Review of the Financial Plan of the City of New York

June 2008

Report 1-2009

New York State
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I. Executive Summary

Last June, New York City's four-year financial plan was based on what appeared to be very conservative economic and revenue assumptions, given the economic environment at that time. During the summer, however, the subprime mortgage crisis sent shockwaves through the national and local economies. As a result, over the course of the current fiscal year the City revised its economic and revenue outlook to keep ahead of adverse economic developments. While revenue collections were much stronger in FY 2008 than the City had projected, the nation and the City appear to be heading toward a significant economic slowdown. The depth and the duration of the slowdown have yet to be determined.

Some economists (such as those at Global Insight, a forecasting service used by the City) expect a short, mild national recession; others predict a period of minimal growth. The City's financial plan assumes a short recession for both the nation and the City. The Gross Domestic Product (GDP) expanded at a rate of only 0.6 percent during the last quarter of 2007 and 0.9 percent during the first quarter of 2008.

Wall Street, the most important industry in the City's economy, has seen its profits battered and has announced large numbers of layoffs. Major financial firms have written off more than $200 billion in losses on mortgage-related and other debts, and Bear Stearns came close to collapse before it was acquired by JPMorgan Chase. Though Wall Street generated near-record profits of $20.9 billion in 2006, it lost a record $11.7 billion in 2007 after posting $20.2 billion in losses during the second half of the year.

Despite these developments, the City is on track to end FY 2008 with a $6.5 billion surplus, including more than $2.5 billion that had been rolled over from the prior year. The City had expected City fund revenues to decline by $1.5 billion in FY 2008 from the record level set in FY 2007, but actual collections are expected to exceed the FY 2007 level by nearly $800 million, producing a net budgetary benefit of $2.3 billion. About half of the revenue came from an end-of-year surge in tax collections believed to be the result of strong capital gains realizations and earnings from hedge fund managers during calendar year 2007.

While FY 2008 was largely spared, the City's May 2008 Financial Plan (the "May Plan") assumes that nonproperty tax revenues will decline by $2.6 billion or 10.4 percent in FY 2009 as business profitability falls, income growth stagnates, and the economy sheds 90,000 jobs, including 25,000 jobs on Wall Street. Collections are expected to decline by another $510 million in FY 2010. The impact on the City's budget will be mitigated by continued growth in property tax collections, which are projected to increase by $1.8 billion over the course of fiscal years 2009 and 2010.

While revenue growth is expected to be subdued during the financial plan period, City-funded spending is projected to grow by nearly 19 percent over the next three years. The relatively rapid rate of spending reflects high levels of debt, relatively generous long-term labor agreements, and rapidly growing pension contributions and health insurance costs. Despite the Mayor's proposal to scale back the capital program by 20 percent over the next four years, debt service is projected to increase by more than 50 percent to $6.4 billion between fiscal years 2008 and 2012.

As a result of these trends, the City projects baseline budget gaps of $4.9 billion in FY 2009, $6.6 billion in FY 2010, $7.6 billion in FY 2011, and $7.1 billion in FY 2012. The Mayor has proposed allocating the FY 2008 surplus of $6.5 billion over the next three years to narrow the projected gaps, including $3.5 billion in FY 2009 and $2.6 billion in FY 2010. An agency gap-closing program with a recurring value of about $1.2 billion would close the remaining budget gap for FY 2009 and would narrow the out-year gaps to $2.8 billion in FY 2010 and about $6 billion annually thereafter.

To further narrow the out-year budget gaps, the Mayor has proposed that the City Council rescind the 7 percent property tax cut implemented at the start of FY 2008—this would generate $1.2 billion annually beginning in FY 2010. The Mayor has also proposed that the municipal unions restructure health insurance benefits to reduce the City's annual costs by $200 million. If the Mayor's recommendations were adopted, the FY 2010 budget gap would be cut in half, to $1.3 billion, and the out-year gaps would be reduced to $4.5 billion annually.

Overall, the City's financial plan is based on conservative economic assumptions, which is prudent given the early stages of the economic slowdown. Our review concludes that the proposed FY 2009 budget is balanced based on reasonable revenue and expenditure assumptions. The FY 2010 budget gap may grow, however, because the recent arbitration award for the Patrolmen's Benevolent Association will increase wages faster than anticipated in the May Plan, and also may affect negotiations with the unions that represent the City's other uniformed employees. Nevertheless, the FY 2010 gap is currently manageable, with more than one year before the start of that fiscal year. Closing the budget gaps projected for fiscal years 2011 and 2012 represent a greater challenge because the City is less likely to have the benefit of large budget surpluses as it has had in recent years.

Figure 1
New York City Financial Plan
(in millions)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
REVENUES					
Taxes					
General Property Tax	$ 13,009	$ 13,838	$ 14,868	$ 15,862	$ 16,664
Other Taxes	24,079	21,439	20,938	21,934	23,409
Discretionary Transfers	546	546	- - -	- - -	- - -
Tax Audit Revenue	1,059	577	579	579	579
Tax Reduction Program	- - -	(3)	1,219	1,293	1,353
Subtotal Taxes	38,693	36,397	37,604	39,668	42,005
Miscellaneous Revenue	6,423	5,567	5,278	5,355	5,363
Unrestricted Intergovernmental Aid	255	340	340	340	340
Anticipated State and Federal Aid	- - -	- - -	- - -	- - -	- - -
Less: Intra-City Revenues	(1,502)	(1,506)	(1,436)	(1,436)	(1,436)
Disallowances against Categorical Grants	(15)	(15)	(15)	(15)	(15)
Subtotal: City Funds	$ 43,854	$ 40,783	$ 41,771	$ 43,912	$ 46,257
Other Categorical Grants	1,100	1,006	1,001	1,003	1,006
Inter-Fund Revenues	451	458	425	419	419
Total City & Inter-Fund Revenues	$ 45,405	$ 42,247	$ 43,197	$ 45,334	$ 47,682
Federal Categorical Grants	5,993	5,395	5,313	5.303	5,313
State Categorical Grants	11,201	11,505	11,938	12,801	13,101
Total Revenues	**$ 62,599**	**$ 59,147**	**$ 60,448**	**$ 63,438**	**$ 66,096**
EXPENDITURES					
Personal Service					
Salaries and Wages	$ 20,743	$ 21,646	$ 22,688	$ 24,132	$ 24,401
Pensions	5,745	6,179	6,700	6,793	6,891
Fringe Benefits	6,349	6,740	7,028	7,627	8,229
Subtotal - Personal Service	$ 32,837	$ 34,565	$ 36,416	$ 38,552	$ 39,521
Other Than Personal Service					
Medical Assistance	$ 5,797	$ 5,602	$ 5,756	$ 5,916	$ 6,089
Public Assistance	1,219	1,177	1,176	1,176	1,176
Pay-As-You-Go Capital	- - -	- - -	- - -	- - -	- - -
All Other	17,960	17,946	18,435	19,076	19,579
Subtotal - Other Than Personal Service	$ 24,976	$ 24,725	$ 25,367	$ 26,168	$ 26,844
General Obligation, Lease and MAC Debt Service	5,723	3,717	2,111	4,789	5,319
FY 2007 Budget Stabilization & Discretionary	(4,054)	- - -	- - -	- - -	- - -
FY 2008 Budget Stabilization & Discretionary	4,519	(3,973)	- - -	- - -	- - -
FY 2009 Budget Stabilization & Discretionary	- - -	1,319	(1,319)	- - -	- - -
FY 2010 Budget Stabilization & Discretionary	- - -	- - -	350	(350)	- - -
General Reserve	100	300	300	300	300
Subtotal - Expenditures	$ 64,101	$ 60,653	$ 63,225	$ 69,459	$ 71,984
Less: Intra-City Expenses	(1,502)	(1,506)	(1,436)	(1,436)	(1,436)
Total Expenditures	**$ 62,599**	**$ 59,147**	**$ 61,789**	**$ 68,023**	**$ 70,548**
Gap To Be Closed	**$ - - -**	**$ - - -**	**$ (1,341)**	**$ (4,585)**	**$ (4,452)**

Source: NYC Office of Management and Budget

Figure 2
OSDC Risk Assessment of NYC Financial Plan
(in millions)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
			Better/(Worse)		
Gap Per May 2008 Plan	**$ - - -**	**$ - - -**	**$ (1,341)**	**$ (4,585)**	**$ (4,452)**
FY 2010 Gap-Closing Program					
Increase Real Property Tax Rate	- - -	- - -	(1,223)	(1,298)	(1,359)
Restructure Employee Health Insurance	- - -	- - -	(200)	(200)	(200)
Restated Gap Per May 2008 Plan	**$ - - -**	**$ - - -**	**$ (2,764)**	**$ (6,083)**	**$ (6,011)**
OSDC Risk Assessment					
PBA Arbitration Award	(200)	(110)	(110)	(115)	(120)
Tax Revenues	100	400	400	400	400
Investment Income	- - -	60	- - -	- - -	- - -
GASB 49	- - -	- - -	- - -	(500)	(500)
OSDC Risk Assessment	**(100)**	**350**	**290**	**(215)**	**(220)**
Surplus/(Gap) to be Closed[1]	**$ (100)**	**$ 350**	**$ (2,474)**	**$ (6,298)**	**$ (6,231)**
Additional Risks and Offsets					
PBA Award Applied to All Other Uniformed Employees	$ (341)	$ (166)	$ (180)	$ (156)	$ (158)
Wage Increases for All Employees at Projected Inflation Rate	- - -	- - -	- - -	(136)	(363)

[1] The May Plan includes a general reserve of $100 million in FY 2008 and $300 million annually in fiscal years 2009 through 2012.

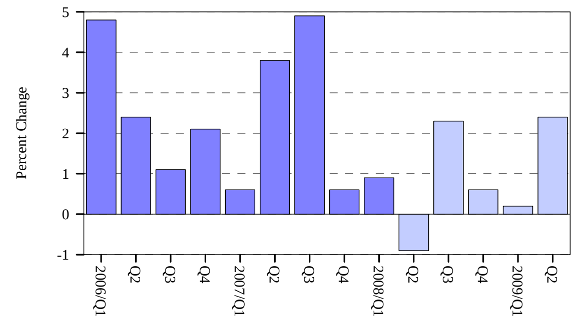
II. Economic Trends

The national economy has weakened since last summer and appears to be headed toward a significant slowdown. The depth and duration of the slowdown have yet to be determined.

The Gross Domestic Product (GDP) expanded at a rate of only 0.6 percent in the last quarter of 2007 and 0.9 percent in the first quarter of 2008 (see Figure 3). The contraction in residential construction has led to declines in overall business spending while tightening credit standards, falling home prices, job losses, and higher prices—especially for food and energy—have significantly constrained consumer spending, which accounts for about two thirds of economic activity.

