Review of the Financial Plan of the City of New York

Report 11-2017

OFFICE OF THE NEW YORK STATE COMPTROLLER

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Message from the Comptroller

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As the State's chief financial officer, I have a constitutional and statutory responsibility to oversee the finances of the City of New York.

This report discusses the economic, fiscal and social challenges facing New York City in an effort to promote an informed discussion. I encourage every City stakeholder to learn more about these issues and to participate fully in the public debate.

Thomas P. DiNapoli
State Comptroller

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I. Executive Summary

On January 24, 2017, the City of New York released a modification to its financial plan (“the January Plan”) covering fiscal years 2017 through 2021 (see Figure 1). Since the budget was adopted in June 2016, the City has implemented a citywide savings program, freed up unneeded reserves, and recognized unplanned spending and continued weakness in nonproperty tax collections.

After taking these changes into account, the City projects a surplus of nearly $3.1 billion in FY 2017. The surplus was generated almost exclusively from reserves ($1.8 billion) and the citywide savings program ($1.2 billion).

The City intends to transfer the surplus to FY 2018, balancing that year’s budget. Although the budget gaps for fiscal years 2019 and 2020 have increased since June 2016, this is mostly because the City has increased its reserves.

The January Plan projects budget gaps of $3.3 billion in FY 2019, $2.5 billion in FY 2020 and $1.8 billion in FY 2021. The gaps are relatively small as a share of City fund revenues (averaging 3.8 percent). In addition, the budgets for these years include reserves of $1.25 billion. If not needed, the reserves could be used to narrow the projected gaps.

In most years, the surplus has been driven by unanticipated nonproperty tax collections (e.g., personal income, business and sales taxes). Collections exceeded the City’s expectations by $1.4 billion in FY 2013 and by about $2.4 billion in each of fiscal years 2014 and 2015, offsetting the budgetary impact of unplanned spending and helping to balance the following year’s budget. Last year, nonproperty tax collections were higher by just $362 million and accounted for only a small share of the $4 billion surplus.

The January Plan assumes that nonproperty tax collections will be lower by $258 million in FY 2017 and by $537 million in FY 2018. If nonproperty tax collections continue to disappoint, closing the out-year budget gaps could be more challenging, especially if the City also has to address unplanned spending or the impact of federal or State actions.

On January 17, 2017, the Governor released his executive budget for State fiscal year (SFY) 2017-2018. The proposed budget would adversely impact the City’s financial plan by an estimated $561 million beginning in FY 2018. For example, the proposed budget would increase education aid to New York City by $295 million, which is $244 million less than the amount anticipated in the January Plan for FY 2018.

The President recently signed an executive order that is intended to pressure “sanctuary cities” into providing information on undocumented immigrants. The executive order permits the federal government to withhold funds to those jurisdictions that refuse to comply.

New York City’s budget anticipates the receipt of $8.8 billion in federal funding in FY 2017, which represents about 10 percent of its budget. The budgetary impact of the President’s executive order will depend on how it is implemented and the role of Congress, and possibly the courts.

With 3.2 million immigrants, New York City has the largest immigrant population of any city in the nation. The Office of the State Comptroller (OSC) estimates that immigrants accounted for $271 billion in economic activity in 2015, or nearly one-third of the City’s gross product. Many industries, such as finance and technology, rely on immigrants to maintain their competitiveness.

The new administration also supports other initiatives that could affect New York City. While the administration has made broad policy pronouncements, it has not yet developed these initiatives, making it impossible to quantify the potential impact. These include repeal and replacement of the Affordable Care Act (ACA), tax reform, increased infrastructure spending, cuts in nondefense spending, and rolling back securities industry regulations.

The repeal of the ACA could result in 1.1 million City residents losing Medicaid coverage, and another 460,000 losing coverage through insurance plans offered through the State's health insurance exchange. If this were to occur, it is unclear whether the City or the State would assume any financial responsibility for these individuals. However, it is likely that the City would lose $305 million annually beginning in FY 2018 if a provision in the ACA that increased Medicaid reimbursement rates to states that expanded Medicaid eligibility is repealed.

Since 2009, the City has added more than 620,000 jobs, the largest expansion in its history. A number of sectors have contributed to the expansion, but the securities industry has played a smaller role than in the past. A more diversified economy is less dependent on one industry for economic growth, helping to insulate the City against a cyclical downturn.

While the City's economy remains strong, it is showing signs of slowing. Job growth has declined from an average of nearly 125,000 jobs during calendar years 2014 and 2015, to less than 90,000 in 2016 (the sixth consecutive year of job gains of more than 85,000). The January Plan assumes job growth will slow further to 55,500 jobs in 2017.

Despite the strength of the local economy, tax collections have weakened. Last year, collections grew by 3.2 percent, less than half the average gain during fiscal years 2011 through 2015. Tax collections are projected to slow further to 2.4 percent in FY 2017.

OSC has identified budget risks totaling $359 million in FY 2017, mostly from continued weakness in tax collections (see Figure 2). The City, however, has reserves that could mitigate the impact. In FY 2018, the risks grow to nearly $1.6 billion. More than three-quarters of the risks stem from items outside the City's direct control, such as the impact of State and federal actions.

The Health and Hospitals Corporation continues to face serious financial challenges, including a decline in patient utilization. Nonetheless, the City remains confident that the Corporation will not require further assistance in the current fiscal year because the Corporation expects to receive additional Medicaid payments. The Corporation could require assistance in the future since its transformation plan relies heavily on federal aid.

While the City faces significant budget risks, it has record reserves that will help it manage through difficult times. The general reserve stands at $1 billion annually beginning in FY 2018, and the City has set aside $250 million annually in its Capital Stabilization Reserve. It has also replenished the Retiree Health Benefits Trust, which now has a balance of $4 billion.

The Mayor has indicated that the City will continue to expand the citywide savings program, which would help reduce the size of the projected budget gaps and mitigate adverse developments. The current program is expected to generate nearly $4.2 billion over five years.

In conclusion, the economy is strong, but job growth and tax collections are slowing and external risks beyond the City's direct control are increasing. Many of the changes contemplated at the federal level cannot be quantified at this time, creating added uncertainty. To its credit, the City has prudently built up its reserves to historic levels, which will provide a cushion against any adverse development.

FIGURE 1
New York City Financial Plan
(in millions)

	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Revenues					
Taxes					
General Property Tax	$ 24,196	$ 25,629	$ 27,292	$ 28,618	$ 29,929
Other Taxes	29,646	30,556	31,712	33,079	34,208
Tax Audit Revenue	1,041	850	721	721	721
Subtotal: Taxes	$ 54,883	$ 57,035	$ 59,725	$ 62,418	$ 64,858
Miscellaneous Revenues	6,835	6,362	6,602	6,804	6,807
Unrestricted Intergovernmental Aid	57	- - -	- - -	- - -	- - -
Less: Intra-City Revenue	(2,039)	(1,786)	(1,781)	(1,787)	(1,787)
Disallowances Against Categorical Grants	200	(15)	(15)	(15)	(15)
Subtotal: City Funds	$ 59,936	$ 61,596	$ 64,531	$ 67,420	$ 69,863
Other Categorical Grants	980	856	847	837	833
Inter-Fund Revenues	655	658	658	595	593
Federal Categorical Grants	8,826	7,012	6,811	6,809	6,781
State Categorical Grants	14,417	14,546	15,008	15,404	15,718
Total Revenues	**$ 84,814**	**$ 84,668**	**$ 87,855**	**$ 91,065**	**$ 93,788**
Expenditures					
Personal Service					
Salaries and Wages	$ 25,829	$ 27,316	$ 28,796	$ 29,634	$ 30,222
Pensions	9,413	9,819	10,100	10,152	10,170
Fringe Benefits	9,606	10,258	10,981	11,920	12,701
Subtotal: Personal Service	$ 44,848	$ 47,393	$ 49,877	$ 51,706	$ 53,093
Other Than Personal Service					
Medical Assistance	5,915	5,915	5,915	5,915	5,915
Public Assistance	1,584	1,594	1,605	1,617	1,617
All Other	28,801	26,776	27,001	26,914	27,121
Subtotal: Other Than Personal Service	$ 36,300	$ 34,285	$ 34,521	$ 34,446	$ 34,653
Debt Service	6,388	6,581	7,301	7,960	8,372
FY 2016 Budget Stabilization & Discretionary Transfers	(4,038)	- - -	- - -	- - -	- - -
FY 2017 Budget Stabilization	3,055	(3,055)	- - -	- - -	- - -
Capital Stabilization Reserve	- - -	250	250	250	250
General Reserve	300	1,000	1,000	1,000	1,000
Subtotal	$ 86,853	$ 86,454	$ 92,949	$ 95,362	$ 97,368
Less: Intra-City Expenses	(2,039)	(1,786)	(1,781)	(1,787)	(1,787)
Total Expenditures	**$ 84,814**	**$ 84,668**	**$ 91,168**	**$ 93,575**	**$ 95,581**
Gap to be Closed	**$ - - -**	**$ - - -**	**$ (3,313)**	**$ (2,510)**	**$ (1,793)**

Source: NYC Office of Management and Budget

FIGURE 2
OSC Risk Assessment of the New York City Financial Plan
(in millions)

	Better/(Worse)				
	FY 2017	**FY 2018**	**FY 2019**	**FY 2020**	**FY 2021**
Surplus/(Gaps) Per NYC Financial Plan	**$ - - -**	**$ - - -**	**$ (3,313)**	**$ (2,510)**	**$ (1,793)**
Differences in Estimation:					
Tax Revenues	(215)	(200)	(200)	(200)	(200)
Uniformed Agency Overtime	(100)	(200)	(200)	(200)	(200)
Special Education Medicaid Reimbursement	(23)	(79)	(79)	(79)	(79)
Hiring Delays	50	- - -	- - -	- - -	- - -
Public Assistance	20	20	20	20	20
Homeless Shelters	- - -	(127)	(127)	(127)	(127)
Debt Service	- - -	150	- - -	- - -	- - -
Miscellaneous Revenues	- - -	75	75	75	75
Sale of Taxi Medallions	- - -	- - -	(107)	(257)	(367)
Revenue from Development Opportunities	- - -	- - -	- - -	(100)	- - -
Subtotal	**(268)**	**(361)**	**(618)**	**(868)**	**(878)**
Outside the City's Direct Control:					
Sales Tax Asset Receivable Corporation	(50)	(200)	(150)	- - -	- - -
State Budget Impact	(41)	(561)	(561)	(561)	(561)
Federal ACA Medicaid Reimbursement	- - -	(305)	(305)	(305)	(305)
Health and Hospitals Corporation	- - -	(164)	(164)	(164)	(164)
Subtotal	**(91)**	**(1,230)**	**(1,180)**	**(1,030)**	**(1,030)**
OSC Risk Assessment	**(359)**	**(1,591)**	**(1,798)**	**(1,898)**	**(1,908)**
Potential Surplus/(Gaps) Per OSC[1]	**$ (359)**	**$ (1,591)**	**$ (5,111)**	**$ (4,408)**	**$ (3,701)**

[1] The January Plan includes a general reserve of $300 million in FY 2017 and $1 billion in each of fiscal years 2018 through 2021, which, if not needed, could be used to help close the projected budget gaps. In addition, the Capital Stabilization Reserve has a balance of $250 million in each of fiscal years 2018 through 2021, and the Retiree Health Benefits Trust, which the City has used in the past as a rainy-day fund, has a balance of $4 billion.

II. Economic Trends

In the last seven years, New York City has experienced the strongest job recovery on record. The City's economy, however, may be entering a period of transition. One sign is that the pace of job growth started to slow in 2016 (although it was still strong by historical standards), and the January Plan assumes job growth will ease further in 2017.

In addition, external risks are increasing. Domestic fiscal, monetary and regulatory policies are beginning to undergo changes that could impact economic growth. New York City is the world's premier international business center, and changes in trade policies and the rise of protectionism could also have a significant impact on the local economy.

More fundamentally, New York City embodies the ideal of American diversity that thrives on the energy of its immigrant population. Changes in policies that restrict or limit immigration could impact the work force that businesses rely upon and could dampen the pace of local economic growth.

The National Economy

The current economic expansion began in June 2009 and has lasted 91 months, which is the fourth-longest post–World War II expansion on record (much longer than the average length of 58 months). Of these long expansions, however, the current one has been the weakest.

The nation's gross domestic product (GDP) grew at a rate of 1.6 percent in 2016, slower than in the previous two years. Economic growth was impacted by lower business spending and slowing productivity. The January Plan assumes that GDP will grow by 2.3 percent in 2017, which is consistent with the view of most economists.

