Review of the Financial Plan of the City of New York

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I. Executive Summary

Last summer the subprime mortgage crisis sent shockwaves through the national and local economies. Over the past year, credit has tightened; financial institutions have written off more than $200 billion in bad debt and posted record losses; home values have dipped nationally and have begun to weaken in New York City; job growth has weakened; and inflation has strengthened, particularly for energy and food prices.

While revenue collections were much stronger in FY 2008 than the City had feared, the nation and the City are clearly heading toward a significant economic slowdown. Some economists expect a short, mild national recession; others predict a period of minimal growth. The City's four-year financial plan (the "June Plan") takes the more conservative approach and assumes a short recession for the nation and the City.

The national Gross Domestic Product (GDP) grew at an annual rate of only 0.6 percent during the last quarter of 2007 and by 1.0 percent during the first quarter of 2008, and in the first half of 2008 the nation lost 438,000 jobs. Consumer spending—which accounts for two thirds of economic activity—has been constrained, and consumer confidence fell below the low point of the recession of the early 1990s.

Wall Street, the most important industry in the City's economy, generated near-record profits of $20.9 billion in 2006, but lost a record $11.7 billion in 2007 after posting $20.2 billion in losses during the second half of the year. Even though the industry lost $22.4 billion during the first quarter of 2008, the City's financial plan assumes that the securities industry will recover by the second half of 2008 and generate $7.1 billion in profits for the year—an unlikely outcome. As a result, business tax collections may be weaker than anticipated during the financial plan period.

Over the past six months, Wall Street has announced large numbers of layoffs. The City expects Wall Street to shed 25,000 jobs from its recent peak of 188,000 jobs in September 2007—a decline of 13.4 percent, but less than the 40,800 jobs lost during the last recession. As of May 2008, the securities industry had lost only 4,000 jobs, but losses will accelerate as severance payments to laid-off employees are exhausted.

Despite these developments, the City is expected to end FY 2008 with a $6.6 billion surplus, including more than $2.5 billion that was 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 exceeded the FY 2007 level by nearly $850 million, producing a net budgetary benefit of $2.4 billion. About half of the unanticipated 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 June Plan (see Figure 1) 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 City loses some 90,000 jobs. Nonproperty tax collections are expected to drop by another $510 million in FY 2010. The impact on the budget will be mitigated by continued growth in property tax collections, which will increase by $1.7 billion during fiscal years 2009 and 2010.

While revenue growth will be subdued during the financial plan period, City-funded spending will grow by nearly 21 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 four-year capital program by 20 percent, debt service will rise by more than 50 percent to $6.4 billion by FY 2012.

These trends produce budget gaps of $5 billion in FY 2009, $7.3 billion in FY 2010, $8 billion in FY 2011, and $7.7 billion in FY 2012. The June Plan allocates the FY 2008 surplus of $6.6 billion over the next three years to reduce the gaps. Agency actions, with a recurring value of about $1 billion, will close the remaining budget gap for FY 2009 and narrow the out-year gaps to $3.8 billion in FY 2010 and about $6.6 billion annually thereafter.

To further narrow the out-year budget gaps, the Mayor has asked the City Council to rescind the 7 percent property tax cut enacted at the start of FY 2008 so as to generate $1.2 billion annually beginning in FY 2010. The Mayor has also proposed that the municipal unions restructure health insurance benefits to save the City $200 million annually. Even if these recommendations are adopted, the FY 2010 budget gap will still total $2.3 billion and the out-year gaps will average $5.1 billion.

Our review concludes that the FY 2009 budget is balanced based on relatively conservative revenue and expenditure assumptions. The greatest risk to the City's financial plan would come from a deeper or longer economic slowdown. If needed, the City could draw upon reserves funded with recent surpluses, such as $812 million in the Budget Stabilization Account, to maintain budget balance in FY 2009. Balancing the budget in subsequent years will be more difficult. The budget gaps could exceed $4 billion in FY 2010 and average $7.4 billion during fiscal year FY 2011 and 2012 (see Figure 2).

Over the next two years, both New York State and New York City will have to navigate through turbulent economic waters, and both will have to make difficult choices to balance their budgets. Last year, the City acted quickly as adverse economic developments came into focus, which helped mitigate the impact. The State Comptroller encourages the City to remain proactive and to maintain its commitment to prudent fiscal practices.

Figure 1
New York City Financial Plan
(in millions)

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
REVENUES					
Taxes					
General Property Tax	$ 13,021	$ 13,782	$ 14,737	$ 15,676	$ 16,423
Other Taxes	24,063	21,425	20,923	21,953	23,393
Discretionary Transfers	546	546	- - -	- - -	- - -
Tax Audit Revenue	1,039	577	579	579	579
Tax Reduction Program	- - -	(3)	1,219	1,293	1,353
Subtotal Taxes	38,669	36,327	37,458	39,501	41,748
Miscellaneous Revenue	6,527	5,671	5,303	5,365	5,383
Unrestricted Intergovernmental Aid	254	340	340	340	340
Anticipated State and Federal Aid	- - -	- - -	- - -	- - -	- - -
Less: Intra-City Revenues	(1,511)	(1,538)	(1,453)	(1,452)	(1,452)
Disallowances against Categorical Grants	(15)	(15)	(15)	(15)	(15)
Subtotal: City Funds	$ 43,924	$ 40,785	$ 41,633	$ 43,739	$ 46,004
Other Categorical Grants	1,131	1,029	1,005	1,006	1,010
Inter-Fund Revenues	446	463	425	419	419
Total City, Capital IFA & Other Cat. Funds	$ 45,501	$ 42,277	$ 43,063	$ 45,164	$ 47,433
Federal Categorical Grants	6,002	5,366	5,283	5,273	5,282
State Categorical Grants	11,267	11,526	11,939	12,803	13,103
Total Revenues	**$ 62,770**	**$ 59,169**	**$ 60,285**	**$ 63,240**	**$ 65,818**
EXPENDITURES					
Personal Service					
Salaries and Wages	$ 20,921	$ 21,942	$ 22,974	$ 24,424	$ 24,694
Pensions	5,745	6,296	6,822	6,890	6,994
Fringe Benefits	6,386	6,719	7,008	7,607	8,209
Subtotal - Personal Service	$ 33,052	$ 34,957	$ 36,804	$ 38,921	$ 39,897
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	17,941	18,340	18,461	19,090	19,589
Subtotal - Other Than Personal Service	$ 24,957	$ 25,119	$ 25,393	$ 26,182	$ 26,854
General Obligation, Lease and MAC Debt Service	5,661	3,598	2,047	4,797	5,327
FY 2007 Budget Stabilization & Discretionary	(4,054)	- - -	- - -	- - -	- - -
FY 2008 Budget Stabilization & Discretionary	4,625	(4,079)	- - -	- - -	- - -
FY 2009 Budget Stabilization & Discretionary	- - -	812	(812)	- - -	- - -
FY 2010 Budget Stabilization & Discretionary	- - -	- - -	350	(350)	- - -
General Reserve	40	300	300	300	300
Subtotal - Expenditures	$ 64,281	$ 60,707	$ 64,082	$ 69,850	$ 72,378
Less: Intra-City Expenses	(1,511)	(1,538)	(1,453)	(1,452)	(1,452)
Total Expenditures	**$ 62,770**	**$ 59,169**	**$ 62,629**	**$ 68,398**	**$ 70,926**
Gap Per June 2008 Plan	**$ - - -**	**$ - - -**	**$ (2,344)**	**$ (5,158)**	**$ (5,108)**