Figure 3

Change in Gross Domestic Product

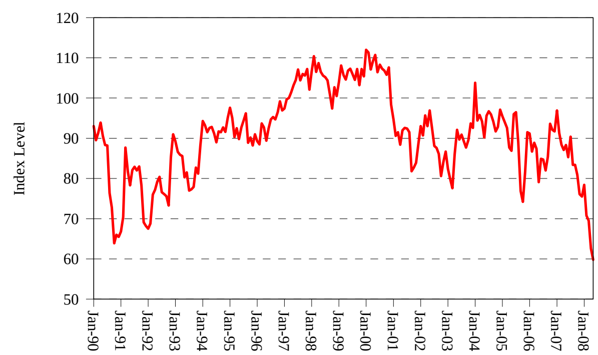


Sources: NYC Office of Management and Budget; U.S. Bureau of Economic Analysis; Global Insight

In the first quarter of 2008, growth in consumer spending slowed to 1 percent and consumer confidence fell sharply—dipping beneath the low point of the recession of the early 1990s—suggesting that further consumer retrenchment is likely (see Figure 4). The Institute for Supply Management's non-manufacturing index, which measures service sector activity, declined by 16.2 percent in January 2008, but had recovered much of the loss by May 2008.

Figure 4

Level of Consumer Sentiment

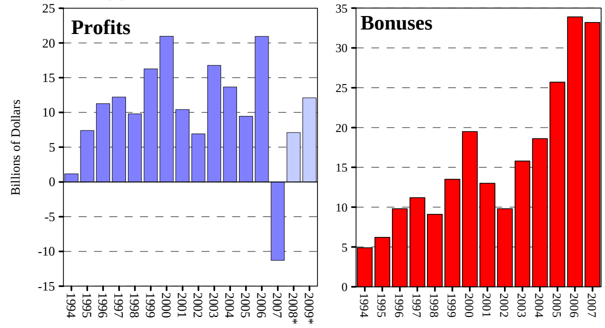


Source: University of Michigan

Given current trends, some economists (such as at Global Insight, a forecasting service used by the City) expect a short, mild national recession; others predict a period of minimal growth. The City's May 2008 Financial Plan assumes a short recession for both the nation and the City. The May Plan assumes that the GDP will decline by only 0.2 percent during the first half of 2008 and then increase by 2 percent on an annual basis during the third quarter (reflecting the impact of the Federal Reserve's interest rate reductions and the federal stimulus package), but will then weaken through early 2009 as the benefits of the federal stimulus package diminish. The May Plan assumes that the GDP will pick up strength again in mid-2009 as the recovery takes hold. The City expects Gross City Product to contract by 7.5 percent during 2008 and by 1.3 percent during 2009 before growth resumes.

Figure 5

Wall Street Profits and Bonuses



* City forecast

Notes: Profits are for broker/dealer operations of NYSE member firms.

Sources: NYS Department of Labor; New York Stock Exchange; Securities Industry and Financial Markets Association; NYC Office of Management and Budget; OSDC analysis

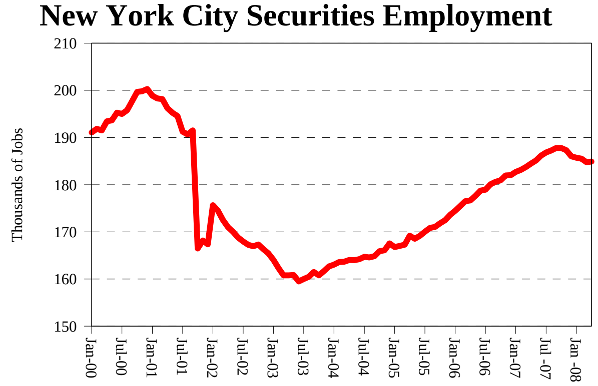
Wall Street, the most important industry in the City's economy, has seen its profits battered and has announced large numbers of layoffs. Major financial firms have written off more than $200 billion in losses on mortgage-related and other debts, and Bear Stearns came close to collapse before it was acquired by JPMorgan Chase. While Wall Street generated near-record profits of $20.9 billion in 2006, it lost a record $11.7 billion in 2007 after posting $20.2 billion in losses during the second half of the year. (The last loss was $160 million in 1990.) The City's financial plan assumes that the securities industry will recover by the second half of 2008 and generate profits of $7.1 billion in 2008 and $12.1 billion in 2009 (see Figure 5).

Securities industry bonuses remained near record levels in 2007 despite the huge losses. The State Comptroller estimated that Wall Street bonuses declined by only 2 percent from their record high in 2006, to $33.2 billion. In general, changes in bonuses tend to lag behind changes in profits, as firms initially seek to retain high-performing employees before lower profits force cutbacks. The City assumes that Wall Street bonuses will decline by more than 20 percent in 2008, pulling down the average industry salary by 7.3 percent in 2008 and 11 percent in 2009.

In the last half-century, Wall Street has experienced six extended periods of employment contraction (beginning in 1962, 1969, 1972, 1987, 1994, and 2000). On a seasonally adjusted basis, employment declines during these periods have averaged 12.7 percent after one year and 14.2 percent after two years. In the current downturn, the number of Wall Street jobs peaked in October 2007 and has since declined by 1.5 percent or 2,900 jobs (see Figure 6). The City projects that Wall Street will lose 25,000 jobs between this peak and an expected trough in the second quarter of 2009. This represents a decline of 13.4 percent in 7 quarters—within the range of the historical average.

Figure 6

New York City Securities Employment



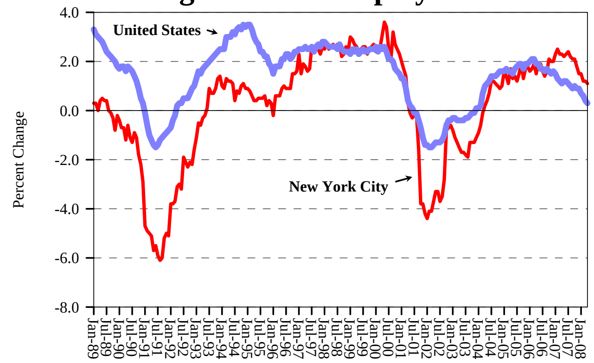
Note: Data has been seasonally adjusted.

Source: NYS Department of Labor; OSDC analysis

The City's job market has held up better than the nation's so far in the current slowdown (see Figure 7). Employment in the City was higher by 45,800 jobs during the first four months of 2008 compared with the same period last year. The City expects, however, that job losses will be proportionally greater in New York City than in the nation (a decline of 2.4 percent compared to a national decline of 0.5 percent), and that the contraction will last longer in New York. The City expects the local job market to deteriorate rapidly beginning in mid-2008 as the losses on Wall Street reverberate through the rest of the economy.

Figure 7

Change in Total Employment



Note: Data not seasonally adjusted; change is from comparable period one year earlier.
Sources: NYS Department of Labor; U.S. Bureau of Labor Statistics; OSDC analysis

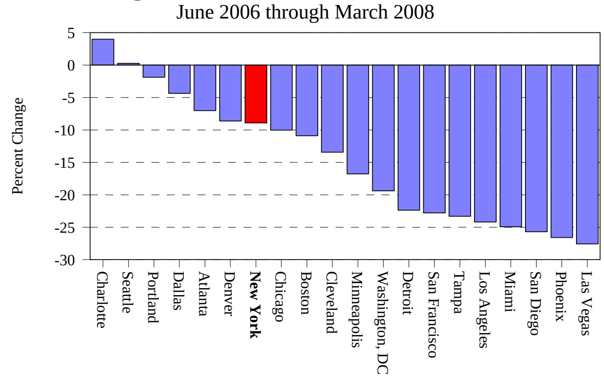
Compared with prior recessions, the City expects the current downturn to be mild. Employment is expected to decline, from a peak in the second quarter of 2008 to an anticipated trough in the third quarter of 2009, by about 90,000 jobs—significantly less than the average loss of 324,000 jobs in each of the previous four recessions.

The New York metropolitan region's real estate market has begun to weaken but not as much as in many markets in the rest of the nation (see Figure 8). Home values in the New York metropolitan region have declined by 8.9 percent between June 2006 and March 2008, but the declines in some other markets have exceeded 20 percent.

Figure 8

Changes in Metro-Area Home Values

June 2006 through March 2008

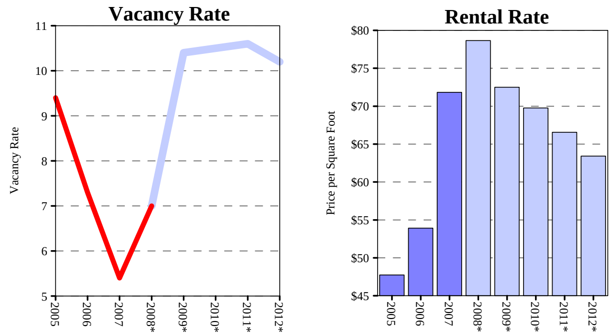


Sources: Moody's Economy.com, Standard & Poor's/Case Shiller Index

While the number of single-family homes sold in Brooklyn, Queens, the Bronx, and Staten Island dropped by more than 60 percent in the first quarter of 2008, the median sales price has held steady. The sale prices for condominiums and cooperative apartments in Manhattan, however, continue to grow although there have been fewer sales and apartments have stayed on the market longer. Prudential Douglas Elliman reported that during the first quarter of 2008, condo prices rose by 36 percent compared to one year earlier, while co-op prices rose by 23 percent. The May Plan assumes that median single-family home prices in the outer boroughs will decline by about 17 percent between the third quarter of 2007 and the second quarter of 2009, and that the number of sales will decline by almost 22 percent.

Demand for office space in New York City has remained strong, but it is expected to soften as the economy weakens and current construction yields additional space. The May Plan assumes that the average office vacancy rate in Manhattan will nearly double by 2009, rising to 10.4 percent, and that average rents will increase by 9.5 percent in 2008 before declining in 2009 (see Figure 9).

Figure 9
Manhattan Commercial Property



* City forecast
Sources: Cushman & Wakefield; NYC office of Management and Budget

Inflationary pressures in the economy are placing additional burdens on consumers and businesses. The average price of regular gasoline in the New York City-Westchester area reached an all-time high of $4.25 per gallon in the week of May 30, 2008—28.1 percent higher than a year earlier. Food prices in the broader metropolitan area have also been climbing, rising by 4.7 percent in the first four months of 2008 compared to the same period one year earlier. Rising food and energy costs have helped push the overall local inflation rate to nearly 3.7 percent in the first four months of 2008. The May Plan, however, assumes that the inflationary surge will be short-lived as the economic slowdown and lower demand for energy will reduce inflation to 2.1 percent in 2009 and comparable amounts in subsequent years.