Since 2010, the nation has added 13.9 million jobs (6.3 million more than were lost during the Great Recession), which has raised annual employment to a record 144.3 million jobs. However, the pace of job growth slowed to 1.7 percent in 2016, compared to 2 percent, on average, during the prior two years.

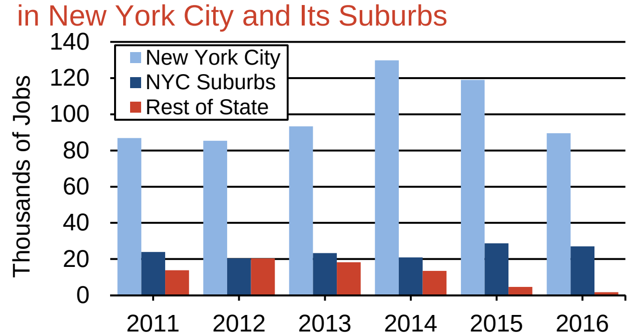
After keeping interest rates near zero for seven years to help support the economy, the Federal Reserve raised short-term interest rates by 25 basis points in December 2015 and again in December 2016. The Fed has indicated that it intends to raise interest rates further, given a strong labor market and rising inflation. However, the Fed has also indicated that uncertainties over the course of fiscal policy could influence the prospects for future rate changes.

New York State Employment

Between 2009 and 2016, New York State added 825,000 jobs (587,000 more than were lost during the recession). Although the State added 118,000 jobs in 2016, the rate of job growth has slowed from 1.8 percent in 2014 to 1.3 percent in 2016 (the slowest rate of growth since 2010).

Job growth has been driven by New York City and the surrounding suburbs (Nassau, Suffolk, Westchester, Rockland, and Orange counties). Upstate, job growth has slowed in recent years and came to a virtual halt in 2016 (see Figure 3).

FIGURE 3
Job Growth Has Been Concentrated in New York City and Its Suburbs



Sources: NYS Department of Labor; OSC analysis

New York City Employment

New York City's economy continues to set new records. The current job recovery is the strongest on record (see Figure 4). More than 620,000 jobs have been added since 2009 (six times the amount lost in the recession), bringing employment to a record 4.3 million jobs.

While still strong, the pace of job growth has slowed from an average of nearly 125,000 jobs during calendar years 2014 and 2015, to 89,500 in 2016 (the sixth consecutive year that more than 85,000 jobs were added). The January Plan assumes job employment growth will slow further to 55,500 jobs in 2017.

Since 2009, the health care sector increased by one-fifth to 495,200 jobs, and it now accounts for 11.5 percent of all jobs in the City. Repeal of the Affordable Care Act or significant cuts in federal funding for health care could impact the sector.

Business services accounted for nearly one-quarter of the jobs added since 2009, but job growth slowed significantly in 2016. In addition, the number of retail trade jobs declined for the first time since 2009.

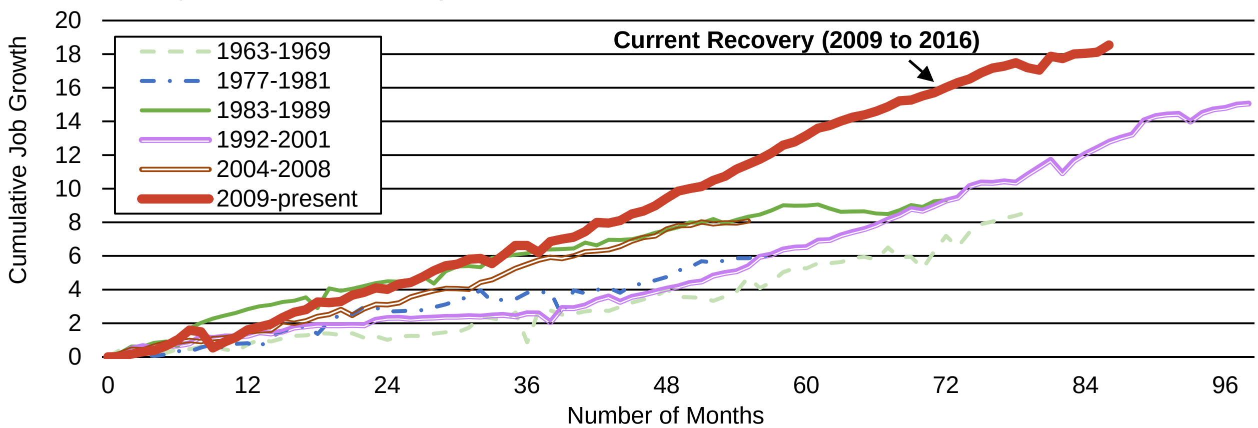
Securities Industry

The securities industry remains an important part of the City's economy, accounting for more than one-fifth of private sector wages, even though it is 8 percent smaller than before the financial crisis and has contributed less to economic growth during the current recovery than it has in the past.

The industry added 2,400 jobs in 2014 and 4,500 jobs in 2015, but growth slowed to less than 1,000 jobs in 2016. Securities industry employment averaged 173,400 jobs during 2016, the highest level since the financial crisis.

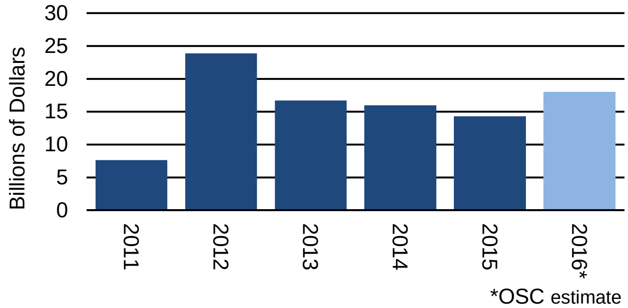
The profitability of the securities industry is traditionally measured by the pretax profits for the broker/dealer operations of New York Stock Exchange member firms. Profitability was strong during the first three quarters of 2016 ($15 billion) and the nation's six largest financial firms reported strong fourth-quarter results, which bodes well for the securities industry. After three years of lower profits (see Figure 5), OSC expects profits to exceed $18 billion in 2016, the highest level in four years.

FIGURE 4
New York City Labor Market Expansions



Note: Data are seasonally adjusted. Adjustment prior to 1990 was made by OSC.
Sources: NYS Department of Labor; OSC analysis

FIGURE 5
Securities Industry Profits



Note: Pretax profits for broker/dealer operations of New York Stock Exchange member firms.
Sources: Securities Industry and Financial Markets Association; NYSE/Intercontinental Exchange; OSC analysis

The January Plan assumes that bonuses paid to securities industry employees in New York City will increase by 2 percent. Preliminary data suggests that this forecast is reasonable. OSC will release its annual estimate of Wall Street bonuses in March 2017, after most firms have completed their bonus payment.

Tourism

Tourism is an integral part of the City's economy. According to NYC & Company, the official tourism and marketing organization of New York City, there were 60.3 million visitors in 2016, a new record. While the number of visitors is expected to set another record in 2017, the number of international visitors is expected to decline. NYC & Company attributes the decline to the anti-immigrant policies of the new federal administration. The economic impact could be significant since foreign visitors spend four times as much as domestic visitors.

The latest Beige Book analysis from the Federal Reserve indicated that tourism activity has continued to soften. Broadway attendance was up 2.1 percent for the year, but declined by 3.6 percent in the fourth quarter, according to the Broadway League. Hotel occupancy declined by 1 percent and the average daily room rate fell by 4.7 percent through October 2016 (the latest data available), according to CBRE Hotels.

The Role of Immigrants

In 2010 and 2015, OSC released reports that highlighted the role that immigrants played in New York City's economy. Since 1970, the number of immigrants has more than doubled, and in recent years immigrants have accounted for 38 percent of the City's population, the largest share in 100 years.

With 3.2 million immigrants, New York has the largest immigrant population of any city in the nation (twice as large as second-ranked Los Angeles). Almost 2 million immigrants (including 307,000 commuters) worked in New York City in 2015, comprising 42 percent of the work force.

OSC estimates that immigrants accounted for $271 billion in economic activity in 2015, or nearly one-third of the City's total gross product. Immigrants earned $104.2 billion in wages in 2015, one-third of the total wages paid to all workers in the City. Many of the City's industries, such as finance and technology, rely on immigrants to maintain their competitiveness.

Conclusion

New York City's economy is strong, but there are signs that the local economy may be in a period of transition, as evidenced by weaker job growth. Potential cuts in federal spending, more restrictive immigration policies, further strengthening of the dollar and uncertainty surrounding international trade have increased risks for the City's economy. On the other hand, federal tax reform, increased infrastructure spending and financial deregulation could provide a short-term economic boost. Over the next year, more details will become available that will allow the economic impact of these proposals to be assessed.

III. Changes Since the Beginning of the Fiscal Year

The January Plan incorporates a number of changes since the FY 2017 budget was adopted in June 2016, including a drawdown of unneeded reserves, a citywide savings program and modestly higher revenues that were mostly offset by higher-than-planned spending (see Figure 6, next page). After taking these changes into account, the City projects a surplus of nearly $3.1 billion in FY 2017.

The City intends to transfer the surplus to FY 2018, balancing that year's budget. Although the budget gaps for fiscal years 2019 and 2020 have increased since June 2016, this is mostly because the City has increased its reserves.

The January Plan projects budget gaps of $3.3 billion in FY 2019, $2.5 billion in FY 2020 and $1.8 billion in FY 2021. The gaps are relatively small as a share of City fund revenues (averaging 3.8 percent). In addition, the budgets for these years include reserves of $1.25 billion. If not needed, the reserves could be used to narrow the projected gaps.

City fund revenues are projected to be higher by $427 million in FY 2017, driven by unanticipated audit payments ($327 million). Property tax collections were also higher, but nonproperty taxes (e.g., real estate transaction, sales and business taxes) were lower. The City also lowered its forecast of City fund revenues for fiscal years 2018 and 2019 because of another delay in the sale of taxi medallions and continued weakness in nonproperty taxes.

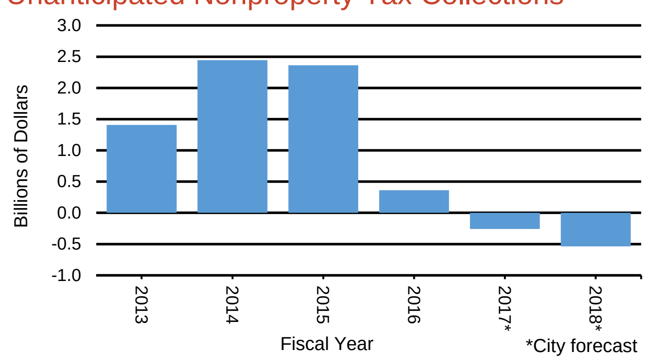
City-funded spending is expected to be higher by $392 million in FY 2017 and by a cumulative total of $2.6 billion through FY 2020. Agencies identified new needs totaling $1.9 billion during this period, mostly for homeless services, higher overtime and a number of new education initiatives. Pension contributions will be higher by a total of $713 million to make up for lower-than-expected investment earnings in FY 2016.

The FY 2017 surplus ($3.1 billion) was generated almost exclusively from reserves and a citywide savings program. Since the beginning of FY 2017, the City has freed up $1.8 billion in reserves.[2] It is also implementing a savings program that is expected to generate $1.2 billion in FY 2017 and nearly $4.2 billion over five years (see Section VI for a detailed discussion).

In most years, the surplus has been driven by unanticipated nonproperty tax collections. For example, collections (excluding audits) exceeded the City's expectations by $1.4 billion in FY 2013 and by about $2.4 billion in each of fiscal years 2014 and 2015 (see Figure 7), offsetting the budgetary impact of unplanned spending and helping to balance the following year's budget.

Last year, nonproperty tax collections were higher by just $362 million, and the January Plan assumes collections will be lower by $258 million in FY 2017 and $537 million in FY 2018. If nonproperty tax collections continue to disappoint, closing the out-year budget gaps could be more challenging, especially if the City also has to address unplanned spending or cuts in federal funding.

FIGURE 7
Unanticipated Nonproperty Tax Collections



Note: Excludes audits.
Sources: NYC Office of Management and Budget; NYC Comptroller; OSC analysis

[2] The City drew down the general reserve by $700 million and the Capital Stabilization Reserve by $500 million. It also drew down the Reserve for Disallowances by $200 million and anticipates savings of $400 million from overestimating prior years' expenses.