Source: NYC Office of Management and Budget

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

		Better/(Worse)		
	FY 2009	**FY 2010**	**FY 2011**	**FY 2012**
Gap Per June 2008 Plan	**$ - - -**	**$ (2,344)**	**$ (5,158)**	**$ (5,108)**
Excluding Resources Anticipated From FY 2010 Gap-Closing Program				
Increased Real Property Tax Rate	- - -	(1,223)	(1,298)	(1,359)
Restructured Employee Health Insurance	- - -	(200)	(200)	(200)
Gap to be Closed	**$ - - -**	**$ (3,767)**	**$ (6,656)**	**$ (6,667)**
OSDC Risk Assessment				
Tax Revenues	(200)	(150)	(100)	(100)
Energy Costs	(45)	(25)	- - -	- - -
Pension Contributions	- - -	(69)	(126)	(185)
GASB 49	- - -	- - -	(500)	(500)
OSDC Risk Assessment	**(245)**	**(244)**	**(726)**	**(785)**
Surplus/(Gap) to be Closed Per OSDC[1]	**$ (245)**	**$ (4,011)**	**$ (7,382)**	**$ (7,452)**
Additional Risks and Offsets				
Wage Increases at the Projected Inflation Rate	- - -	- - -	(136)	(363)

[1] The June Plan includes a general reserve of $40 million in FY 2008 and $300 million annually in fiscal years 2009 through 2012.

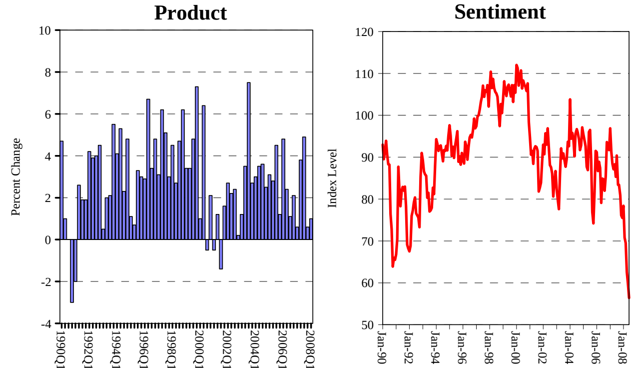
II. Economic Trends

The national and local economies have been adversely affected over the past year by the housing and credit crisis that has battered the financial markets. While New York City's economy has so far outperformed most other parts of the country and the nation as a whole, the local economy is beginning to reflect the impact of the economic slowdown. Even though the City acted quickly to revise its economic and revenue forecasts as the crisis developed, the depth and duration of the economic slowdown remains the greatest risk to the City's financial plan for the foreseeable future.

The national Gross Domestic Product (GDP) expanded at an annual rate of only 0.6 percent during the last quarter of 2007 and at 1 percent during the first quarter of 2008—far slower than in recent years (see Figure 3). Overall business activity has slowed sharply, and consumer spending grew by only 1.1 percent during the first quarter of 2008. Consumer spending—which accounts for about two thirds of economic activity—has been constrained in response to tighter credit, falling home values, job losses, and higher prices, especially for food and energy. Consumer confidence fell sharply during the first half of 2008—dipping beneath the low point of the recession of the early 1990s (see Figure 3), suggesting that further consumer retrenchment is likely.

Figure 3

Change in Gross Domestic Product | **Level of Consumer Sentiment**



Sources: U.S. Bureau of Economic Analysis; University of Michigan

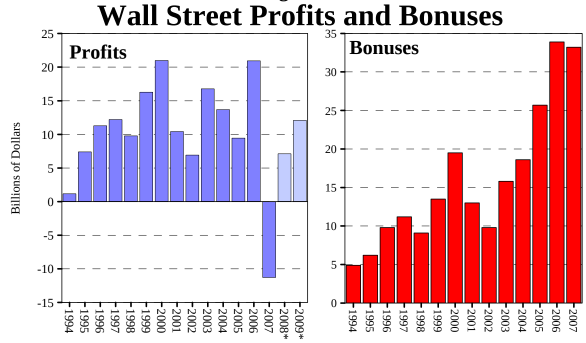
Some economists expect a short, mild national recession; others predict a period of minimal growth. The City's June 2008 Financial Plan (the "June Plan") assumes a short recession for both the nation and the City.

The June Plan expects that the GDP will decline slightly during the first half of 2008, but that growth will rebound during the second half of the year as the federal stimulus package ripples through the economy. GDP growth is expected to weaken during the first quarter of 2009 as the benefits of the stimulus package diminish, but then to pick up strength in mid-2009 as a recovery takes hold. Data released since the City's economic forecasts were developed has led Global Insight (a forecasting service used by the City) to raise its expectation of GDP growth during the first half of 2008, but to lower its growth estimates for late 2008 and early 2009—including two quarters of declines during this period. The City expects Gross City Product to contract by 7.5 percent during 2008 and by 1.3 percent during 2009 before growth resumes.

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 effectively collapsed and was acquired by JPMorgan Chase.

Figure 4

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

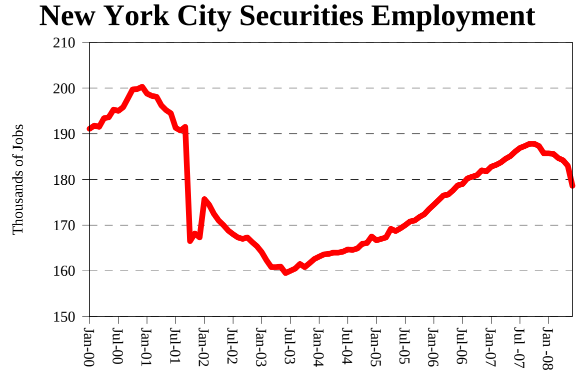
Wall Street generated near-record profits of $20.9 billion in 2006, but it lost a record $11.3 billion in 2007 after posting $20.2 billion in losses during the second half of the year. Moreover, the industry lost $22.4 billion during the first quarter of 2008—a new record. The June Plan assumes that the securities industry will recover by the second half of 2008 and generate $7.1 billion in profits for the year overall (see Figure 4). To achieve the City's profit forecast for this year, profits would have to average nearly $10 billion over the remaining three quarters of 2008—a level of profitability that exceeds even those of the industry's boom periods.