Tourism continues to show strong growth. Although local tourism suffered in the wake of the September 2001 terrorist attacks, the number of visitors has surged in recent years—especially for overseas visitors who are benefiting from the weak value of the dollar. The dollar has declined sharply against a broad range of currencies—including the euro, the pound, the yen, and the Canadian dollar—which makes travel to the City much less expensive for overseas visitors.

Overall, the City's financial plan is based on conservative economic assumptions, which is prudent given the early stages of the economic slowdown. Nevertheless, the City still faces some risks. On a national level, the downturn in the housing market has not yet reached bottom and the eventual recovery may take several years; consumer and business spending may remain weak due to higher costs, lower incomes and profits, and high debt burdens; and inflation may become entrenched. In addition, the credit crisis may have a more prolonged impact on Wall Street than currently envisioned.

III. Fiscal Year 2008

A close examination of the May Plan reveals that the City will end FY 2008 with a surplus of $6.5 billion. Of this amount, nearly $2.6 billion was rolled over from prior years and deposited in the FY 2008 Budget Stabilization Account at the start of the fiscal year. As shown in Figure 10, $3.9 billion in surplus resources was generated in the current year, primarily from unanticipated tax collections ($1.6 billion), a drawdown in reserves ($800 million), an agency gap-closing program ($618 million), and unanticipated revenue from tax audits ($500 million). Over the course of FY 2008, the national and local economic outlook has deteriorated, causing the FY 2009 budget gap to grow by $752 million to reach $4.9 billion, and causing the out-year gaps to grow by about $3.2 billion annually, reaching $6.6 billion in FY 2010 and $7.6 billion in FY 2011.

A. Revenue Reestimates

The City's revenue forecasts for fiscal years 2008 through 2011 appeared overly conservative in June 2007 given the economic environment at that time. Over the summer, however, the economic outlook rapidly deteriorated as the full dimension of the national housing downturn and financial credit crunch came into focus. In response, the City lowered its revenue forecasts in November and again in January. The City benefited, however, from unexpected revenue collections in March and April. As a result, revenue collections are now expected to be $2.3 billion *higher* in FY 2008 than projected at the beginning of the fiscal year.

About half of the unanticipated revenue came from a surge in tax collections (mostly from the personal income tax) this spring. Virtually all of the personal income tax revenue came from significantly higher payments on 2007 income (made in association with the April 15 filing deadline) believed to be the result of higher-than-expected capital gains realizations and earnings from hedge fund managers.[2]

The deteriorating economic outlook and the downturn on Wall Street have further dampened the City's expectations for subsequent years. The May Plan assumes that revenue collections will be lower than projected last June by $402 million in FY 2009, $2 billion in FY 2010, and $1.6 billion in FY 2011. The lower forecasts are mostly attributed to an expected decline in collections from personal income, business, and real estate transaction taxes.

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2 About two thirds of the increased collections came from higher payments by individuals who requested extensions for filing their final returns. The City had expected these payments to decline sharply; instead, they rose by nearly 90 percent compared with April 2007 collections.

Figure 10
Financial Plan Reconciliation
July 2007 Plan vs. May 2008 Plan

(in millions)

	Better/(Worse)			
	FY 2008	**FY 2009**	**FY 2010**	**FY 2011**
Surplus/(Gap) Per July 2007 Plan	**$ 2,552**	**$ (4,102)**	**$ (3,397)**	**$ (4,369)**
Revenues				
Real Estate Transaction Tax	$ (49)	$ (347)	$ (427)	$ (506)
Personal Income Tax	1,091	(23)	(911)	(627)
Business Taxes	176	(296)	(464)	(308)
Real Property Tax	25	(262)	(318)	(309)
Sales Tax	283	18	(208)	(286)
All Other Taxes	114	52	85	107
Subtotal	1,640	(858)	(2,243)	(1,929)
Tax Audits	500	- - -	- - -	- - -
Rescinded Tax Initiatives	68	236	279	296
Non-Tax Revenues	121	220	(3)	43
Total	**2,329**	**(402)**	**(1,967)**	**(1,590)**
Expenditures				
Collective Bargaining	(93)	(439)	(1,075)	(1,611)
Pension Contributions	(17)	211	(152)	(56)
Energy	(17)	(81)	(158)	(174)
Health Insurance	(2)	(39)	(42)	(46)
Federal Fringe Benefits Reimbursement	126	116	89	89
Reestimate of Prior-Year Expenses	500	- - -	- - -	- - -
General Reserve	200	- - -	- - -	- - -
Pay-As-You-Go Capital	100	200	200	200
Debt Service	81	211	225	266
All Other	128	(529)	(298)	(288)
Total	**1,006**	**(350)**	**(1,211)**	**(1,620)**
Net Change During FY 2008	**3,335**	**(752)**	**(3,178)**	**(3,210)**
Surplus/(Gap) Per May 2008 Plan	**5,887**	**(4,854)**	**(6,575)**	**(7,579)**
FY 2009 Gap-Closing Program				
Agency Actions	618	1,306	1,206	1,146
Surplus Transfers	(6,505)	3,548	2,605	350
Total	**(5,887)**	**4,854**	**3,811**	**1,496**
Remaining Gap to be Closed	**$ - - -**	**$ - - -**	**$ (2,764)**	**$ (6,083)**

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

Other changes in the City's forecast for the major tax categories are discussed below.

- Business tax collections are now projected to be $176 million higher than the City's June 2007 forecast. Collections have benefited from overpayments made by securities firms at the start of the year; higher payments by foreign banks; and strong earnings in nonfinancial sectors. Reduced profitability in the financial sector are expected to significantly lower collections beginning in FY 2009.
- Collections from real estate transaction taxes are projected to be only slightly lower in FY 2008 than forecast at the beginning of the year—but much lower in subsequent years. The significantly lower estimates reflect fewer transactions, lower prices in Manhattan, and a sharp drop-off in the number of large commercial transactions (due to financing difficulties and lower demand for office properties). Overall, transaction tax collections are expected to decline from a record $3.3 billion in FY 2007 to $1.9 billion in FY 2009.
- Sales tax collections are now projected to be $283 million higher than forecast at the beginning of the fiscal year. Collections have grown by 5.4 percent during the first nine months of FY 2008—a faster rate of growth than the 4.6 percent gain in all of FY 2007. Sales tax collections have benefited from strong income gains in calendar year 2007 and by the surge in tourism.

B. Expenditure Reestimates

In FY 2008, a drawdown in reserves ($800 million), lower-than-planned agency spending ($139 million), and additional federal reimbursement for fringe benefits ($126 million)[3] more than offset higher-than-planned collective bargaining costs and contributed more than $1 billion to the FY 2008 surplus. In subsequent years, however, spending is projected to be higher than forecast one year ago, by $350 million in FY 2009, $1.2 billion in FY 2010, and $1.6 billion in FY 2011. Most of the increases reflect higher-than-planned collective bargaining costs.

In fiscal years 2009 through 2011, the impact of unplanned spending in the agencies and higher energy costs will be offset with resources that had been set aside to fund capital projects on a pay-as-you-go basis and with debt service savings. Debt service was revised to reflect savings from: defeasing bonds issued by the Jay Street Development Corporation, lower City interest payments on bonds issued by the Hudson Yards Infrastructure Corporation (because PILOT payments were higher than expected), delays in the City's capital program, and the Mayor's proposal to cut the capital program by 20 percent. In November 2007, the City reduced its planned pension contributions by $211 million in FY 2009 and by greater amounts in

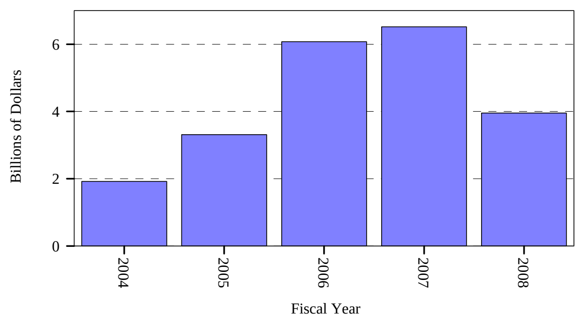
[3] In FY 2008, the City negotiated a higher federal reimbursement rate for fringe benefit costs in the health and social services agencies to reflect City contributions to the Retiree Health Benefits Trust Fund.

subsequent years to reflect the benefit of unexpected pension fund investment earnings in FY 2007. These savings were more than offset in fiscal years 2010 and 2011 by the expectation that investment earnings in FY 2008 would fall far short of the target and actuarial reestimates.

C. Current-Year Operating Results

In recent years, surging Wall Street profits and rising real estate values and transactions, combined with conservative revenue forecasts, resulted in unanticipated resources during the fiscal year. As shown in Figure 11, the amount of unanticipated resources has grown since the last recession, peaking at more than $6.5 billion in FY 2007; and is expected to decline sharply in FY 2008, reflecting the deterioration in the local economy. The City intends to transfer these surplus resources, along with those generated in prior years, to help close projected budget gaps.

Figure 11
Surplus Resources Generated in the Current Year

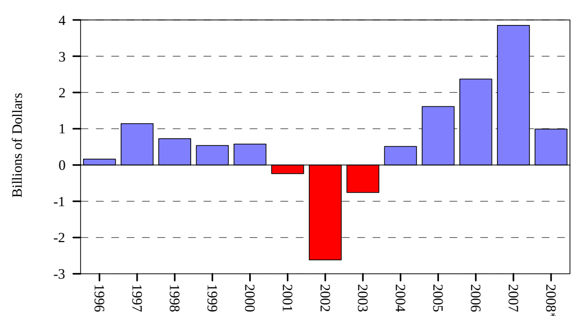


Sources: NYC Office of Management and Budget; NYC Comptroller; OSDC analysis

The transfer of resources between years masks the relationship between recurring revenues and expenditures. A clearer picture of the City's fiscal condition can be obtained by examining the results of current-year operations—the difference between revenues and expenditures in the current year. This entails adjusting for surplus transfers and other factors that impede transparency.

As shown in Figure 12, the size of the current-year surplus has grown each year since the end of the last recession, and peaked in FY 2007 at nearly $3.9 billion. The current-year surplus in FY 2008 is projected to decline dramatically—to $989 million. In FY 2009, spending is projected to exceed current-year resources by $3.8 billion, a clear sign of fiscal stress.[4] Nonetheless, the FY 2009 budget will be balanced using surplus resources accumulated in prior years.

Figure 12
Results of Current-Year Operations



* OSDC estimate
Sources: NYC Office of Management and Budget; NYC Comptroller; OSDC analysis

[4] The projected operating deficit for FY 2009, adjusted for surplus transfers, narrows to $3.2 billion (see revenue and expenditure trends shown in Figures 18 and 27 later in this report) when the $641 million benefit from the early retirement of debt in FY 2007 is factored in.