FIGURE 6
Financial Plan Reconciliation—City Funds
January 2017 Plan vs. June 2016 Plan
(in millions)

	Better/(Worse)			
	FY 2017	FY 2018	FY 2019	FY 2020
Projected Gaps Per June 2016 Plan	**$ - - -**	**$ (2,816)**	**$ (2,945)**	**$ (2,326)**
Revenue Reestimate				
General Property Tax	171	219	372	427
Personal Income Tax	(70)	(60)	(81)	60
Business Taxes	(71)	(299)	(195)	(204)
Sales Tax	(72)	7	30	73
Real Estate Transaction Taxes	(138)	(199)	(117)	(11)
Other Taxes	93	15	(6)	(21)
Tax Audits	327	136	7	7
Subtotal: Taxes	**240**	**(181)**	**10**	**331**
All Other	187	(114)	(118)	(15)
Total	**427**	**(295)**	**(108)**	**316**
Citywide Savings Program				
Agency Actions	970	526	530	535
Debt Service	235	368	156	155
Total	**1,205**	**894**	**686**	**690**
Reserves				
General Reserve	700	- - -	- - -	- - -
Capital Stabilization Reserve	500	(250)	(250)	(250)
Prior-Year Payable	400	- - -	- - -	- - -
Disallowances of Federal and State Aid	215	- - -	- - -	- - -
Total	**1,815**	**(250)**	**(250)**	**(250)**
New Needs				
Department of Homeless Services	(153)	(153)	(153)	(153)
Department of Education	(49)	(56)	(49)	(50)
Uniformed Agencies	(36)	(106)	(89)	(123)
Other Health and Social Services	(18)	(58)	(40)	(41)
Pension Contributions	9	(109)	(246)	(367)
All Other	(145)	(106)	(119)	(206)
Total	**(392)**	**(588)**	**(696)**	**(940)**
Net Change During FY 2017	**3,055**	**(239)**	**(368)**	**(184)**
Surplus/(Gap)	**$ 3,055**	**$ (3,055)**	**$ (3,313)**	**$ (2,510)**
Surplus Transfer	(3,055)	3,055	- - -	- - -
Projected Gaps Per January 2017 Plan	**$ - - -**	**$ - - -**	**$ (3,313)**	**$ (2,510)**

Sources: NYC Office of Management and Budget; OSC analysis

IV. Potential Impact of the State Budget

On January 17, 2017, the Governor released his executive budget for State fiscal year (SFY) 2017-2018. The proposed budget would increase education aid to New York City by $295 million in FY 2018, $244 million less than assumed in the January Plan. However, the amount of education aid in the adopted budget has historically been higher than initially proposed by the Governor.

While the City may be eligible to receive a portion of $200 million in statewide grants, the details of these programs have not been released.

The Governor has proposed a number of other actions that could adversely impact the City's financial plan by $41 million in FY 2017 and a net of $317 million annually in subsequent years. The initiatives with the largest impacts are discussed below.

- Increasing per-pupil tuition aid to charter schools and requiring school districts to offset a reduction in State tuition aid to charter schools would increase the City's costs by $198 million in FY 2018 and possibly larger amounts in subsequent years.
- Reducing State reimbursement to the City for administration of the Medicaid program would increase the City's costs by $50 million annually beginning in FY 2018, unless the City generates an equal amount of State savings by obtaining federal Medicaid reimbursement for school supportive health services provided to students with disabilities. The City has had difficulty making such claims in the past, and it is unlikely that it will be able to meet the State target.
- Reducing the foster care block grant and shifting foster care tuition costs to the City would cost $22 million in FY 2017 and $44 million annually beginning in FY 2018.
- Reducing State funding for public health programs would increase costs by $33 million annually beginning in FY 2018.
- Shifting to the City the cost of special education students in residential placements would increase costs by $10 million in FY 2017 and $20 million annually thereafter.
- Reducing State funding for child care and offsetting the impact by redirecting federal funds used by the City for a variety of programs, including senior centers, would cost the City $9 million in FY 2017 and $17 million annually thereafter.
- Requiring internet retailers that provide a marketplace for smaller sellers to collect State and local sales taxes would benefit the City by $41 million annually.
- Maximizing commercial insurance reimbursement for children with disabilities enrolled in the early intervention program would save the City $9 million annually.

The Mayor has voiced concern that proposed changes in the Foundation Aid formula for education aid could weaken the State's continued commitment to funding the Campaign for Fiscal Equity settlement. He is also concerned about the long-term budgetary impact of the Governor's proposal to revive New York City's 421-a tax abatement program.

The Governor's budget would reduce funding to the City University of New York's senior colleges by 5.2 percent, but the impact is expected to be mitigated by the proceeds from the sale of a State-owned building used by Hunter College.

The New York City Housing Authority would be allocated up to $100 million for State-approved capital projects and other improvements at facilities it owns or operates, but none of these funds may be obligated until the $100 million appropriated two years ago for similar purposes is fully obligated as determined by the State director of the budget.

The impact of the Governor's proposed budget on the Metropolitan Transportation Authority is discussed later in this report (see Section X).

V. Federal Actions

The President supports a number of initiatives that could have a significant impact on New York City. For example, the President signed an executive order that is intended to pressure “sanctuary cities” into providing information on undocumented immigrants to U.S. Citizenship and Immigration Services. The executive order permits the Attorney General and the Secretary of the Department of Homeland Security to withhold federal funds, except as deemed necessary for law enforcement purposes, to those jurisdictions that willfully refuse to comply.

New York City’s budget anticipates the receipt of $8.8 billion in federal funding in FY 2017, which represents about 10 percent of its budget. Nearly two-thirds is allocated to social services ($3.7 billion) and education ($1.7 billion). Another $1.4 billion is devoted to recovery efforts related to Superstorm Sandy. The budgetary impact of the President’s executive order will depend on how it is implemented and the role of Congress, and possibly the courts.

A 2012 Supreme Court decision held that the federal government could not penalize states that refused to expand Medicaid eligibility under the Affordable Care Act (ACA). While the federal government can withhold a grant, it must be for reasons related to the grant’s purpose. Any effort to withhold funds appropriated by Congress could also be challenged, since the President’s authority to impound funds has been limited to 45 days since 1974.

The President also supports other initiatives that could affect New York City. While the administration has made broad policy pronouncements, it has not yet developed these initiatives, making it impossible to quantify the potential impact. For example, the President supports the repeal and replacement of the ACA, which expanded Medicaid eligibility and offers health insurance coverage through the State’s health insurance exchange.

The repeal of the ACA could result in 1.1 million City residents losing Medicaid coverage, and another 460,000 losing insurance through plans offered through the State’s health insurance exchange. If this were to occur, it is unclear whether the State or City would assume any financial responsibility for these individuals. It is likely, however, that the City would lose $305 million annually from a provision in the ACA that increased the Medicaid reimbursement rate to states that expanded Medicaid eligibility.

Efforts by the new administration to reduce corporate and personal income taxes could boost economic activity. To pay for the tax cuts, it has been suggested that Congress could limit the deductibility of state and local taxes, limit the federal tax exemption for municipal bonds or take other unforeseen actions that could affect the City.

The President has voiced support for a program to rebuild the nation’s infrastructure, including airports, bridges, highways and ports. New York City could benefit from such an initiative, but no details are yet available. Proposals to reduce regulations on the securities industry could boost profits and City tax revenues, but also could increase risk-taking and volatility.

To help pay for increased spending on infrastructure and defense, Congress may consider cuts to entitlement programs and discretionary spending, as it has in the past. Capping Medicaid funds to the states would generate savings for the federal government, but would have an adverse impact on the budgets of New York State and New York City, as well as the local economy. New York City benefits from about $20 billion in federal Medicaid funds that flow through the State’s budget to hospitals and other health care providers in the City.

VI. Citywide Savings Program

In November 2016, the Mayor announced a citywide savings program that was expected to generate $2.1 billion during fiscal years 2017 through 2021. At that time, the Mayor stated that additional actions would be included in the preliminary budget for FY 2018. As anticipated, the January Plan includes actions that doubled the value of the program to nearly $4.2 billion.

Of this amount, half ($2.1 billion) would be generated during fiscal years 2017 and 2018 from debt service and agency actions (see Figure 8). As discussed below, agency actions include reimbursement reestimates, efficiencies and expense reestimates.

Reimbursement reestimates are expected to generate $658 million in FY 2017, but only $204 million in FY 2018. The value for FY 2017 is higher because it includes federal and State grants for social services and public transportation programs ($422 million) in prior years that are not expected to recur.

Efficiencies account for only a small share of the citywide savings program. According to the City, efficiencies account for 16 percent of the program's value during the first two years. The amount of resources from efficiencies would grow from $141 million in FY 2017 to almost $200 million by FY 2020, when the initiatives are fully implemented. More than half of the savings would come from shifting financial responsibility for certain programs from the City to the federal or State governments. Savings are also expected from imposing caps on civilian overtime (e.g., skilled trade personnel) and other initiatives, such as procurement savings.

Expense reestimates will generate $170 million in FY 2017, but then decline to $130 million annually thereafter. FY 2017 will benefit from hiring and contract delays that are not expected to recur. The City also eliminated the reserve that provides agencies with funds to offset the impact of inflation on procurement.

More than one-quarter of the savings in the citywide savings program (nearly $1.1 billion) would come from lower debt service. One-third of the savings would come from the City not needing to borrow to meet its cash flow needs during the financial plan period, given its large cash reserves. Savings from variable-rate debt, excess State building aid and delays in capital commitments make up most of the balance.

The citywide savings program includes some initiatives that may fall short of target. In the event that this occurs, the State Comptroller recommends that the City be prepared with alternative initiatives. The Mayor has already indicated that he intends to expand the program by $500 million when he releases the executive budget in the spring, which could reduce the size of the projected budget gaps.

FIGURE 8
Citywide Savings Program
(in millions)

	FY 2017	FY 2018
Agency Actions		
Reimbursement Reestimates	$ 658	$ 204
Expense Reestimates	170	130
Efficiencies	141	192
Subtotal	**970**	**526**
Debt Service	**235**	**368**
Total	**$ 1,205**	**$ 894**

Note: Totals may not add due to rounding.
Sources: NYC Office of Management and Budget

VII. Revenue Trends

The January Plan assumes revenues, including federal and State categorical aid, will total $84.7 billion in FY 2018. Locally generated sources, or City fund revenues (i.e., taxes and fees) account for 73 percent of this amount. City fund revenues are projected to total $61.6 billion in FY 2018, an increase of 2.8 percent (see Figure 9, next page).

Last year, tax collections slowed significantly. Growth in FY 2016 (3.2 percent) was less than half the average annual increase of 6.9 percent during fiscal years 2011 and 2015. The City expects that growth will remain weak in FY 2017 (2.4 percent) and FY 2018 (3.9 percent).

The property tax, the City's single-largest revenue source, was the primary driver of revenue growth in fiscal years 2016 and 2017, and is projected to continue driving growth in FY 2018. Despite a robust economy, growth in nonproperty taxes ceased in FY 2016 (the worst performance since FY 2010), and the January Plan assumes only a small improvement this year (see Figure 10).

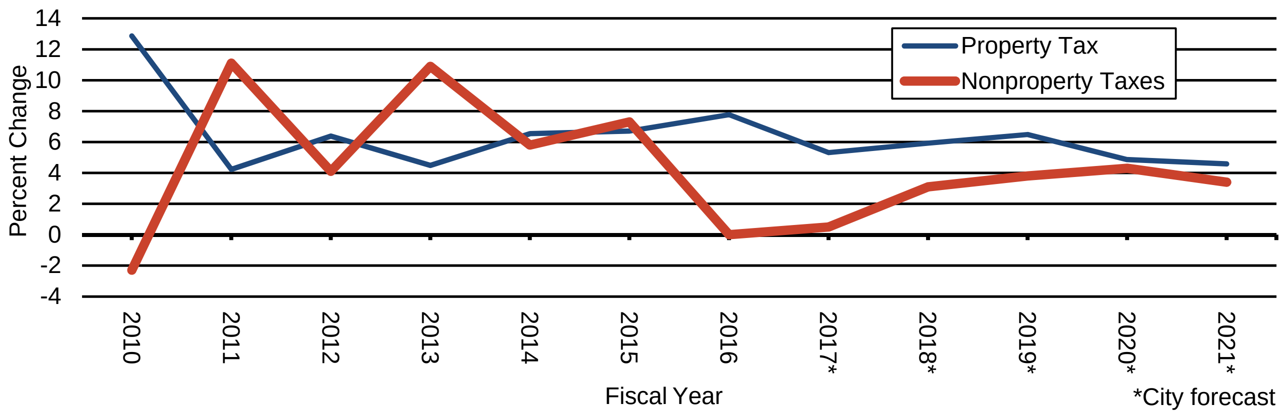
The outlook for nonproperty taxes has weakened as the year has progressed, reflecting some slowing in the City's economy and recent trends in tax collections. Since the beginning of the fiscal year, the City has lowered its forecast of nonproperty tax revenue (excluding audits) by $258 million in FY 2017 and by $537 million in FY 2018. The January Plan assumes that nonproperty tax collections will rise by 3.1 percent in FY 2018, but that forecast may be optimistic.

