Review of the Financial Plan of the City of New York

Report 11-2018

OFFICE OF THE NEW YORK STATE COMPTROLLER
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Message from the Comptroller

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

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

Thomas P. DiNapoli
State Comptroller

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I. Executive Summary

New York City's economy is strong and continues to post solid job gains. It added 715,000 jobs between 2009 and 2017, making this the largest and longest job expansion in the post–World War II period. After adding 81,000 jobs in 2017, employment reached 4.4 million, 615,000 more than the prerecession peak. More jobs were added in the boroughs outside of Manhattan than in any other expansion.

With record job growth, the unemployment rate has declined from a recessionary peak of 9.5 percent to 4.5 percent in 2017, the lowest level in 41 years. The City is on pace for continued job gains in 2018, although growth is expected to slow for the fourth consecutive year as the labor market tightens.

Recent gyrations in the stock market have raised concerns about renewed market volatility, which had been absent for years. In addition, inflation and interest rates are now rising after an extended period when both were historically low. Some economists are concerned that the economy may overheat in response to federal tax cuts and higher federal spending.

The Mayor's preliminary executive budget for FY 2019 and the associated financial plan ("the February Plan"; see Figure 1) assumes continued economic growth and a short-term boost from higher capital gains and bonuses.

The February Plan projects a surplus of $2.6 billion in FY 2018 (the City ended FY 2017 with a surplus of $4.2 billion), which will be used to balance the FY 2019 budget. The surplus results largely from a reduction in unneeded reserves and a citywide savings program.

The February Plan projects budget gaps of $2.2 billion in FY 2020 and $1.5 billion in FY 2021, as well as a gap of $1.7 billion in FY 2022. These gaps are relatively small as a share of City fund revenues, but they do not reflect the next round of collective bargaining or the impact of State actions.

The February Plan provides funding for annual wage increases of 1 percent after the expiration of current agreements, but the actual cost will be determined through negotiation or arbitration.

The Governor's proposed executive budget for FY 2018-19 would increase State education aid to New York City by $248 million in FY 2019, but this is less than assumed in the February Plan. The enacted State budget, however, historically includes more education aid than initially proposed by the Governor.

The Governor's proposed budget includes a number of provisions that could increase the City's costs. For example, the Governor's budget would cap or reduce State reimbursement for a number of programs. The City's budget could also be adversely impacted by State actions approved in prior years that are scheduled to take effect in FY 2019.

The proposed State budget also includes proposals related to the Metropolitan Transportation Authority (MTA) that would impact the City's budget. For example, the City would be required to fully fund the capital costs of New York City Transit, which operates the subway and bus system, and match the State's capital contribution to the MTA's emergency Subway Action Plan (SAP). In addition, the City could come under pressure to contribute operating funds to the SAP.

In December 2017, the federal government approved changes in the tax code that could reduce corporate and personal income taxes by a net of nearly $1.5 trillion over 10 years, caps the deductibility of state and local taxes at $10,000, and further restricts the deductibility of mortgage interest.

These changes will benefit some taxpayers in the City, but the tax liability and the cost of home ownership will increase for others. The changes in the federal tax code also introduce greater uncertainty about the City's tax forecasts.

For example, personal income tax withholding and estimated payments were $1.3 billion higher for December 2017 than in the prior year, fueled by taxpayers who prepaid their taxes in 2017 because the new tax law limits the deductibility of state and local taxes beginning in 2018. The February Plan assumes that this change in taxpayer behavior will have no impact on collections in FY 2018, but the actual impact may not be known until later in the fiscal year.

Business tax collections have been an area of concern ever since the State tax law was changed in 2015. While the law was expected to be revenue-neutral, collections have declined and fallen short of expectations every year since then. In FY 2018, business tax collections are projected to fall short of the City's initial forecast by $495 million. While collections may fall short of the City's expectations in subsequent years as well, real property tax collections are likely to be significantly higher than projected by the City during the latter part of the financial plan period.

The City also anticipates $929 million in proceeds from the sale of taxi medallions during the financial plan period, but the value of medallions has plummeted after Uber and other ride-sharing providers entered the market.

Congress recently reached an agreement to fund the government through March 23, 2018, while also raising spending targets for the military and for domestic programs for two years. Congress still has to approve appropriation bills, but it appears that the immediate threat of federal budget cuts has lessened. However, growing federal deficits may renew calls for cuts in entitlement programs and domestic spending during the financial plan period.

The Health and Hospitals Corporation will benefit from the two-year agreement approved by Congress. Cuts in federal payments to hospitals that treat a disproportionate number of uninsured patients will be delayed for another two years, although the cuts could be larger in the following years. While the Corporation has made some progress in implementing its transformation plan, it still faces serious financial challenges. The City has not released a financial plan for the Corporation since May 2017, making it difficult to assess the Corporation's current financial condition and its prospects for the future.

State actions represent the largest risk to the City's financial plan in the near term ($502 million in FY 2019; see Figure 2), but these issues will not be resolved until the State budget is enacted. Meanwhile, the City's economy is strong, the FY 2019 budget is balanced and the out-year gaps are manageable under current conditions. To its credit, the City's revenue estimates are relatively conservative, the City has maintained its reserves at historic levels and it continues to expand the citywide savings program.

FIGURE 1
New York City Financial Plan
(in millions)

	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
Revenues					
Taxes					
General Property Tax	$ 26,080	$ 27,674	$ 29,154	$ 30,438	$ 30,721
Other Taxes	29,915	31,269	32,348	33,423	34,181
Tax Audit Revenue	1,299	1,056	721	721	721
Subtotal: Taxes	$ 57,294	$ 59,999	$ 62,223	$ 64,582	$ 65,623
Miscellaneous Revenues	6,995	6,712	6,932	6,964	6,793
Unrestricted Intergovernmental Aid	- - -	- - -	- - -	- - -	- - -
Less: Intra-City Revenue	(2,132)	(1,757)	(1,749)	(1,754)	(1,754)
Disallowances Against Categorical Grants	85	(15)	(15)	(15)	(15)
Subtotal: City Funds	$ 62,242	$ 64,939	$ 67,391	$ 69,777	$ 70,647
Other Categorical Grants	1,098	870	860	855	855
Inter-Fund Revenues	674	670	606	605	605
Federal Categorical Grants	8,650	7,219	6,973	6,955	6,939
State Categorical Grants	14,776	14,968	15,463	15,838	16,251
Total Revenues	**$ 87,440**	**$ 88,666**	**$ 91,293**	**$ 94,030**	**$ 95,297**
Expenditures					
Personal Service					
Salaries and Wages	$ 27,273	$ 28,571	$ 29,394	$ 30,037	$ 29,677
Pensions	9,590	9,802	9,764	9,678	9,882
Fringe Benefits	9,972	10,678	11,556	12,318	12,999
Subtotal: Personal Service	$ 46,835	$ 49,051	$ 50,714	$ 52,033	$ 52,558
Other Than Personal Service					
Medical Assistance	5,915	5,915	5,915	5,915	5,915
Public Assistance	1,594	1,605	1,617	1,617	1,617
All Other	30,112	28,097	28,067	28,310	28,641
Subtotal: Other Than Personal Service	$ 37,621	$ 35,617	$ 35,599	$ 35,842	$ 36,173
Debt Service	6,412	7,089	7,664	8,127	8,815
FY 2017 Budget Stabilization	(4,180)	- - -	- - -	- - -	- - -
FY 2018 Budget Stabilization	2,584	(2,584)			
Capital Stabilization Reserve	- - -	250	250	250	250
General Reserve	300	1,000	1,000	1,000	1,000
Subtotal	$ 89,572	$ 90,423	$ 95,227	$ 97,252	$ 98,796
Less: Intra-City Expenses	(2,132)	(1,757)	(1,749)	(1,754)	(1,754)
Total Expenditures	**$ 87,440**	**$ 88,666**	**$ 93,478**	**$ 95,498**	**$ 97,042**
Gap to be Closed	**$ - - -**	**$ - - -**	**$ (2,185)**	**$ (1,468)**	**$ (1,745)**

