Review of the Financial Plan of the City of New York

Report 9-2017

Message from the Comptroller

December 2016

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 citizen to learn more about these issues and to participate fully in the public debate.

Thomas P. DiNapoli
State Comptroller

Contents

I. Executive Summary

On November 17, 2016, the City of New York released a modification to its four-year financial plan ("the November Plan") covering fiscal years 2017 through 2020 (see Figure 1). The November Plan incorporates a number of changes since the budget was adopted in June 2016, including a Citywide Savings Program, higher-than-planned spending and a small reduction in projected tax collections.

After taking these changes into account, the City projects a surplus of $439 million in FY 2017. The surplus, in combination with other changes, reduced the FY 2018 budget gap from $2.8 billion to $2.2 billion. The gaps for fiscal years 2019 and 2020 are essentially unchanged at $2.9 billion and $2.4 billion.

While the gaps are relatively small as a share of City fund revenues (averaging 3.9 percent), closing them could be more difficult than in recent years because the growth in tax collections has slowed. In recent years, tax collections have greatly exceeded expectations and the additional revenues were available to offset unplanned costs and to close projected budget gaps.

In each of fiscal years 2014 and 2015, for example, tax collections exceeded the City's initial forecast by more than $3 billion. While the amount of unanticipated tax collections declined to $1.4 billion in FY 2016, it still accounted for more than one-third of the $4 billion surplus that year. (A drawdown of unneeded reserves accounted for half of the surplus.)

City-funded spending is now expected to be higher by nearly $1 billion during the financial plan period. Most of the additional cost ($756 million) stems from an increase in pension contributions because investment earnings were lower than expected last year.

Last year, spending exceeded the City's initial estimates by nearly $1.6 billion. Fortunately, tax collections were much stronger than expected, which mitigated the impact. In the current fiscal year, however, collections have been weaker than expected, and the City lowered its forecast by $127 million.

Tax collections grew at an average annual rate of 6.9 percent during fiscal years 2011 through 2015, but growth slowed to 3.2 percent in FY 2016 and is expected to slow further, to less than 2 percent, in FY 2017. Property tax collections remain strong, but nonproperty tax collections are expected to fall by 0.5 percent in FY 2017, the first decline since FY 2010.

City-funded spending is projected to grow by 4.5 percent annually during the financial plan period, more than twice the inflation rate. Growth is driven by the cost of labor agreements, higher costs for employee fringe benefits and debt service, and new programmatic initiatives.

New York City's economy remains strong, and although job growth is slowing it continues to set new records. In 2016, the City is on pace to add 90,000 jobs, the sixth consecutive year of job gains of more than 85,000.

The City has added more than 600,000 jobs since 2009, the largest expansion in its history. Many sectors, including leisure and hospitality, business services, and health care, have made significant contributions. A more diversified economy helps insulate the City against cyclical downturns. The global economy, however, remains weak and vulnerable to shocks.

Although job growth and tax collections are slowing, the FY 2017 surplus will likely grow as the year progresses and the City frees up unneeded reserves. Although tax collections could be lower and overtime costs could be higher, the impact could be offset by savings in debt service and other favorable developments (see Figure 2).

The Health and Hospitals Corporation, however, continues to face serious financial challenges. It projects a cash balance of $116 million by June 30, 2017, enough to pay its bills for only seven days. This forecast assumes implementation of a transformation plan, which is valued at $779 million in FY 2017.

The transformation plan relies heavily on additional federal aid ($1.4 billion over four years), which has not yet been approved and may not be consistent with the policies of the incoming administration. The Corporation is also falling short of targets to reduce staffing and increase membership in MetroPlus (a health insurance plan owned by the Corporation). Unless the transformation plan succeeds, the City could be called upon to increase its support.

The City's out-year budget gaps could be significantly larger for a number of reasons. For example, the City anticipates $731 million from the sale of taxi medallions during fiscal years 2018 through 2020, but the sale has been repeatedly delayed and market conditions remain unsettled. In addition, the homeless population may not decline as quickly as anticipated in the November Plan.

The State is also recouping savings that accrued to the City when it refinanced bonds of the Sales Tax Asset Receivable Corporation. The November Plan reflects the impact for only the first 12 months under the assumption that the law will be changed. According to current law, the City will lose $50 million in FY 2017, $200 million in FY 2018 and $150 million in FY 2019.

The Governor will release his budget for State Fiscal Year 2017-2018 in January 2017. The November Plan assumes that education aid will grow by $494 million, comparable to last year, but State personal income tax collections have fallen far short of target. In addition, last year the

Governor proposed actions that would have shifted $1 billion in costs to the City.

Although it is too early to quantify the potential impact, the incoming federal administration has signaled its support for changes in existing federal programs and taxes, as well as regulations affecting the financial services industry. New York City's budget includes about $7 billion in federal aid, mostly for social service and education programs.

In addition, an estimated $20 billion in federal funds flow through the State budget to provide Medicaid benefits to City residents. About half of the budget for the Health and Hospitals Corporation and nearly the entire non-rent share of the budget for the New York City Housing Authority are federally funded.

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, and the City has created a $500 million Capital Stabilization Reserve. The City has also replenished the Retiree Health Benefits Trust, which now has a balance of $4 billion.

The Mayor has also implemented a Citywide Savings Program (valued at $1 billion over two years) in November for the first time during his tenure. The Mayor intends to expand the program in January to help narrow the projected budget gaps.

In conclusion, the economy is strong, but job growth and tax collections are slowing. In addition, a number of budget risks could increase the size of the out-year budget gaps, mostly from factors that are outside of the City's control. To its credit, the City has prudently maintained its reserves at 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
Revenues				
Taxes				
General Property Tax	$ 24,025	$ 25,410	$ 26,920	$ 28,191
Other Taxes	29,752	31,092	32,081	33,182
Tax Audit Revenue	741	716	716	716
Subtotal: Taxes	$ 54,518	$ 57,218	$ 59,717	$ 62,089
Miscellaneous Revenues	6,624	6,442	6,695	6,798
Unrestricted Intergovernmental Aid	- - -	- - -	- - -	- - -
Less: Intra-City Revenue	(1,961)	(1,778)	(1,772)	(1,779)
Disallowances Against Categorical Grants	(15)	(15)	(15)	(15)
Subtotal: City Funds	$ 59,166	$ 61,867	$ 64,625	$ 67,093
Other Categorical Grants	972	856	847	838
Inter-Fund Revenues	655	657	595	594
Federal Categorical Grants	8,534	6,799	6,638	6,638
State Categorical Grants	14,130	14,390	14,860	15,346
Total Revenues	**$ 83,457**	**$ 84,569**	**$ 87,565**	**$ 90,509**
Expenditures				
Personal Service				
Salaries and Wages	$ 25,815	$ 27,227	$ 28,710	$ 29,544
Pensions	9,422	9,830	10,110	10,161
Fringe Benefits	9,636	10,222	10,890	11,838
Subtotal: Personal Service	$ 44,873	$ 47,279	$ 49,710	$ 51,543
Other Than Personal Service				
Medical Assistance	5,915	5,915	5,915	5,915
Public Assistance	1,584	1,594	1,605	1,616
All Other	28,672	26,323	26,612	26,558
Subtotal: Other Than Personal Service	$ 36,171	$ 33,832	$ 34,132	$ 34,089
Debt Service	6,473	6,916	7,384	8,032
FY 2016 Budget Stabilization & Discretionary Transfers	(4,038)	- - -	- - -	- - -
FY 2017 Budget Stabilization	439	(439)	- - -	- - -
Capital Stabilization Reserve	500	- - -	- - -	- - -
General Reserve	1,000	1,000	1,000	1,000
Subtotal	$ 85,418	$ 88,588	$ 92,226	$ 94,664
Less: Intra-City Expenses	(1,961)	(1,778)	(1,772)	(1,779)
Total Expenditures	**$ 83,457**	**$ 86,810**	**$ 90,454**	**$ 92,885**
Gap to be Closed	**$ - - -**	**$ (2,241)**	**$ (2,889)**	**$ (2,376)**