If current trends persist, OSC expects that tax collections could be lower than assumed in the January Plan by $215 million in FY 2017 and by $200 million annually through FY 2021. Moreover, it remains to be seen how policies enacted by the new federal administration will impact the City's economy and tax collections.

In addition, sales tax collections will be lower under current State law (by $400 million during the financial plan period), as the State recoups savings that accrued to the City from refinancing bonds of the Sales Tax Asset Receivable Corporation at lower interest rates.

The January Plan also anticipates $731 million in revenue from the sale of taxi medallions during fiscal years 2019 through 2021, and $100 million in FY 2020 from development opportunities at properties leased to the Health and Hospitals Corporation. As discussed later in this section, the receipt of these proceeds is uncertain.

FIGURE 10
Annual Change in Tax Revenues



Note: Excludes audits.
Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

FIGURE 9
City Fund Revenues
(in millions)

	FY 2017	FY 2018	Annual Growth	FY 2019	FY 2020	FY 2021	Average Three-Year Growth Rate
General Property Tax	$ 24,196	$ 25,629	5.9%	$ 27,292	$ 28,618	$ 29,929	5.3%
Personal Income Tax	11,155	11,493	3.0%	11,890	12,496	13,007	4.2%
Sales Tax	7,044	7,564	7.4%	7,910	8,289	8,592	4.3%
Business Taxes	5,938	6,045	1.8%	6,247	6,392	6,596	3.0%
Real Estate Transaction Taxes	2,505	2,479	-1.0%	2,643	2,825	2,875	5.1%
Other Taxes	3,004	2,975	-1.0%	3,022	3,077	3,138	1.8%
Tax Audits	1,041	850	-18.3%	721	721	721	-5.3%
Subtotal: Taxes	**54,883**	**57,035**	**3.9%**	**59,725**	**62,418**	**64,858**	**4.4%**
Miscellaneous Revenues	4,853	4,576	-5.7%	4,821	5,017	5,020	3.1%
Grant Disallowances	200	(15)	NA	(15)	(15)	(15)	0.0%
Total	**59,936**	**61,596**	**2.8%**	**64,531**	**67,420**	**69,863**	**4.3%**

Sources: NYC Office of Management and Budget; OSC analysis

1. General Property Tax

In January 2017, the City released its preliminary property tax roll for FY 2018 (the final roll will be released in May), which showed continued strong growth in property values. As a result, the City increased its forecast for fiscal years 2018 through 2021 by a cumulative total of $1.5 billion.

As a result, property tax collections will surpass $25.6 billion in FY 2018, accounting for 45 percent of total tax revenue. In fiscal years 2019 through 2021, property tax growth is expected to remain strong, accounting for an outsized share (55 percent) of total tax growth. (Growth will be supported by the continued phase-in of property value increases in earlier years, as required by state law.)

Strong growth in property values has helped drive tax growth throughout the current economic expansion. Between fiscal years 2010 and 2017, property values rose by 48 percent, lifting collections by $8 billion, an average annual gain of 5.9 percent. The January Plan also increased property tax revenues in FY 2017 by $171 million, reflecting lower refund payments.

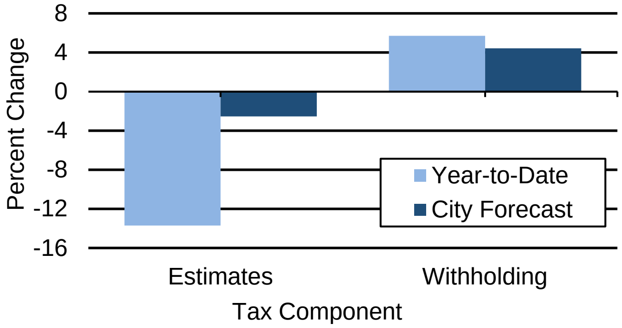
2. Personal Income Tax

Personal income tax collections have weakened in recent years, rising by just 1 percent in FY 2016 after growing at an average annual rate of 8.3 percent during fiscal years 2010 through 2015. This was the slowest rate of growth since the recession, reflecting declines in bonuses and capital gains.

In FY 2017, year-to-date collections have increased at a similar rate (1.1 percent), reflecting continuing weakness. Although the City has lowered its personal income tax forecast for FY 2017 by $70 million since the beginning of the year, the January Plan still expects growth to accelerate to 3.9 percent in FY 2017.

Year-to-date weakness in quarterly estimated tax payments (generated on capital gains and other nonwage income) is dragging down overall growth. As seen in Figure 11 on the next page, collections have declined by 13.7 percent in the first seven months of FY 2017 (compared to the City's forecast of a 2.5 percent decline). While collections could be lower by $150 million based on current trends, final payments on April 15 will determine whether the annual target will be met.

FIGURE 11
Change in Major Components of the Personal Income Tax in FY 2017



Sources: NYC Office of Management and Budget; OSC analysis

Withholding from workers' paychecks (which account for nearly three-quarters of net collections) has grown by 5.7 percent during the first seven months of the year, primarily driven by a 15.7 percent increase in January. The pace of growth in the coming months will depend on the level of bonuses and the rate of job growth.

Since the beginning of FY 2017, the City has increased the amount it anticipates from the State to correct for distributional errors in prior years by $69 million (the State collects the City's personal income tax). However, conversations with State budget representatives suggest that such payments could exceed the City's estimate.

The January Plan assumes that personal income tax collections will grow by 3 percent in FY 2018, to reach $11.5 billion. Although job growth is projected to slow, the City expects increases in wages and bonuses.

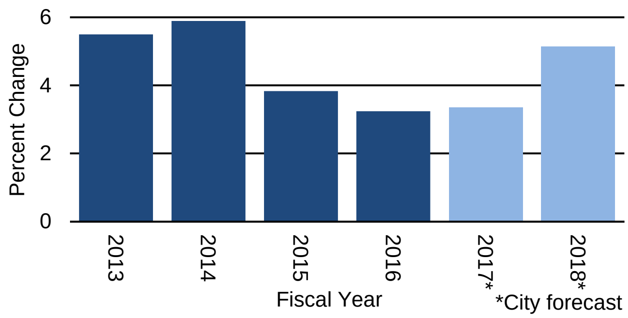
The January Plan assumes that personal income tax collections will increase at an average rate of 4.2 percent during fiscal years 2019 through 2021. However, anticipated changes in federal fiscal policies may impact economic activity and change taxpayer behavior in ways not yet reflected in the City's budget.

3. Sales Tax

Growth in sales tax collections has also weakened in recent years, from an average of 5.7 percent during fiscal years 2013 and 2014 to an average of 3.5 percent during fiscal years 2015 and 2016.[3] Collections remained weak in the first half of the current fiscal year, and the January Plan assumes collections will grow by 3.4 percent to reach $7.2 billion.

The January Plan assumes that collections will increase by 5.1 percent in FY 2018, considerably faster than in recent years (see Figure 12). While wage growth may accelerate as the City anticipates, OSC is concerned that changes in federal immigration and foreign policies could adversely affect tourism from overseas. OSC estimates that sales tax collections may fall short of the level estimated in the January Plan by $100 million annually beginning in FY 2018 if collections grow at a similar rate as in recent years.

FIGURE 12
Growth in Sales Tax Collections



Note: Adjusted for the impact of the sales tax intercept.
Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

[3] Sales tax collections have been adjusted to reflect the State's recouping of savings that accrued to the City from refinancing bonds of the Sales Tax Asset Receivable Corporation.

4. Real Estate Transaction Taxes

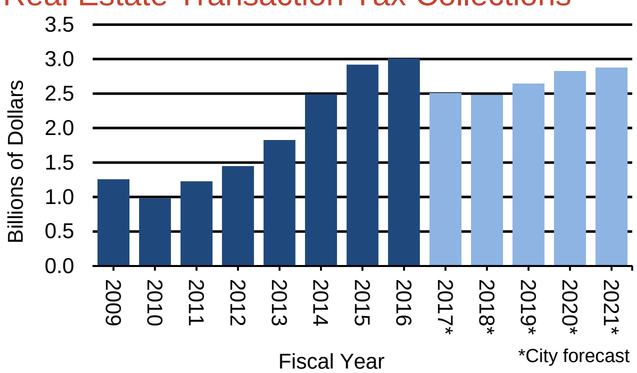
Revenues from the real estate transaction taxes (the real property transfer tax and the mortgage recording tax) grew rapidly during fiscal years 2010 through 2016 as the economy recovered from the Great Recession. The January Plan assumes collections will decline by 16.8 percent in FY 2017, the first decline in seven years (see Figure 13).

While collections slowed during the first half of the fiscal year, it is too soon to tell whether this slowdown reflects, as some observers have suggested, a temporary pause due to uncertainties surrounding the presidential election.

The January Plan assumes that collections will decline by 1 percent in FY 2018, totaling slightly less than $2.5 billion. Transaction activity is expected to be constrained by higher interest rates and a stronger dollar, which may deter some foreign buyers.

FIGURE 13

Real Estate Transaction Tax Collections



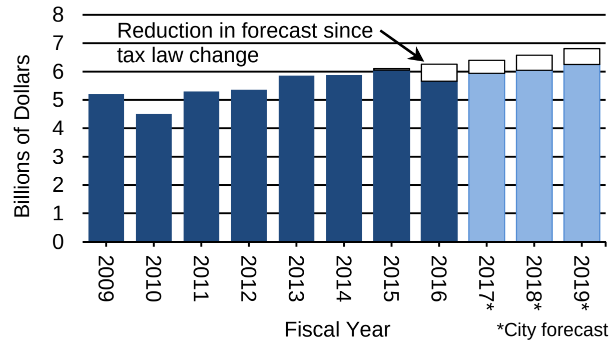
Sources: NYC Comptroller; NYC Office of Management and Budget

5. Business Taxes

In April 2015, the State passed a corporate reform bill that combined the City's banking and general corporation taxes. While this change was intended to be revenue-neutral, since then the City has lowered its business tax forecast by a cumulative total of $2.2 billion for fiscal years 2015 through 2019 (see Figure 14).

FIGURE 14

Business Tax Collections



Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

Last year, collections fell short of the City's expectations by $471 million, resulting in the first decline in six years. Collections declined by 1.4 percent during the first half of FY 2017, but the January Plan assumes that collections will grow by 4.9 percent for the full year. OSC assumes that growth will be more modest, yielding $250 million less in FY 2017 and $100 million less in subsequent years.

However, the budgetary impact could be mitigated in FY 2017 because the City had set aside $185 million in estimated overpayments when the tax law first took effect in 2015. If these resources are utilized, the budgetary impact would be reduced to $65 million.

6. Miscellaneous Revenues

Miscellaneous revenues (e.g., licenses, fines, fees and sale proceeds) are projected to total $4.6 billion in FY 2018, which is 5.7 percent less than projected for FY 2017. Since June 2016, the City has raised its forecast (excluding the impact of the sale of taxi medallions) for FY 2017 by $153 million and raised the forecasts for fiscal years 2018 through 2020 by an average of $60 million annually. OSC estimates that miscellaneous revenues could be higher by $75 million annually beginning in FY 2018 based on current trends.

The State authorized the sale of 2,000 additional taxi medallions in 2012. After the sale of 350 medallions in FY 2014, the City has repeatedly postponed the sale of the remaining 1,650 medallions because the growing presence of alternatives to taxis, such as Uber and Lyft, has lowered the demand for taxi medallions.

The City had planned to sell the remaining medallions over five years beginning in FY 2018, but it has delayed the sale by one year in hopes that market conditions will improve. The City still expects to realize $731 million from the sale during the financial plan period ($107 million in FY 2019, $257 million in FY 2020 and $367 million in FY 2021), but until the City has an opportunity to test the market, there is a risk that the anticipated amount may not be realized.

The City also expects to receive $100 million in FY 2020 from development opportunities at properties leased to the Health and Hospitals Corporation. The City intends to transfer the proceeds to the Corporation to help balance its budget. In the event of a shortfall, the City may be called upon to make up the difference or the Corporation may be required to implement deeper cuts than already planned.