Source: NYC Office of Management and Budget

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

	Better/(Worse)				
	FY 2018	**FY 2019**	**FY 2020**	**FY 2021**	**FY 2022**
Gaps Per NYC Financial Plan	**$ - - -**	**$ - - -**	**$ (2,185)**	**$ (1,468)**	**$ (1,745)**
Differences in Estimation					
Personal Income Tax Revenues	175	- - -	- - -	- - -	- - -
Business Tax Revenues	- - -	(250)	(250)	(250)	(250)
Special Education Medicaid Reimbursement	(64)	(64)	(64)	(64)	(64)
Uniformed Agency Overtime	(25)	(125)	(125)	(125)	(125)
Sale of Taxi Medallions	- - -	(107)	(257)	(367)	(198)
Debt Service	- - -	100	- - -	- - -	- - -
Miscellaneous Revenues	- - -	50	50	50	50
Revenue from HHC Development Opportunities	- - -	- - -	(100)	- - -	- - -
Subtotal	**86**	**(396)**	**(746)**	**(756)**	**(587)**
State Actions					
Executive Budget Proposals[1]	(97)	(251)	(238)	(240)	(240)
Sales Tax Asset Receivable Corporation	- - -	(150)	- - -	- - -	- - -
Charter School Tuition Payments		(101)	(240)	(417)	(633)
Subtotal	**(97)**	**(502)**	**(478)**	**(657)**	**(873)**
OSC Risk Assessment[2]	**(11)**	**(898)**	**(1,224)**	**(1,413)**	**(1,460)**
Potential Gaps Per OSC[3,4]	**$ (11)**	**$ (898)**	**$ (3,409)**	**$ (2,881)**	**$ (3,205)**

[1] The Metropolitan Transportation Authority has proposed an emergency Subway Action Plan with a total value of $836 million. The Governor's executive budget includes $428 million of State funds for the operating ($254 million) and capital ($174 million) portions of the program. The Governor's proposed budget would require the City to match the State's capital contribution, which would likely be funded through the City's capital program.

[2] Wage increases at the projected inflation rate after the expiration of current labor agreements could increase the City's costs beyond the resources it has set aside for this purpose by $56 million in FY 2018, $194 million in FY 2019, $469 million in FY 2020, $926 million in FY 2021 and $1.5 billion in FY 2022. The actual cost will be determined through negotiation or arbitration and could be more or less than the projected inflation rate.

[3] The February Plan includes a general reserve of $300 million in FY 2018 and $1 billion in each of fiscal years 2019 through 2022. In addition, the Capital Stabilization Reserve has a balance of $250 million in each of fiscal years 2019 through 2022.These resources could mitigate budget risks or, if not needed, could be used to help close the projected budget gaps.

[4] The Retiree Health Benefits Trust, which the City has used in the past as a rainy-day fund, has a balance of nearly $4.3 billion (net of any prepayments).

II. Changes Since the Beginning of the Fiscal Year

The City has made a number of changes to its revenue and expenditure forecasts since the budget was adopted in June 2017. As a result, the City now projects a surplus of $2.6 billion in FY 2018. As shown in Figure 3, the surplus results mostly from the citywide savings program and a reduction in unneeded reserves.

FIGURE 3
Major Changes in FY 2018 Financial Plan
(City funds in millions)

	Better/(Worse)
Reserves	$ 2,045
Citywide Savings Program	666
Tax Audits	449
Business Tax	(495)
Agency New Needs	(434)
Other Nonproperty Taxes	185
Miscellaneous Revenues	168
Net Change	**$ 2,584**

Sources: NYC Office of Management and Budget; OSC analysis

Since the beginning of the fiscal year, the City has reduced its reserves by more than $2 billion. For example, the general reserve was lowered by $900 million, leaving a balance of $300 million. Other sources include a reduction in the reserves for real property tax delinquencies ($355 million), federal and State disallowances ($100 million) and collective bargaining ($40 million). In addition, the City eliminated the capital stabilization reserve ($250 million) and anticipates savings from overestimating prior years' expenses ($400 million).

The citywide savings program is expected to generate $3.3 billion through FY 2022. According to the City, more than 40 percent of the savings will come from reestimates, one-third will come from efficiencies and the rest will come from debt service. The Mayor has indicated that an expansion of the program is likely in the spring with the release of his executive budget.

As part of the efficiency program, the Department of Correction will close a detention center on Rikers Island, eliminating the need for nearly 700 correction officers. The Department of Education has reduced the number of teachers in the Absent Teacher Reserve (who are not assigned to full-time teaching duties) by offering retirement and severance incentives.

The City also benefited from higher-than-expected pension fund investment earnings in FY 2017, which were reflected in the November 2017 financial plan. Unanticipated investment earnings allowed the City to reduce planned pension contributions by a total of $1.4 billion during fiscal years 2019 through 2022.

Tax audits are expected to generate an additional $449 million in FY 2018, but the increase will be offset by a reduction in business tax collections ($495 million). Other nonproperty tax collections are expected to be higher by $185 million, and miscellaneous revenues are expected to be higher by $168 million.

Agencies identified new spending needs of $434 million in FY 2018 and similar amounts in subsequent years. More than one-third of the needs are concentrated in the Department of Homeless Services, with much smaller amounts allocated to other agencies.

The February Plan projects budget gaps of $2.2 billion in FY 2020 and $1.5 billion in FY 2021, as well as a gap of $1.7 billion in FY 2022. These gap estimates are relatively small as a share of City fund revenues (averaging only 2.6 percent), but they do not reflect the potential impact of State or federal actions, or the next round of collective bargaining. The budgets for these years each include a general reserve of $1 billion and a capital stabilization reserve of $250 million, which, if not needed for other purposes, could be used to narrow the gaps.