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**
Surplus/(Gaps) Per NYC Financial Plan	**$ - - -**	**$ (2,241)**	**$ (2,889)**	**$ (2,376)**
Health and Hospitals Corporation	(300)	- - -	- - -	- - -
Uniformed Agency Overtime	(125)	(150)	(150)	(150)
Tax Revenues	(50)	(125)	(125)	(125)
Sales Tax Asset Receivable Corporation	(50)	(200)	(150)	- - -
Special Education Medicaid Reimbursement	(23)	(79)	(79)	(79)
Debt Service	100	- - -	- - -	- - -
Miscellaneous Revenues	75	100	100	100
Hiring Delays	75	- - -	- - -	- - -
Public Assistance	20	20	20	20
Homeless Shelters	- - -	(180)	(180)	(180)
Sale of Taxi Medallions	- - -	(107)	(257)	(367)
Revenue from Development Opportunities	- - -	- - -	- - -	(100)
OSC Risk Assessment	**(278)**	**(721)**	**(821)**	**(881)**
Potential Surplus/(Gaps) Per OSC[1]	**$ (278)**	**$ (2,962)**	**$ (3,710)**	**$ (3,257)**

---

[1] The November Plan includes a general reserve of $1 billion in each of fiscal years 2017 through 2020, which, if not needed, could be used to help close the projected budget gaps. In addition, the Capital Stabilization Reserve has a balance of $500 million in FY 2017, 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

Job growth is slowing in New York City, but it continues to set new records. By the end of 2016, the City will have added more than 600,000 jobs since 2009, the largest job expansion on record. Moreover, the current economic expansion has relied less on the securities industry than in the past. Other sectors such as leisure and hospitality, business services, and health care have been the driving force behind the current economic expansion. A diversified economy is less dependent on one industry for economic growth.

A number of factors could impact the City's economy during the financial plan period. The global economy remains weak and vulnerable to shocks. A new administration in Washington is likely to pursue different fiscal policies, including lower taxes and increased spending on defense and infrastructure. While such changes could boost economic and wage growth in the near term, they could also contribute to inflationary pressures and higher interest rates.
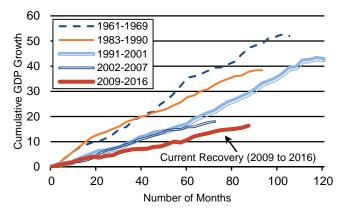
The National Economy

The nation has added 15.4 million jobs since the end of the recession (6.7 million more than were lost), reaching a record of 145 million jobs in November 2016. Job growth in the nation, however, has slowed from 2.1 percent in 2015 to 1.8 percent through the first 11 months of 2016.

The nation's economic expansion has continued for 89 months, a much longer period than the average length of recoveries during the post–World War II era (58 months). While the current recovery is the fourth-longest, it has been the weakest as measured by growth in gross domestic product (see Figure 3).

While the nation's gross domestic product (GDP) grew at an annualized rate of 3.2 percent in the third quarter, it is expected to grow by less than 2 percent for all of 2016, a slower rate of growth

FIGURE 3
Longest Post–World War II Expansions

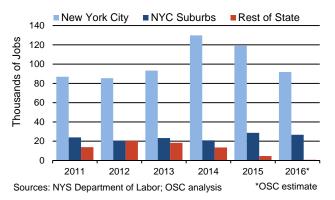Sources: U.S. Bureau of Economic Analysis; OSC analysis

than in the previous two years. Growth has been constrained by weak business spending and falling productivity. IHS Markit and most economists, however, expect growth to pick up in 2017, averaging 2.3 percent.

The yield on the benchmark 10-year Treasury note increased from 1.83 percent on November 7 (the day before the election) to 2.48 percent on December 13, reflecting the likelihood of higher interest rates in the future. On December 14, 2016, the Federal Reserve raised short-term interest rates by 25 basis points and indicated that rates are likely to increase further during 2017.

New York Employment Trends

Between 2009 and 2015, New York State added 706,500 jobs, 469,200 more than were lost during the recession. In addition, the State is on pace to add another 120,000 jobs in 2016. However, the rate of job growth has slowed from 1.7 percent in 2015 to 1.3 percent through the first 11 months of 2016.

FIGURE 4
Change in Employment by Region in
New York State

New York City **NYC Suburbs** **Rest of State**

Sources: NYS Department of Labor; OSC analysis   *OSC estimate

Moreover, job growth has not been consistent across the state. In 2015, New York City and its suburbs (Nassau, Suffolk, Westchester, Rockland and Orange counties) added 147,700 jobs (97 percent of all jobs added in the State that year). As shown in Figure 4, job growth remained strong in the downstate region through the first 11 months of 2016, but upstate job growth has come to a virtual halt.

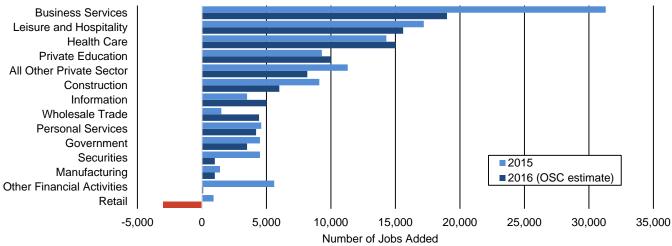In 2014, New York City gained nearly 130,000 jobs, the largest one-year gain on record, and 2015 was the first time the City added more than 100,000 jobs for two consecutive years. Although job growth has slowed in 2016, employment in New York City is on track to reach a new record level of 4.3 million jobs. OSC estimates that the City will add 90,000 jobs in 2016 (compared to 119,000 in 2015), which would be the sixth consecutive year that job growth has exceeded 85,000 jobs.

Business services, leisure and hospitality, and health care account for half of the job gains in 2016 (see Figure 5). Although the business services sector is on pace to add 19,000 jobs, it is one-third fewer jobs than last year. The health care and leisure and hospitality sectors are on pace for similar gains as last year (about 15,000 jobs each).

Private education is on track to add 10,000 jobs, slightly ahead of last year's pace. Three-quarters of these jobs are in colleges and universities.
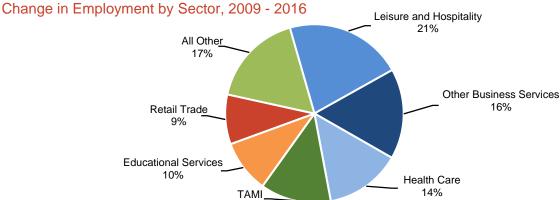
While the retail sector was a large contributor to job growth earlier in the recovery with 59,000 jobs gained through 2015, it is on pace to lose more than 3,000 jobs in 2016.