Even though Wall Street had a record loss in 2007, the State Comptroller estimated that bonuses paid to New York City declined by only 2 percent to $33.2 billion (see Figure 4). Historically, changes in bonuses tend to lag behind changes in profits, as firms seek to retain high-performing employees before lower profits force layoffs. The City assumes that bonuses will decline by more than 20 percent in 2008, pulling down the average industry salary by 7.3 percent in 2008 and by 11 percent in 2009.

Over the past six months, financial firms announced large numbers of layoffs. The City projects that Wall Street will lose 25,000 jobs from its recent peak in September 2007 (see Figure 5)—a decline of 13.4 percent. Such a decline is less than the 40,800 loss experienced during the last recession, but is within the range experienced by Wall Street during periods of market correction over the past half-century.

Figure 5

New York City Securities Employment



Note: Data has been seasonally adjusted.

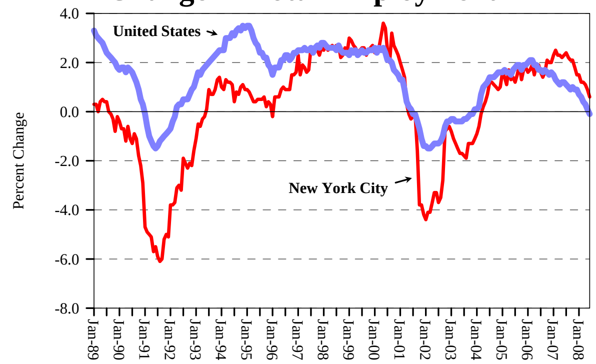
Sources: NYS Department of Labor; OSDC analysis

As of June 2008, securities employment had declined by 9,200 jobs, or 4.9 percent, from a seasonally adjusted peak of nearly 188,000 positions in September 2007. Reported job losses will accelerate as severance payments to laid-off employees are exhausted.

Since December, the nation has lost 438,000 jobs while the City has gained 11,000 jobs. In recent months local employment has begun to decline, but the decline is likely to accelerate as the losses on Wall Street ripple through the rest of the economy. The June Plan assumes that job losses will be proportionally greater in the City than in the nation (a decline of 2.4 percent compared to a national decline of 0.5 percent), as has been the case in recent downturns (see Figure 6).

Figure 6

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.

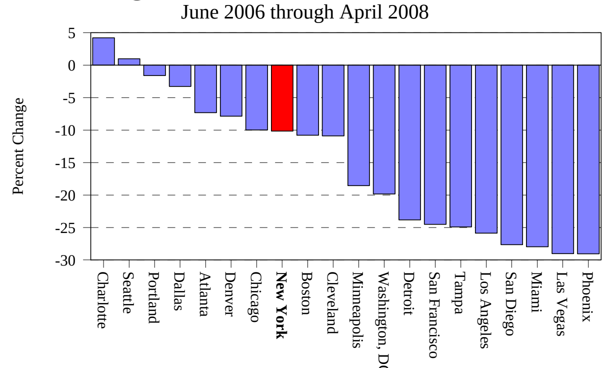
The New York metropolitan region's real estate market has begun to weaken, but not as much as in many markets in the rest of the nation (see Figure 7). Home values in the New York region have declined by 10.1 percent between June 2006 and April 2008, but the declines in many other markets have exceeded 20 percent.

The number of single-family homes sold in Brooklyn, Queens, the Bronx, and Staten Island dropped by more than 35 percent in the first quarter of 2008, and the median sales price has begun to ease. Sale prices continue to grow for condominiums and cooperative apartments in Manhattan, but the number of sales has fallen and properties have stayed on the market longer. Prudential Douglas Elliman reported that during the second quarter of 2008, condo prices rose by 32.9 percent compared to one year earlier, while co-op prices rose by 11.2 percent; however, total sales of co-ops and condos fell by 21.8 percent. The June 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.

Figure 7

Changes in Metro-Area Home Values

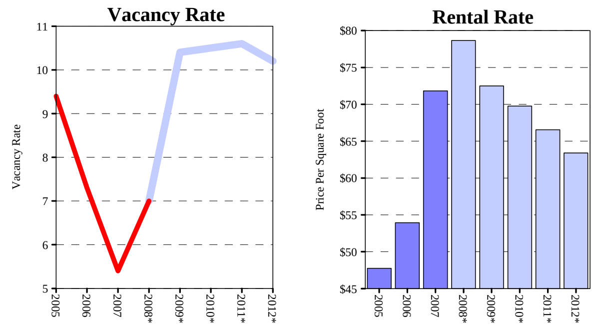
June 2006 through April 2008



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

Demand for office space in New York City has begun to soften as the economy has weakened, and further declines are expected as current construction is completed. The June 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 8).

Figure 8
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 $4.40 per gallon in the week of July 11, 2008—$1.16 or 35.8 percent higher than a year earlier. Food prices in the broader metropolitan area have also been climbing, rising by 5 percent in the first half of 2008 compared to the same period one year earlier. Recent flooding in the Midwest has damaged crops, which could put further pressure on prices. Rising food and energy costs have helped push the overall local inflation rate to 3.8 percent in the first half of 2008. The June Plan assumes that the inflationary surge will be short-lived as the economic slowdown and lower energy demand reduce inflation to about 2 percent annually beginning in 2009. Although the price of oil has eased in recent weeks, most economic forecasters believe oil prices will remain high and that inflationary pressures in the economy are still building. The weak dollar, which recently reached a new low against the euro, is contributing to higher oil prices.

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.

While the City's financial plan is based on conservative economic assumptions, the economic slowdown is in its early stages and significant risks remain. The crisis in the housing and credit markets has not yet reached bottom, as evidenced by the recent need for federal intervention to support Fannie Mae and Freddie Mac. In addition, consumer and business spending may remain weak if inflation becomes entrenched; personal income and business profits continue to fall; and debt burdens continue to rise. The Federal Reserve has recently expressed concern that the risks to both economic growth and inflation have increased since June. Finally, the credit crisis may be prolonged and have a deeper impact on Wall Street than currently envisioned.

III. Fiscal Year 2008

A close examination of the June Plan reveals that the City will end FY 2008 with a surplus of $6.6 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. Unanticipated tax collections ($1.7 billion), a drawdown in reserves ($860 million), an agency gap-closing program ($618 million), and unanticipated revenue from tax audits ($480 million) helped to generate a $4 billion surplus in FY 2008 (see Figure 9). Over the course of FY 2008, a deteriorating national and local economic outlook and unanticipated labor costs caused the FY 2009 budget gap to grow by $1.2 billion to reach $5 billion, and the out-year gaps to grow by about $3.6 billion annually, reaching $7.3 billion in FY 2010 and $8 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 that 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 2007 and again in January 2008. The City benefited, however, from unexpected revenue collections in March and April 2008, and revenue collections for FY 2008 overall are now expected to be $2.4 billion *higher* than projected at the beginning of the fiscal year.