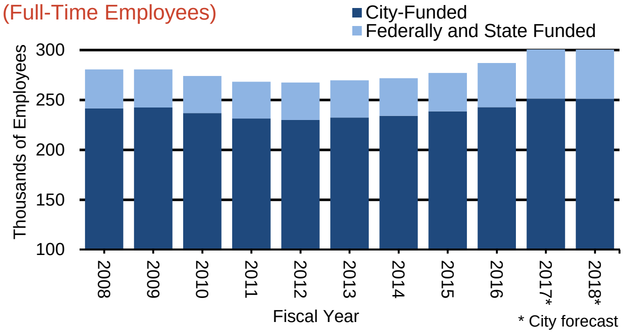
VIII. Expenditure Trends

The Mayor's preliminary budget for FY 2018 totals $84.7 billion, including programs funded with federal and State categorical grants. The portion funded with locally generated revenue (i.e., City funds) will total $61.6 billion. After adjusting for surplus transfers, which can mask expenditure trends, City-funded spending (including reserves) is projected to reach nearly $64.7 billion (see Figure 15).

City-funded spending is projected to grow by 6.1 percent in FY 2018 (3.9 percent excluding reserves), after increasing by 4.5 percent in FY 2017. Growth is driven by the cost of labor agreements, higher costs for employee fringe benefits and debt service.

The City's full-time work force (including jobs funded by federal and State categorical grants) grew by 19,579 employees between fiscal years 2012 and 2016 (see Figure 16). In FY 2016, the City added 9,829 employees (teachers, police officers and correction officers accounted for nearly two-thirds of the new hires), the largest one-year increase since FY 2004. These additions increased the work force to 287,000 (of which 242,878 were funded exclusively by the City), exceeding the prerecession level by 6,353.

FIGURE 16
Staffing
(Full-Time Employees)

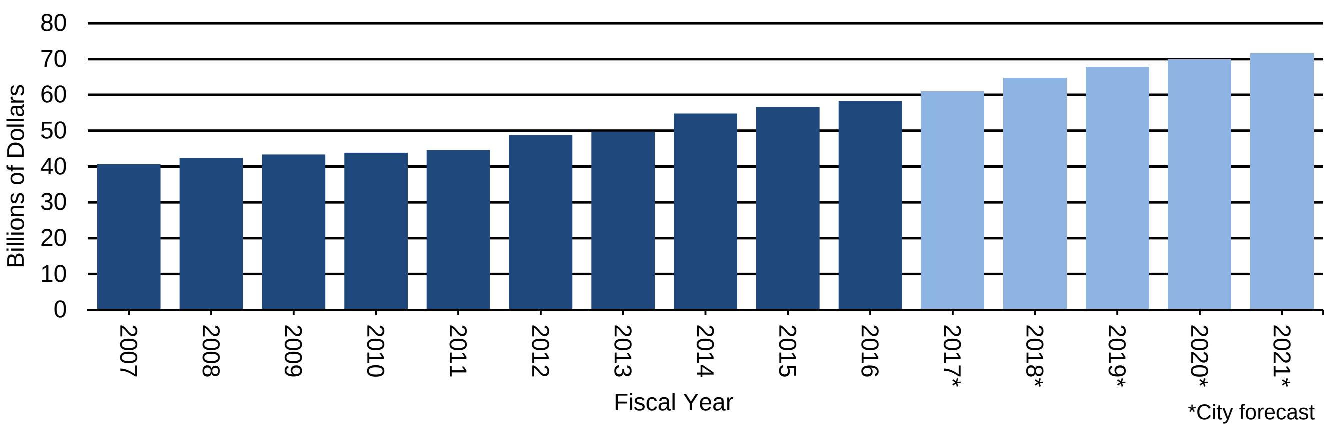


Note: Staffing levels are as of June 30 of each fiscal year.

Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

The January Plan assumes the addition of another 13,701 employees in FY 2017, with hiring concentrated in the health and welfare agencies and the Department of Education. Although the work force continues to expand, the City has fallen short of its hiring targets. The City added 5,416 employees during the first half of FY 2017, 7,502 fewer than planned. If this trend continues, OSC estimates that the City could realize savings of $50 million from hiring delays in FY 2017.

FIGURE 15
City-Funded Expenditures



Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

FIGURE 17
Trends in City-Funded Spending Categories
(in millions)

	FY 2017	FY 2018	Annual Growth	FY 2019	FY 2020	FY 2021	Average Three-Year Growth Rate
Salaries and Wages	$ 17,295	$ 18,766	8.5%	$ 20,114	$ 20,844	$ 21,300	4.3%
Pension Contributions	9,269	9,674	4.4%	9,955	10,008	10,026	1.2%
Medicaid	5,813	5,813	0.0%	5,813	5,813	5,813	0.0%
Debt Service	6,123	6,318	3.2%	7,043	7,709	8,138	8.8%
Health Insurance	4,643	5,021	8.1%	5,467	5,992	6,602	9.6%
Other Fringe Benefits	2,748	2,834	3.1%	3,046	3,377	3,550	7.8%
Energy	748	781	4.4%	802	832	862	3.3%
Judgments and Claims	536	552	3.0%	567	585	600	2.8%
Public Assistance	630	708	12.4%	713	719	719	0.5%
Other	13,214	12,934	-2.1%	13,074	12,801	12,796	-0.4%
Subtotal	**61,019**	**63,401**	**3.9%**	**66,594**	**68,680**	**70,406**	**3.6%**
General Reserve	300	1,000	NA	1,000	1,000	1,000	NA
Prior Years' Expenses	(400)	- - -	NA	- - -	- - -	- - -	NA
Capital Stabilization Reserve	- - -	250	NA	250	250	250	NA
Total	**$ 60,919**	**$ 64,651**	**6.1%**	**$ 67,844**	**$ 69,930**	**$ 71,656**	**3.5%**

Note: Debt service has been adjusted for surplus transfers.
Sources: NYC Office of Management and Budget; OSC analysis

The January Plan is based on the trends shown in Figure 17 and discussed below.

1. Collective Bargaining

As of February 2017, the City had negotiated new labor agreements through FY 2018 with all of the major municipal unions. The agreements call for wage increases of 10 percent over seven years for civilian employees and 11 percent over seven years for uniformed employees. The City expects the remaining unions with expired contracts to reach conforming agreements.

The agreements also compensate members of the United Federation of Teachers (UFT) and other employees for two annual wage increases of 4 percent that were provided to most other municipal unions in 2009 and 2010 but not to these employees.

In November 2015, a three-member arbitration panel awarded police officers two annual wage increases of 1 percent for fiscal years 2011 and 2012, which was consistent with the City's financial plan. Recently, the City and the Patrolmen's Benevolent Association reached agreement on a contract that calls for wage increases of 9 percent over a five-year period, which conforms to the wage pattern for other uniformed employees.

Police officers will also receive a new salary differential (2.25 percent of base salary) for patrol duties associated with the Mayor's neighborhood policing initiative. The cost of the differential will be offset by a reduction in the salary schedule for newly hired police officers.

The parties also agreed to jointly support legislation to increase the disability pension benefits of police officers hired after June 30, 2009, consistent with legislation enacted in 2016 to improve the disability benefits of firefighters hired after that date. Currently, police officers hired after June 2009 receive 50 percent of their highest five-year average salary, offset by 50 percent of the Social Security Disability Insurance benefit. (By contrast, employees hired before that date receive 75 percent of their highest salary with no Social Security offset.) Under the agreement, police officers who elect to receive the improved benefit will contribute an additional 1 percent of their salary toward the cost of the benefit.

The City estimates that these labor agreements will cost a total of $13.8 billion during fiscal years 2014 through 2018 (the end of the contract period). The cost will be partially offset by resources that had been set aside by the City in its labor reserve prior to reaching new wage agreements ($3.5 billion), and from health insurance savings ($4.4 billion) that are expected to result from a separate agreement between the City and its unions. The net budgetary impact will total $5.9 billion.

The budgetary impact will be greatest during fiscal years 2018 through 2021, and will peak at $4 billion in FY 2021. Beginning in FY 2018, the cost will continue to rise after the expiration of the contracts because of lump-sum payments to compensate members of the UFT and other employees for the time they went without wage increases, as well as the full impact of wage increases granted in prior years.

The January Plan includes resources to fund annual wage increases of 1 percent after the expiration of the current round of collective bargaining, which for most employees begin to expire during FY 2018. The actual cost of the next round of collective bargaining will be determined through negotiation or arbitration, and could be higher than assumed in the January Plan. Wage increases at the projected inflation rate, for example, would increase costs by $150 million in FY 2018, $423 million in FY 2019, $938 million in FY 2020 and nearly $1.6 billion in FY 2021.

2. Health Insurance

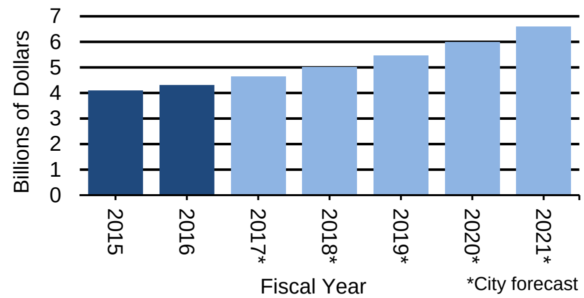
As part of the current round of collective bargaining, the City and the Municipal Labor Committee reached agreement in May 2014 to identify savings that could be used to help fund wage increases for municipal employees.

The agreement calls for savings of $400 million in FY 2015, $700 million in FY 2016, $1 billion in FY 2017 and $1.3 billion in FY 2018, with recurring savings of $1.3 billion in subsequent years. The agreement includes provisions that provide incentives to both the City and the unions for exceeding the planned targets.

Thus far, more than three-quarters of the $3.4 billion in savings (nearly $2.7 billion over four years) has come from administrative actions and lower-than-planned increases in health insurance premiums. Cost-containment initiatives are expected to save $593 million (mostly from higher co-payments), or 17 percent of the total.

The City reached the savings targets for fiscal years 2015 and 2016, and reports that it is on track to meet the $1 billion target for FY 2017 and the $1.3 billion target for FY 2018. Despite these savings, City-funded health insurance costs are projected to reach $6.6 billion by FY 2021 (see Figure 18), $2.3 billion (54 percent) more than in FY 2014.

FIGURE 18
Health Insurance Costs
City-Funded



Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

3. Pension Contributions

After rising rapidly between fiscal years 2003 and 2012, the growth in City-funded pension contributions slowed over the next three years. The slower rate of growth reflects the impact of changes in assumptions and methodologies used to calculate City pension contributions, better-than-expected investment returns, and savings from lower-cost pension plans for City employees hired after March 31, 2012.

However, pension contributions resumed growing in FY 2015. The January Plan assumes contributions will rise from $8.1 billion to nearly $10 billion in FY 2019 and then level off (see Figure 19). The increased cost reflects revised mortality tables to reflect longer life expectancies and lower-than-expected investment earnings during fiscal years 2015 and 2016. Contributions will average 15 percent of City fund revenues during the financial plan period.

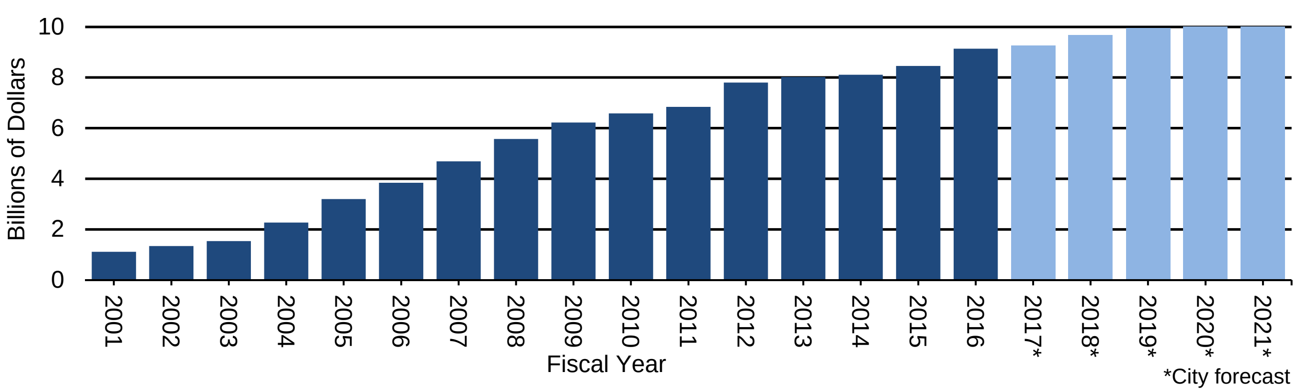
As a result, the unfunded net liability of the City's five pension systems rose by $11.7 billion to $64.8 billion in FY 2016. In the aggregate, the pension systems had sufficient assets to fund, on a market value basis, 65.6 percent of their accrued pension liabilities, which was 4.5 percentage points less than in the prior year.