IV. Impact of the Enacted State Budget

The enacted State budget increases education aid to New York City by $644 million for the 2008-2009 school year, which is the third-largest increase in history and consistent with the increase promised last year as part of the resolution of the Campaign for Fiscal Equity litigation. Other State initiatives will increase the City's costs, however, by a net of $124 million over the course of fiscal years 2008 and 2009 (see Figure 13). Most of the adverse impact ($85 million) comes from only a partial restoration in funding to the City under the Aid and Incentives to Municipalities (AIM) program. The City's January 2008 Financial Plan had assumed a full restoration as promised by then-Governor Spitzer last year. The City remains concerned that a higher State fee charged to health insurance carriers will be passed along to consumers in the form of higher health insurance premiums, including those paid by the City of New York (not reflected in Figure 13).

Figure 13
Impact of the Enacted State Budget
(in millions)

Better/(Worse)

	FY 2008	**FY 2009**	**FY 2010**	**FY 2011**	**FY 2012**
AIM Revenue Sharing	$ (85)	$ - - -	$ - - -	$ - - -	$ - - -
Child Welfare	(8)	(8)	- - -	- - -	- - -
Public Health Services	(6)	(6)	- - -	- - -	- - -
PIT Admin. Charge	(3)	(10)	(10)	(10)	(10)
Cigarette Taxes	(3)	(24)	(24)	(23)	(23)
Internet Sales Tax	- - -	27	28	28	29
Wicks Law	- - -	2	7	11	14
Other Actions	(1)	1	6	6	6
Total	**$ (106)**	**$ (18)**	**$ 7**	**$ 12**	**$ 16**

Sources: NYC Office of Management and Budget; OSDC analysis

According to the City, the following State actions, combined with the partial restoration in funding under the AIM program, will increase the City's costs by a net of $124 million during fiscal years 2008 and 2009.

- The State cigarette tax was raised by $1.25 per pack to $2.75 per pack (a total of $4.25 per pack in combined State and City taxes). This is expected to reduce consumption or encourage smokers to obtain cigarettes from out-of-state sources. As a result, the City estimates that City cigarette and sales tax revenue will decline by about $24 million annually.
- The amount charged to the City for administering the personal income tax (PIT) was increased by $10 million annually. Last year, the State increased the charge from $40 million to $70 million to reflect the full cost of providing this service.

- Support for child welfare and public health programs was reduced, which will increase City costs by $14 million in each of FY 2008 and FY 2009.
- A tax was imposed on certain Internet sales, which the State expects will generate $27 million in sales tax revenues for the City in City FY 2009, and slightly larger amounts in subsequent years.
- The minimum threshold (i.e., the Wicks Law) was raised for projects that require separate bids for electrical, plumbing, and heating and air conditioning work—from $50,000 to $3 million, which will save an estimated $244 million over ten years. The City estimates that the savings to the operating budget from this initiative will total $2 million in FY 2009, $7 million in FY 2010, $11 million in FY 2011, and $14 million in FY 2012.

Other notable actions taken by the State include making permanent (as assumed in the City's January 2008 Financial Plan) the 1 percent sales tax that was scheduled to expire on July 1, 2008. This is expected to generate about $1.2 billion annually for the City. Also, the City continues to benefit from State initiatives implemented in prior years. These include the State cap that limits annual growth in the local share of Medicaid to 3 percent, and the State takeover of the local share of the Family Health Plus program. The State estimates that together these will benefit the City by $522 million in City FY 2009 alone. The State Legislature has not acted on the City's proposal to raise the borrowing authority of the Transitional Finance Authority.

Metropolitan Transportation Authority

The enacted State budget increases State aid to the Metropolitan Transportation Authority (MTA) by $105 million, which is $53 million less than the MTA assumed in its financial plan. (The reduction reflects the MTA's share of statewide administrative cost savings.) The funding shortfall will increase the size of the MTA's projected budget gap for calendar year 2009 to $269 million. While the MTA has not indicated how it intends to close the 2009 budget gap, it has announced that it would delay planned service enhancements in light of lower-than-expected collections from real estate transaction taxes. The MTA still projects budget gaps of $1.4 billion in 2010 and $1.7 billion in 2011. In addition, the current capital program is experiencing significant cost overruns and the Governor has appointed a commission to identify sources of funding for the next five-year capital program.

Health and Hospitals Corporation

The enacted State budget reduces Medicaid revenue to the Health and Hospitals Corporation by a net of $14 million in FY 2008, rising to about $33 million annually thereafter. The reduction reflects the impact of State efforts to improve primary and preventive medical care by reallocating Medicaid funding from inpatient settings to outpatient settings.

V. Program to Eliminate the Gap

The May Plan projects baseline budget gaps of $4.9 billion for FY 2009, $6.6 billion for FY 2010, $7.6 billion for FY 2011, and $7.1 billion for FY 2012. To balance the FY 2009 budget and to narrow the out-year gaps, the Mayor has proposed a program to eliminate the gap (see Figure 14).

To narrow the projected budget gaps, the Mayor has proposed that the $6.5 billion surplus forecast for FY 2008 be allocated over the next three years. The Mayor would transfer $3.5 billion to FY 2009, $2.6 billion to FY 2010, and $350 million to FY 2011. The Mayor has also proposed an agency gap-closing program that would close the remaining budget gap forecast for FY 2009 and would further narrow the out-year gaps. These proposals will be considered by the City Council in June as part of the FY 2009 budget process. The May Plan also assumes that the City Council will adopt the Mayor's proposal to raise property taxes beginning in FY 2010, though this matter will not come under City Council consideration for another year.

Figure 14
Gap-Closing Program
(in millions)

	FY 2009	FY 2010	FY 2011	FY 2012
Surplus/(Gap) Per May 2008 Plan	**$ (4,854)**	**$ (6,575)**	**$ (7,579)**	**$ (7,121)**
Surplus Transfers	3,548	2,605	350	- - -
FY 2009 Agency Program	1,306	1,206	1,146	1,110
Increase Property Tax	- - -	1,223	1,298	1,359
Restructure Employee Health Insurance	- - -	200	200	200
Subtotal	4,854	5,234	2,994	2,669
Remaining Gap to be Closed	**$ - - -**	**$ (1,341)**	**$ (4,585)**	**$ (4,452)**

Sources: NYC Office of Management and Budget; OSDC analysis

Agency actions are expected to generate $618 million in FY 2008, $1.3 billion in FY 2009, and about $1.2 billion annually thereafter (see Figure 15), with more than half of the actions concentrated in the Department of Education and the Police Department. Of these amounts, 89 percent would come from expense reductions, mostly as a result of scaling back services or planned enhancements. About half of the savings will come from personnel actions, which would reduce planned staffing levels by almost 5,000 employees. Nearly one quarter of the staff reduction would come from a three-year delay in the expansion of the police force.[5]

[5] The January Plan expected the police force to increase by another 1,000 officers by June 2010. The May Plan has delayed this expansion until June 2011.

Figure 15
FY 2009 Agency Program
(in millions)

	FY 2008	FY 2009	FY 2010	FY 2011
Department of Education	180.1	428.3	377.5	375.5
Social Services	75.9	39.0	39.3	39.3
Sanitation	39.7	86.6	41.2	40.1
Police Department	33.8	135.6	131.1	83.5
Transportation	27.7	33.3	34.3	30.7
Correction	24.2	20.5	24.3	19.2
Admin. for Children's Services	21.8	57.2	58.0	58.2
Fire Department	20.4	30.4	31.0	30.3
Citywide Admin. Services	17.1	18.6	19.5	19.5
Health & Mental Health Services	17.0	29.1	28.8	28.8
Information Technology	12.3	29.9	30.8	30.8
Homeless Services	10.6	24.6	20.6	20.5
Health and Hospitals Corp.	10.1	2.5	11.6	3.4
Elected Officials	9.5	26.1	24.4	34.4
Finance	9.0	39.6	41.5	41.5
Libraries	8.0	25.4	25.4	25.4
Youth	8.0	15.2	15.2	15.2
CUNY	5.8	14.3	14.3	14.3
Parks	1.9	23.9	22.9	16.9
Misc. Budget and Pensions	31.3	103.6	98.0	99.3
Procurement Savings	- - -	55.5	55.5	55.5
Other	53.7	67.2	61.2	64.1
Total	**$ 617.9**	**$ 1,306.4**	**$ 1,206.4**	**$ 1,146.4**

Source: NYC Office of Management and Budget

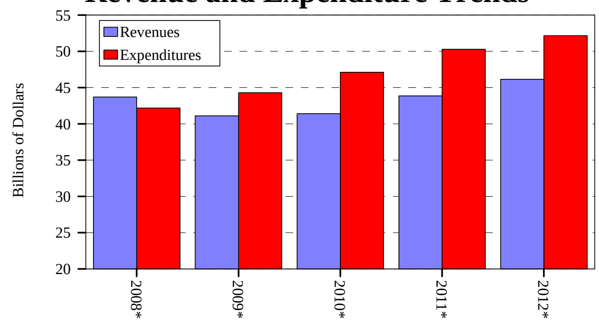
The Mayor reduced funding to the Department of Education (DOE) by $180 million in January 2008. Of that amount, $100 million was allocated to the schools, which has reduced funding for extracurricular programs and professional development. For FY 2009, the Mayor has proposed cutting back planned City funding by $428 million, and the DOE currently plans to pass along $181 million of that cut to the schools. The programmatic impact of these reductions has not yet been determined. (Also, the impact on services could be mitigated with $56 million in surplus resources that would be transferred from FY 2008 to FY 2009.) The Chancellor has stated that the budget cuts could fall disproportionately on some of the City's better-performing schools because of restrictions in the use of State education aid that target aid to underperforming schools. Some advocates have urged the City to restore City funding to mitigate the adverse impact.

VI. Revenue and Expenditure Trends

The May Plan assumes that City fund revenues will decline in FY 2009 as the economic slowdown takes its toll on collections, and that revenue growth will resume in FY 2011. During the same period, spending is projected to continue to grow at a steady pace (see Figure 16). Overall, City fund revenues are projected to grow at an average annual rate of 1.4 percent during fiscal years 2009 through 2012, while expenditures are forecast to grow at an average annual rate of 5.4 percent. As a result, the City projects large baseline budget gaps.

Figure 16

Revenue and Expenditure Trends



Note: Adjusted for surplus transfers, TFA, and TSASC. Excludes FY 2010 gap-closing program.
Sources: NYC Office of Management and Budget; NYC Comptroller; OSDC analysis

A. Revenue Trends

The overall economic outlook continues to deteriorate and the credit crunch is still battering Wall Street. Over the course of the past year, the City has modified its economic and revenue outlook to keep ahead of these adverse developments. While the State has also acted to reflect changes in the economy, the City's economic and revenue assumptions are more conservative than those underlying the enacted State budget.