More than half of the unanticipated revenue came from a surge in tax collections (mostly from the personal income tax) in the spring. Most 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 June Plan assumes that revenue collections will be lower than projected last June by $401 million in FY 2009, $2.1 billion in FY 2010, and $1.8 billion in FY 2011. The lower forecasts are mostly attributed to expected declines in collections from the personal income, business, and real estate transaction taxes.

[2] More than two thirds of the increased personal income tax 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 9
Financial Plan Reconciliation
July 2007 Plan vs. June 2008 Plan

(in millions)

	Better/(Worse)			
	FY 2008	**FY 2009**	**FY 2010**	**FY 2011**
Surplus/(Gap) Per July 2007 Plan	**$ 2,552**	**$ (3,752)**	**$ (3,747)**	**$ (4,369)**
Revenues				
Real Estate Transaction Tax	$ (58)	$ (347)	$ (427)	$ (506)
Personal Income Tax	1,256	(23)	(911)	(627)
Business Taxes	(3)	(296)	(464)	(308)
Real Property Tax	37	(318)	(449)	(495)
Sales Tax	300	18	(208)	(286)
All Other Taxes	118	43	71	91
Subtotal	1,650	(923)	(2,388)	(2,131)
Tax Audits	480	- - -	- - -	- - -
Rescinded Tax Initiatives	68	236	279	296
Non-Tax Revenues	216	286	3	37
Total	**2,414**	**(401)**	**(2,106)**	**(1,798)**
Expenditures				
Collective Bargaining	(303)	(715)	(1,365)	(1,882)
Pension Contributions	(17)	211	(152)	(56)
Energy	(11)	(119)	(203)	(209)
Federal Fringe Benefits Reimbursement Rate	126	116	89	89
Reestimate of Prior-Year Expenses	500	- - -	- - -	- - -
General Reserve	260	- - -	- - -	- - -
Pay-As-You-Go Capital	100	200	200	200
Debt Service	124	212	290	293
Council Initiatives and Technical Adjustments[3]	- - -	(72)	41	41
All Other	248	(638)	(343)	(336)
Total	**1,027**	**(805)**	**(1,443)**	**(1,860)**
Net Change During FY 2008	**3,441**	**(1,206)**	**(3,549)**	**(3,658)**
Projected Surplus/(Gap) as of June 2008	**5,993**	**(4,958)**	**(7,296)**	**(8,027)**
FY 2009 Gap-Closing Program				
Agency Actions[4]	618	1,145	1,081	1,021
Surplus Transfers	(6,611)	3,813	2,448	350
Total	**(5,993)**	**4,958**	**3,529**	**1,371**
Gap to be Closed	**$ - - -**	**$ - - -**	**$ (3,767)**	**$ (6,656)**

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

3 Council initiatives include additional resources for discretionary programs, such as $45 million for youth services, and technical changes include $119 million in debt service savings that were reflected in the Mayor's Executive Budget.

4 The value of the agency program is now lower than reflected in the Mayor's Executive Budget by $162 million in FY 2009 and $125 million in subsequent years. The reduction largely reflects partial restorations in planned cuts to the Department of Education ($125 million).

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

- Business tax collections will be lower than forecast one year ago by an average of $350 million during fiscal years 2009 through 2011. This will occur because the financial sector has generated record losses due to write-downs of bad debt: the losses will result in tax credits, thus reducing tax collections in future years.
- Real property tax collections will be lower by $318 million in FY 2009 and $495 million in FY 2011 compared to the forecast at the beginning of the fiscal year, reflecting the slowdown in the real estate market. Nonetheless, property tax collections are projected to grow by $3.4 billion during the plan period.
- Collections from real estate transaction taxes will be $58 million lower in FY 2008 than forecast at the beginning of the year—and 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 will be $300 million higher in FY 2008 than forecast at the beginning of the fiscal year, but then will grow at a slower rate for fiscal years 2010 through 2012. Collections have grown by 5.4 percent during the first 11 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 ($860 million), lower-than-planned agency spending ($248 million), and additional federal reimbursement for fringe benefits ($126 million)[5] 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 $805 million in FY 2009, $1.4 billion in FY 2010, and $1.9 billion in FY 2011, largely reflecting unplanned collective bargaining costs.

For fiscal years 2009 through 2011, the impact of unplanned spending has been mitigated by eliminating a reserve to fund capital projects on a pay-as-you-go basis, and by lower debt service. Debt service was reduced by $124 million in FY 2008 and by about $300 million during each of fiscal years 2009 through 2011 because of savings from debt refundings; the City's liability to fund interest payments on bonds issued by the Hudson Yards Infrastructure Corporation was reduced; and the capital

[5] 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.

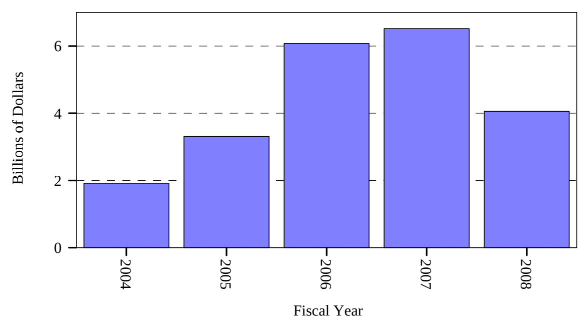
program was delayed and reduced by 20 percent in accordance with the Mayor's recommendation.

In November 2007, the City reduced its planned pension contributions by $125 million in FY 2009 and by greater amounts in subsequent years to reflect extraordinary pension fund investment earnings in FY 2007. These savings, however, will be mostly offset in fiscal years 2010 and 2011 by a shortfall in investment earnings in FY 2008. FY 2009 will benefit from a one-year delay in the planned implementation of certain recommendations by the City's actuarial consultant. The Plan also reflects the cost of recent State legislation that enhanced teachers' benefits.

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 10, the amount of unanticipated resources peaked 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 narrow future budget gaps.

Figure 10
Surplus Resources Generated in the Current Year

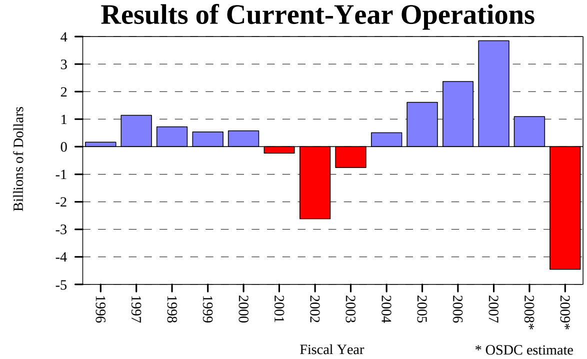


Sources: NYC Office of Management and Budget; NYC Comptroller; OSDC analysis

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, such as discretionary actions.