III. Federal and State Issues

As discussed below, changes in federal and State policies can have important implications for New York City's budget and its residents.

1. Changes in Federal Tax Policy

In December 2017, the federal government enacted revisions in the tax code that could reduce corporate and personal income taxes by a net of nearly $1.5 trillion over 10 years (according to the Congressional Budget Office), caps the deductibility of state and local taxes at $10,000 for taxpayers and further restricts the deductibility of mortgage interest.

The law also eliminated the ability of municipal issuers to refund tax-exempt debt more than 90 days in advance of the call date. In the past, the City has realized savings of about $100 million annually from advanced refundings. In addition, lower tax rates may reduce the attractiveness of housing tax credits, which the City relies on for its housing program.

In addition, the law eliminated the individual mandate under the Affordable Care Act (ACA), which required individuals to have health insurance or to pay a penalty. The Congressional Budget Office estimated that eliminating the mandate could increase the number of uninsured people by 13 million by 2027 and could increase insurance premiums by 10 percent annually.

In an effort to provide relief to taxpayers, the Governor proposes to permit the State, New York City and other school districts and counties to establish charitable gift trusts, health charitable accounts, and elementary and secondary education charitable accounts. Under the new federal tax code, charitable contributions are not capped in the same way as state and local taxes. Taxpayers making donations would be eligible to claim a tax credit against their State personal income or local property taxes.

2. Federal Budget

On February 9, 2018, Congress approved a two-year budget agreement that increases the cap on military spending by $165 billion and the cap on nondefense spending by $131 billion. It also includes $89 billion for disaster relief in California, Florida, Puerto Rico and Texas, and suspends the debt limit for one year. Congress also agreed to maintain current spending levels through March 23, 2018, or until it approves appropriation bills. In addition, Congress has agreed to extend funding for the Children's Health Insurance Program for 10 years.

The President subsequently released a budget proposal for FFY 2019 (which begins October 1, 2018). The budget focuses heavily on cuts to social safety net programs and nondefense discretionary spending. However, the proposed budget is unlikely to be approved by Congress since members had already agreed to higher spending targets. As a result, the immediate threat of federal budget cuts appears to have lessened.

The President has outlined a 10-year $1.5 trillion initiative to rebuild the nation's infrastructure, including airports, bridges and highways. The President's proposed budget calls for spending $200 billion over 10 years, and assumes that states, localities and the private sector will provide the remaining $1.3 trillion. Last year, the President made a similar proposal, but it was not acted upon by Congress.

As a result of increased spending and tax cuts, the federal budget deficit could increase from $665 billion in FFY 2017 to more than $1 trillion by FFY 2019. The combination of economic stimulus and growing budget deficits could increase interest rates, which will make it more expensive to service the debt and difficult to stimulate the economy in the event of a recession. Growing federal deficits could also renew calls to reduce entitlement programs and domestic spending.

3. State Budget

On January 16, 2018, the Governor released his executive budget for State fiscal year (SFY) 2018-2019. The proposed budget would increase education aid to New York City by $248 million in FY 2019, $211 million less than assumed in the February Plan. The City has indicated that the receipt of State education aid in future years also is at risk ($461 million in FY 2020, growing to $766 million in FY 2022).

The amount of education aid in the adopted State budget has historically been higher than initially proposed by the Governor. Last year, a shortfall was mitigated by the City by delaying new programmatic initiatives.

The Governor's executive budget includes a number of actions, which the City estimates could increase its costs by a net of $97 million in FY 2018, $251 million in FY 2019 and slightly smaller amounts in subsequent years.[5] The largest initiatives are discussed below.

- Capping State reimbursement of child welfare costs would cost the City $65 million in FY 2018 and $129 million annually thereafter.
- Reducing State reimbursement for summer-school special education programs would cost the City $65 million beginning in FY 2019.
- Eliminating State reimbursement for supplemental tuition assistance to charter schools will cost the City $60 million annually beginning in FY 2019.
- Eliminating State reimbursements for the Close to Home program (which allows juvenile offenders to remain in their communities) would cost the City $15 million in FY 2018 and $31 million annually thereafter.
- Capping State funding for rental costs for charter schools would cost the City $18 million in FY 2018 and $24 million in FY 2019.
- Requiring internet retailers who provide a marketplace for third-party sellers to collect State and local sales taxes would benefit the City by $59 million in FY 2019 and $78 million annually thereafter. A similar proposal was included in the SFY 2017-2018 executive budget, but was rejected by the State Legislature.

The Governor's executive budget also includes a proposal authorizing the State budget director to cut certain local assistance payments by up to 3 percent if projected State tax receipts for SFY 2018-2019 decline by $500 million or more compared to the estimates in the Governor's proposed budget. Another proposal would extend and broaden a provision enacted in 2017 allowing the State budget director to impose spending cuts if certain federal assistance is reduced by $850 million or more.

Last year, the State required school districts to fund increased tuition costs at charter schools beginning in FY 2019. The City's preliminary estimate is that this requirement will increase its costs by an additional $101 million in FY 2019, growing to $633 million in FY 2022, if not offset by changes in State education aid to the City.

The State also raised the age of criminal responsibility for most crimes from 16 years to 17 years, effective on October 1, 2018, and to 18 years, effective on October 1, 2019. The City would be required to contribute to the cost unless the State waives the local share (which would be based on proof of financial hardship). The executive budget includes a dedicated appropriation of $100 million for State and local costs associated with this initiative, as well as other possible sources of funding. The City estimates that the law could increase its costs by about $200 million beginning in FY 2019.

[5] The State Division of the Budget believes that the impact of the Governor's executive budget for SFY 2018-2019 on New York City's financial plan would be considerably less than estimated by the City.

4. Metropolitan Transportation Authority

In July 2017, the Metropolitan Transportation Authority (MTA) announced a two-phase Subway Action Plan to address the deterioration of the subway system. Phase 1, with an estimated cost of $836 million over two years, would focus on stabilizing and improving the system. The Governor has proposed that the City and the State share the cost of Phase 1.[6]

The Governor's proposed budget includes $428 million to help fund the operating costs ($254 million) and capital costs ($174 million) of Phase 1. It would effectively require the City to match the State's capital contribution.

In the absence of a commitment by the City to provide funding for the operating budget portion of Phase 1, the MTA has scaled back the program. Nonetheless, the City could come under pressure to contribute up to $254 million in operating budget funds for Phase 1.

The Governor has also proposed that the City be required to fully fund the capital needs of New York City Transit, which averages $3.3 billion annually. If approved, the City's debt service costs would increase significantly. In addition, the Governor has proposed that the MTA raise funding for its capital program by establishing transportation improvement subdistricts in the City to levy assessments on the incremental property tax revenues generated from MTA capital improvements. The budgetary impact of these proposals is unclear.

