion of city-funded PS expenditures for the uniformed service agencies are allocated to overtime expenditures generated by uniformed and civilian personnel with the majority being produced by uniformed workers.

**FY 2010 ADOPTED PERSONAL SERVICES VS. OVERTIME  
UNIFORMED AGENCY EXPENDITURES**

**TABLE 12**

(\$ in millions)

	Police	Fire	Sanitation	Correction
<b>FY 2010</b>				
PS Budget	\$4,096	\$1,487	\$776	\$871
OT Budget	\$373	\$183	\$65	\$60
OT as % of PS	9%	12%	8%	7%
<b>FY 2011</b>				
PS Budget	\$4,195	\$1,483	\$816	\$886
OT Budget	\$390	\$183	\$66	\$64
OT as % of PS	9%	12%	8%	7%
<b>FY 2012</b>				
PS Budget	\$4,272	\$1,481	\$822	\$902
OT Budget	\$390	\$183	\$66	\$65
OT as % of PS	9%	12%	8%	7%
<b>FY 2013</b>				
PS Budget	\$4,258	\$1,478	\$820	\$899
OT Budget	\$391	\$183	\$66	\$65
OT as % of PS	9%	12%	8%	7%
Note: Above expenditures are city-funded and are for uniformed and civilian personnel.				

Most notable from the table, it is observed that although about 50 percent of total uniformed overtime spending, or \$373 million, is accounted for by the Police Department, their overtime costs account for only nine percent of their total city-funded department budget, or \$4.1 billion. In comparison, the Fire Department has a considerably smaller budget for PS of about \$1.5 billion and overtime expenditures of \$183 million but the ratio of overtime spending to PS spending is three percentage points higher than the Police Department. Over the last few fiscal years, Fire Department overtime spending has climbed for various reasons, but much of the cause is attributed to personnel shortages that are the result of a higher-than-normal sick rate for uniformed personnel.

As shown in Table 13 on page 34, the city expects to spend close to \$682 million in FY 2010, \$703 million in FY 2011, \$704 million in FY 2012, and \$705 million in FY 2013 on uniformed overtime. As discussed in "Uniformed Services Overtime", starting on page 12, we hold at risk about \$19 million for uniformed overtime in FY 2009 based on our baseline spending forecast. As shown in Table 13 on page 34, we additionally hold at risk, under the same forecasting method, \$104 million in FY 2010, \$82 million in FY 2011, and \$81 million in each of FYs 2012 and 2013. By using this method of forecasting, we assume that spending will remain constant over the life of the financial plan; however, this may be too optimistic given uniformed agencies' historical spending.

TABLE 13

**PROJECTED UNIFORMED SERVICES OVERTIME RISK FYs 2010 to 2013**

(\$ in millions)

City Forecast	FY 2010	FY 2011	FY 2012	FY 2013
Police	\$373.3	\$390.4	\$390.3	\$390.6
Fire	183.4	182.8	182.6	182.5
Correction	65.3	65.7	66.1	66.1
Sanitation	59.8	64.3	65.3	65.3
<b>Total Overtime</b>	<b>\$681.9</b>	<b>\$703.2</b>	<b>\$704.3</b>	<b>\$704.5</b>
Projected Baseline Growth	\$785.4	\$785.4	\$785.4	\$785.4
<b>Risk to Budget</b>	<b>\$103.5</b>	<b>\$82.2</b>	<b>\$81.1</b>	<b>\$80.9</b>
Note: Totals include uniformed and civilian personnel. Numbers may not add due to rounding.				

In Table 14, we further our analysis to define average year-to-year growth and average annual growth extending from FYs 2005-2009. Here, the average year-to-year growth for uniformed agencies was 2.28 percent and the average annual growth rate was 2.18 percent, while at the same time, nonuniformed agencies experienced average annual growth of 7.26 percent. If we apply the average year-to-year growth of 2.28 percent, we project that the risk increases to \$122 million in FY 2010 and \$155 million by FY 2013. Since the average annual growth is slightly less, the budget risk in the same time frame is relatively the same.