FIGURE 5
New York City Job Growth By Sector

Sources: NYS Department of Labor; OSC analysis

Note: TAMI is technology, advertising, media and information. 2016 is an OSC estimate.
Sources: NYS Department of Labor; U.S. Bureau of Labor Statistics; OSC analysis

By the end of 2016, the City will have added more than 600,000 jobs since 2009 (a gain of 17 percent), the largest job expansion on record. Job growth has been broad-based, reflecting the increased diversification of the City's economy (see Figure 6).

Securities Industry

The securities industry remains an important part of the City's economy, although it is smaller than before the financial crisis and it has contributed less to economic growth in recent years than in the past. For example, the industry accounted for 39 percent of the growth in total private sector wages between 1990 and 2007, but accounted for 11 percent between 2010 and 2015.

Economic growth since 2010 has been driven by other sectors, primarily the TAMI and business services sectors. Each of these sectors accounted for one-fifth of private sector wage growth between 2010 and 2015, nearly twice the share of the securities industry. In addition, the private education and health care sectors have each grown by 6 percent.

Employment in the securities industry is 8 percent smaller than it was before the recession, although the number of jobs in the rest of the City's private sector increased by 17 percent between 2007 and 2015.

Nonetheless, the industry remains a large part of the City's economy, accounting for nearly 21 percent of private sector wages in 2015.

The industry added 2,400 jobs in 2014 and another 4,500 jobs in 2015, the first two consecutive years of job gains since the financial crisis. Employment continued to rise through March 2016, but since then it has fallen as the industry cuts costs to bolster profitability. In November 2016, there were 172,300 employees (seasonally adjusted) in the securities industry in New York City, 2,600 fewer than in March. Despite the decline, the industry is still likely to post a small net gain for all of 2016 as a result of gains earlier in the year.

The pre-tax profits for the broker/dealer operations of New York Stock Exchange member firms (the traditional measure of securities industry profitability) have fallen for the past three years. Lower revenues (especially from trading) and higher legal expenses related to the financial crisis contributed to the decline.

Profitability was strong during the first three quarters of 2016 ($15 billion), slightly better than last year. In 2015, the industry was on pace for higher profits, but it reported a small loss in the fourth quarter (the first quarterly loss since 2011). As a result, profits declined by 10.5 percent, the third year of declining profits.

Barring an unexpected development, OSC expects profits to exceed $18 billion in 2016 (the highest level in four years), a dramatic reversal from the trend of the three prior years. The November Plan assumes that profits will increase from $14.3 billion in 2015 to $15.8 billion in 2016.

Despite increased profitability, the industry has set aside 3 percent less for compensation than last year. The amount set aside in the fourth quarter could determine the size of bonuses. The November Plan assumes bonuses will increase by slightly more than 1 percent in the City. OSC plans to issue its annual estimate in March 2017.

Unemployment

The national unemployment rate fell to 4.6 percent in November 2016, less than half its recessionary peak. New claims for unemployment benefits have declined from a peak of 665,000 in March 2009, and have stayed below 300,000 for the past 93 weeks.

New York State's unemployment rate fell from its recessionary peak (8.9 percent) to 5.1 percent in November 2016, only slightly higher than the prerecession level. The unemployment rate in New York City was 5.7 percent, nearly half the recessionary peak.

Tourism

Tourism is an integral part of the City's economy. In 2015, total visitors to New York City reached a record 58.5 million, according to NYC & Company, the City's official tourism and marketing organization. While the City expects the number of visitors to reach a new record in 2016 (60.3 million), one-fifth of the tourists are international visitors, who may be impacted by the rising value of the dollar.

According to the Broadway League, attendance and ticket sales for Broadway shows have weakened as the year progressed. In the third quarter, sales declined by 2.5 percent and attendance declined by 0.5 percent. Growth in hotel tax revenue, another indicator of international tourism and spending, also declined during the third quarter.

Construction and Real Estate

The New York Building Congress forecasts that construction spending will reach $43.1 billion in 2016, an increase of 26 percent, driven by nonresidential spending. The Building Congress anticipates that construction spending will decline slightly to $42.1 billion in 2017.

During the current expansion, the City's real estate markets have experienced rising property values and increased transactional activity. However, it appears that transactional activity has begun to slow. According to data from New York City's Department of Finance, the total value of sales through the first three quarters of 2016 has declined by 6.5 percent. While the value of residential sales continues to rise, commercial sales have declined by 19 percent.

Conclusion

New York City's economy remains strong, although job growth has slowed from the record pace of the past two years. In addition, the securities and retail sectors have reported job losses. Uncertainties arising from the global economy and new fiscal and monetary policies could pose challenges for the City's economy and budget in the coming years. Fiscal stimulus, against the backdrop of strong labor markets, could cause interest rates and inflation to increase faster than currently anticipated.

III. Changes Since the Beginning of the Fiscal Year

The November Plan incorporates a number of changes since the budget was adopted in June 2016, including a Citywide Savings Program, higher-than-planned spending and a small reduction in projected tax collections. After taking these changes into account, the City projects a surplus of $439 million in FY 2017.

The projected surplus, in combination with other changes, reduced the FY 2018 budget gap from $2.8 billion to $2.2 billion. The budget gaps for fiscal years 2019 and 2020 are essentially unchanged at $2.9 billion and $2.4 billion, respectively (see Figure 8, next page).

The gaps are relatively small as a share of City fund revenues (averaging 3.9 percent). The budgets for those years also include a general reserve of $1 billion, which, if not needed, could be used to narrow the projected gaps.

The Citywide Savings Program is expected to generate $691 million in FY 2017, but half of that amount in subsequent years because the program relies heavily on nonrecurring actions. Nonetheless, the program is expected to generate a total of $1.7 billion over four years.

Debt service savings are expected to total $339 million since the City has not needed to borrow to meet its cash flow needs in FY 2017, and variable and fixed-term interest rates remain well below the levels assumed by the City.

Agency actions will generate nearly $1.4 billion over four years, with almost half of the resources coming from revenue actions. Another third will come from cost reestimates and accruals. Administrative efficiencies account for only a small share of the expected resources.
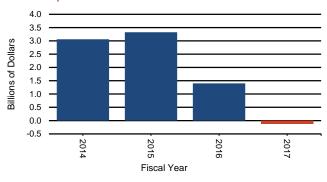
Tax collections fell short of the City's expectations during the first quarter of the fiscal year. As a result, the City lowered its forecast by a net of $127 million in FY 2017. The City is waiting until January 2017 before revising its forecast for the balance of FY 2017 and for subsequent years.

In total, City-funded spending is projected to be higher than planned by a total of $994 million during the financial plan period. Most of the additional cost ($756 million during fiscal years 2018 through 2020) stems from higher pension contributions because FY 2016 investment earnings were lower than expected. Agency spending is projected to exceed the City's initial forecast by $129 million in FY 2017 (mostly for homeless services) and by considerably smaller amounts in subsequent years.