Tax collections provide the largest portion of City fund revenues, and collections are expected to grow by only 0.8 percent in FY 2008 after four years of strong growth.[6] Tax collections are projected to decline by 5.7 percent in FY 2009 based on the City's economic assumptions of national and local recessions.

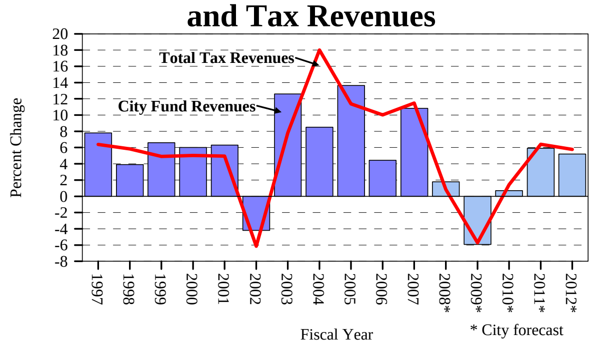
Nonproperty tax revenues (excluding audits) are expected by the City to decline by $2.6 billion or 10.4 percent in FY 2009 as business profitability falls, jobs are eliminated, and income growth stagnates (or possibly declines, after being adjusted for rising inflation). Collections are expected to decline again in FY 2010 by another $510 million or 2.3 percent. The expected declines in nonproperty tax collections would be partially offset in FY 2009 by an increase of $828 million, or 6.4 percent, in real property tax collections, and in FY 2010 by an increase of $1 billion or 7.4 percent (excluding the impact of the Mayor's proposed increase in property taxes). Nonproperty tax collections are expected to resume their growth in FY 2011, increasing by 6.4 percent.

[6] Tax collections would have grown by 4.2 percent in FY 2008 if not for the $1.1 billion reduction in property taxes, enacted at the beginning of the year. Over the prior four years, tax collections grew at an average annual rate of 12.6 percent (after adjusting for tax changes).

Overall, City fund revenues are on track to rise by only 1.8 percent in FY 2008 after four years of strong revenue growth (at an average of 9.3 percent per year; see Figure 17).[7] The May Plan assumes that City fund revenues will decline by 5.9 percent in FY 2009 and show almost no growth in FY 2010 (see Figure 18), as the impact of the economic slowdown constrains revenue collections; and that significant growth will only resume in FY 2011 as the economy improves (with projected gains of 5.9 percent in FY 2011 and 5.2 percent in FY 2012).

Based upon year-to-date collections, tax revenues are likely to be $100 million higher than forecast in FY 2008. In subsequent years, our review finds that the May Plan's tax revenue forecasts are more conservative than its economic outlook, and that collections could be $400 million higher than forecast.

Figure 17
Annual Change in City Fund Revenues and Tax Revenues



Note: Excludes proposed tax changes. Adjusted for debt service on TFA and tobacco bonds and the transfer of TSASC revenues to benefit FY 2008.
Sources: NYC Comptroller; NYC Office of Management and Budget; OSDC analysis

Figure 18
City Fund Revenues
(in millions)

	FY 2008	FY 2009	Annual Growth	FY 2010	FY 2011	FY 2012	Average Three-Year Growth Rate
Taxes							
Property Tax	$ 13,009	$ 13,837	6.4%	$ 14,866	$ 15,859	$ 16,660	6.4%
Personal Income Tax	8,596	7,576	-11.9%	7,034	7,707	8,224	2.8%
Sales Tax	4,817	4,664	-3.2%	4,666	4,837	5,161	3.4%
Business Taxes	5,686	4,938	-13.2%	4,910	5,328	5,744	5.2%
Real Estate Transaction Taxes	2,581	1,934	-25.1%	1,883	1,860	1,968	0.6%
Other Taxes	3,102	3,097	-0.1%	3,206	3,349	3,468	3.8%
Audits	1,059	577	-45.5%	579	579	579	0.1%
Subtotal	**38,850**	**36,623**	**-5.7%**	**37,144**	**39,519**	**41,804**	**4.5%**
Miscellaneous Revenues	4,602	4,151	-9.8%	3,933	4,011	4,020	-1.1%
Unrestricted Intergovernmental Aid	255	340	33.3%	340	340	340	0.0%
Grant Disallowances	(15)	(15)	0.0%	(15)	(15)	(15)	0.0%
Total	**$ 43,692**	**$ 41,099**	**-5.9%**	**$ 41,402**	**$ 43,855**	**$ 46,149**	**3.9%**
Increase in Real Property Tax Rate	- - -	- - -	NA	1,223	1,298	1,359	NA
Total Including Tax Increase	**$ 43,692**	**$ 41,099**	**-5.9%**	**$ 42,625**	**$ 45,153**	**$ 47,508**	**4.9%**

Note: Personal income tax includes the portion of those revenues used to pay debt service on bonds issued by the TFA. Miscellaneous revenues have been adjusted for the transfer of TSASC revenues. Totals may not add due to rounding.
Sources: NYC Office of Management and Budget; OSDC analysis

[7] Our estimates of City fund revenues include the portion of personal income tax revenues dedicated to pay debt service on bonds issued by the TFA, and revenues dedicated to pay debt service on tobacco bonds. The estimate has also been adjusted for the transfer of TSASC revenues to benefit FY 2008.

1. Real Estate Transaction Taxes

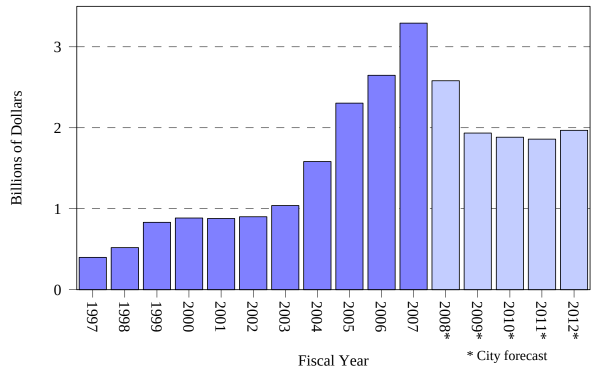
Over the last several years, collections from the real estate transaction taxes (i.e., real property transfer and mortgage recording taxes) have surged along with increases in property values and the number of transactions (including for premier commercial properties). Between fiscal years 2002 and 2007, collections grew from less than $1 billion to nearly $3.3 billion (see Figure 19). The May Plan assumes that collections will decline by 21.5 percent in FY 2008 and by another 25 percent in FY 2009, reflecting weakness in the real estate market.

Sales of commercial property in the City had been helped by the large Manhattan sales—those valued at $50 million or greater. Although these are few in number—they account for less than 3 percent of all commercial transactions—their values have surged in recent years. With declines in both the number and average size of transactions, the value of these large sales has fallen in FY 2008, and the total value for all other commercial sales shows a similar weakness (see Figure 20).

Transactions data from the New York City Department of Finance show that median home prices in the boroughs outside of Manhattan have flattened and the number of sales has dropped drastically—more than 60 percent in the first quarter of 2008 compared to the same period one year earlier (see Figure 21).

Figure 19

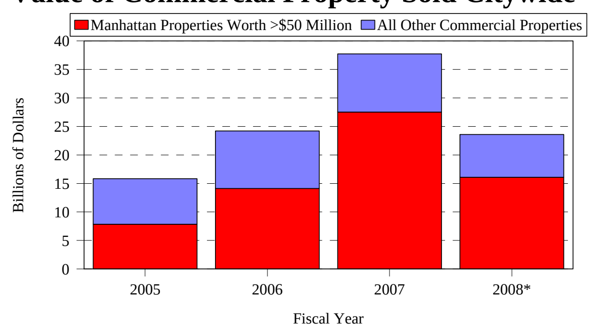
Real Estate Transaction Tax Revenues



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

Figure 20

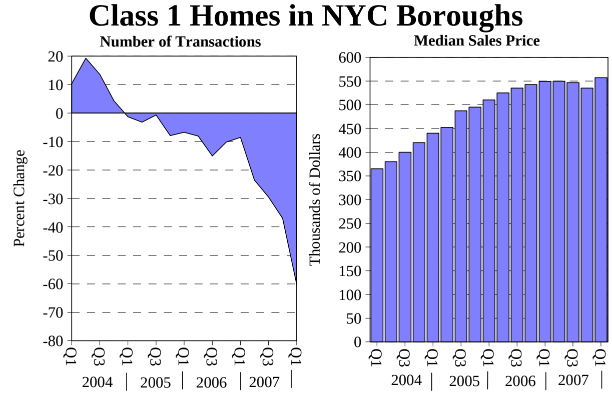
Value of Commercial Property Sold Citywide



* FY2008 data is year-to-date through April.
Note: All Other Commercial Properties category includes Manhattan properties worth less than $50 million and all commercial properties in the other boroughs.
Source: NYC Department of Finance

Figure 21

Class 1 Homes in NYC Boroughs



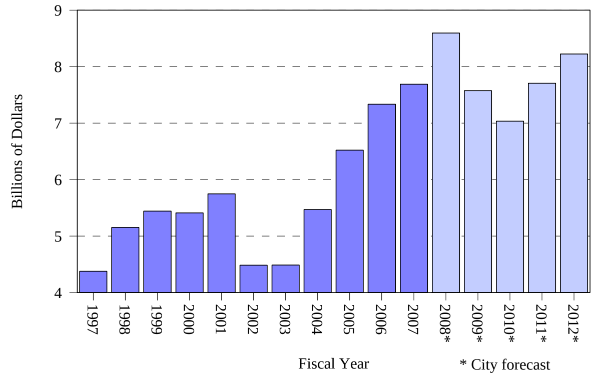
Note: Includes single- and multifamily homes in Brooklyn, Queens, the Bronx, and Staten Island.
Source: NYC Department of Finance

2. Personal Income Tax

Personal income tax collections surged by 11.8 percent in FY 2008 to $8.6 billion, reflecting the underlying strength of the 2007 economy (see Figure 22). Collections are projected by the City to decline by $1 billion (12 percent) in FY 2009—reflecting the combination of lower Wall Street bonuses, job losses, and a drop in capital gains realizations. While Wall Street bonuses declined only slightly in 2007, the City expects bonus payments will be significantly lower in 2008 (by at least 20 percent) given the sharp decline in Wall Street profitability. With job losses and weak economic conditions expected to continue into calendar year 2009, collections are forecast to decline by an additional 7.1 percent in FY 2010. An expected resumption of job growth and wages is projected to boost collections beginning in FY 2011.