TABLE 14

**PROJECTED RISK BASED ON AVERAGE GROWTH ASSUMPTIONS**

(\$ in millions)

City Forecast	FY 2010	FY 2011	FY 2012	FY 2013
<b>Total Uniformed Overtime</b>	<b>\$681.9</b>	<b>\$703.2</b>	<b>\$704.3</b>	<b>\$704.5</b>
Avg Yr-to-Yr Growth @ 2.28%	\$803.3	\$821.7	\$840.4	\$859.6
<b>Risk to Budget</b>	<b>\$121.5</b>	<b>\$118.5</b>	<b>\$136.1</b>	<b>\$155.1</b>
Avg Annual Growth @ 2.18%	\$802.5	\$820.0	\$837.9	\$856.2
<b>Risk to Budget</b>	<b>\$120.7</b>	<b>\$116.8</b>	<b>\$133.6</b>	<b>\$151.7</b>
Note: Totals include uniformed and civilian personnel.				

Uniformed service overtime spending is one of a few areas in the city's budget that is directly under management control, but it has climbed to new spending levels over the past few fiscal years. The city has done little to control overtime spending and has only dedicated \$51 million in agency savings to deal with this issue as part of its FY 2010 agency program. As the city contends with rising pension, healthcare, and Medicaid costs, which are not under its direct control, it must be diligent in managing this growing expenditure.

**Department of Education**

The city modified its current FY 2010 Adopted Budget, with spending authorization to the sum of \$18.309 billion in operational funding (not including other categorical and intracity funds). This is \$724 million more than the estimated FY 2009 close, or an annual growth rate of 4.12 percent. In FYs 2004-08, the average percentage growth for the total DOE budget was 5.90 percent. By comparison, the five-year projection for FYs 2009-13 has a total average percentage growth of 2.86 percent.

The city's funding share remains rather constant. In FYs 2004-08, city funding averaged \$6.231 billion, or an average 41.89 percent of DOE's budget. From FYs 2009 through 2013, it is projected to average \$7.705 billion, or an average 41.34 percent of the department's total. However, in FYs 2004-08 the city's average growth was 6.58 percent;

whereas in FYs 2009-13, the average growth is projected to be 2.88 percent, with city funding for FY 2013 forecasted at \$8.055 billion.

Between FYs 2004-08 state funding provided an average contribution of \$6.801 billion, or an average 45.72 percent of the department total operational budget. From FYs 2009 through 2013, aid from the state averages \$8.773 billion, or 47.07 percent of the average total budget. However, the projected five years, FYs 2009-13, growth dips in comparison to the most recent five prior years. In FYs 2004-08, the average growth rate measured 6.67 percent; whereas in FYs 2009-13, it is currently projected to be 3.51 percent. State funding for FY 2013 is presently projected at \$9.543 billion.

With the aid from the stimulus, federal funding for FY 2010 is estimated at adoption to be \$2.756 billion. This amount represents \$1.013 billion more than FY 2009, or an annual growth of 58.1 percent. In FY 2011, federal funding is estimated to be \$2.78 billion. Of this \$2.78 billion, \$1.025 billion is coming by way of the federal stimulus package, adding to Title I funding, the Individual with Disability Education Act and the Fiscal Stabilization Fund. Federal funding in FYs 2012 and 2013 remains constant at \$1.764 billion in each year, for a drop of \$1.016 billion. In the recent past, in FYs 2004-08, the average growth rate for federal funding has been 1.26 percent. In FYs 2009-13, the average growth rate is presently projected to increase to 3.88 percent.

#### **School Governance**

The issue regarding mayoral control of DOE has yet to be determined. Since June 14, 2002, the mayor has been granted control of the city schools by the state. However, this governance includes a "sunset" provision - absent an agreement to extend the law by the governor and legislature, most of its provisions expired at the end of the city's fiscal year, June 30, 2009 and school control reverted to its former structure, a seven-member central Board Of Education. While the state assembly has passed a bill granting mayoral control, the senate has not yet acted. As of July 1, 2009 the mayor and borough presidents reconstituted a Board of Education and agreed to leave the current governance structure in place.