[6] Phase 2, with an estimated cost of $8 billion, would focus on long-term capital improvements. The sources of funding for Phase 2 have not been identified.

IV. Revenue Trends

The February Plan assumes that revenues, including federal and State categorical aid, will total $88.7 billion in FY 2019. Locally generated revenues (i.e., City funds), which account for 73 percent of this amount ($64.9 billion), are projected to rise by 4.3 percent.

Revenue growth has benefited from New York City's strong economy. The City added 715,000 jobs between 2009 and 2017, making this the largest and longest job expansion in the post–World War II period. The City is on pace for continued job gains in 2018, although growth is expected to slow for the fourth consecutive year as the labor market tightens.

A reduction in federal corporate and personal income tax rates, as well as limitations on the deductibility of state and local taxes, became effective on January 1, 2018. Many taxpayers prepaid state and local taxes in December 2017, when such payments were still fully deductible.

As a result, personal income tax collections were much higher than anticipated for December 2017. The City believes these unanticipated payments were accelerated from later in the fiscal year and will have no impact on full-year collections. However, the changes in the federal tax code make it difficult to predict taxpayer behavior and the impact on City tax collections.

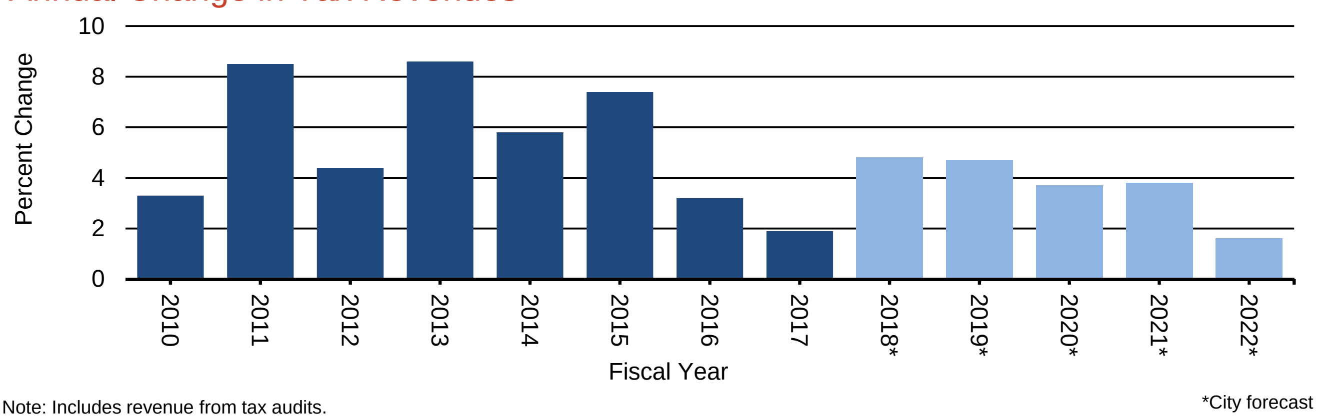
After increasing by 1.9 percent in FY 2017, tax collections (including audits) are expected to increase by 4.8 percent in FY 2018 and by another 4.7 percent in FY 2019 (see Figure 4). According to the City, growth will be driven by increases in real property tax collections, which account for nearly half (46 percent) of all tax revenues. Property tax collections are projected to increase by 6.1 percent in FY 2019, reflecting continued strong growth in property values.

Nonproperty taxes are projected to increase by 3.6 percent in FY 2019, the fastest rate in four years. The improvement reflects an expectation of stronger growth in personal income and sales taxes, as well as a resumption of growth in business and real estate transaction taxes.

The City will likely receive an additional $175 million in personal income tax distributions from the State in FY 2018. However, business tax revenues could fall short by $250 million in FY 2019, and sales tax collections will be lower by $150 million as the State recoups savings that accrued to the City from refinancing bonds of the Sales Tax Asset Receivable Corporation.

Other risks include the receipt of $929 million from the sale of taxi medallions during the financial plan period and $100 million in FY 2020 from development opportunities at properties leased to the Health and Hospitals Corporation.

FIGURE 4
Annual Change in Tax Revenues



Note: Includes revenue from tax audits.
Sources: NYC Office of Management and Budget; OSC analysis

FIGURE 5
Trends in City Fund Revenues
(in millions)

	FY 2018	FY 2019	Annual Growth	FY 2020	FY 2021	FY 2022	Average Three-Year Growth Rate
General Property Tax	$ 26,080	$ 27,674	6.1%	$ 29,154	$ 30,438	$ 30,721	3.5%
Personal Income Tax	11,857	12,184	2.8%	12,756	13,270	13,706	4.0%
Sales Tax	7,340	7,906	7.7%	8,227	8,577	8,712	3.3%
Business Taxes	5,532	5,979	8.1%	6,099	6,226	6,290	1.7%
Real Estate Transaction Taxes	2,364	2,397	1.4%	2,431	2,465	2,521	1.7%
Other Taxes	2,822	2,803	-0.7%	2,835	2,885	2,952	1.7%
Tax Audits	1,299	1,056	-18.7%	721	721	721	-11.9%
Subtotal: Taxes	**57,294**	**59,999**	**4.7%**	**62,223**	**64,582**	**65,623**	**3.0%**
Miscellaneous Revenues	4,863	4,955	1.9%	5,183	5,210	5,039	0.6%
Grant Disallowances	85	(15)	NA	(15)	(15)	(15)	0.0%
Total	**62,242**	**64,939**	**4.3%**	**67,391**	**69,777**	**70,647**	**2.8%**

Sources: NYC Office of Management and Budget; OSC analysis

The February Plan is based on the trends shown in Figure 5 and discussed below.

1. General Property Tax

In January 2018, the City released the preliminary property tax roll for FY 2019 (the final roll will be released in May), which showed stronger-than-expected growth in property values. As a result, the City increased its real property tax forecast by a total of $1.5 billion during fiscal years 2019 through 2022.

Collections are forecast to increase by 6.1 percent in FY 2019, but the February Plan assumes growth will slow during the remainder of the financial plan period. While the new federal tax code could dampen home values, the City's forecasts are very conservative. For example, collections are projected to increase by only 0.9 percent in FY 2022. Unless a severe economic downturn occurs, which seems unlikely, property tax collections are likely to be much higher than forecast in the February Plan.

2. Personal Income Tax

Although job gains have slowed over the past three years, the City continues to post solid gains. After adding 81,000 jobs in 2017, the City assumes growth of another 55,300 jobs in 2018 and 49,700 jobs in 2019.

The February Plan also assumes that private sector bonuses will increase by 6.8 percent in 2017 and by 8.6 percent in 2018. In addition, it assumes that capital gains will increase by 10.7 percent in 2017 (compared to a decline in 2016) and by 9.6 percent in 2018. These conditions will boost personal income tax collections, at least in the short term.