Closing the projected budget gaps for fiscal years 2018 through 2020 could be more difficult than in recent years because of weak tax collections. In recent years, tax collections have greatly exceeded expectations and the additional revenues were available to offset unplanned costs and to close projected budget gaps.

For example, tax collections exceeded the City's initial forecast by more than $3 billion in each of fiscal years 2014 and 2015 (see Figure 7). While the amount of unanticipated tax collections declined to $1.4 billion in FY 2016, it still accounted for 35 percent of the $4 billion surplus in FY 2016. (A drawdown of unneeded reserves contributed another $2 billion to the surplus.) In contrast, the City has lowered its tax revenue forecast in the current fiscal year.

FIGURE 7
Unanticipated Tax Revenues

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

FIGURE 8
Financial Plan Reconciliation—City Funds
November 2016 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				
Business Taxes	(73)	- - -	- - -	- - -
Real Estate Transaction Taxes	(70)	- - -	- - -	- - -
Personal Income Tax	(41)	- - -	- - -	- - -
Sales Tax	19	- - -	- - -	- - -
Other Taxes	13	- - -	- - -	- - -
Tax Audits	25	- - -	- - -	- - -
Subtotal: Taxes	**(127)**	- - -	- - -	- - -
All Other	4	(16)	(6)	(3)
Total	**(123)**	**(16)**	**(6)**	**(3)**
Citywide Savings Program				
Agency Actions	540	280	283	281
Debt Service	151	33	72	83
Total	**691**	**313**	**355**	**364**
New Needs				
Pension Contributions	- - -	(120)	(258)	(378)
Agency Spending	(129)	(41)	(35)	(33)
Total	**(129)**	**(161)**	**(293)**	**(411)**
Net Change During FY 2017	**439**	**136**	**56**	**(50)**
Surplus/(Gap)	**$ 439**	**$ (2,680)**	**$ (2,889)**	**$ (2,376)**
Surplus Transfer	(439)	439	- - -	- - -
Projected Gaps Per November 2016 Plan	**$ - - -**	**$ (2,241)**	**$ (2,889)**	**$ (2,376)**

Sources: NYC Office of Management and Budget; OSC analysis

IV. Revenue Trends

Revenues, including federal and state categorical aid, are projected to total $83.5 billion in FY 2017. The portion of the budget funded with locally generated revenues (i.e., City funds), such as taxes and fees, is projected to increase by less than 1 percent in FY 2017 to $59.2 billion (see Figure 10, next page).

Tax collections have been slowing in recent years. After growing at an average annual rate of 6.9 percent during fiscal years 2011 through 2015, collections slowed to 3.2 percent in FY 2016, and the City expects collections to slow further to 1.7 percent in FY 2017.

Property taxes, which account for 44 percent of tax revenues, continue to show strong gains, but nonproperty tax collections have been weak. Last year, nonproperty taxes showed almost no gains, and the June Plan assumed that nonproperty taxes would decline slightly, by $258 million in FY 2017.

However, nonproperty tax collections fell short of expectations during the first quarter of FY 2017. Business tax collections accounted for most of the shortfall, but real estate transaction taxes were also much weaker than expected. As a result, the City lowered its nonproperty tax forecast by $127 million to $30.5 billion. This represents a decline of 0.5 percent, the first
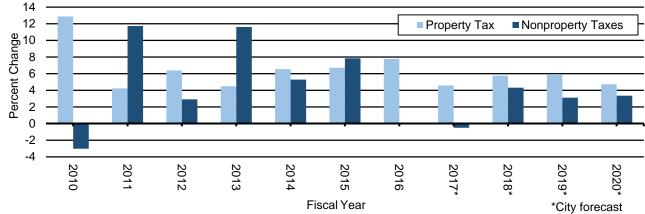
decline since FY 2010 (see Figure 9). If current trends persist, OSC estimates that tax collections could be lower than the City's revised forecast by $50 million in FY 2017 and by $125 million annually thereafter (primarily due to weakness in business and real estate transaction taxes).

The November Plan assumes that nonproperty tax collections will rebound sharply in FY 2018, increasing by 4.3 percent, which appears optimistic under current conditions. It also remains to be seen how the policies adopted by the new federal administration will impact City tax collections.

In addition, sales tax revenue will be lower than assumed in the November Plan (by a cumulative total of $400 million during the financial plan period) based on current State law. Pursuant to legislation enacted in April 2016, the State will recoup savings that accrued to the City from refinancing bonds of the Sales Tax Asset Receivable Corporation.

The November Plan also anticipates $731 million from the sale of taxi medallions during fiscal years 2018 through 2020, and $100 million in FY 2020 from developing properties leased to the Health and Hospitals Corporation. For reasons discussed later in this section, the receipt of these resources is uncertain.

FIGURE 9
Annual Change in Tax Revenues

Sources: NYC Office of Management and Budget; OSC analysis

FIGURE 10
City Fund Revenues
(in millions)

	FY 2016	FY 2017	Annual Growth	FY 2018	FY 2019	FY 2020	Average Three-Year Growth Rate
General Property Tax	$ 22,974	$ 24,025	4.6%	$ 25,410	$ 26,920	$ 28,191	5.5%
Personal Income Tax	10,733	11,184	4.2%	11,553	11,971	12,436	3.6%
Sales Tax	6,911	7,135	3.2%	7,557	7,880	8,216	4.8%
Business Taxes	5,663	5,936	4.8%	6,344	6,442	6,596	3.6%
Real Estate Transaction Taxes	3,009	2,573	-14.5%	2,678	2,760	2,836	3.3%
Other Taxes	3,170	2,924	-7.8%	2,960	3,028	3,098	1.9%
Tax Audits	1,161	741	-36.2%	716	716	716	-1.1%
Subtotal: Taxes	**53,621**	**54,518**	**1.7%**	**57,218**	**59,717**	**62,089**	**4.4%**
Miscellaneous Revenues	5,110	4,663	-8.7%	4,664	4,923	5,019	2.5%
Grant Disallowances	(0.8)	(15)	NA	(15)	(15)	(15)	0.0%
Total	**58,730**	**59,166**	**0.7%**	**61,867**	**64,625**	**67,093**	**4.3%**

Sources: NYC Office of Management and Budget; OSC analysis

1. General Property Tax

In FY 2017, property values grew by 9.8 percent to reach $1 trillion. Property value growth was strongest for one-, two- and three-family homes, at 12.2 percent. Values for large residential and commercial properties, which are based on market conditions in prior years, grew by 9.5 percent and 6.5 percent, respectively.

Strong growth in property values has helped drive tax growth throughout the current economic expansion. Between fiscal years 2010 and 2017, collections increased by $7.8 billion, an average annual gain of 5.8 percent. The November Plan projects that property tax collections will reach $24 billion in FY 2017.

The City has set aside $1.7 billion in FY 2017 as a reserve to cover delinquencies, refunds and tax abatements. Since FY 2009, the amount needed has not exceeded $1.5 billion. Thus, OSC believes the City will draw down at least $100 million in unneeded reserves as the year progresses.
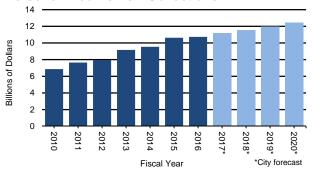
2. Personal Income Tax

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

However, estimated payments on capital gains and other nonwage income were weaker than expected through the first quarter. As a result, the City lowered its forecast by $41 million to $11.2 billion in FY 2017 (see Figure 11, next page). Estimated payments could increase if taxpayers sell stocks to benefit from the recent stock market rally, but taxpayers could also hold off in anticipation of federal tax reforms.