Major fiscal challenges lie ahead for DOE. The higher income tax rates aiding the state's revenue is due to end in 2012, thus reducing the likelihood of increased state funding to DOE. The stimulus federal funds, which have enabled the state to provide additional funding, are nonrecurring and expire in FY 2011. Thereby it is important that efficiencies and savings that the department has used to date will need to be extended and expanded in order to meet the challenges that lie ahead.

#### **RISKS AND OFFSETS**

Our risk evaluation of the city's financial plan is shown in Table 3 on page 5. We project nonproperty tax collections will be below the city's projections by \$150 million in FY 2011 and \$75 million in FY 2012. We project an additional loss in nonproperty taxes of \$70 million in FY 2010 due to the delayed enactment by the state legislature of the sales tax program. We also project shortfalls in property tax revenue, due to uncertainty regarding property values, of \$100 million in FY 2011, \$200 million in FY 2012 and \$300

million in FY 2013. We estimate that miscellaneous revenue will be above the city's plan by \$100 million in FY 2010 and \$150 million in each of FYs 2011 through 2013. We estimate that uniformed services overtime, based on our analysis and historical growth rates, will exceed what the city has budgeted by \$104 million in FY 2010, \$82 million in FY 2011 and \$81 million in each of FYs 2012 and 2013.

In April 2008, the Financial Control Board granted the city's request for a deferral of budgetary implementation of Statement 49 of the Government Accounting Standards Board (GASB), which requires specific pollution remediation costs that currently are categorized as capital items to be accounted for in the expense budget starting in FY 2009. With this deferral, the city is now required to include funding for pollution remediation projects in its expense budget instead of the capital budget in FYs 2011 and beyond. The city estimates the expense budget costs at up to \$500 million annually. The city has engaged the accounting firm of KPMG to determine exactly what the impact would be of implementing GASB 49. Meanwhile, there is no allocation to cover operating expenditures for pollution remediation, which places a risk to the financial plan of \$500 million in each of FYs 2011-13.<sup>12</sup>

The city is proposing that a 10 percent healthcare contribution be made by active and retired city workers. This proposal will add savings to those already agreed upon from a restructuring of the health plan. Since this proposal will need approval from the city's organized labor, we hold at risk \$357 million in FY 2011, \$386 million in FY 2012, and \$418 million in FY 2013. The city hopes to achieve pension savings of \$200 million beginning in FY 2011 and continuing throughout the life of the plan. These savings are expected to be realized through the creation of a Tier 5 pension plan for newly employed city workers, which will need approval by the state legislature.

Including these risks, we estimate that the city will have a budget gap of \$74 million in FY 2010, which is more manageable than the projected budget imbalance in the outyears of the financial plan. The city faces gaps estimated at more than \$6 billion in each of FYs 2011 and 2012 and almost \$7 billion in FY 2013.

## **THE CAPITAL PROGRAM PROFILE AND ASSOCIATED DEBT**

In addressing its budget imbalance, the city has acted to reign in the growth rate of debt service costs, one of its largest and fastest growing expenses. Given that debt service expenditures are mainly driven by capital spending, the city announced a reduction in the capital program one year ago. Specifically, the city reduced its four-year capital plan with the goal of containing the growth rate in projected debt service costs to be more in line with the rate of growth for tax revenues, the resource used to pay debt service costs. The city has now extended the capital program reductions over ten years in its final ten-year capital strategy that was released along with the executive budget in May.

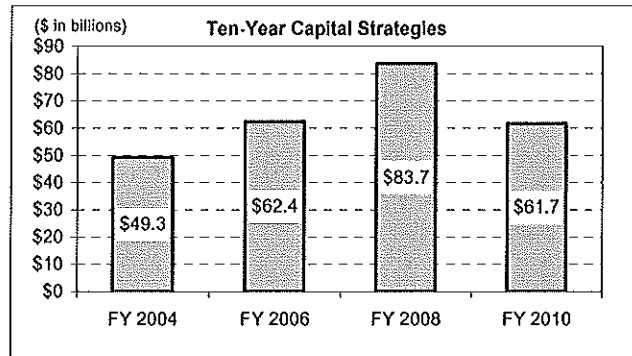
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<sup>12</sup> For a detailed discussion on the implication of GASB 49, see the section in our July 2008 Report titled "Debt Service Impact of Capital Program Deferral."