Figure 22

Personal Income Tax Revenues



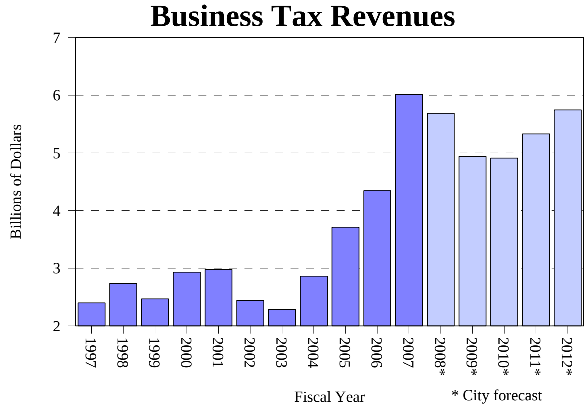
Sources: NYC Comptroller; NYC Office of Management and Budget; OSDC analysis

3. Business Taxes

After rising rapidly over the past four years, business tax collections are expected to decline from $6 billion in FY 2007 to $4.9 billion in FY 2009 (see Figure 23). The City's estimates assume that the large losses recorded by financial firms last year will generate tax credits that will depress collections for some time. The slowing economy is also expected to reduce profits for other types of businesses, and business audit tax revenues—which were boosted in recent years by several large audits of financial firms—are expected to be reduced to more traditional levels.

Figure 23

Business Tax Revenues



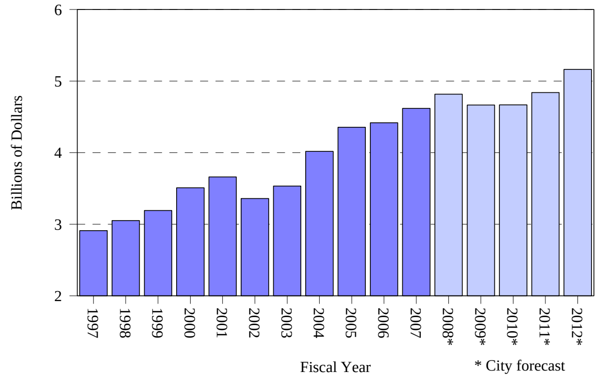
Sources: NYC Comptroller; NYC Office of Management and Budget; OSDC analysis

4. Sales Tax

Sales tax revenues have shown steady growth over the past few years (see Figure 24), reflecting robust income gains and surging levels of tourism (especially by overseas visitors capitalizing on the weak dollar). The May Plan assumes that the weakening domestic economy and slower consumer spending will reduce collections in FY 2009 by 3.2 percent. Collections are expected to remain flat in FY 2010 but then increase by 5.2 percent in fiscal years 2011 and 2012 as the economy strengthens.

Figure 24

Sales Tax Revenues



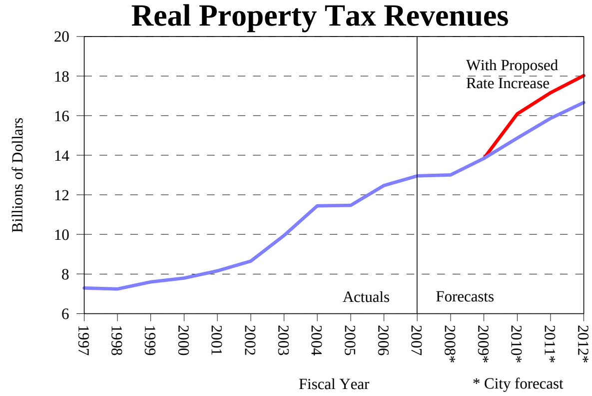
Sources: NYC Comptroller; NYC Office of Management and Budget; OSDC analysis

5. Real Property Tax

Real property taxes are the only major tax projected to increase annually during the financial plan period, growing by 6.4 percent in FY 2009, 7.4 percent in FY 2010, 6.7 percent in FY 2010, and 5.1 percent in FY 2012. Between fiscal years 2008 and 2012, this growth translates into a gain of nearly $3.7 billion. Collections would increase by another $1.2 billion if the Mayor’s proposal to raise property taxes is approved by the City Council next year (see Figure 25).

Figure 25

Real Property Tax Revenues



Note: Revenues do not increase in FY 2008 due to the 7 percent rate reduction.
Sources: NYC Comptroller; NYC Office of Management and Budget; OSDC analysis

Even though the real estate market has begun to weaken, property tax revenues are still expected to increase because provisions of State Law that limit property tax growth during periods of rising values also limit the impact of a downturn.

6. Miscellaneous Revenues

In FY 2009, miscellaneous revenues are projected to decline by $451 million from the FY 2008 forecast. More than half of the decline ($272 million) is attributable to a reduction in interest income, in part as a result of recent reductions in the federal funds rate. (The Federal Reserve has reduced interest rates by 3.25 percentage points since September 2007.) Interest income, however, could be $60 million higher than projected in FY 2009 from investment earnings on nearly $2 billion in surplus resources from FY 2008 that will be used to pay FY 2010 debt service.

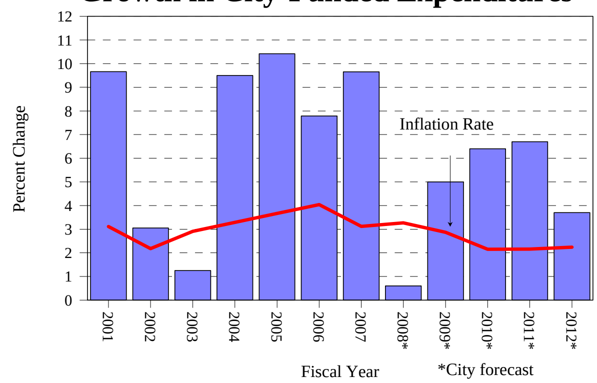
B. Expenditure Trends

City-funded expenditures grew at average annual rates of nearly 10 percent during fiscal years 2004 and 2005, and 8.8 percent during fiscal years 2006 and 2007.[8] Most of the growth was due to the rising cost of debt service, Medicaid, pensions, and other employee benefits. The City also contributed $2.5 billion to the Retiree Health Benefits Trust Fund ($1 billion in FY 2006 and $1.5 billion in FY 2007), and retired nearly $1.3 billion in outstanding debt in FY 2007. Excluding these discretionary actions, spending would have grown more slowly (by 2.5 percent in FY 2006 and by 7.5 percent in FY 2007).

In FY 2008, expenditures are projected to grow by only 0.6 percent because spending in FY 2007 was elevated due to a number of discretionary actions, such as contributing $1.5 billion to the Retiree Health Benefits Trust Fund and retiring $1.3 billion in outstanding bonds. Excluding these discretionary actions, spending would have grown by 9.3 percent in FY 2008. Spending is projected to grow by 5 percent in FY 2009 and by higher rates in fiscal years 2010 and 2011, reflecting rising costs for debt service, salaries and wages, and health insurance (see Figure 26).

Figure 26

Growth in City-Funded Expenditures



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

Nondiscretionary spending (i.e., pension contributions, Medicaid, debt service, and employee health insurance costs) continues to consume a greater share of City fund revenues despite steps taken by the State in recent years to cap the growth in the local share of Medicaid to 3 percent annually and despite the Mayor's proposal to scale back the capital program by 20 percent. Even after such efforts, nondiscretionary expenditures are projected to consume 51.5 percent of City fund revenues by FY 2012, up from 32.7 percent in FY 2000.

8 Adjusted for surplus transfers and for debt service on bonds issued by the Transitional Finance Authority (TFA) and by TSASC.

The May Plan is premised on the assumptions shown in Figure 27 and discussed below.

Figure 27
Estimated City-Funded Expenditures
(Adjusted for Surplus Transfers, TFA, and TSASC)
(in millions)

	FY 2008	FY 2009	Annual Growth	FY 2010	FY 2011	FY 2012	Average Three-Year Growth Rate
Salaries and Wages	$11,712	$12,499	6.7%	$13,651	$14,574	$14,773	5.7%
Debt Service	4,215	4,429	5.1%	4,803	5,886	6,427	13.2%
Medicaid	5,602	5,490	-2.0%	5,644	5,803	5,977	2.9%
Pension Contributions	5,574	6,007	7.8%	6,523	6,616	6,714	3.8%
Health Insurance	2,949	3,288	11.5%	3,656	4,127	4,666	12.4%
Other Fringe Benefits	2,404	2,361	-1.8%	2,303	2,241	2,157	-3.0%
Energy	801	890	11.1%	957	974	976	3.1%
Judgments and Claims	662	688	3.9%	738	795	856	7.6%
Public Assistance	441	438	-0.8%	437	437	437	0.0%
General Reserve	100	300	200%	300	300	300	0.0%
Other	7,732	7,909	2.3%	8,109	8,534	8,877	3.9%
Subtotal	**42,193**	**44,299**	**5.0%**	**47,121**	**50,288**	**52,160**	**5.6%**
Health Insurance Restructuring	- - -	- - -	NA	(200)	(200)	(200)	NA
Total	**$42,193**	**$44,299**	**5.0%**	**$46,921**	**$50,088**	**$51,960**	**5.6 %**

Sources: NYC Office of Management and Budget; OSDC analysis

1. Salaries and Wages

The May Plan assumes that salaries and wages will grow by 6.7 percent in FY 2009, 9.2 percent in FY 2010, 6.8 percent in FY 2011, and by only 1.4 percent in FY 2012. The growth rates reflect the cost of existing labor agreements and those anticipated for the 2007-2010 round of collective bargaining, as well as annual increases of 1.25 percent in subsequent years. Raises at the projected inflation rate would increase City costs by $136 million in FY 2011 and $363 million in FY 2012. (See “Collective Bargaining” in Section VII for a detailed discussion.)

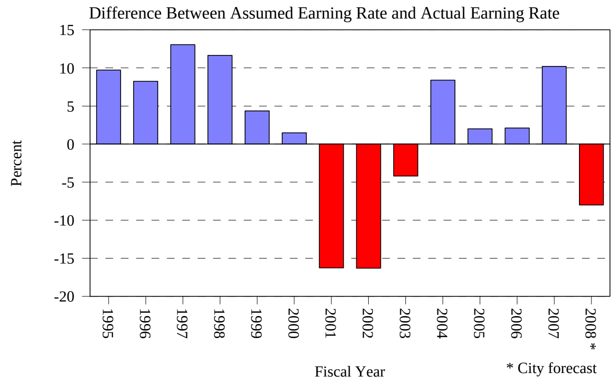
The May Plan assumes that overtime costs in the uniformed agencies will total $689 million in FY 2008 and slightly less in subsequent years. While our analysis indicates that overtime costs are likely to be higher by $80 million in FY 2008 and by an average of $149 million annually in subsequent years, the budgetary impact is likely to be offset by the receipt of federal and State grants and underspending in other personal service categories. The increase in uniformed overtime costs is primarily driven by the difficulties in achieving recruitment and retention targets.