As of February 17, 2017, the pension funds had earned about 8.3 percent on their investments, compared with the expected return of 7 percent for the full fiscal year.

The City has engaged the services of an independent actuarial consultant, as required under the City Charter, to conduct a biennial audit of the pension system. The January Plan assumes that the assumptions and methodologies used to calculate pension contributions will remain unchanged.

However, the prior consultant recommended that the pension systems revise their overtime assumptions to reflect the increased use of overtime, which would have increased contributions by about $250 million annually. The consultant may affirm the recommendations of the previous consultant, or make other recommendations, which could increase (or decrease) planned contributions.

FIGURE 19
Pension Contributions
City-Funded



Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

4. Medicaid

Medicaid provides health insurance to low-income children and adults, and is the largest payer of long-term care. It also provides subsidies to health care providers, such as the Health and Hospitals Corporation, which serve large numbers of low-income patients and uninsured patients. Enrollment grew slowly in the years following the recession, but accelerated with the implementation of the federal Affordable Care Act (ACA) in January 2014. Currently, 43 percent of the City's population is enrolled in Medicaid.

The January Plan assumes that the City-funded share of Medicaid will total $5.8 billion in FY 2017 (10 percent of City-funded revenue) and will remain at that level because the State assumed financial responsibility for the growth in the local share. These estimates assume no change in federal or State Medicaid policies.

However, the President supports the repeal and replacement of the ACA, which could result in 1.1 million residents losing Medicaid coverage, and another 460,000 losing insurance through plans offered through the health insurance exchange. It has also been suggested that the federal government may place a cap on Medicaid funding to the states. Currently, funding rises or falls based on the number of enrollees and the amount of services rendered.

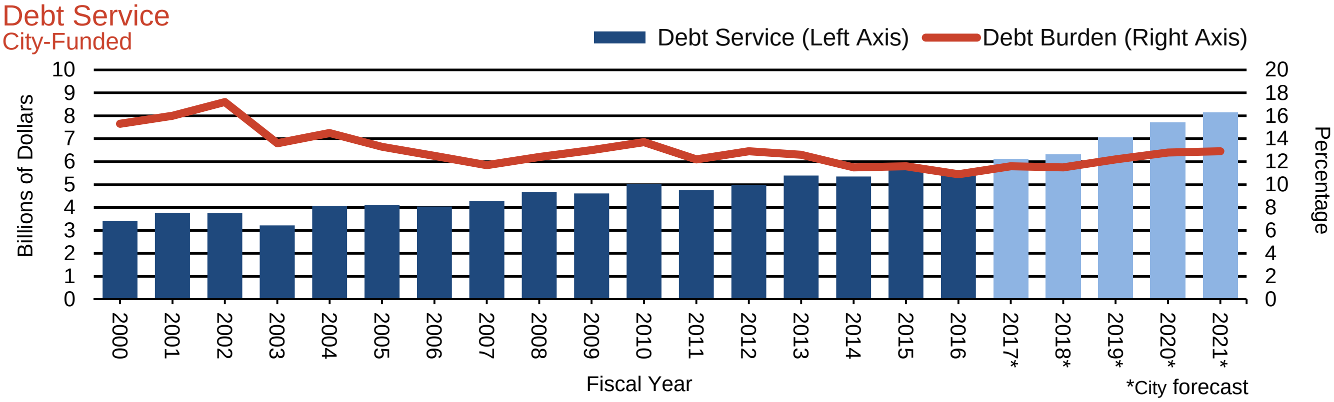
5. Debt Service

Since the beginning of the fiscal year, the City has realized nearly $1.1 billion in debt service savings during the financial plan period. Nonetheless, City-funded debt service is projected to grow by $2.5 billion (44 percent) to $8.1 billion between fiscal years 2016 and 2021 (see Figure 20). Borrowing is expected to more than double during that period as the City expands its capital program. By FY 2021, debt outstanding is expected to reach $89.5 billion, $19.5 billion more than in FY 2016.

Figure 20 also shows that debt service as a share of tax revenue (i.e., the debt burden) would rise from 10.9 percent in FY 2016 to 12.9 percent in FY 2021. Debt service would account for a larger share of tax revenue by FY 2021, but the share would remain below 15 percent, a level that is considered high. To prevent debt service from rising too quickly as a share of tax revenues, the City has created a Capital Stabilization Reserve ($250 million annually beginning in FY 2018).

The City's debt service projections are based on a number of assumptions, which may increase or decrease the debt burden. For example, the debt service forecasts assume that the City will meet its annual capital commitment target, but the City has a long history of falling short of this target.

FIGURE 20
Debt Service
City-Funded



Note: Debt service amounts are adjusted for prepayments and defeasances.
Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

Debt service is also dependent on interest rates. In recent years, interest rates have been at historic lows and the City has realized significant savings from refinancing outstanding debt and from variable-rate debt. However, interest rates have begun to rise.

The City may continue to realize debt service savings (at least in the short term) given its conservative interest-rate assumptions, but there is also the risk that interest rates will increase more rapidly than expected. For FY 2018, OSC estimates that the City could realize savings of $150 million from lower-than-expected variable interest rates. If interest rates continue to rise, however, the opportunities for debt service savings will diminish in future years.

The new federal administration supports efforts to revise the federal tax code, which could reduce personal income taxes. A reduction in the top tax rate could reduce the appeal of tax-exempt bonds. In addition, proposals have been made in the past to cap or eliminate the federal tax exemption for municipal bonds. If that were to occur, municipalities might have to increase the interest rate on bonds to attract investors, which could increase borrowing costs.

6. Public Assistance

The largest public assistance programs in New York State are the Family Assistance (FA) and Safety Net Assistance (SNA) programs. The FA program, which is fully federally funded, provides five years of lifetime benefits to low-income families with children. The SNA program, which is funded by the City and the State, provides benefits to families that have exhausted their federal benefits and to low-income individuals who are ineligible for federal benefits.

The FA caseload fell sharply in response to reforms enacted in the 1990s, including the introduction of time limits and work requirements. After five years, there was a sharp increase in SNA enrollment as families exceeded their lifetime FA benefits and transferred to the State program.

The City's public assistance caseload has remained relatively stable since 2008, though in recent years it has increased. The caseload rose by 11 percent between May 2014 and December 2016 to reach 374,300. Nearly all of the increase occurred in the SNA program, which is funded by the State and City.

The City attributes most of the increase to changes in policies rather than economic conditions. For example, the City and State have granted public assistance recipients greater flexibility in scheduling appointments, which has reduced the number of people who lose their benefits for missing appointments. The City also increased the amount of hours of education and training that can be applied to a recipient's work requirements, which has allowed more low-income students to receive benefits.

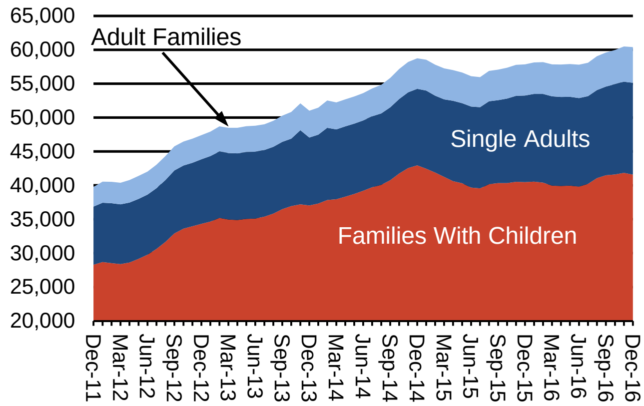
The January Plan assumes that the SNA caseload will increase by nearly 11,000 to reach 238,376 by June 30, 2017. In December 2016, the caseload was far below the year-end target. If SNA enrollment continues to grow more slowly than anticipated, the City could realize savings of $20 million annually. These savings could be offset by an increase in rental payments to low-income families at risk of eviction pursuant to a pending court settlement.

The January Plan assumes the City-funded cost of public assistance will total $708 million in FY 2018. (The federal and State governments fund $887 million of public assistance.)

7. Homeless Services

Despite increased spending on homeless prevention initiatives and subsidized housing, the number of homeless people residing in shelters operated by the Department of Homeless Services (DHS) has reached record levels (see Figure 21). The City expected the shelter population to remain relatively stable in FY 2017, but the population has increased by 4.5 percent since the beginning of the fiscal year. In December 2016, the caseload reached 60,383.

FIGURE 21
People in Homeless Shelters



Source: NYC Department of Homeless Services

The City now expects spending to be higher than previously planned by $256 million in FY 2017 ($123 million in City funds) as a result of the growth in the shelter population and the City's greater reliance on more costly short-term housing (e.g., commercial hotels). The Mayor recently released a plan to build 90 new homeless shelters across the City over the next five years to reduce the City's reliance on commercial hotels.

The January Plan assumes that the cost of providing shelter will reach a record $1.7 billion in FY 2017 (nearly $950 million in City funds). However, it also assumes that the cost of sheltering the homeless will decline by $148 million in FY 2018. The City optimistically assumes that the family population will remain stable and that the single-adult population will decline sharply. Nevertheless, the single-adult population continues to rise, reaching a record level of 13,500 individuals in December 2016.

Despite the City's efforts, reducing homelessness has been challenging. While it appears that the number of families with children in City shelters may be stabilizing, there is not yet any evidence that the single-adult population has stabilized, let alone begun to decline as the City is anticipating. As a result, OSC estimates that the City-funded cost of sheltering homeless adults could be higher by $127 million annually beginning in FY 2018.

Last year, New York State appropriated $2 billion to create and preserve affordable and supportive housing to address homelessness statewide. So far, the State has allocated only $150 million. The balance has not been allocated because the Governor and legislative leaders have not reached agreement on the use of these funds. The Governor's executive budget includes an additional $527 million for this purpose.

8. Uniformed Agencies

Overtime costs (both for uniformed and civilian employees) in the uniformed agencies set a new record in FY 2016 at $1.4 billion. While overtime in the Police Department and the Department of Sanitation declined, it set a new record at the Department of Correction ($275 million), at nearly twice the amount two years earlier.

During the first half of FY 2017, overtime costs among the four agencies totaled $680 million, which is $174 million more than the City had planned. Of this amount, the Police Department spent an additional $73 million and the Department of Correction spent an additional $68 million (and nearly exhausted its annual overtime budget of $138 million).

Both the Police Department and the Department of Correction have been dealing with issues that have increased overtime. Since November 2016, the Police Department has been challenged with protecting the President and his family while they reside in the City. The City has estimated the cost of security for the period between Election Day and Inauguration Day (January 20, 2017) at $24 million. The City is seeking reimbursement from the federal government, but so far it has appropriated only $7 million for this cost.

The Police Department estimates that it will spend between $127,000 to $146,000 per day to protect the First Lady and her son while they reside in Trump Tower after the inauguration, raising the total to about $50 million in the current fiscal year. Costs will increase to an estimated average daily rate of $308,000 during presidential visits to New York City. Other agencies, particularly the Fire Department, will also incur unplanned costs.

Understaffing and federal mandates have largely driven overtime costs within the Department of Correction. In recent years, the department has been unable to maintain staffing at planned levels because attrition has been greater than expected. Last year, more than 1,000 correction officers left the department (twice as many as in FY 2013), and another 598 officers left in the first six months of FY 2017. As a result, the department was 259 officers below its staffing target at the end of December 2016, requiring mandatory posts to be covered on overtime.

The January Plan assumes that City-funded overtime will decline by $224 million to less than $1.1 billion in FY 2017, with most of the reduction in the Police and Correction departments. However, current trends suggest that overtime will exceed the City's budget by a substantial amount. OSC projects that overtime could be higher by a net of $100 million in FY 2017 and by $200 million annually beginning in FY 2018.

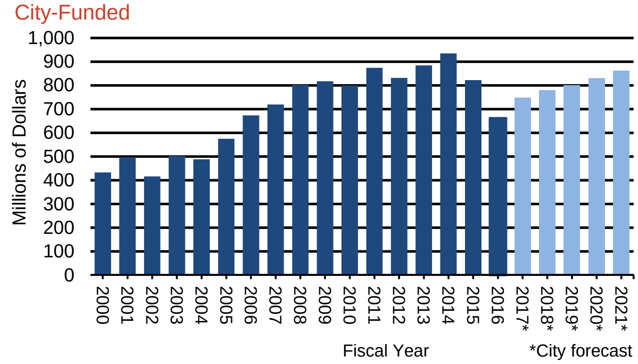
9. Energy

Energy costs (i.e., electricity, fuel and heat) reached a record level of $935 million in FY 2014 (see Figure 22). Costs declined by 12 percent in FY 2015 as prices for electricity, fuel and heat fell sharply, and declined by another 18 percent in FY 2016 when the winter was relatively mild.