Collections that come from paychecks (i.e., withholding) met the City's expectations in the first quarter, but were a bit stronger through November. In another positive development, the City has received higher-than-planned payments from the State to correct for distributional errors in prior years. Current trends and conversations with State budget representatives suggest that the City may realize at least $100 million more than budgeted.

The November Plan assumes that personal income tax collections will increase at an average rate of 3.6 percent during fiscal years 2018 through 2020. However, potential changes in federal fiscal policies may impact economic activity and change taxpayer behavior in ways not anticipated by the City.
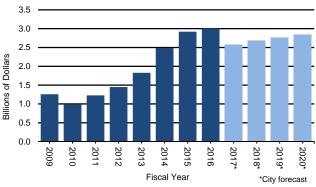
3. Sales Tax

In recent years, sales tax collections have risen steadily, boosted by spending from a robust local economy and a record number of tourists visiting New York City. Growth averaged 5.7 percent during fiscal years 2013 and 2014, but slowed over the next two years, averaging 3.5 percent.

The City expects sales tax collections will increase by 4.7 percent in FY 2017, excluding the impact of the sales tax intercept. However, collections grew by only 2.1 percent during the first four months of the current fiscal year. Based on current trends, OSC forecasts that sales tax collections may fall short of the level anticipated in the November Plan by $50 million annually during fiscal years 2017 through 2020.

4. Real Estate Transaction Taxes

Revenues from the real estate transaction taxes (the real property transfer tax and the mortgage recording tax) have grown rapidly during the recovery, rising from $1 billion in FY 2010 to $3 billion in FY 2016 (see Figure 12). Growth slowed in FY 2016, and the June Plan expected collections to decline in FY 2017, the first decline in seven years.
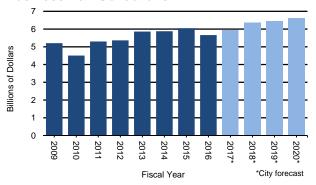
However, collections were even weaker than expected during the first quarter of FY 2017, declining by nearly 16 percent. As a result, the November Plan lowered the City's forecast by $70 million to $2.6 billion in FY 2017. Based on current trends, OSC believes collections will fall short of the City's revised forecast by $75 million in FY 2017 and by similar amounts in subsequent years.

According to data from the Department of Finance, the value of building sales declined by 22 percent during the first quarter of FY 2017, driven by a 43 percent decline in commercial sales. The sales of large commercial properties, which are valued at more than $50 million, fell by 75 percent.

5. Business Taxes

In April 2015, the State enacted legislation that combined the City's banking and general corporation taxes. The change was expected to be revenue-neutral, but collections in FY 2016 fell $471 million short of expectations at the beginning of the year. As a result, collections declined for the first time in six years (see Figure 13).

FIGURE 13
Business Tax Collections

Sources: NYC Comptroller; NYC Office of Management and Budget

Collections fell $298 million short of the City's year-end forecast for FY 2016 and continued to fall short during the first quarter of FY 2017. According to the City's Office of Management and Budget, the change in the tax law has reduced liabilities for some taxpayers, resulting in higher-than-anticipated refunds or credits against current-year tax liabilities. As a result, the City has reduced its forecast for FY 2017 by $73 million.

Nonetheless, the City still expects business tax collections to increase by 4.8 percent ($273 million). OSC forecasts that business tax collections will increase by 2.6 percent, $125 million less than forecast by the City, based on current trends partially offset by the prospects for higher Wall Street profits. Since the implications of the changes in the tax law are not yet fully understood, the shortfall could be significantly higher in subsequent years.

6. Miscellaneous Revenues

Miscellaneous revenues are expected to total $4.7 billion in FY 2017. These include recurring resources, such as fines and fees, and nonrecurring resources, such as proceeds from the sale of taxi medallions or City property.

OSC estimates that recurring revenues such as fines, rental payments, and charges for services could be higher, by $75 million in FY 2017 and $100 million annually thereafter.

The November Plan anticipates revenue from the sale of 1,650 new taxi medallions over three years ($107 million in FY 2018, $257 million in FY 2019 and $367 million in FY 2020), but the sale has been repeatedly delayed and market conditions remain unsettled. The growing presence of alternatives to taxis such as Uber and Lyft has lowered demand for taxi medallions. Consequently, OSC believes these revenues could be at risk.

The City 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.

V. Expenditure Trends

Expenditures, including those funded with federal and State categorical grants, are projected to total $83.5 billion in FY 2017. The portion of the budget funded with locally generated revenue (i.e., City funds) will total $59.2 billion. After adjusting for surplus transfers and debt defeasances, which can mask expenditure trends, City-funded spending is projected to grow by 7.6 percent in FY 2017 (5.1 percent excluding reserves) to $62.8 billion (see Figure 14).

City-funded spending is projected to grow at an average annual rate of 4.5 percent during the financial plan period (nearly twice the projected inflation rate) to reach $69.5 billion by FY 2020. Growth is driven by the cost of labor agreements, higher costs for employee fringe benefits and debt service, and new programmatic initiatives.

The City's full-time work force (including jobs fully funded by the federal and State governments) grew by 19,579 employees between fiscal years 2012 and 2016 (see Figure 15). In FY 2016, the City added 9,829 full-time 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

FIGURE 15
Staffing
(Full-Time Employees)

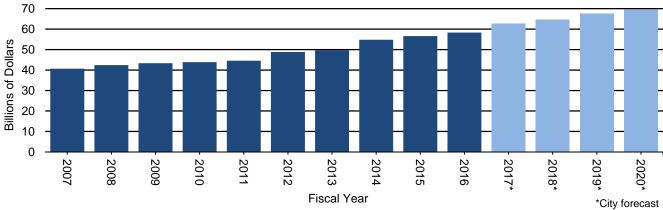Note: Staffing levels are as of June 30 of each fiscal year.
Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

242,878 were funded exclusively by the City), exceeding the prerecession level by 6,353.

The November Plan assumes the addition of another 13,601 employees in FY 2017, with hiring concentrated in the health and welfare agencies and the Department of Education. Last year the City fell far short of its hiring targets, and it continues to fall short in the current year as well. As a result, OSC believes that the City may realize savings of $75 million from hiring delays in FY 2017.

The November Plan is based on the trends shown in Figure 16 (next page) and discussed subsequently.