### Profile of the FY 2010 Ten-Year Capital Strategy

The final version of the FY 2010 Ten-Year Capital Strategy totaling \$62 billion reflects a \$22 billion, or 26 percent, reduction compared to the final FY 2008 strategy.<sup>13</sup> To put the reduction in context, it should be noted that the FY 2008 Ten-Year Capital Strategy was spiked by \$21 billion over the FY 2006 Ten-Year Strategy. The FY 2008 strategy originated at the height of an economic boom when the city was the recipient of a record revenue windfall. In fact, the total amount of capital commitments entered into during FY 2008 represents a historical high for the city at \$12.1 billion, and the forecast for FY 2009 is even higher at \$13 billion. Now, in reaction to the current slumping economy, the city downsized the FY 2010 strategy. On an annual basis, commitments in the current strategy are forecasted to average approximately \$7.6 billion during the first four years, and then recede during the last six years to \$5.2 billion. Nevertheless, the total level is only smaller than the FY 2006 strategy by \$700 million and larger than the FY 2004 strategy by \$12 billion, as shown in the figure above.



As illustrated in Table 15 on page 38, \$47 billion of the capital commitments (or contracts) in the new strategy are city-funded. This is \$18.2 billion lower than the previous strategy. To reduce its debt service costs, the city cut the portion of the capital program that is funded with general obligation (g.o.) bonds by \$13.3 billion. The city expects to partially offset this cut with the use of \$1.7 billion of g.o. bonds issued in the form of federally subsidized bonds for school construction. City debt service does not include payments for Water Authority bonds, which are issued to support environmental protection capital projects and are backed by water sewer user fees levied on city residents. The capital program supported by Water Authority bonds was also downsized by \$6.6 billion.

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<sup>13</sup> Every two years, the city modifies and releases the Ten-Year Capital Strategy, which includes projects involving major physical maintenance, construction and acquisition of capital assets for the ensuing ten-year period. A preliminary version of the FY 2010 strategy was submitted in November 2008.

# THE TEN-YEAR CAPITAL STRATEGY HAS BEEN CUT BY \$22 BILLION

TABLE 15

(\$ in billions)

Ten-Year Capital Strategy	FYs 2008-17	FYs 2010-19	Change
Commitments by Funding Sources:			
General Obligation	\$45.8	\$32.5	(\$13.3)
Water Authority	19.4	12.8	(6.6)
QSCBs & QZABs Funding	--	1.7	1.7
Total City Funds	\$65.2	\$47.0	(\$18.2)
Federal Funds	\$2.5	\$3.1	\$0.6
State Funds	15.4	11.5	(3.9)
Other NonCity Funds	0.6	0.1	(0.5)
Total NonCity Funds	\$18.5	\$14.7	(\$3.8)
<b>Total Financing</b>	<b>\$83.7</b>	<b>\$61.7</b>	<b>(\$22.0)</b>

Additionally, the FY 2010 Ten-Year Capital Strategy includes \$15 billion of commitments that are slated to be funded mainly from state and federal sources. Noncity-funded commitments were reduced by a combined \$3.8 billion compared to the FY 2008 strategy.

In downsizing the total ten-year capital strategy, the city trimmed commitments across almost all agencies, sparing only the Administration for Children's Services. While the level of cuts varied by agency, the ones with the largest share of commitments were scaled back the most.

At \$62 billion, the scaled-down strategy reflects the city's current long-range capital priorities. The priorities can be identified by the distribution of commitments into three main categories: state of good repair, which represents essential repair work largely because of deferred maintenance; programmatic replacement, which represents replacement of equipment and asset components at regular intervals at the end of their life cycle; and program expansion, which represents the addition of assets. Almost all, \$21.5 billion of the \$22 billion, reductions in commitment compared to the prior strategy were applied to state of good repair and programmatic replacement projects, with less than \$500 million trimmed from program expansion. For the new strategy, state of good repair projects remain the largest share at 47 percent despite being cut by \$11 billion.<sup>14</sup> Meanwhile, there was a decisive shift in representation away from programmatic replacement (down six percentage points at 22 percent from a \$10 billion cut) toward program expansion (up eight percentage points at 31 percent).