The January Plan assumes that energy costs will rise by 13 percent in FY 2017 to $748 million and will continue to increase in FY 2018, reaching about $862 million by FY 2021. Although energy costs have risen, the forecast for FY 2021 is lower than the cost in FY 2013.

The Governor recently announced an agreement to close the Indian Point nuclear power plant by 2021. The agreement will not affect New York City or the MTA because these entities have long-term agreements with the New York Power Authority, which has not purchased electricity from Indian Point since 2013.

Figure 22
Energy Costs
City-Funded



Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

IX. Preliminary 10-Year Capital Plan

In January 2017, the City released its biennial preliminary 10-year capital strategy, which totals $89.6 billion. The proposed strategy is $5.8 billion larger than the May 2015 strategy, with most of the increase concentrated in environmental protection and the Department of Transportation. The City would fund $83.3 billion of the cost, an increase of $7.8 billion.

As shown in Figure 23 and discussed below, nearly three-quarters of the capital resources would be invested in projects involving education, environmental protection, transportation and housing.

Education projects would be allocated $20.4 billion, mostly to support the construction of new schools and the rehabilitation and expansion of existing schools ($15.3 billion). The remainder would support emergency repairs, administrative costs, technology upgrades and enhanced security systems ($5.1 billion).

Environmental protection projects ($17.7 billion) would focus on maintaining and protecting the City's water supply, including pollution control, maintenance and upkeep of the water supply and distribution system, and sewers. The City's third water tunnel, which delivers water from upstate reservoirs, would be allocated $990 million to complete construction.

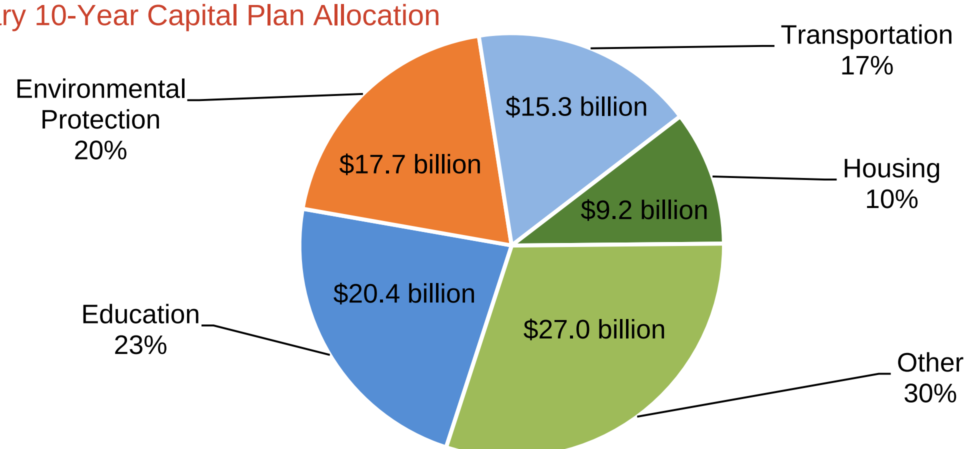
Of the $15.3 billion allocated to transportation projects, nearly $8.2 billion would support the reconstruction and rehabilitation of bridges, including $2.5 billion for the Brooklyn-Queens Expressway and the East River bridges. Another $5.2 billion would fund street and sidewalk reconstruction, such as resurfacing 7,640 lane miles.

The MTA would receive $655 million over the next 10 years. The City has not yet included its commitment to fund $1.8 billion of the MTA's 2015-2019 capital program as it waits for the State to make its initial contribution.

Housing projects would receive $9.2 billion, including $8.6 billion to fund the construction and preservation of affordable and special needs housing. Funding for housing projects has increased by $5.8 billion since 2011 as the Mayor continues his program to construct and preserve 200,000 affordable apartments by 2024. The New York City Housing Authority will receive $1.3 billion, including $1 billion to repair 729 roofs.

Public safety projects would receive $6.5 billion for the Police, Correction and Fire departments and the courts. The City would construct a new property clerk warehouse, renovate the Rodman's Neck Firearms Training Facility, and construct a new adolescent correctional facility.

FIGURE 23
Preliminary 10-Year Capital Plan Allocation



Source: NYC Office of Management and Budget; OSC analysis

X. Semi-Autonomous Entities

1. Health and Hospitals Corporation

The Health and Hospitals Corporation (the largest municipal hospital system in the country) continues to face serious financial challenges. Factors contributing to the crisis include large numbers of uninsured patients, increased competition for Medicaid patients, reduced federal funding and high overhead costs.

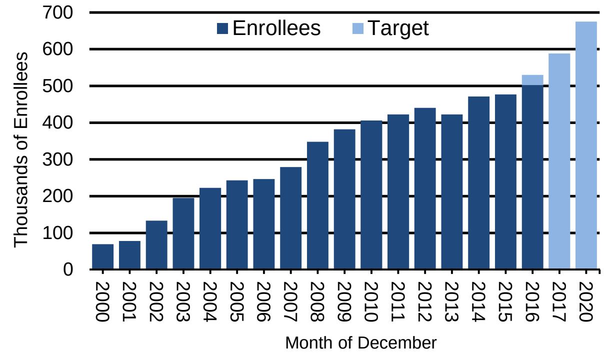
The Corporation's financial situation has deteriorated so much in recent years that it has increasingly relied on the City to meet its financial obligations. In FY 2017, the City will provide $1.9 billion in financial support, representing nearly one-third of the Corporation's total revenues.

Despite assistance from the City and its own efforts, the Corporation projects a $1.8 billion budget gap by FY 2020. In April 2016, it announced a transformation plan in an effort to realign spending and revenues to balance the budget by FY 2020.

The plan counts on a large increase in enrollment in MetroPlus, a health insurance plan owned by the Corporation. The plan assumes that enrollment will increase by one-third (173,000 members) by FY 2020. However, MetroPlus has had difficulty attracting and retaining members.

Last year, the Corporation fell short of its enrollment target by 27,600 members (see Figure 24). MetroPlus added only 1,100 members during the first half of FY 2017, far fewer than its target of 60,000 for the full year. MetroPlus premiums on the State's health insurance exchange increased by an average of 29 percent in 2017, complicating its efforts to increase enrollment.

FIGURE 24
MetroPlus Enrollment

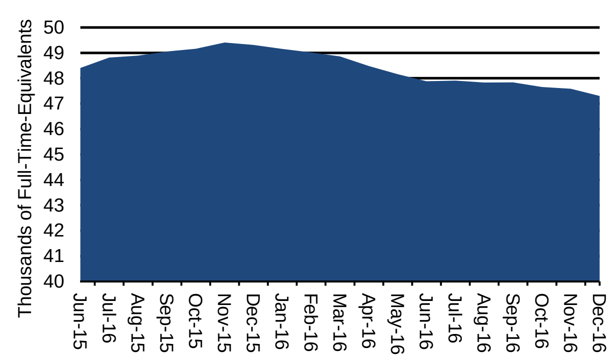


Sources: Health and Hospitals Corporation; OSC analysis

The Corporation also has had difficulty reducing staffing levels, but is now making progress. Last year, the Corporation had planned to reduce staffing by 1,000 full-time-equivalents (FTEs), but staffing increased by nearly 1,000 during the first half of the fiscal year. Staffing declined in the second half, but the Corporation incurred $27 million in unplanned costs.

The Corporation is having greater success in the current fiscal year. It reported that the work force totaled 47,304 FTEs at the end of December 2016 (see Figure 25), 577 fewer than at the beginning of the fiscal year and only slightly lower than the target. The Corporation plans to reduce staffing by a total of 926 FTEs in FY 2017 for $50 million in recurring savings.

FIGURE 25
Health and Hospitals Corporation Staffing



Sources: Health and Hospitals Corporation; OSC analysis

Other cost-reduction initiatives are expected to generate savings of $1.5 billion over five years through FY 2020. Most of the resources ($1 billion) would come from restructuring the Corporation's health care services, but a plan has not yet been made public.

The transformation plan relies heavily on additional federal assistance ($1.4 billion over four years).[4] In FY 2017, the Corporation is counting on the receipt of $467 million in Medicaid funding, but only half of that amount has received the necessary approvals.

The transformation plan assumes that the federal government will extend Medicaid coverage to undocumented immigrants for nonemergency services to generate $18 million in FY 2017 and $96 million annually beginning in FY 2018. However, it seems unlikely that this initiative will be approved by the new administration.

Federal actions that target undocumented immigrants and the repeal of the Affordable Care Act (ACA) could put existing federal funding streams at risk. For example, Medicaid currently reimburses hospitals for emergency room services provided to undocumented immigrants.

The new federal administration supports the repeal and replacement of the ACA, which expanded Medicaid eligibility and reduced the number of uninsured. The Corporation estimates that 340,000 of its patients and MetroPlus members could lose insurance coverage if the ACA is repealed. The Corporation has not estimated the potential budgetary impact of the repeal of the ACA.

In January 2017, the Corporation indicated that it would end the fiscal year with a cash balance of about $110 million (assuming successful implementation of the transformation plan), enough to pay its bills for only seven days.

[4] Medicaid and uninsured patients represent nearly 70 percent of the Corporation's hospital stays, and about half ($3.2 billion) of the budget is funded by the federal government.

However, the number of patients receiving services at the Corporation's facilities continues to decline and patient revenues were $75 million short of target through November 2016. Unless this trend is reversed, the shortfall could grow as the year progresses.

Last year, the Corporation's financial situation was worse than originally projected. As a result, the City relieved the Corporation of $337 million in financial obligations, including debt service on bonds issued by the City on the Corporation's behalf. The City still expects reimbursement for the cost of medical malpractice claims ($140 million) and employee fringe benefits ($24 million) during the financial plan period.

The City remains confident that the Corporation will not require additional assistance in the current fiscal year because the Corporation is likely to receive as much as $200 million in unplanned one-time Medicaid payments. While these funds can provide a cushion in the current year, the Corporation could require additional City funding in the future since its transformation plan relies so heavily on federal assistance.

Despite the challenges facing the Corporation, it has not revised its four-year financial plan since June 2016. (In contrast, New York City has revised its financial plan twice since then.) OSC encourages the Corporation to update its accrual and cash financial plans, and to revise its transformation plan as needed.

Given the changes contemplated at the federal level, the current environment may present the Corporation with its greatest challenge in decades. The Corporation must scrutinize every aspect of its operation to generate savings while maintaining access to health care and patient safety as priorities.

2. Department of Education

New York City has the largest public school system in the nation, operating more than 1,800 schools and serving more than 1.1 million students. The January Plan allocates $29.6 billion in FY 2017 for costs associated with educating children in the City's public schools.[5] Of this amount, $16.8 billion (57 percent) would come from the City and $10.9 billion (37 percent) would come from the State, with $1.7 billion (6 percent) coming from the federal government.

Since the end of the recession, the State has increased education aid to New York City by an annual average of $611 million. The Governor's executive budget would increase education aid by $295 million in FY 2018, $244 million less than assumed in the January Plan. However, the enacted budget usually includes a higher level of education aid than the amount initially proposed by the Governor.

While the City may be eligible to receive additional education funding from a proposed $150 million Fiscal Stabilization Fund and from $50 million in new competitive grants, the details of these programs have not yet been released.

While the Governor has proposed extending mayoral control over the City's public school system by three years, he has also proposed eliminating references in State law to a future phase-in of Foundation Aid, instead offering the FY 2018 distribution as a base from which to calculate future increases. The Mayor is concerned that this might weaken the State's commitment to address statewide inequities in education funding.

Each year, the Department of Education submits Medicaid reimbursement claims for eligible services provided to special education students. However, the department has historically had difficulty substantiating such claims to the federal government.

The department hired a consultant to improve the claiming process, but the computer system used to document claims has encountered its own problems. The City plans to spend an additional $97 million during the financial plan period (nearly $16 million in FY 2017 and about $20 million annually over the next four years) to address the shortcomings. The department is making several other improvements to increase the likelihood of receiving Medicaid reimbursements.