FIGURE 14
City-Funded Expenditures

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

FIGURE 16
Trends in City-Funded Spending Categories
(in millions)

	FY 2016	FY 2017	Annual Growth	FY 2018	FY 2019	FY 2020	Average Three-Year Growth Rate
Salaries and Wages	$ 16,758	$ 17,357	3.6%	$ 18,735	$ 20,104	$ 20,807	6.2%
Pension Contributions	9,139	9,278	1.5%	9,686	9,965	10,017	2.6%
Medicaid	5,879	5,813	-1.1%	5,813	5,813	5,813	0.0%
Debt Service	5,641	6,208	10.1%	6,652	7,127	7,781	7.8%
Health Insurance	4,317	4,753	10.1%	5,058	5,457	5,933	7.7%
Other Fringe Benefits	2,715	2,793	2.9%	2,846	3,062	3,356	6.3%
Energy	669	738	10.3%	791	842	873	5.8%
Judgments and Claims	720	536	-25.6%	552	567	585	3.0%
Public Assistance	641	670	4.5%	709	715	720	2.4%
Other	11,664	13,119	12.5%	12,705	12,862	12,584	-1.4%
Subtotal	**58,143**	**61,265**	**5.4%**	**63,547**	**66,514**	**68,469**	**3.8%**
Retiree Health Benefits Trust	500	- - -	NA	- - -	- - -	- - -	NA
General Reserve	- - -	1,000	NA	1,000	1,000	1,000	NA
Prior Years' Expenses	(329)	- - -	NA	- - -	- - -	- - -	NA
Capital Stabilization Reserve	- - -	500	NA	- - -	- - -	- - -	NA
Total	**$ 58,314**	**$ 62,765**	**7.6%**	**$ 64,547**	**$ 67,514**	**$ 69,469**	**3.4%**

Note: Debt service has been adjusted for surplus transfers and redemptions. The November Plan assumes that the Health and Hospitals Corporation will reimburse the City for the cost of medical malpractice ($140 million), even though it failed to do so in FY 2016.
Sources: NYC Office of Management and Budget; OSC analysis

1. Collective Bargaining

As of November 2016, the City had negotiated new labor agreements through FY 2018 with nearly all of the municipal unions, with the notable exception of the union representing its police officers. 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.
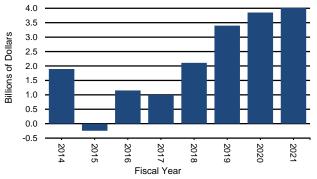
The agreements also compensate members of the United Federation of Teachers (UFT) and other employees for two annual wage increases of 4 percent that were provided to most other municipal unions in 2009 and 2010 but not to these employees.

The City and the Patrolmen's Benevolent Association (PBA) have not been able to reach a negotiated agreement. One year ago, 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.

In the summer of 2016, the Public Employment Relations Board found that the negotiations between the City and the PBA for a subsequent agreement had also reached an impasse. The board recently appointed a mediator to facilitate negotiations between the two parties, but a resolution does not appear to be imminent. If mediation fails, the dispute could be resolved through binding arbitration.

The City estimates that these agreements will cost $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 during fiscal years 2014 through 2018 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 (see Figure 17). 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.

FIGURE 17
Net Budgetary Impact of Labor Settlements

Sources: NYC Office of Management and Budget; OSC analysis

The November 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 would be 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 November Plan. Wage increases at the projected inflation rate, for example, would increase costs by $139 million in FY 2018, $432 million in FY 2019 and $956 million in FY 2020.

2. 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,[2] better-than-expected investment returns,[3] and savings from lower-cost pension plans for City employees hired after March 31, 2012.
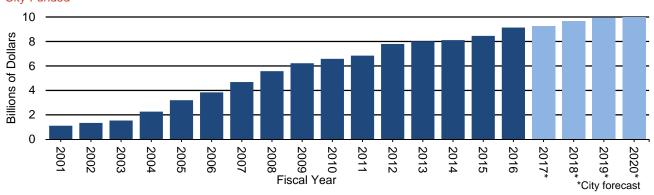
However, pension contributions rose more quickly in FY 2016 (by 8 percent) as the City Actuary adopted revised mortality tables to reflect longer life expectancies. This change increased City pension contributions by $600 million annually beginning in FY 2016.

According to the City Actuary, the unfunded net liability of the City's five pension systems rose 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 as of June 30, 2016, 4.5 percentage points less than in the prior year.

---

[2] These include a longer amortization period for unfunded liabilities, which held down contributions during the financial plan period but will result in higher costs over the longer term.

[3] The pension funds earned, on average, 13.4 percent annually on their investments during fiscal years 2010 through 2014, compared to the expected annual return of 7 percent.

FIGURE 18
Pension Contributions
City-Funded

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

The November Plan assumes that pension contributions will rise from $9.1 billion in FY 2016 to $10 billion by FY 2020 (see Figure 18) as the impact of lower-than-expected investment earnings during fiscal years 2015 and 2016 increase required contributions.[4] Pension contributions account for about 15 percent of City fund revenues.

The November Plan assumes that the assumptions and methodologies used to calculate pension contributions remain unchanged. However, 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 prior consultant recommended that the pension systems revise their overtime assumptions to reflect the increased use of overtime in recent years, which would have increased contributions by about $250 million annually. The consultant may affirm the recommendations of the previous consultant, or recommend additional changes, which could increase (or decrease) planned contributions.
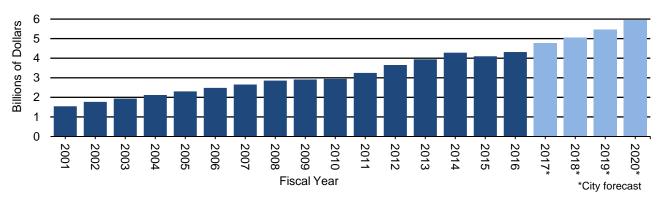
3. Health Insurance

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 to exceed the planned targets. The City reached these savings targets for FY 2015 and FY 2016, and anticipates that it will meet the $1 billion savings target for FY 2017.

Thus far, more than three-quarters of the $3.4 billion in savings ($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 $544 million (mostly from higher co-pays), or 16 percent of the total.

---

4   In FY 2015, the pension systems earned 3.2 percent (less than half of the 7 percent expected gain), and in FY 2016 the systems earned less than 1.5 percent. The pension funds gained, on average, an estimated 2 percent on their investments through the first five months of FY 2017.

FIGURE 19
Health Insurance Costs
City-Funded

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

Recently, the State approved a 7.8 percent increase to health insurance premiums for active employees, which will take effect in FY 2018. The increase is less than the City assumed for that year (9 percent), generating estimated savings of $70 million in FY 2018, $75 million in FY 2019, and $80 million in FY 2020. After taking this development into account, the City is only $134 million away from meeting the savings target of $1.3 billion for FY 2018.

Despite the savings from the agreement with the Municipal Labor Committee, City-funded health insurance costs are projected to reach $5.9 billion by FY 2020 (see Figure 19), nearly $1.7 billion (39 percent) more than in FY 2014.

4. Debt Service

City-funded debt service is projected to grow by $2.1 billion (38 percent) to $7.8 billion between fiscal years 2016 and 2020 (see Figure 20, next page). Borrowing is expected to more than double during that period as the City expands its capital program. By FY 2020, debt outstanding will reach $85 billion, $15 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 2020. Debt service would account for a larger share of tax revenue by FY 2020, 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 established a $500 million Capital Stabilization Reserve. The reserve could be used to defease debt to hold down the rise in debt service.

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. The City, however, has a long history of falling short.

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.

FIGURE 20
Debt Service
City-Funded

Debt Service (Left Axis) — Debt Burden (Right Axis)

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

Although interest rates are rising, the City is still likely to realize debt service savings (at least in the short term) given its conservative interest rate assumptions. The November Plan already recognizes savings of $151 million in FY 2017, and OSC believes another $100 million in savings in variable rate debt is likely. If interest rates continue to rise, however, the opportunities for debt service savings will diminish in future years.