Changes in the federal tax code are affecting personal income tax collections in ways that are not fully understood. For example, withholding and estimated payments for December 2017 were $1.3 billion higher than in the prior year as some taxpayers prepaid their taxes in 2017 because the new tax law limits the deductibility of state and local taxes beginning in 2018.

The February Plan assumes that accelerated tax payments will have no impact on collections for the full year, but changes in taxpayer behavior are difficult to predict, making tax forecasts more complicated and less certain.

Personal income tax collections are projected to grow by 4.8 percent in FY 2018 based on a continuation of solid job and wage growth, as well as strong capital gains.[7] The February Plan assumes that the increase will be partly offset by a reduction in State distribution payments, but this appears unlikely based on conversations with State budget representatives and year-to-date trends.[8] As a result, the Office of the State Comptroller (OSC) expects State distributions to be higher by $175 million in FY 2018.

Collections (excluding State payments for distributional errors) are projected to rise by 4 percent in FY 2019 and to average 4.4 percent during fiscal years 2020 through 2022.

3. Sales Tax

Sales tax collections strengthened at the end of 2017, reflecting higher wages, increased consumer confidence and strong holiday sales. In addition, the City received a large payment from the State in November 2017 as part of a settlement with a single taxpayer.

Collections have also benefited from continued strength in tourism. NYC & Company (the City's tourism agency) estimates that the number of visitors rose to a record 61.8 million in 2017, but the number of international visitors (who spend more than domestic visitors) declined slightly. The number of total visitors is forecast to rise to 63.6 million in 2018.

Sales tax collections are expected to increase by 4.5 percent in FY 2018 (after adjusting for the impact of State sales tax intercepts). Continued favorable economic conditions are expected to boost the growth in collections to 4.9 percent in FY 2019 (the fastest rate in five years).

4. 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 since then business tax collections have declined and fallen short of expectations. Collections have continued to disappoint in FY 2018, with the City reducing its forecast by $495 million since the start of the fiscal year. The February Plan assumes collections will total $5.5 billion in FY 2018, only $82 million more than last year.

Nonetheless, the February Plan assumes collections will increase by 8.1 percent in FY 2019, an increase of $447 million. While higher corporate and Wall Street profits are likely to increase tax collections, the City's forecast may be overly optimistic given recent history. As a result, OSC believes collections could fall short of the City's target by as much as $250 million in FY 2019 and in subsequent years.

5. Real Estate Transaction Taxes

In FY 2018, real estate transaction taxes (the mortgage recording tax and real property transfer tax) are projected to decline for the second consecutive year (by 6.7 percent). According to the City, the drop reflects an expected decline in the number of large commercial transactions. Residential activity, in contrast, remains strong.

The February Plan assumes collections will increase by 1.4 percent in FY 2019, reaching $2.4 billion. The City expects an increase in commercial activity in response to favorable investment provisions in the new federal tax law.

[7] Adjusted for changes in the administration of the STAR program. The estimate excludes State payments to correct for past distributional errors.

[8] All personal income tax payments are made to the State. The State remits to the City an estimate of its share each month. The State subsequently reviews the results and makes adjustments as necessary.

6. Audit Revenue

Each year, the Department of Finance conducts audits of individuals and businesses to ensure compliance with the tax code. The February Plan increased the forecast for audit revenue in FY 2018 by $449 million to a record $1.3 billion. The February Plan assumes audit collections will decline to $1.1 billion in FY 2019 and then decline to $721 million annually in fiscal years 2020 through 2022. More than 90 percent of audit revenue is expected to come from business audits. Given recent changes in the business tax law, the potential exists for higher collections.

7. Asset Sales

The State authorized the sale of 2,000 additional taxi medallions in 2012. After the sale of 350 medallions in FY 2014, the City has repeatedly postponed the sale of the remaining 1,650 medallions because the expansion of alternatives to taxis, such as Uber and Lyft, has significantly changed the market.

The average sale price for a taxi medallion peaked at $1 million in calendar year 2014, but fell by two-thirds over the next three years. The average sale price was only $335,800 in 2017. The February Plan, however, assumes the remaining medallions will be sold at an average price of $728,000, generating $929 million during the financial plan period ($107 million in FY 2019, $257 million in FY 2020, $367 million in FY 2021 and $198 million in FY 2022). Given current market conditions, this amount is unlikely to be realized.

The City also expects to receive $100 million in FY 2020 from development opportunities at properties leased to the Health and Hospitals Corporation. The City intends to transfer the proceeds to the Corporation to help balance its budget. If these development opportunities do not materialize as expected, 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

The Mayor's preliminary budget for FY 2019 totals nearly $88.7 billion, including programs funded with federal and State categorical grants. The portion funded with locally generated revenue (i.e., City funds) will total $64.9 billion.

After adjusting for surplus transfers, which can mask expenditure trends, City-funded spending is projected to grow by 5.8 percent in FY 2019 (see Figure 6). Excluding reserves and savings from prior years' expenses, spending would increase by 3.7 percent (more than twice as fast as the projected local inflation rate), driven by personal service costs and debt service.

The pace of spending is projected to slow over the balance of the financial plan period, from 3 percent in FY 2020 to 1.6 percent in FY 2022. While health insurance and debt service costs are expected to grow rapidly, the February Plan assumes salary and wage costs will grow slowly and decline after 2021, when the last of the lump-sum payments under the current collective bargaining agreement will be made.

The February Plan assumes that employees will receive annual wage increases of 1 percent after the expiration of current contracts. The cost of future agreements will be determined by negotiation or arbitration, and the final cost could be higher than assumed in the February Plan.

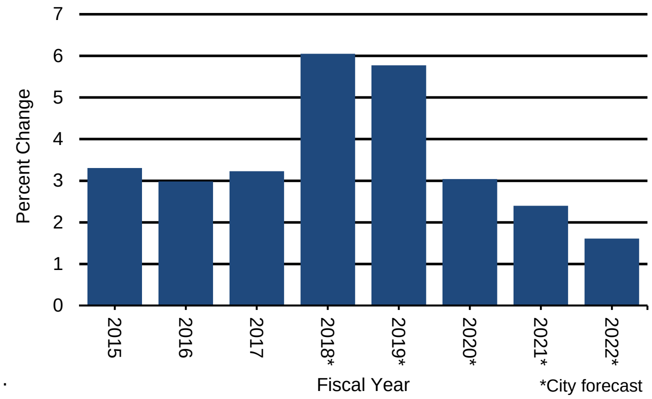
Overtime costs in the uniformed agencies could exceed planned levels, but debt service could be lower based on the City's conservative interest rate assumptions. In addition, the City continues to fall short of its planned capital commitment levels.

In the wake of the Great Recession, the City's full-time work force (including jobs funded by federal and State categorical grants) declined by 13,226 employees between fiscal years 2008 and 2012. Teachers and uniformed employees made up two-thirds of the reduction, with the balance concentrated in the health and welfare agencies.