As shown in Figure 11, 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 $1.1 billion. In FY 2009, spending is projected to exceed current-year resources by $4.5 billion, a clear sign of fiscal stress. Nonetheless, the FY 2009 budget will be balanced using surplus resources accumulated in prior years.

Figure 11
Results of Current-Year Operations



Note: Adjusted for surplus transfers, TFA, TSASC, and discretionary actions.
Sources: NYC Office of Management and Budget; NYC Comptroller; OSDC analysis

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 12). 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 12).

Figure 12
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 beginning in FY 2009. During FY 2007, 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, which has reached its borrowing limit.

The enacted State budget also affects the Metropolitan Transportation Authority (MTA) and the Health and Hospitals Corporation (HHC). While the State increased aid to the MTA by $105 million in 2008, the amount was $40 million less than the MTA assumed in its financial plan. (The reduction reflects the MTA's share of statewide administrative cost savings.) In addition, the State reduced Medicaid revenue to the HHC 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.

The State's four-year financial plan also projects large out-year budget gaps. Given the developing economic slowdown and its focus on Wall Street—which provides up to 20 percent of State revenues—the State, just like the City, will have to take additional actions to balance next year's budget and to narrow the gaps projected for subsequent years. These State actions could adversely affect the City's four-year financial plan.

V. Program to Eliminate the Gap

The June Plan projects baseline budget gaps of $5 billion for FY 2009, $7.3 billion for FY 2010, $8 billion for FY 2011, and $7.7 billion for FY 2012 (see Figure 13). To narrow the projected gaps, the financial plan allocates the $6.6 billion surplus forecast for FY 2008 over the next three years: $3.8 billion to FY 2009, $2.4 billion to FY 2010, and $350 million to FY 2011. The June Plan also includes an agency gap-closing program that would close the remaining gap forecast for FY 2009 and would further narrow the out-year gaps. Although the economic outlook has weakened, in April 2008 the three major ratings agencies affirmed the City's long-term credit rating at the highest levels since the fiscal crisis of the 1970s, citing the City's strong management controls and its demonstrated ability to close projected budget gaps.

The June Plan also reflects the Mayor's proposals that the City Council rescind the 7 percent property tax cut enacted at the start of FY 2008 so as to generate $1.2 billion annually beginning in FY 2010, and that the municipal unions restructure health insurance benefits to save the City $200 million annually. Even if these recommendations are adopted, the FY 2010 budget gap will still total $2.3 billion and the out-year gaps will average $5.1 billion.

Figure 13
Gap-Closing Program
(in millions)

	FY 2009	FY 2010	FY 2011	FY 2012
Projected Surplus/(Gap) as of June 2008	**$ (4,958)**	**$ (7,296)**	**$ (8,027)**	**$ (7,652)**
Surplus Transfers	3,813	2,448	350	- - -
FY 2009 Agency Program	1,145	1,081	1,021	985
Increase Property Tax	- - -	1,223	1,298	1,359
Restructure Employee Health Insurance	- - -	200	200	200
Subtotal	4,958	4,952	2,869	2,544
Gap Per June 2008 Plan	**$ - - -**	**$ (2,344)**	**$ (5,158)**	**$ (5,108)**

Sources: NYC Office of Management and Budget; OSDC analysis

Agency actions are expected to generate $1.1 billion in FY 2009, and about $1 billion annually thereafter (see Figure 14), with 44 percent of the actions concentrated in the Department of Education and the Police Department. Of these amounts, 88 percent will 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 are expected to reduce planned staffing levels by almost 5,000 employees. Nearly one quarter of the staff reduction will come from a three-year delay in the expansion of the police force.[6]

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

Figure 14
FY 2009 Agency Program
(in millions)

	FY 2008	FY 2009	FY 2010	FY 2011
Department of Education	$ 180.1	$ 303.3	$ 252.5	$ 250.5
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	33.1	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	28.3	28.3
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	0.8	19.7	18.4	18.4
Finance	9.0	39.6	41.5	41.5
Libraries	8.0	9.4	25.4	25.4
Youth	8.0	8.6	15.2	15.2
CUNY	5.8	9.0	14.3	14.3
Parks	1.9	23.9	22.9	16.9
Energy Conservation	31.3	103.6	82.6	76.7
Procurement Savings	- - -	55.5	55.5	55.5
Other	62.4	64.8	83.1	103.2
Total	**$ 617.9**	**$1,144.5**	**$1,081.4**	**$1,021.4**

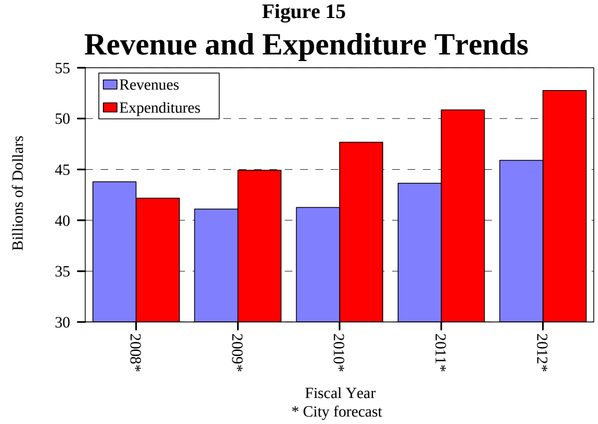
Source: NYC Office of Management and Budget

In January 2008, the Mayor’s preliminary executive budget proposed a reduction in planned funding to the Department of Education (DOE). In FY 2008, funding was reduced by $180 million and the DOE allocated $100 million of the cut to the schools, which reduced funding for core student services, extracurricular programs, and professional development. The Mayor also proposed reducing planned City funding by $428 million in FY 2009 and about $375 million in subsequent years, and the DOE planned to pass $181 million of those cuts to the schools. During the negotiations over the FY 2009 budget, however, the City Council and the Mayor agreed to rescind $125 million of the education cuts planned for FY 2009 and subsequent years. The adopted budget also rescinded proposed cuts for FY 2009 to libraries ($16 million), youth services ($6.6 million), elected officials ($6.4 million), and the City University of New York ($5.3 million).

VI. Revenue and Expenditure Trends

The June Plan assumes that City fund revenues will decline in FY 2009 (as the economic slowdown takes its toll on collections), stagnate in FY 2010, and finally resume growth in FY 2011. During the same period, spending is projected to continue to grow at a steady pace (see Figure 15). Overall, City fund revenues are projected to grow at an average annual rate of 1.2 percent during fiscal years 2009 through 2012, while spending is expected to grow at an average annual rate of 5.8 percent. As a result, the City projects large baseline budget gaps.