5. Homeless Services

The number of homeless people residing in shelters operated by the Department of Homeless Services (DHS) reached a new record of 59,960 in October 2016 (see Figure 21), despite increased spending on homeless prevention initiatives and subsidized housing.

The June 2016 financial plan assumed that the shelter population would remain at the May 2016 level through June 2017 and then decline during FY 2018. The shelter population, however, increased by 3.5 percent in just five months as the number of individuals entering the system outpaced the number placed in permanent housing. The number of individuals in the family

program, which account for 69 percent of the shelter population, increased by 4.2 percent.

The cost of providing shelter is projected to total $1.5 billion in FY 2017, 55 percent higher than four years earlier. The City-funded cost is projected to total $847 million, including $52 million that was added in the November Plan to address higher-than-expected caseload growth. The federal government funds about one-third of the DHS budget.

FIGURE 21
People in Homeless Shelters

Source: NYC Department of Homeless Services

However, the City has not yet revised its caseload or cost estimates for the remainder of the financial plan period. For example, the City still expects the cost of providing shelter to decline to $1.2 billion in FY 2018 based on the assumption that the caseload will decline sharply next year.

While the City continues to develop low-cost housing and expand its homeless prevention initiatives, reducing homelessness has been challenging. Until the caseload begins to decline, OSC believes it is reasonable to assume that the cost of providing shelter will not fall below the City's forecast for FY 2017. As a result, OSC estimates that the City-funded cost of sheltering the homeless could be higher by $180 million annually beginning in FY 2018.
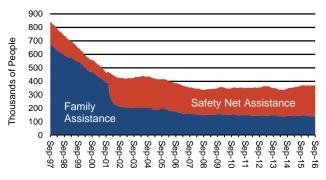
6. Public Assistance

The two 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 benefits and transferred to the State program (see Figure 22).

While the public assistance caseload has remained relatively stable since 2008, there has been a small increase in recent years. The caseload increased by 35,600 (11 percent) to 372,000 (including 9,800 emergency assistance recipients) between May 2014 and September

FIGURE 22
Public Assistance Caseload

Source: NYC Human Resources Administration

2016. Nearly all of the increase occurred in the State- and City-funded SNA program.

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 growth in the SNA caseload has slowed considerably and has increased by only 800 since the beginning of the fiscal year. Despite the slowing, the November Plan still assumes the caseload will increase by 10,000 in FY 2017.

The November Plan also assumes that the City-funded cost of public assistance will reach $670 million in FY 2017. (The federal government funds $597 million of public assistance.) If SNA enrollment continues to grow more slowly than the City anticipates, the City could realize annual savings of $20 million beginning in FY 2017.

7. Medicaid

Medicaid provides health insurance for low-income children and adults, and is the largest payer of long-term care. Medicaid also provides subsidies to health care providers, such as the Health and Hospitals Corporation, which serve large numbers of Medicaid recipients and the uninsured.

The November Plan assumes that the City's share of the cost of Medicaid will total $5.8 billion in FY 2017 (10 percent of City-funded revenue) and remain at that level because the State took over the growth in the local share of Medicaid.

Enrollment in the federal Medicaid program in New York City grew slowly in the years following the recession, but accelerated with the implementation of the federal Affordable Care Act (ACA) in January 2014. The ACA expanded Medicaid eligibility to millions of Americans who were previously ineligible for the program.

In New York City, Medicaid enrollment exceeded 3.7 million people in December 2015, an increase of 16 percent, or more than 500,000 people since December 2013. Currently, nearly half of the City's population is enrolled in Medicaid.

The incoming federal administration supports the repeal and replacement of the ACA, which could increase the number of uninsured and reduce federal Medicaid funding. The City has realized savings of more than $300 million annually from a provision in the ACA that increases the federal reimbursement rate to states that expanded Medicaid eligibility. Repeal of the ACA could put these savings at risk.

8. Uniformed Agencies

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

Overtime costs totaled $466 million through the first four months of FY 2017, slightly lower than last year but $130 million more than planned. The Police and Correction departments accounted for three-quarters of the unplanned spending. The Police Department spent $52 million more than planned and the Department of Correction spent an additional $48 million.

The Department of Correction has been unable to maintain staffing at planned levels because attrition has been growing. Last year, more than 1,000 correction officers left the department, twice as many as in FY 2013. Attrition accelerated during the first quarter of FY 2017, with 45 percent more officers leaving compared with the same period last year. At the end of September, the department reported that 533 uniformed positions were vacant, requiring posts to be covered through overtime.

The November Plan assumes that overtime will decline by $300 million in FY 2017, but overtime costs during the first quarter have been similar to last year. While overtime could exceed expectations by nearly $300 million in FY 2017, savings in other personal service costs and the receipt of federal and state grants could mitigate the budgetary impact. For these reasons, OSC estimates a net cost of $125 million in FY 2017 and $150 million annually thereafter.
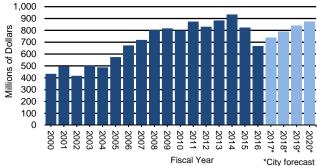
New York City is seeking $35 million from the federal government to cover the cost of protecting the President-elect and his family between election day and the inauguration (January 20, 2017). Unless such costs are reimbursed by the federal government, the City would be required to fund these costs and any additional costs the City might incur for security after January 20, 2017.

9. Energy

Energy costs (i.e., electricity, fuel and heat) reached a record high of $935 million in FY 2014 (see Figure 23), mainly because of a harsh winter. Energy costs declined by 28 percent to $669 million in FY 2016 as the winter was relatively mild and prices for electricity, fuel and heat were lower than in the past. The November Plan assumes that energy costs will increase by 11 percent to $738 million in FY 2017, and will continue to increase to $873 million by FY 2020. While energy costs have risen, they still remain low by historical standards.

FIGURE 23

Energy Costs
City-Funded

Fiscal Year   *City forecast

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

VI. Semi-Autonomous Entities

1. Health and Hospitals Corporation

The Health and Hospitals Corporation, which is the largest municipal hospital system in the country and serves 1.2 million patients, 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. The City has allowed the Corporation to delay payments to the City and forgave $337 million owed in FY 2016. In total, the City has increased its financial support to the Corporation to $2 billion, representing one-quarter 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, the Corporation announced a transformation plan that would realign spending and revenues to balance the budget by FY 2020.

The transformation plan relies heavily on the receipt of additional federal assistance ($1.4 billion over four years). In FY 2017, the Corporation is counting on the timely receipt of $467 million in Medicaid funding, which has yet to receive the necessary approvals. In the past, payments have been delayed and fallen short of the amounts anticipated by the Corporation.

In addition, the incoming federal administration may not be receptive to proposals that increase federal support. In total, about half ($3.2 billion) of the Corporation's budget is funded by the federal government.