<sup>14</sup> The city in its FY 2009 Maintenance Report identified 51 percent, or \$2.8 billion, of \$5.55 billion of recommended maintenance to bring its physical assets up to a state of good repair as being funded in the capital program for FYs 2010-13. This is down from the 60 percent funding level identified in the FY 2008 Maintenance Report. The city is required by charter to produce an annual maintenance report each October that details the recommended amounts of funding over the ensuing four fiscal years to maintain assets and asset systems with a replacement cost of \$10 million or greater and a useful life in excess of ten years. Additionally, the city produces a separate document, usually published around the time the executive budget is released, that reconciles the funding needs to the planned funding for each agency.

The changing profile of the ten-year strategy is dominated by the agencies that are allocated the largest amount of commitments, namely the Department of Education (DOE) and the Department of Environmental Protection (DEP), which together comprise 56 percent of total contracts. The shifts in commitments for DOE and DEP relative to the prior strategy are so substantial that they skew the shape of the current strategy.

### THE VAST MAJORITY OF THE REDUCTION IN COMMITMENTS IS FOR ASSET MAINTENANCE

TABLE 16 (\$ in millions)

	State of Good Repair	Programmatic Replacement	Program Expansion	Total
<b>Total Program</b>	<b><u>\$28,756</u></b>	<b><u>\$13,796</u></b>	<b><u>\$19,123</u></b>	<b><u>\$61,675</u></b>
<b>Percent of Program</b>	<b>47%</b>	<b>22%</b>	<b>31%</b>	<b>100%</b>
<b>Total Change</b>	<b><u>(\$11,250)</u></b>	<b><u>(\$10,257)</u></b>	<b><u>(\$483)</u></b>	<b><u>(\$21,990)</u></b>
Environmental Protection	120	(6,786)	101	(6,565)
Department of Education	(8,095)	(1,200)	2,943	(6,352)
Parks	(1,057)	0	(200)	(1,257)
Bridges	(1,182)	0	0	(1,182)
Courts	0	(78)	(838)	(916)
Highways	(881)	0	0	(881)
Housing Preservation & Development	989	0	(1,807)	(818)
Sanitation	(585)	(186)	(34)	(805)
Correction	(239)	862	(1,095)	(472)
Police	0	(1,421)	970	(451)
Health & Hospitals Corporation	(298)	(128)	0	(426)
Public Buildings	(257)	(142)	0	(399)
Fire Department	(382)	5	0	(377)
Transit Authority	0	(166)	0	(166)
Economic Development & Ports	0	(68)	(81)	(149)
Department of Homeless Services	0	14	(163)	(148)
City University	(16)	(12)	(83)	(111)
Traffic	(109)	0	0	(109)
Housing Authority	(94)	0	0	(94)
Human Resources Administration	(10)	(54)	0	(64)
Cultural Affairs	80	0	(136)	(55)
Ferries	9	(58)	0	(49)
Transportation Equipment	(35)	0	0	(35)
Public Libraries	(27)	0	(5)	(32)
Real Estate	(25)	0	0	(25)
Citynet, Equipment & Boro. President	835	(859)	0	(24)
Department for the Aging	(19)	0	0	(19)
Juvenile Justice	13	2	(24)	(9)
Department of Health	25	(1)	(31)	(7)
Administration for Children's Services	(10)	19	0	9

Note: Numbers may not add due to rounding.

Commitments for DOE, at \$22 billion, were pared back by \$8.1 billion for repairs and \$1.2 billion for replacements, but grew by \$2.9 billion for expansion, netting a decrease of \$6.4 billion, as illustrated in Table 16. The cut in repairs for schools comprises 72 percent of the citywide reductions for this category. Equally as significant, the increase in expansion contracts for DOE substantially offsets the combined decrease of \$3.4 billion for the other agencies, bringing the net reduction to \$483 million.