Figure 15



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 as the credit crunch continues to batter 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 much stronger growth.[7] Tax collections are projected to decline by 5.9 percent in FY 2009 based on the City's economic assumptions of national and local recessions.

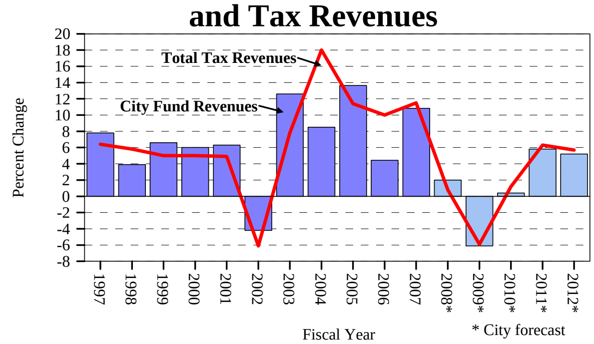
The City expects nonproperty tax revenues (excluding audits) to decline by $2.6 billion or 10.4 percent in FY 2009 as business profitability falls, jobs are eliminated, and income growth stagnates (or possibly declines, after being adjusted for rising inflation). Collections are expected to decline again in FY 2010 by another $510 million or 2.3 percent. These expected declines would be partially offset in FY 2009 by an increase of $761 million, or 5.8 percent, in real property tax collections; and in FY 2010 by an increase of $954 million, or 6.8 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 that year.

[7] Tax collections would have grown by 4.1 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 2 percent in FY 2008 after four years of strong revenue growth (at an average of 9.3 percent per year; see Figure 16).[8] The June Plan assumes that City fund revenues will decline by 6.1 percent in FY 2009 and show almost no growth in FY 2010 (see Figure 17), 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 5.8 percent in FY 2011 and 5.2 percent in FY 2012).

Figure 16

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

Our review finds that business tax collections may be lower than assumed in the June Plan by $200 million in FY 2009 and by lesser amounts in subsequent years due to the record losses reported by financial firms in the first quarter of 2008. While personal income tax collections may be higher than anticipated during the first half of the fiscal year, these gains may be offset in the second half given recent developments on Wall Street.

Figure 17
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	$ 13,021	$ 13,781	5.8%	$ 14,735	$ 15,673	$ 16,419	6.0%
Personal Income Tax	8,773	7,576	-13.6%	7,034	7,707	8,224	2.8%
Sales Tax	4,834	4,664	-3.5%	4,666	4,837	5,161	3.4%
Business Taxes	5,489	4,938	-10.0%	4,910	5,328	5,744	5.2%
Real Estate Transaction Taxes	2,572	1,934	-24.8%	1,883	1,860	1,968	0.6%
Other Taxes	3,113	3,082	-1.0%	3,190	3,333	3,452	3.9%
Audits	1,039	577	-44.5%	579	579	579	0.1%
Subtotal	**38,841**	**36,552**	**-5.9%**	**36,997**	**39,317**	**41,547**	**4.4%**
Miscellaneous Revenues	4,697	4,223	-10.1%	3,941	4,005	4,024	-1.6%
Unrestricted Intergovernmental Aid	254	340	33.9%	340	340	340	0.0%
Grant Disallowances	(15)	(15)	0.0%	(15)	(15)	(15)	0.0%
Total	**$ 43,777**	**$ 41,100**	**-6.1%**	**$ 41,263**	**$ 43,647**	**$ 45,896**	**3.7%**
Increase in Real Property Tax Rate	- - -	- - -	NA	1,223	1,298	1,359	NA
Total Including Tax Increase	**$ 43,777**	**$ 41,100**	**-6.1%**	**$ 42,486**	**$ 44,945**	**$ 47,255**	**4.8%**

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

8 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

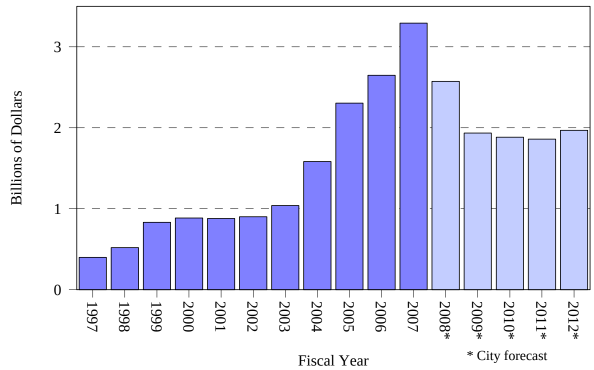
Over the last several years, collections from the real estate transaction taxes (i.e., the real property transfer tax and the mortgage recording tax) have surged along with increases in property values and the number of transactions (including for premier commercial properties). Between fiscal years 2002 and 2007, collections grew from less than $1 billion to nearly $3.3 billion (see Figure 18). The June Plan assumes that collections will decline by 21.9 percent in FY 2008 and by another 24.8 percent in FY 2009, reflecting weakness in the real estate market.

In recent years, sales of commercial property in the City were helped by the large sales in Manhattan—those valued at $50 million or more. Although these are few in number—they account for less than 3 percent of all commercial transactions—their values surged in the last several 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 19).

Transactions data from the New York City Department of Finance show that median home prices in the boroughs outside of Manhattan have begun to ease and that the number of sales has dropped drastically—more than 35 percent in the first quarter of 2008 compared to the same period one year earlier (see Figure 20).

Figure 18

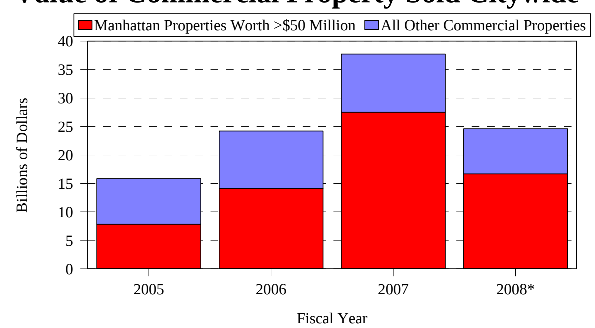
Real Estate Transaction Tax Revenues



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

Figure 19

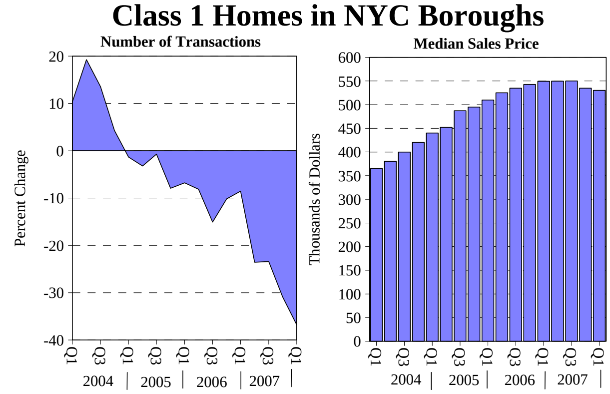
Value of Commercial Property Sold Citywide