The incoming federal administration also has proposed repealing and replacing the Affordable Care Act, which expanded Medicaid eligibility and reduced the number of uninsured. The Corporation also benefits from federal regulations that extend Medicaid eligibility to undocumented immigrants for emergency room services. Medicaid and uninsured patients represent nearly 70 percent of the Corporation's hospital stays.
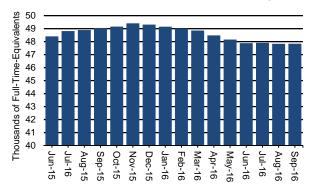
The transformation plan also counts on a large increase in enrollment in MetroPlus, a health insurance plan owned by the Corporation. The plan assumes that enrollment will increase by 175,000 members (35 percent) by FY 2020, generating $101 million in FY 2017 and $316 million over four years.

Last year, MetroPlus added 29,000 members, and the Corporation expects to add twice as many (60,000) in FY 2017. However, enrollment declined during the first quarter of FY 2017. At this time it appears unlikely that the Corporation will achieve its $101 million target in FY 2017.

Cost-reduction initiatives are expected to generate cumulative savings of $1.8 billion over five years through FY 2020. Most of the resources ($1 billion) would come from actions expected to restructure the Corporation's health care services, but a plan has not yet been made public. The Corporation anticipates savings of only $5 million from this source in FY 2017.

Staff reductions are expected to save $300 million over five years. The Corporation had planned to reduce staffing by 1,000 full-time-equivalents (FTEs) in FY 2016 to achieve $100 million in savings. Instead, staffing increased by nearly 1,000 during the first half of the fiscal year (see Figure 24). While staffing declined in the second half, the Corporation incurred $27 million in unplanned costs.

FIGURE 24
Health and Hospitals Corporation Staffing

The Corporation plans to reduce staffing by 926 FTEs in FY 2017 for $50 million in savings. As of September 2016, staffing levels were essentially unchanged from the June level and 250 above the September target. Consequently, personal service costs were higher than planned through the first quarter, making the savings target increasingly unlikely to be achieved.

The Corporation projects a cash balance of $116 million for June 30, 2017, enough to pay its bills for only seven days. This forecast assumes successful implementation of the transformation plan, which is valued at $779 million in FY 2017. If the transformation plan falls short of target, the City could be called upon to increase its support by as much as $300 million in FY 2017.

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 November Plan allocates $29.6 billion to the Department of Education for FY 2017. State and federal funds account for 43 percent of the education budget, and changes in funding policies at the state or federal level could have a significant impact on the City and its educational programs.

The November Plan assumes that State education aid, which supports 35 percent of the education budget, will increase by $494 million to $10.8 billion in FY 2018, comparable to the increase last year. However, State personal income tax collections have fallen short of target, and there can be no assurance that education aid will increase as much as the City anticipates. The Governor is scheduled to release his proposed budget in January 2017, which will include his recommendation for education aid.

Each year, the Department submits claims to the federal government for Medicaid reimbursement for services provided to students with special needs. The Department, however, has encountered problems with the computer system that is used to document such claims. The Department has said that resolving the system's problems continues to be a high priority.

The November Plan assumes Medicaid payments of $41 million in FY 2017 and $97 million beginning in FY 2018. Last year, the Department received $18 million in reimbursement. Until the Department demonstrates that it can adequately document such claims, OSC considers the receipt of $23 million in FY 2017 and $79 million annually thereafter to be uncertain.

In total, the November Plan anticipates the receipt of $1.8 billion in federal education aid in FY 2018. It remains to be seen whether the new administration will pursue policies that will increase or reduce aid to New York City's public schools.

3. Metropolitan Transportation Authority

The Metropolitan Transportation Authority (MTA) projects positive year-end cash balances through calendar year 2019, but a $319 million budget gap for 2020. These estimates assume continued growth in the regional economy and in the use of MTA services, as well as biennial fare and toll increases.

Since January 2016, the MTA has identified $2.1 billion in additional resources, mostly from lower-than-expected debt service and energy costs. About one-third was used to cover the higher cost of employee fringe benefits. These resources, in combination with additional cost-reduction initiatives, allowed the MTA to narrow the budget gaps, improve service, increase maintenance, fund new capital projects and help reduce unfunded pension liabilities.

The MTA intends to raise fares and tolls by 4 percent in March 2017 and by another 4 percent in 2019. A recent OSC report found that fares have increased by 45 percent between 2007 and 2015, nearly three times faster than inflation. The report also found that the MTA has recovered from the recession, but it still faces challenges. The MTA's revenues are very sensitive to changes in the economy, as evidenced by the large revenue losses that the MTA experienced during the last recession. The MTA must also reach new labor agreements with its employees as current contracts will begin to expire in December 2016.

There is also uncertainty as to how the State and the City will fund $9.2 billion of their promised commitments to the MTA's 2015-2019 capital program. In addition, nearly one-quarter ($6.9 billion) of the MTA's 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.

VII. Other Issues

1. Federal Funding

New York City's budget counts on the receipt of about $7 billion in federal aid. About half is devoted to social service programs, such as public assistance and child welfare programs. Another $1.7 billion is devoted to education, and much of the balance is dedicated to housing and public safety programs. New York City residents also benefit from an estimated $20 billion in federal Medicaid funding that flows through the State's budget.

The incoming federal administration has signaled its support for changes in existing federal programs, tax rules and rates, as well as regulations affecting the financial services industry, which is an important part of the City's economy. While such changes could affect the City's budget, it is too early to determine the impact.

Among the changes under consideration include the elimination of federal funding to cities that shield undocumented immigrants from deportation; the repeal and replacement of the Affordable Care Act (which extended Medicaid eligibility to hundreds of thousands of New York City residents); and increased spending on infrastructure. The combination of increased spending and large tax cuts could lead to larger deficits, increasing pressure to cut entitlement programs and discretionary spending.

The Health and Hospitals Corporation relies even more heavily on federal funding than the City. More than half of its budget ($3.2 billion) is federally funded, and the Corporation is seeking an increase in federal aid to help close growing budget gaps.

The non-rent portion of the budget for the New York City Housing Authority (NYCHA) is almost entirely funded by the federal government (about $2 billion annually). NYCHA also relies almost exclusively on the federal government to fund its capital program ($4.6 billion over five years).
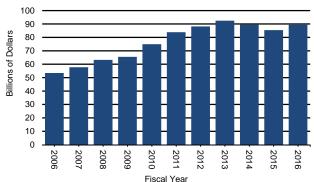
2. Post-Employment Benefits

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 25). The increase is driven mostly by revised mortality tables to 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 $2.8 billion in FY 2020, an increase of 30 percent in four years.

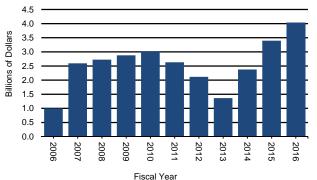**FIGURE 25**
Unfunded OPEB Liability

Sources: NYC Actuary; OSC analysis

3. Retiree Health Benefits Trust

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

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

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 26).

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

In FY 2015, revenues 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 to the RHBT, which increased the year-end balance to $4 billion, the highest amount ever.
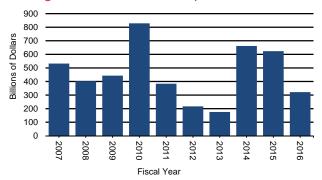
4. Prior Years' Expenses

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 that average $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 27). The benefit resulted largely from an overestimation of prior-year expenses in the Department of Education ($400 million, mostly for contractual special education services). The November Plan does not anticipate any resources from this source during the financial plan period.

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