Last year, the department submitted claims totaling $18 million, $79 million less than the target at the beginning of the fiscal year. The January Plan assumes that the amount of Medicaid reimbursement will more than double to $41 million in FY 2017 and will reach $97 million annually beginning in FY 2018.

Until the City can demonstrate that it can adequately document such claims, it remains uncertain whether the City can increase reimbursements above last year's level, putting $23 million in FY 2017 and $79 million annually thereafter at risk.

[5] As part of these costs, $7.6 billion has been allocated to fund fringe benefits, including pensions, and another $2.3 billion has been allocated to fund debt service on capital improvements.

3. Metropolitan Transportation Authority

In September 2016, OSC issued a report that concluded that the Metropolitan Transportation Authority (MTA) had recovered from the recession, but that it still faced challenges. Labor agreements were set to expire beginning in December 2016, and the State and City had not yet identified the sources of their $9.2 billion contribution to the MTA's capital program.

The report noted that fares and tolls increased by 45 percent between 2007 and 2015, nearly three times faster than inflation. It cautioned that the MTA's revenues are very sensitive to changes in the economy, as evidenced by the large revenue losses it experienced during the last recession.

On January 15, 2017, the MTA reached a tentative labor agreement with the Transport Workers Union (TWU), its largest union. The agreement covers the period from January 2017 to May 2019, and calls for a total wage increase of 5 percent and enhanced dental benefits.

Although the cost of the TWU agreement is greater than the MTA had budgeted, the MTA has indicated that the added cost can be accommodated in its financial plan. The agreement states that the negotiations will be reopened if the Long Island Rail Road's unions receive larger wage increases than those provided to the TWU.

On January 16, 2017, the Governor released his executive budget for SFY 2017-2018. The budget allocates $4.5 billion in tax revenues and State subsidies to the MTA in 2017, $125 million less than the MTA expected.

The proposed budget would allocate $75 million less than expected in Metropolitan Mass Transportation Operating Assistance, and would reduce by $67 million the amount of funding the State provides the MTA to offset the impact of exemptions to the metropolitan commuter transportation mobility tax that the State granted to schools and small businesses in 2011. Other tax revenues would increase slightly, mitigating the impact of these actions.

In February 2017, the MTA projected positive year-end cash balances through calendar year 2019, but a $372 million budget gap for 2020 ($53 million larger than projected in November 2016). These estimates assumed continued growth in the regional economy and in the use of MTA services, as well as biennial fare and toll increases of 4 percent beginning in 2017.

The Governor's proposed budget continues the State's commitment to contribute $8.3 billion toward the MTA's $29.5 billion capital program. The State intends to provide $750 million in bond proceeds and another $250 million in financial settlement funds. The State has not identified the sources of the remaining $7.3 billion in funding.

The State intends to provide the MTA with the remaining $7.3 billion after the MTA has effectively exhausted all other existing sources of capital funding, but no later than SFY 2025-26 or by the completion of the capital program.

The Governor's budget includes $1.5 billion in new appropriations, in addition to $2.9 billion appropriated in SFY 2016-17, that could be used for capital grants if the State elects to provide direct financial support. In addition to capital grants, the State's fulfillment of its commitment could include authorizing the MTA to issue its own bonds backed by an existing or new State revenue source.

Nearly one-quarter ($6.9 billion) of the MTA's 2015-2019 capital program is funded by the federal government. It is too soon to determine whether there will be changes in federal policies that would increase or decrease federal support to the MTA's capital program.

4. New York City Housing Authority

The New York City Housing Authority (NYCHA) is an important component of the City's supply of affordable housing. NYCHA manages approximately 180,000 apartments that house more than 400,000 residents, which amounts to 8 percent of the City's rental apartments for almost 5 percent of the City population. As of November 2016, nearly 270,000 more individuals were awaiting an opportunity to rent NYCHA public housing units.

Federal funds make up approximately 90 percent ($1.9 billion) of the revenue that is not funded by tenant rental payments. As a result of insufficient federal appropriations for public housing, NYCHA estimates that $1.3 billion of federal funding has been forgone since 2001. Coupled with other fiscal and management challenges, NYCHA has been unable to adequately fund operations, and the City's public housing properties have fallen into disrepair.

In response to these challenges, NYCHA presented a 10-year plan in May 2015 to close projected budget deficits and to improve the condition of its facilities. As part of the plan, the City has committed nearly $170 million annually in new financial support by relieving NYCHA of its commitments to reimburse the New York City Police Department, make payments to the City in lieu of taxes, and fund most community centers. The City provided funding so NYCHA would house additional homeless families.

The remainder of the plan was based on a number of assumptions, and relied on improved operational performance and the cooperation of the federal and State governments, the unions and private developers. NYCHA originally expected to generate $285 million during calendar years 2017 and 2018 from cost-reduction and revenue-enhancement initiatives. However, it now expects $222 million during this period.

After revising its forecasts to reflect lower-than-anticipated costs for health insurance and energy, NYCHA's five-year financial plan shows a surplus of $21 million in 2017 and $61 million in 2018. These estimates, however, assume successful implementation of cost-reduction and revenue-enhancement initiatives. For example, NYCHA is counting on the receipt of $117 million in 2017 and $140 million in 2018 from sale of development rights.

NYCHA's most recent five-year capital plan only funds $5.6 billion of $17 billion in total capital needs. To help narrow the gap, NYCHA is counting on $3.1 billion in private capital by enrolling 15,000 units over 10 years in the federal Rental Assistance Demonstration (RAD) program.

So far, NYCHA has secured $325 million for capital improvements to 1,400 RAD units and has received federal approval to seek financing for an additional 1,700 units ($300 million). NYCHA has applied for additional units, but all of the RAD slots currently available nationwide have been allocated. As a result, there is no assurance that the remaining $2.5 billion in private capital funds will be realized.

XI. Other Issues

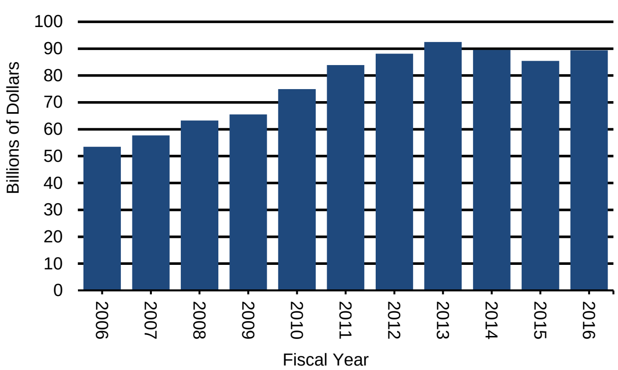
1. Post-Employment Benefits

The City's unfunded liability for post-employment benefits other than pensions (OPEBs) increased by $3.9 billion to $89.4 billion in FY 2016, the first increase since FY 2013 (see Figure 26). The increase is driven mostly by revised mortality tables that reflect longer life expectancies.

In 2015, the Governmental Accounting Standards Board approved two rules (which take effect in FY 2018) that could increase the City's OPEB liability. For example, entities that do not fund their OPEB liabilities on an actuarial basis could be required to discount future costs using an interest rate that is lower than the assumed rate of return on investments, which would increase the unfunded liability.

The City, like many employers, does not fund its OPEB liabilities on an actuarial basis but rather pays the annual cost of benefits to current retirees on a pay-as-you-go (PAYGO) basis. OPEB costs, on a PAYGO basis, are projected to rise from nearly $2.2 billion in FY 2016 to $3 billion in FY 2021, an increase of nearly 39 percent over five years.

FIGURE 26
Unfunded OPEB Liability



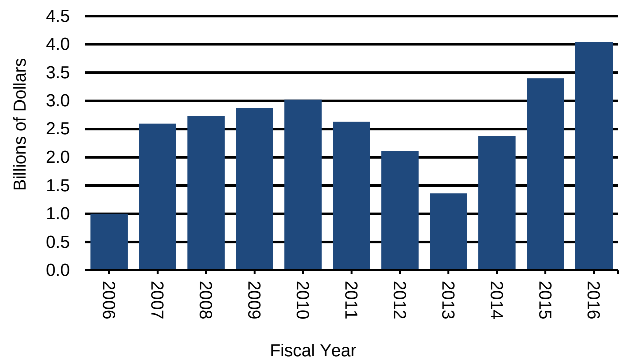
Sources: NYC Actuary; OSC analysis

2. Retiree Health Benefits Trust

In FY 2006, the City established the Retiree Health Benefits Trust (RHBT) to help fund the future cost of OPEBs. During fiscal years 2006 and 2007, the City deposited $2.5 billion of surplus resources into the RHBT. These resources were invested and earned interest, with the balance exceeding $3 billion by FY 2010.

While the City's RHBT was intended to help fund future OPEB liabilities, it has been used as a rainy-day fund. The City drew down much of the resources in the RHBT during fiscal years 2011 through 2013 as it managed through the Great Recession (see Figure 27).

FIGURE 27
RHBT Year-End Balance



Note: Adjusted for prepayments in fiscal years 2008 and 2009.
Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

The City had planned to use $1 billion from the RHBT to help balance the FY 2014 budget, but nonproperty tax collections grew faster than anticipated, permitting the City to rescind the planned transfer and to contribute $864 million to the RHBT.

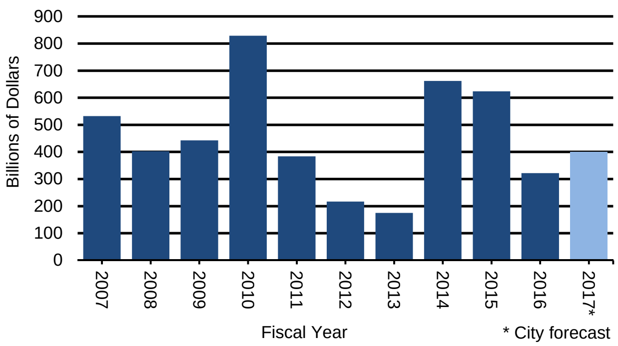
In FY 2015, tax collections also grew much faster than expected, allowing the City to contribute another $955 million to the RHBT. In FY 2016, the City contributed an additional $500 million, which increased the year-end balance to $4 billion, the highest amount ever.

3. Prior Years' Expenses

At the end of each fiscal year, the City estimates the amount of expenses that have been incurred but not yet paid, and the amount of revenues earned but not yet received. The City generally makes conservative estimates because an unfunded liability has a budgetary impact in the current fiscal year.

Over the past 10 years, the City has realized net resources of $459 million annually from overestimating prior years' expenses and from underestimating prior years' receivables. In FY 2016, the City realized a net benefit of $322 million (see Figure 28), largely from an overestimation of prior-year expenses in the Department of Education. The January Plan anticipates savings of $400 million in FY 2017, but none in subsequent years.

FIGURE 28
Savings from Prior Years' Expenses

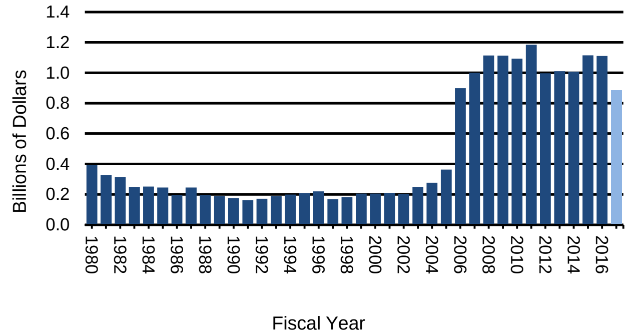


Note: Adjusted for annual changes in prior-year receivables.
Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

4. Reserve for Disallowances

The City maintains a reserve for disallowances of federal and State aid. From fiscal years 1980 through 2005, the reserve averaged $230 million annually, but the City began to increase the reserve in FY 2006 after federal audits found that claims for $800 million in Medicaid reimbursement could not be fully documented. The reserve reached nearly $1.2 billion by the end of FY 2010 (see Figure 29).

FIGURE 29
Reserve for Disallowances



Sources: NYC Office of Management and Budget; NYC Comptroller; OSC analysis

After most of the Medicaid liability had been settled, the City reduced the reserve to $1 billion in FY 2012, based on a change in the methodology used to calculate the risk of future disallowances. The size of the reserve in the years since then has been adjusted annually based on changes to the five-year average of categorical aid.

The City recently completed a review of the risk methodology and found that actual disallowances over the past five years were lower than anticipated. Based on these results, the City believes the reserve can be reduced by $200 million. In addition, the City no longer plans to make a $15 million contribution to the reserve in FY 2017, which will raise the financial plan benefit to $215 million in that year. To the extent that the reserve is not needed to offset future disallowances of federal or State aid, additional funds could be used to help balance the budget.

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