* FY 2008 data is year-to-date through May.
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 20

Class 1 Homes in NYC Boroughs



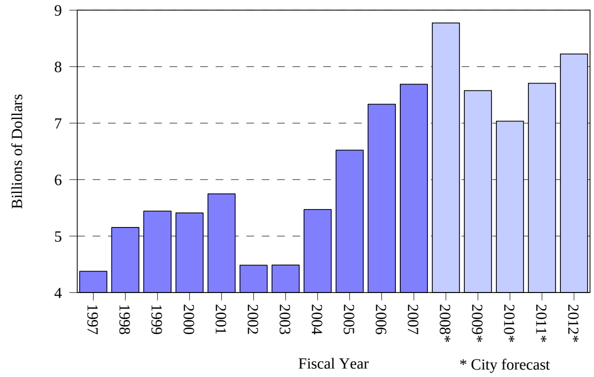
Note: Includes single- and multi-family homes in Brooklyn, Queens, the Bronx, and Staten Island.
Source: New York City Department of Finance

2. Personal Income Tax

Personal income tax collections surged by 14.1 percent in FY 2008 to $8.8 billion, reflecting the underlying strength of the 2007 economy (see Figure 21). The City projects that collections will decline by $1.2 billion (13.6 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 dropped only slightly in 2007, the City expects bonus payments to 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 7.2 percent in FY 2010. An expected resumption of job growth and wages is projected to boost collections beginning in FY 2011.

Figure 21

Personal Income Tax Revenues



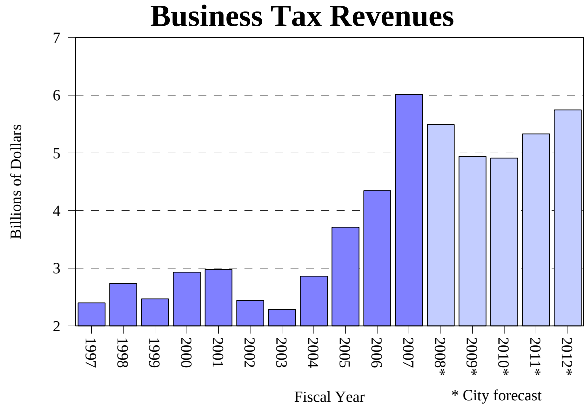
Sources: NYC Comptroller; NYC Office of Management and Budget; OSDC analysis

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 22). 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 drop to more traditional levels. Record losses during the first quarter of calendar year 2008 suggest that Wall Street is unlikely to recover as quickly as the June Plan assumes, and that financial firms are likely to generate additional tax credits that will further depress business tax collections in the coming years.

Figure 22

Business Tax Revenues

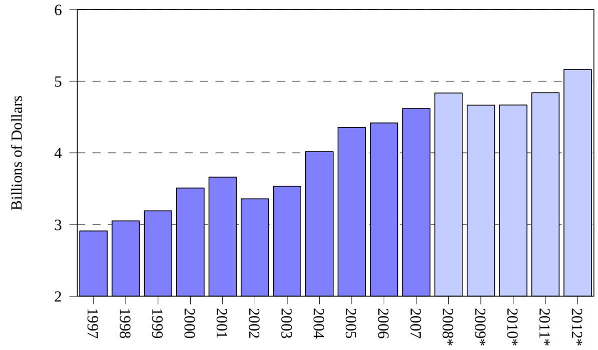


Sources: NYC Comptroller; NYC Office of Management and Budget; OSDC analysis

4. Sales Tax

Sales tax revenues have shown steady growth over the past few years (see Figure 23), reflecting robust income gains and surging levels of tourism (especially by overseas visitors capitalizing on the weak dollar). The June Plan assumes that the weakening domestic economy and slower consumer spending will reduce collections in FY 2009 by 3.5 percent. Collections are expected to remain flat in FY 2010 but then increase at an average rate of 5.2 percent in fiscal years 2011 and 2012 as the economy strengthens.

Figure 23
Sales Tax Revenues

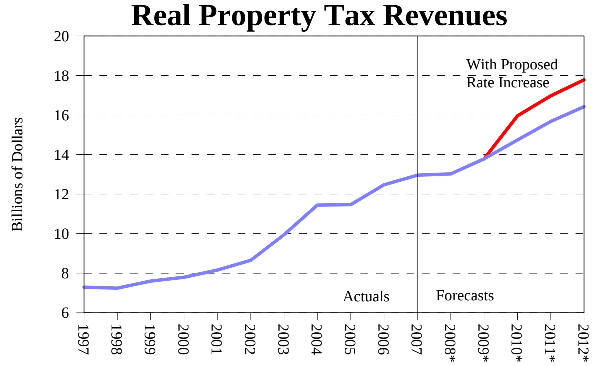


Sources: NYC Comptroller; NYC Office of Management and Budget; OSDC analysis

5. Real Property Tax

Real property taxes are the only major tax projected to increase annually during the financial plan period, growing by 5.8 percent in FY 2009, 6.9 percent in FY 2010, 6.4 percent in FY 2011, and 4.8 percent in FY 2012. Between fiscal years 2008 and 2012, this growth translates into a gain of $3.4 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 24).[9] Even though the real estate market has begun to weaken, property tax revenues are still expected to grow because large increases in real estate values over the past few years are still being phased in as required by State Law.

Figure 24
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

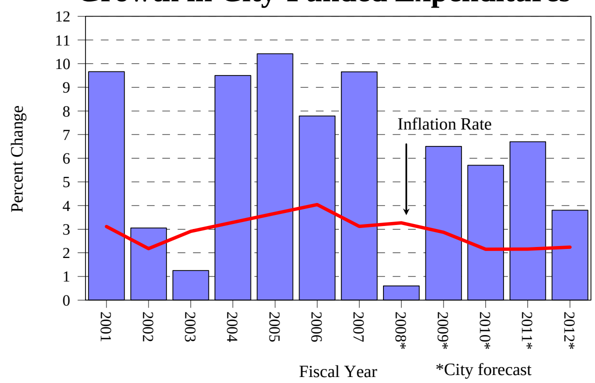
[9] The June Plan assumes that the State will reauthorize the $400 home owner rebate, which has an annual cost of $256 million and expires at the end of FY 2009.

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.[10] 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).