Over the past five years, as the financial condition of the City has improved, the City's full-time work force (including positions funded by federal and State categorical grants) increased by 28,032 employees (10.5 percent). These additions increased the work force to the highest level since the 1975 fiscal crisis (295,455 full-time employees in FY 2017, of which 248,349 were City-funded; see Figure 7).

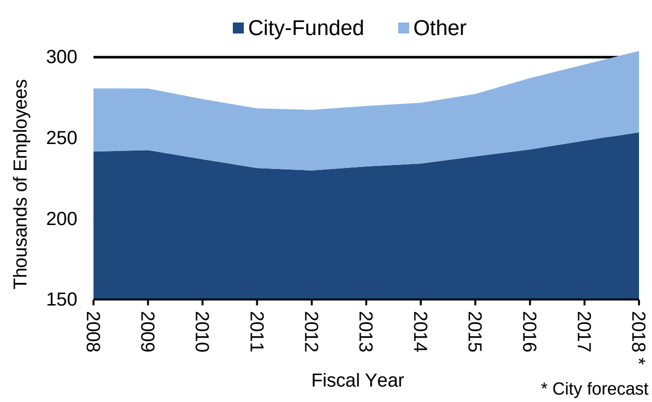
The February Plan assumes the addition of 8,376 employees during FY 2018, with hiring concentrated in the health and welfare agencies and civilian employees at the Police Department.

FIGURE 6
Growth in City-Funded Expenditures



Sources: NYC Office of Management and Budget; OSC analysis

FIGURE 7
Work Force Reaches Record Levels



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

FIGURE 8
Trends in City-Funded Spending
(in millions)

	FY 2018	FY 2019	Annual Growth	FY 2020	FY 2021	FY 2022	Average Three-Year Growth Rate
Salaries and Wages	$ 18,478	$ 19,790	7.1%	$ 20,563	$ 21,035	$ 20,302	0.9%
Pension Contributions	9,446	9,658	2.2%	9,619	9,534	9,738	0.3%
Debt Service	6,148	6,832	11.1%	7,412	7,882	8,575	7.9%
Medicaid	5,813	5,813	0.0%	5,813	5,813	5,813	0.0%
Health Insurance	4,740	5,276	11.3%	5,797	6,402	6,954	9.6%
Other Fringe Benefits	2,756	2,958	7.3%	3,245	3,396	3,524	6.0%
Energy	760	780	2.6%	811	849	881	4.1%
Judgments and Claims	552	567	2.7%	585	600	615	2.7%
Public Assistance	708	713	0.7%	719	719	719	0.3%
Other	14,537	13,886	-4.5%	13,762	13,765	14,021	0.3%
Subtotal	**63,938**	**66,273**	**3.7%**	**68,326**	**69,995**	**71,142**	**2.4%**
Prior Years' Expenses	(400)	- - -	NA	- - -	- - -	- - -	NA
General Reserve	300	1,000	NA	1,000	1,000	1,000	NA
Capital Stabilization Reserve	- - -	250	NA	250	250	250	NA
Total	**$ 63,838**	**$ 67,523**	**5.8%**	**$ 69,576**	**$ 71,245**	**$ 72,392**	**2.3%**

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

The February Plan is based on the trends shown in Figure 8 and discussed below.

1. Collective Bargaining

The City has reached labor agreements with the major unions that represent nearly all of the City's work force for the 2010-2017 round of collective bargaining. The cost of these agreements during the contract period ($13.8 billion during fiscal years 2014 through 2018) were partly offset by savings from 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) from a separate agreement between the City and its unions. The net cost is expected to total nearly $5.9 billion during the contract period.

The cost of the agreements will continue to grow beyond the current contract period as the City compensates members of the United Federation of Teachers and other employees for the time they went without wage increases that were provided to most other municipal unions in 2009 and 2010. The net annual budgetary impact will peak at $3.9 billion in FY 2021, and as a result salary and wage costs will decline in FY 2022.

The February Plan includes resources to fund annual wage increases of 1 percent after the expiration of the current round of collective bargaining.[9] The actual cost will be determined through negotiation or arbitration, and could be higher than assumed in the February Plan. Wage increases at the projected inflation rate, for example, would increase costs by $56 million in FY 2018, $194 million in FY 2019, $469 million in FY 2020, $926 million in FY 2021 and $1.5 billion in FY 2022.

[9] By March 31, 2018, nearly half of the labor agreements covering the municipal work force will have expired.

2. Health Insurance

The City and the Municipal Labor Committee (MLC) reached an agreement in May 2014 to generate health insurance savings for the City's budget to help fund wage increases for municipal employees. Under the agreement, the City and the unions agreed to generate a cumulative total of $3.4 billion during fiscal years 2015 through 2018, and $1.3 billion in recurring savings beginning in FY 2019.

The City met the target for fiscal years 2015 through 2017, and is on track to realize the FY 2018 target. Despite these savings, the City-funded cost of health insurance will reach nearly $7 billion by FY 2022 (see Figure 9), $2.7 billion (62 percent) more than before the agreement took effect in FY 2014.

More than three-quarters of the $3.4 billion in cumulative savings has come from lower-than-planned increases in health insurance premiums and other administrative actions. Cost-containment initiatives are expected to account for one-fifth of the savings ($687 million), mostly from higher co-payments.

The City is expected to seek additional health insurance savings with the assistance of the municipal unions to help fund wage increases in the next round of collective bargaining. Since the February Plan assumes that the growth in health insurance premiums for active employees will slow from 7 percent in FY 2019 to 5.5 percent in FY 2022, the potential for savings may be limited.

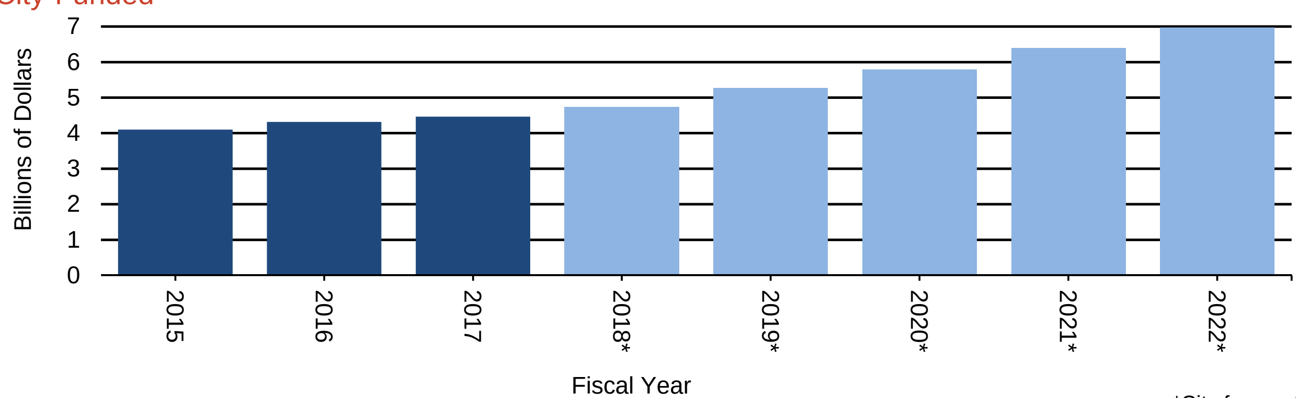
The Health Stabilization Fund (HSF) was established in 1986 pursuant to collective bargaining. Under the agreement, the City pays $35 million annually into the HSF, and contributes additional amounts for each fiscal year in which the rate approved for the Health Insurance Plan for Greater New York exceeds the rates for Group Health Incorporated and Blue Cross Blue Shield.