Nevertheless, even at the net reduced level, commitments for education have grown by one percentage point to its highest proportion of the total strategy at 35 percent.

The first five years of commitments for schools represent the proposed Five-Year Capital Plan for DOE totaling \$11.3 billion. The city provided a five-year lump-sum allocation for DOE's capital program assuming continuation of the 50/50 funding split between the city and the state, with \$1.7 billion of the city's g.o. bonds expected to be issued in the form of federally subsidized Qualified School Construction Bonds and Qualified Zone Academy Bonds.

Commitments for DEP, at \$12.9 billion, reflect a decrease of \$6.8 billion for replacement projects, which was marginally offset by an increase of \$120 million for repairs and \$101 million for expansion, netting a 34 percent reduction at \$6.6 billion. The downsizing of DEP replacement projects comprises 66 percent of the citywide reductions for this category. The city states that the scaled-down level of commitments for DEP represents an attempt to balance significant costs for mandate compliance and improvements to its water supply and sewage systems with as moderate an impact on city water and sewer rate payers. Certain projects, such as the stabilization of wastewater treatment facilities, were reduced by approximately 30 percent. Nevertheless, our review revealed that the areas within DEP that are slated for the largest reductions (water mains and water pollution control) are those where some record-large contracts have been entered into over the three most recent years for projects that were listed in the early years of the FY 2008 strategy.

Compared to DOE and DEP, commitments for the Parks Department have always been relatively small. A \$1.3 billion reduction in commitments to parks in the FY 2010 strategy is noteworthy because it represents a 47 percent drop from the very ambitious \$2.7 billion program included in the FY 2008 strategy. Now at \$1.4 billion, the commitments for parks are higher than they were in the FY 2006 strategy by over \$300 million.

### **Debt Levels**

Despite the cut in the capital program, the FY 2010 Ten-Year Capital Strategy projects that debt service costs will increase steadily through FY 2019, but at a slower rate than previously forecasted.<sup>15</sup> For a comprehensive analysis of the debt resulting from the city's capital program for the years covered by the plan, we use the framework of the annual Statement of Debt Affordability that was released by the city along with the ten-year capital strategy. The Statement of Debt Affordability presents the aggregate debt and debt service levels for all bonds backed by tax revenues sold to support the city's capital program, including city and New York City Transitional Finance Authority (NYCTFA), as well as city lease agreements. The current Statement of Debt Affordability covers the financial plan years of FYs 2009-13.

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<sup>15</sup> The FY 2010 Ten-Year Capital Strategy provides a graph of the projected debt service to tax revenue ratio for FYs 2010-19, but does not include the absolute values of tax revenues. The city notes that it is only required to provide its tax revenue forecasts for the years covered by the plan.

While we employ the Statement of Debt Affordability as a framework, we use our calculation of debt service and the burden it places on the budget and local economy, which is based on information in the current Executive Budget for FYs 2010-13, as our calculation treats the effect of payments from surplus budget resources consistently. As can be seen in Table 17 on page 42, debt service is projected to climb from \$4.8 billion in FY 2010 to \$6.5 billion in FY 2013, for an average annual growth rate of 10.9 percent.<sup>16</sup>

The rising debt service costs will require an increase in per capita spending from \$598 in FY 2010 to \$815 in FY 2013. Furthermore, debt service payments are projected to consume larger shares of tax and total revenues, as well as local personal income. Debt service is projected to rise from 13.9 percent in FY 2010 to 16.0 percent in FY 2013 as a percentage of tax revenues; 8.0 percent in FY 2010 to 9.8 percent in FY 2013 as a percentage of total revenues; and 1.2 percent in FY 2010 to 1.5 percent in FY 2013 as a percentage of local personal income. At the outyear levels, the projected debt service burdens hover around the upper range that has existed since the city emerged from the financial crisis of the 1970s.

At 10.9 percent, the average annual rate of growth for the combined debt service is outstripping the rates for tax revenues at 5.9 percent, total revenues at 3.7 percent, and local personal income at 3.4 percent. It should be noted, however, that debt service costs in FY 2010 were lowered by \$659 million as a result of the early retirement and defeasance of debt. Had budget resources been available to reduce FY 2013 debt service costs by a similar amount, the average annual growth rate would be a lower 7.0 percent.