2. Pension Contributions

City-funded pension contributions will grow by 7.8 percent in FY 2009 to $6 billion, and then will rise by another 11.8 percent to $6.7 billion in FY 2012. The growth is driven by pension investment shortfalls that occurred during fiscal years 2001 through 2003; benefit enhancements and labor settlements; and a $200 million annual reserve beginning in FY 2010 that will fund the recommendations of a City Charter–mandated biennial audit.

State law mandates a pension investment earnings rate assumption of 8 percent, but through the first eleven months of FY 2008 pension investments showed a slight loss. The May Plan assumes no investment gains for FY 2008—in sharp contrast to last year, when the pension funds earned 18.2 percent, or 10.2 percentage points more than the assumed rate of return (see Figure 28). The benefit of last year's gains will be mostly offset by this year's shortfall.[9]

Figure 28
NYC Pension Systems Investment Earning Variance



Source: NYC Comptroller Annual Reports

3. Health Insurance

Health insurance costs for current municipal employees and retirees are projected to increase from $3 billion in FY 2008 to nearly $4.7 billion by FY 2012. The growth primarily reflects the rising cost of health insurance premiums; rates are projected to rise by 9.4 percent in FY 2008, 9.3 percent in FY 2009, and by 8 percent in subsequent years. Even though the City has been unsuccessful so far in its efforts to restructure municipal health insurance costs and realize annual savings of $200 million beginning in FY 2009, the May Plan anticipates the receipt of those savings beginning in FY 2010.

In addition, the Mayor opposes the proposed conversion of the non-profit health insurers Health Insurance Plan of Greater New York (HIP) and Group Health Incorporated (GHI), which covers 93 percent of the municipal work force, to a for-profit entity. The Mayor believes that a for-profit entity would increase health insurance premiums for municipal employees at a faster rate than a non-profit. The conversion requires approval by the New York State Insurance Department.

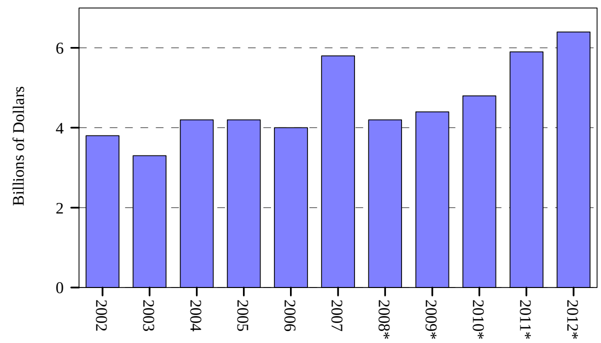
[9] The impact of no investment gains projected for FY 2008 is phased in over six years—increasing planned pension contributions by $121 million in FY 2010, $222 million in FY 2011, and $327 million in FY 2012.

4. Debt Service

Last year, the City used $1.3 billion in surplus resources to pay down debt due in fiscal years 2009 and 2010. This initiative increased debt service costs in FY 2007, but provided short-term budget relief in years when the City was projecting large budget gaps.[10] Debt service costs are projected to reach $6.4 billion by FY 2012 (see Figure 29) despite the Mayor's intention to scale back the capital program by 20 percent.[11] The debt service burden (i.e., debt service as a percent of City fund revenues) will rise from 9.7 percent in FY 2008 to 13.5 percent in FY 2012.[12]

Figure 29

Debt Service



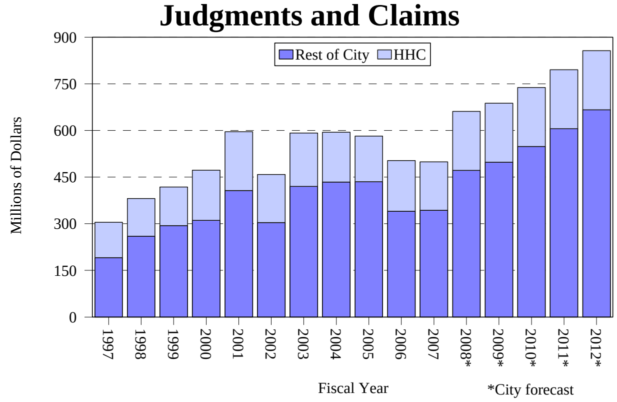
Sources: NYC Office of Management and Budget; NYC Comptroller; OSDC analysis

5. Judgments and Claims

After the cost of judgments and claims remained relatively stable at about $590 million annually during fiscal years 2003 through 2005, it declined to about $500 million during fiscal years 2006 and 2007 (see Figure 30). The May Plan assumes that judgments and claims costs will total $662 million in FY 2008 because of an increase in the average cost and number of settlements—including those that cost more than $1 million—and because of a $33 million award to reimburse the parents of disabled students who placed their children in private schools at public expense. In FY 2009, judgments and claims are expected to total $688 million and to grow by 7.6 percent annually because of the increasing amount of all settlement awards.

Figure 30

Judgments and Claims



Sources: NYC Comptroller's Office; NYC Office of Management and Budget; OSDC analysis

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[10] Debt service has been adjusted for surplus transfers.

[11] We estimate that the Mayor's proposed reduction would save $259 million during the financial plan period and $440 million annually beginning in FY 2020. The City has not yet allocated the proposed cut among the agencies and the capital projects, but expects to provide details in September 2008.

[12] The U.S. Supreme Court recently decided that states could continue to give preferential tax treatment to bonds issued by them and their localities while continuing to tax interest income on bonds issued by other states.

6. Medicaid

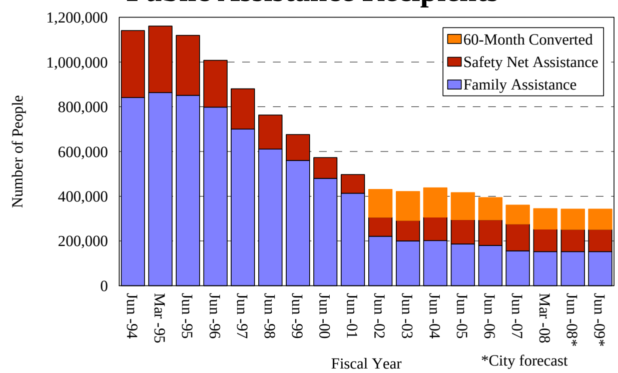
Medicaid costs are projected to decline by $113 million in FY 2009 to $5.5 billion because a supplemental payment made to the Health and Hospitals Corporation in FY 2008 is not expected to reoccur. The May Plan assumes that Medicaid costs will grow at about 3 percent annually, reflecting the State cap on the growth in the local share of Medicaid.

7. Public Assistance

The public assistance caseload declined by 70 percent from 1,160,593 in March 1995 to 344,834 in March 2008 (see Figure 31). The May Plan assumes that the caseload will decline slightly during the financial plan period despite the expectation of an economic downturn. We note that more public assistance recipients do not participate in work activities than in recent years: 62 percent the week of April 27, 2008, compared to 54 percent the week of April 18, 2004.

Figure 31

Public Assistance Recipients



Sources: NYC Human Resources Administration; NYC Office of Management and Budget; OSDC analysis

8. Energy Costs

Energy costs will increase by 11.1 percent to $890 million in FY 2009, and by another 9.7 percent to $976 million in FY 2012. This growth is due to higher transmission and delivery charges from Con Edison, higher production charges from the New York Power Authority, and the closing of the Poletti power plant in Queens. The May Plan also assumes that oil is priced at $90 per barrel, which is substantially less than the peak price of $135 per barrel reached recently. To offset unanticipated increases in energy costs, the May Plan establishes reserves of $76 million in FY 2010, $96 million in FY 2011, and $98 million in FY 2012.

VII. Other Issues

The following issues could have a significant impact on the City's financial plan.

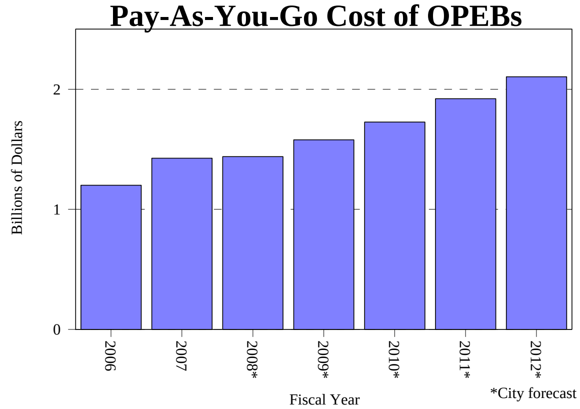
A. Other Post-Employment Benefits

In June 2004, the Governmental Accounting Standards Board (GASB) issued Statement No. 45, which establishes standards for measuring and reporting the expense and related liabilities of other post-employment benefits (OPEBs) on an actuarial basis. Although GASB does not require entities to fund these costs on an actuarial basis, entities could realize significant long-term savings if they did. The State Comptroller recently proposed legislation that would permit localities to create OPEB trusts for this purpose.

In October 2007, the City reported that its accrued liability for past OPEB services was $56.1 billion, and estimated that the present value of its future OPEB obligations was $45.9 billion. Overall, the present value of projected OPEB benefits totaled $102 billion, an increase of $10 billion from the prior fiscal year. The "normal cost," or the portion of the present value of future obligations that is attributed (on an actuarial basis) to services received in the current year, was estimated at $3.3 billion—an increase of $300 million.

Figure 32

Pay-As-You-Go Cost of OPEBs



Sources: Office of the Actuary, NYC Office of Management and Budget; OSDC analysis

To address the growing cost of OPEBs, the City created its own Retiree Health Benefits Trust Fund (RHBT) in 2006, setting aside surplus resources to help fund future costs. These resources are invested, and any earnings will reduce the future cost to City taxpayers. While the City contributed $2.5 billion to the RHBT during fiscal years 2006 and 2007 when the local economy was booming, no such contributions are planned for the future. OPEB costs (pay-as-you-go), on a cash basis, are projected to rise from $1.2 billion in FY 2006 to $2.1 billion by FY 2012, an increase of 75 percent (see Figure 32).

Any future-year contributions to the fund will be determined during the annual budget process. In the future, the City could use the fund's available resources to meet its current-year OPEB obligations, thus possibly freeing up any resources it might have planned to contribute to the fund that year. In this manner the trust fund could serve as a rainy-day fund, although that is not its intended purpose.