Under prior agreements between the City and the MLC, significant resources have been freed up by drawing down the balance in the HSF. In May 2014, the City and the MLC agreed to transfer $1 billion from the HSF to help fund wage increases, reducing the balance to less than $800 million. Since then, the HSF has grown to $1.6 billion.

FIGURE 9

Health Insurance Costs Continue to Grow

City-Funded



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

3. Pension Contributions

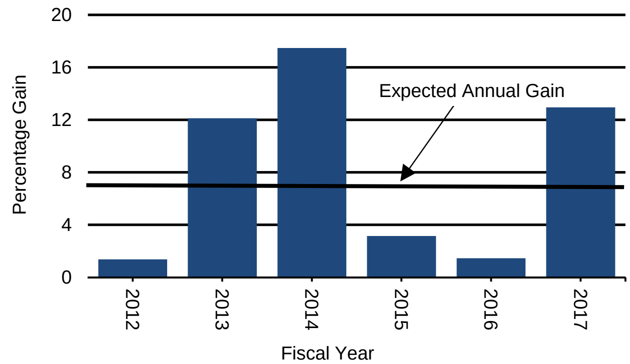
As shown in Figure 10, the February Plan assumes that pension contributions will remain relatively level during the financial plan period, averaging $9.6 billion (14.3 percent of City fund revenues). These estimates could be revised based on actual investment fund performance and the recommendations of an independent actuarial consultant, which is conducting a biennial audit of the pension system as required by the City Charter. The consultant is expected to issue preliminary findings in the near future, and will issue a final report sometime in 2019.

In the four years since the City adopted new financial reporting standards for pension liabilities in FY 2014, the financial condition of the City's five actuarial pension systems has improved. In the aggregate, the pension systems had enough assets to fund (on a market-value basis) 71 percent of their accrued pension liabilities as of the end of FY 2017. During this period, the City's unfunded net liability declined by $3.6 billion to $56.3 billion.

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

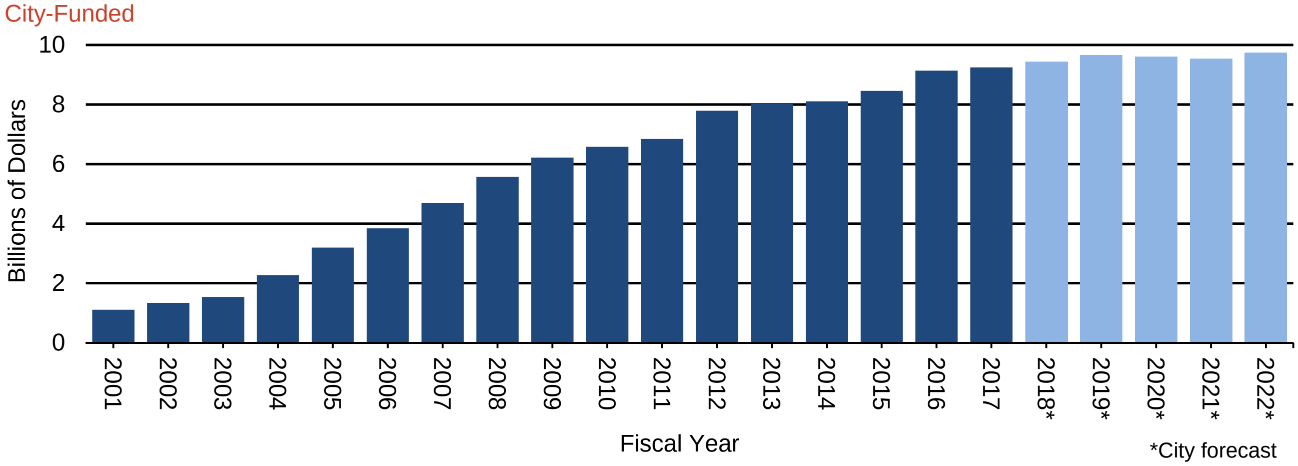
The pension funds have earned, on average, 7.9 percent on their investments during fiscal years 2012 through 2017, compared to the expected annual gain of 7 percent (see Figure 11). Investment earnings totaled about 12 percent through January 26, 2018, but the market has fallen since then and has become more volatile. Pension fund earnings totaled an estimated 8.1 percent as of February 28, 2018.

FIGURE 11
Pension Fund Investment Returns



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

FIGURE 10
Pension Contributions
City-Funded



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

4. Debt Service

City-funded debt service is projected to increase by 47 percent ($2.8 billion) between fiscal years 2017 and 2022 to reach $8.6 billion (see Figure 12). This represents an annual average growth rate of 8 percent, more than twice the rate of growth between fiscal years 2011 and 2017. Debt service costs were held down during this period by historically low interest rates, which reduced the cost of borrowing and allowed the City to realize substantial savings by refinancing outstanding debt at lower rates.