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<sup>16</sup> 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 \$4.665 billion in FY 2010, \$5.775 billion in FY 2011, \$6.251 billion in FY 2012 and \$6.530 billion in FY 2013, for an average annual growth rate of 11.9 percent.

TABLE 17

**DEBT SERVICE AND OUTSTANDING DEBT BURDENS REMAIN HIGH**  
(\$ in millions, except per capita)

	FY 2010	FY 2011	FY 2012	FY 2013	Average Annual Growth
City & NYCTFA Debt Service	\$ 4,791	\$ 5,255	\$ 6,252	\$ 6,530	10.9%
Debt Service Per Capita	598	656	781	815	
<b>Debt Service as Percentage of:</b>					
Tax Revenues	13.9%	14.2%	16.0%	16.0%	
Total Revenues	8.0%	8.4%	9.8%	9.8%	
Local Personal Income	1.2%	1.3%	1.5%	1.5%	
City & NYCTFA Outstanding Debt	\$ 57,169	\$ 60,639	\$ 63,158	\$ 64,986	4.4%
Outstanding Debt Per Capita	7,139	7,572	7,887	8,115	
<b>Outstanding Debt as Percentage of:</b>					
Local Personal Income	14.2%	14.7%	14.8%	14.6%	
Tax Revenues*	\$ 34,367	\$ 37,081	\$ 39,079	\$ 40,827	5.9%
Local Personal Income	403,530	412,120	427,900	446,520	3.4%
*Includes FCB adjustments to accurately reflect the tax revenues used to pay NYCTFA debt service.					

Additionally, Table 17 reveals that the combined outstanding debt is forecasted to grow from \$57.2 billion at the end of FY 2010 to \$65.0 billion at the end of FY 2013, for an average annual growth rate of 4.4 percent. While this growth rate may not seem relatively fast, the outstanding debt value for the base year is high. Outstanding debt per capita is expected to rise from \$7,139 in FY 2010 to \$8,115 in FY 2013, which in FY 2013 is more than \$2,000 greater than the highest debt per capita since the 1980s. Meanwhile, the debt to income ratio is forecasted to range from 14.2 percent to 14.8 percent over the four-year period, where the highest debt to income ratio since the 1980s was 14.2 percent.

## **Glossary of Acronyms**

<b>AIM</b>	Aid and Incentives for Municipalities
<b>AIR</b>	Actuarial Interest Rate
<b>BERS</b>	Board of Education Retirement System
<b>BSA</b>	Budget Stabilization Account
<b>CY</b>	Calendar Year
<b>DEP</b>	Department of Environmental Protection
<b>DOE</b>	Department of Education
<b>FCB</b>	Financial Control Board
<b>FMAP</b>	Federal Medical Assistance Percentages
<b>FY</b>	Fiscal Year
<b>GASB</b>	Government Accounting Standards Board
<b>GCP</b>	Gross City Product
<b>GDP</b>	Gross Domestic Product
<b>G.O. Bonds</b>	General Obligation Bonds
<b>NYCERS</b>	New York City Employees' Retirement System
<b>NYCRS</b>	New York City Retirement Systems
<b>NYCTFA</b>	New York City Transitional Finance Authority
<b>NYSE</b>	New York Stock Exchange
<b>OPEB</b>	Other Postemployment Benefits
<b>OT</b>	Overtime
<b>OTPS</b>	Other than Personal Service
<b>PBA</b>	Patrolmen's Benevolent Association
<b>PEG</b>	Program to Eliminate the Gap
<b>PIT</b>	Personal Income Tax
<b>PS</b>	Personal Service
<b>QSCBs</b>	Qualified School Construction Bonds
<b>QZABs</b>	Qualified Zone Academy Bonds

<b>RHBT</b>	Retiree Health Benefits Trust
<b>STAR</b>	School Tax Relief program
<b>TARP</b>	Troubled Asset Relief Program
<b>TRS</b>	Teachers' Retirement System
<b>UAAL</b>	Unfunded Actuarial Accrued Liability