B. Collective Bargaining

Over the past few years, the City has reached collective bargaining agreements that established a pattern of relatively generous wage increases for both civilian and uniformed employees (see Figure 33).[13] On May 19, 2008, the New York State Public Employment Relations Board (PERB) issued an arbitration award to settle an impasse between the City and the Patrolmen's Benevolent Association (PBA); the award calls for retroactive wage increases of 4.5 percent in 2005 and 5 percent in 2006, which are greater than the pattern assumed in the May Plan. The award also raises the starting salaries for new recruits from $25,100 to $35,881, which has been an obstacle to meeting hiring targets, but reduces the number of annual leave days from 20 to 10. The award includes other provisions that will increase schedule flexibility. The award only covers the period ending July 31, 2006, and it is expected that the PBA will seek binding arbitration for the next round of collective bargaining as well.

Figure 33
Wage Increase Patterns
(Percent Change)

	Civilian	Uniform
2005	3.0	3.0
2006	3.15	3.15
2007	2.0	4.0
2008	4.0	4.0
2009	4.0	4.0
2010	4.0	4.0
2011	1.25	1.25
2012	1.25	1.25

Most of the unions that represent other uniformed employees have reached agreements with the City and received wage increases of 3 percent and 3.15 percent during the 2005-2006 round of collective bargaining. The unions negotiated side letter agreements, however, which permit them to reopen negotiations with the City if another uniformed union receives wage increases that are larger than the pattern.

The City estimates that the PBA award will increase costs by $200 million in FY 2008, including the retroactive cost to FY 2005, and by more than $110 million annually thereafter. Extending the economic terms of the PBA award to the other uniformed unions would increase labor costs by an additional $341 million in FY 2008, $166 million in FY 2009, $180 million in FY 2010, and more than $155 million annually thereafter. Furthermore, these estimates assume that agreements with the other uniformed unions include provisions that would help reduce the cost of higher wage increases.

The City's contract with District Council 37—the largest municipal union, which represents most civilian employees—expired on March 2, 2008.[14] The City expects a new agreement to follow the pattern set forth in the May Plan. The May Plan also assumes that wages will increase at 1.25 percent in each of fiscal years 2011 and 2012 for all employees. If wages were to rise at the projected inflation rate, the City would incur unplanned costs of $136 million in FY 2011 and $363 million in FY 2012.

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13 The City would increase its contribution for uniformed union supplemental benefits by 1.47 percent during the 2007-2008 round of collective bargaining, and by another 1.59 percent during the 2009-2010 round of collective bargaining.

14 Contracts with some of the smaller unions representing certain uniformed employees extend into 2012.

C. Government Accounting Standards Board Statement No. 49

The Government Accounting Standards Board (GASB) has issued Statement No. 49, which requires certain pollution remediation costs to be accounted for as expense items. The City must begin to do so as of the start of FY 2009 (July 1, 2008). Pursuant to the Financial Emergency Act (FEA), such costs may not be included in the City's capital budget or financed through the issuance of bonds, absent action by the Financial Control Board.

The City has estimated that immediate compliance with GASB 49 for budgeting purposes would increase expense budget costs by up to $500 million annually, because certain environmental remediation costs would no longer be eligible for capital reimbursement. These costs would hit the expense budget at the same time the City is dealing with the revenue losses anticipated from the economic slowdown and the Wall Street credit crunch. In addition, the City has had difficulty identifying the environmental remediation component of larger capital projects, such as school renovations. Pursuant to the FEA, the City would be unable to move forward with these capital projects until the environmental remediation costs are identified. The City has hired KPMG to assist in this effort.

While the City intends to comply fully with GASB 49 for financial reporting purposes, the City sought additional time to comply with GASB 49 for budgeting purposes as required by the FEA. The FEA authorizes the Financial Control Board to phase in the implementation of new accounting standards when immediate implementation would have a substantial adverse impact on the delivery of essential services. Given the potential adverse impact on the budget and the technical challenge of identifying the environmental remediation component of larger capital projects, the Financial Control Board approved a resolution of April 30, 2008, which defers the implementation of GASB 49 for budgeting purposes until July 1, 2010. The resolution requires the City to report twice each year on its progress in complying with GASB 49 for budgeting purposes.

D. New York City Housing Authority

Federal, State, and City funding to the New York City Housing Authority (NYCHA) has not kept pace with rising costs. Since 2002, NYCHA has used $400 million in federal funds intended for capital purposes to help balance its operating budget, and has drawn down another $400 million in reserves. NYCHA has also implemented cost-cutting actions, such as reducing staff and streamlining operations, and raised rents. In FY 2006, the City provided NYCHA with a one-time increase in its operating subsidy.

NYCHA, which operates on a calendar-year basis, projects a budget gap of $195 million in 2008 and slightly larger gaps in subsequent years. Although half the year is nearly over, NYCHA is only now proposing a gap-closing plan for the current year. The plan includes raising rents by 5 percent to 15 percent for high-income tenants, which requires federal approval; eliminating community and senior programs; and selling or leasing vacant properties. Given NYCHA's financial situation, the City could be called upon to increase its operating budget subsidy.

Appendix:
City-Funded Staffing Levels

Over the past three years the City increased the size of its workforce by 11,523 employees, and it plans to add another 7,396 employees during FY 2008 even though the Mayor has imposed a hiring freeze.[15] Most of the planned additions during FY 2008 are concentrated in the Department of Education (4,336); in social services, children's services, and homeless services (1,014); in police civilian staffing (827); and in health and mental hygiene (622). As of March 2008, the City-funded workforce totaled 267,516, or 3,286 fewer than forecast for the end of the fiscal year.

The April Plan assumes that staffing levels will decline from the planned level of 270,802 at the end of June 2008 to 268,490 by the end of June 2009, a net reduction of 2,312 employees based on the following changes.

- The Administration for Children's Services (ACS) plans to reduce its staffing level by 280 employees by the end of FY 2009. The ACS had planned to add 670 employees during FY 2008, but as of March 2008 had added less than half of the planned amount.
- The Department of Health and Mental Hygiene plans to add 622 employees during FY 2008, but then reduce its staffing by 58 employees by the end of FY 2009.
- The Department of Education plans to add 4,369 pedagogues during FY 2008 and remain at that level during FY 2009. The number of non-pedagogical employees is expected to decline by 418 during FY 2009.
- The Department of Social Services had planned to add 320 employees during FY 2008, but hiring has not kept pace with attrition. As a result, in March 2008, the agency was 844 employees below the year-end FY 2008 target, and was lower than the FY 2009 target as well.
- In recent years the Police Department has had difficulties meeting its recruitment targets, and the City has postponed plans to expand the size of the police force during fiscal years 2008 through 2010. As a result, the size of the police force is expected to total 35,300 officers at the end of FY 2008, which is 12.4 percent lower than the peak June 2000 level. While the May Plan projects that the department will add 827 civilians during

[15] In October 2007, the City directed its agencies to freeze all City-funded hiring with the exception of positions that immediately affect public health and safety.

FY 2008 and then reduce civilian staffing by 780 positions during FY 2009, this swing reflects a reclassification of part-time employees as full-time.

- The Department of Correction plans to add 250 officers and 150 civilians over the course of fiscal years 2008 and 2009. The department estimates that nearly half of its officers are or will become eligible for retirement in the next five years.
- The Fire Department plans to reduce its uniformed force by 287 firefighters during fiscal years 2008 and 2009, but it plans to increase its civilian workforce by 186 during that period—mostly for ambulance paramedics.
- The City's district attorneys and prosecutors plan to reduce staffing by 255 by the end of FY 2009.
- The Department of Parks and Recreation plans to reduce its workforce by 652 employees in FY 2008 and another 162 employees in FY 2009 as part of the City's hiring freeze and vacancy reduction initiative.

City-Funded Staffing Levels
(Full-Time and Full-Time-Equivalents)

Increase/(Decrease)

		Fiscal Year			Annual Change		Two-Year Change
		FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	
Public Safety		**80,487**	**81,764**	**82,879**	**825**	**(872)**	**(47)**
Police Dept.:	Uniformed	35,489	35,773	35,548	(264)	- - -	(264)
	Civilians	14,343	15,365	16,331	827	(780)	47
Fire Dept.:	Uniformed	11,475	11,633	11,513	(249)	(38)	(287)
	Civilians	4,410	4,484	4,670	53	133	186
Correction:	Uniformed	8,741	8,451	8,466	398	(148)	250
	Civilians	1,271	1,293	1,323	179	(29)	150
District Attys. & Prosecutors		3,342	3,428	3,544	(256)	1	(255)
Probation Department		948	850	1,019	(64)	(9)	(73)
Other		468	487	465	201	(2)	199
Health and Welfare		**24,016**	**24,307**	**24,718**	**1,698**	**(253)**	**1,445**
Social Services		11,103	10,982	11,003	320	(148)	172
Children's Services		6,052	6,319	6,605	670	(280)	390
Health and Mental Hygiene		4,358	4,516	4,797	622	(58)	564
Homeless Services		2,234	2,194	2,042	24	157	181
Other		269	296	271	62	76	138
Environment & Infrastructure		**18,736**	**19,051**	**19,759**	**(408)**	**(395)**	**(803)**
Sanitation:	Uniformed	7,472	7,581	7,605	(1)	(148)	(149)
	Civilians	1,800	1,836	1,898	196	(52)	144
Dept. of Transportation		2,127	2,218	2,307	42	(33)	9
Parks & Recreation		6,906	6,968	7,489	(652)	(162)	(814)
Other		431	448	460	7	- - -	7
General Government		**8,388**	**8,556**	**8,824**	**593**	**(275)**	**318**
Finance		2,250	2,229	2,199	86	(110)	(24)
Law Department		1,359	1,352	1,370	(51)	(6)	(57)
Citywide Admin. Services		1,304	1,277	1,335	118	(48)	70
Taxi & Limo. Commission		436	445	422	54	(14)	40
Investigations		245	245	265	12	(15)	(3)
Board of Elections		378	421	415	(31)	(7)	(38)
Info. Technology & Telecomm.		785	866	978	160	(14)	146
Other		1,631	1,721	1,840	245	(61)	184
Housing		**1,600**	**1,744**	**1,873**	**236**	**28**	**264**
Buildings		979	1,093	1,181	146	48	194
Housing Preservation		621	651	692	90	(20)	70
Department of Education		**111,897**	**113,454**	**116,240**	**4,336**	**(357)**	**3,979**
Pedagogues		89,154	89,369	92,491	4,369	61	4,430
Non-Pedagogues		22,743	24,085	23,749	(33)	(418)	(451)
City University of New York		**6,575**	**6,436**	**6,600**	**14**	**(103)**	**(89)**
Pedagogues		4,115	4,052	4,154	1	(33)	(32)
Non-Pedagogues		2,460	2,384	2,446	13	(70)	(57)
Elected Officials		**2,410**	**2,441**	**2,513**	**102**	**(85)**	**17**
Total		**254,109**	**257,753**	**263,406**	**7,396**	**(2,312)**	**5,084**

Sources: NYC Office of Management and Budget; OSDC analysis