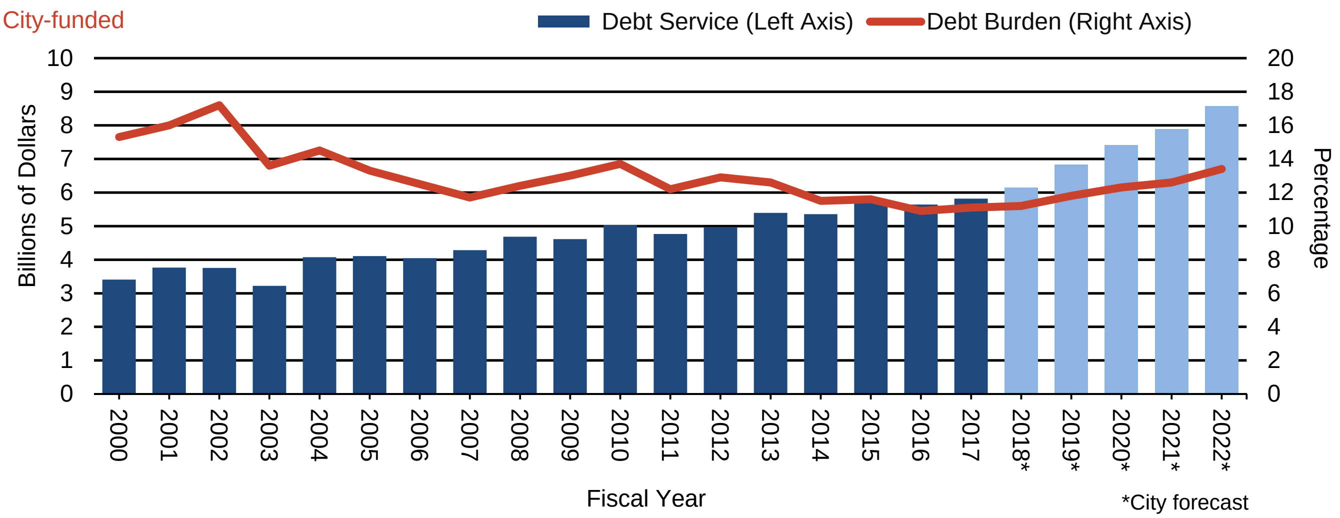
Figure 12 also shows that debt service as a share of tax revenue (i.e., the debt burden) would rise from 11.1 percent in FY 2017 to 13.4 percent in FY 2022. Although debt service would account for a larger share of tax revenue, the share would remain below 15 percent, a level that is considered high.

To prevent debt service from rising too quickly as a share of tax revenues, the City has available an annual capital stabilization reserve of $250 million starting in FY 2019. New changes in federal tax policy, however, could affect the City's borrowing costs in ways that are difficult to predict.

Recent changes to federal tax policy have also eliminated the ability of municipal bond issuers to refund bonds on a tax-exempt basis more than 90 days in advance of their call date, which would reduce the amount of savings to the City from refinancing outstanding debt. The City estimates that this will cost it $100 million annually in forgone savings.

Although the opportunity to refinance outstanding debt in the future will likely be reduced, debt service could still be lower than assumed in the February Plan. The City has historically fallen short of its capital commitment targets, and interest rates, while rising, are likely to stay below the levels assumed by the City. For FY 2019, OSC estimates that the City could realize savings of $100 million from lower-than-expected variable interest rates.

FIGURE 12
Debt Service
City-funded



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

5. Uniformed Overtime

Overtime costs in the four uniformed agencies reached $1.4 billion in FY 2017, setting a new record. While overtime exceeded the City's initial estimate by $351 million, these unplanned costs were mostly offset by hiring delays and by savings in other personal service costs.

The February Plan assumes overtime will decline by $242 million to $1.2 billion in FY 2018. However, overtime exceeded the City's forecast by $126 million through the first five months of the fiscal year (although it was about the same level as last year).

As in past years, unplanned overtime costs could be partly offset by savings in other personal service costs or by the receipt of unplanned federal and State categorical grants. Thus, OSC estimates that overtime could be higher than planned on a net basis by $25 million in FY 2018 and $125 million annually thereafter.

6. Homeless Services

The number of homeless people residing in shelters operated by the Department of Homeless Services (DHS) remains at historic levels despite City efforts to prevent homelessness and to create permanent housing. In January 2018, the caseload totaled 60,451, only slightly less than the peak reached in November 2016 (60,492).

As a result of growth in the shelter population over the past few years, the cost of homeless services has increased from $1 billion in FY 2013 to $1.8 billion in FY 2017. The February Plan assumes costs will remain at that level through FY 2022 ($1.1 billion in City funds).

7. Public Assistance

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

The public assistance caseload totaled 367,997 individuals as of December 2017, and the February Plan assumes no further growth. While the caseload has grown since the beginning of the fiscal year, it was lower by 6,319 compared to one year earlier. The City-funded cost of public assistance is expected to total $708 million in FY 2018 and increase slightly to $719 million beginning in FY 2020.[10]

8. Medical Assistance

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

The February Plan assumes that the City-funded share of Medicaid will total $5.8 billion in FY 2018 (9 percent of City-funded revenue) and will remain at that level because the State has assumed financial responsibility for the growth in the local share. These estimates assume there will be no changes in federal and State policies.

[10] The February Plan assumes that the federal and State governments will fund $887 million of public assistance costs in FY 2018, growing slightly to $898 million beginning in FY 2020.

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

The department submitted claims to the federal government that are expected to generate $33 million in Medicaid revenue in FY 2017. The February Plan anticipates the receipt of $97 million annually, but until the department demonstrates that it can meet the higher annual target, $64 million remains at risk for FY 2018 through FY 2022.

VI. Health and Hospitals Corporation

The Health and Hospitals Corporation is the largest municipal hospital system in the country, providing health and mental health services to almost 1.1 million City residents. However, it faces significant challenges, including declining patient use and the fact that more than one-third of its patients lack health insurance.

In recent years, the Corporation has increasingly relied on the City to meet its financial obligations. In FY 2018, the City is expected to provide $1.8 billion in financial assistance, representing nearly one-third of the Corporation's total revenues.

In FY 2016, the Corporation announced a transformation plan to improve its financial situation, which was expected to generate $6.7 billion over four years. The Corporation has shown progress in reducing staffing and improved billing, but the transformation plan relies heavily on the receipt of additional federal and State aid ($2 billion), which requires federal and State approval that has not yet occurred.

The Corporation was counting on a large expansion in MetroPlus (the Corporation's own health insurance provider) as part of its transformation plan, but enrollment has not increased as expected. For the past two years, monthly enrollment has averaged 502,000 members. Moreover, a larger share of MetroPlus members receive medical services from providers other than the Corporation.

Under the Affordable Care Act, federal payments to hospitals that serve large numbers of uninsured patients were scheduled to decline under the assumption that many uninsured patients would enroll in the Medicaid expansion program or would obtain their own health insurance as mandated under the law.

Implementation has been repeatedly delayed and will be delayed again under the two-year budget bill recently approved by Congress. As a result, the Corporation will receive unanticipated federal payments of $217 million in FY 2018, $366 million in FY 2019 and $98 million in FY 2020.

While these resources will provide additional flexibility in the near term, the reduction in federal payments could be larger than planned in fiscal years 2021 and 2022. Since the City has not released a revised financial plan for the Corporation since May 2017, it is difficult to assess the Corporation's current financial condition and its prospects for the future.[11]

In September 2017, the Corporation appointed a new president and chief executive officer. The new president has proposed modernizing the hospital system by increasing outpatient services, attracting and retaining more insured patients, referring more patients to primary care, and opening urgent care centers to keep patients with less severe illnesses out of emergency departments.

The appointment of the new president and the short-term relief from cuts in federal funding provides an opportunity for the City and the Corporation to develop a long-term plan to address the many challenges facing the Corporation and to release revised accrual and cash financial plans in May 2018.

[11] The City has not released an accrual financial plan for the Corporation since October 2016 or a cash plan since May 2017.

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