Figure 25

Growth in City-Funded Expenditures



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

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 extraordinary discretionary actions (such as the contribution to the Retiree Health Benefits Trust Fund and retiring outstanding bonds). Excluding these actions, spending would have grown by 9.2 percent in FY 2008, far faster than the local inflation rate. Spending is projected to grow by 6.5 percent in FY 2009 and by an average of 6.2 percent in each of fiscal years 2010 and 2011, reflecting rising costs for debt service, salaries and wages, and health insurance (see Figure 25). Spending is projected to grow by 3.8 percent in FY 2012 even though the June Plan sets aside resources to fund only a 1.25 percent wage increase that year.

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 52.0 percent of City fund revenues by FY 2012, up from 32.7 percent in FY 2000.

The June Plan is premised on the assumptions shown in Figure 26; these and other trends in the expenditure budget are discussed below.

[10] Adjusted for surplus transfers and for debt service on bonds issued by the Transitional Finance Authority and by TSASC.

Figure 26
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	$11,898	$12,795	7.5%	$13,938	$14,866	$15,065	5.6%
Debt Service	4,185	4,270	2.0%	4,745	5,865	6,442	14.7%
Medicaid	5,602	5,492	-2.0%	5,644	5,803	5,977	2.9%
Pension Contributions	5,574	6,124	9.9%	6,645	6,713	6,817	3.6%
Health Insurance	2,954	3,262	10.4%	3,628	4,100	4,638	12.5%
Other Fringe Benefits	2,411	2,367	-1.8%	2,310	2,248	2,165	-2.9%
Energy	797	929	16.6%	1,002	1,010	1,010	2.8%
Judgments and Claims	661	658	-0.6%	708	765	826	7.9%
Public Assistance	441	438	-0.8%	437	437	437	0.0%
General Reserve	40	300	650%	300	300	300	0.0%
Other	7,609	8,278	8.8%	8,321	8,746	9,086	3.1%
Subtotal	**42,172**	**44,913**	**6.5%**	**47,678**	**50,853**	**52,763**	**5.6%**
Health Insurance Restructuring	- - -	- - -	NA	(200)	(200)	(200)	NA
Total	**$42,172**	**$44,913**	**6.5%**	**$47,478**	**$50,653**	**$52,563**	**5.5 %**

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

1. Salaries and Wages

The June Plan assumes that salaries and wages will grow by 7.5 percent in FY 2009, 8.9 percent in FY 2010, 6.7 percent in FY 2011, and by only 1.3 percent in FY 2012. The growth reflects the cost of existing labor agreements as well as a recent arbitration award for the Patrolmen's Benevolent Association for the 2004-2006 round of bargaining, which the City assumes will be extended to all other uniformed employees; and other agreements anticipated for the 2007-2010 round of collective bargaining, along with 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 VIII for a detailed discussion.)

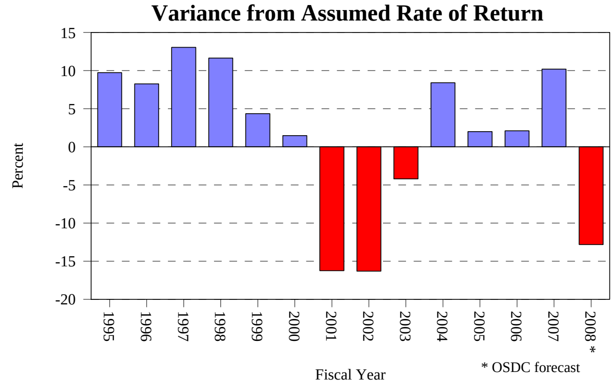
The June Plan assumes that overtime costs in the uniformed agencies will total $673 million in FY 2009 and slightly more in subsequent years. While our analysis indicates that overtime costs are likely to be higher by an average of $118 million annually during the financial plan period, the budgetary impact could be offset by the receipt of federal and State grants and under-spending 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 9.9 percent in FY 2009 to $6.1 billion and will rise by another 11.3 percent to $6.8 billion in FY 2012. The growth in contributions reflects a number of factors, including better-than-anticipated investment earnings in FY 2007, actual and anticipated wage increases, recent legislation that permits incumbent teachers to retire at age 55 with 25 years of service, a $200 million annual reserve beginning in FY 2010 to address the potential costs associated with the recommendations of a City Charter–mandated biennial audit, and an anticipated shortfall in pension fund investment earnings in FY 2008.

Last year, the City's five actuarial pension systems earned 18.2 percent, or 10.2 percentage points more than the assumed rate of return (see Figure 27). The June Plan assumes that as a result of high volatility in the stock market the pension systems will earn nothing on their investments during FY 2008, which will increase future contributions by $121 million in FY 2010, $220 million in FY 2011, and $327 million in FY 2012. We estimate that the pension systems actually lost 4.8 percent on their investments, which would increase future contributions by an additional $69 million in FY 2010, $126 million in FY 2011, and $185 million in FY 2012.

Figure 27
Pension Fund Investment Earnings
Variance from Assumed Rate of Return



Source: NYC Comptroller Annual Reports

3. Health Insurance

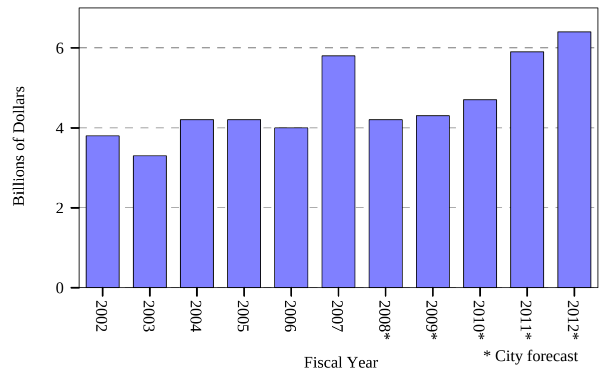
Health insurance costs for municipal employees and retirees are projected to increase from $3 billion in FY 2008 to $4.6 billion by FY 2012. The growth primarily reflects rising health insurance premiums, which will increase by 9.4 percent in FY 2009, based on the rate increase enacted by the Health Insurance Plan of Greater New York (HIP), and are expected to increase by 8 percent annually 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 June Plan anticipates the receipt of those savings beginning in FY 2010.

In addition, the Mayor opposes the proposed conversion of the not-for-profit health insurers HIP and Group Health Incorporated (GHI), which collectively cover 93 percent of the municipal workforce, 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 not-for-profit. The conversion requires approval by the New York State Insurance Department.

4. Debt Service

In FY 2007, 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.[11] (In FY 2008, the City used nearly $2 billion in surplus resources to pre-fund FY 2010 debt service costs.) Despite this action and the Mayor's intention to scale back the capital program by 20 percent, debt service costs are projected to reach $6.4 billion by FY 2012 (see Figure 28).[12] The debt service burden (i.e., debt service as a percent of City fund revenues) will rise from 9.6 percent in FY 2008 to 14 percent in FY 2012.[13]

Figure 28
Debt Service

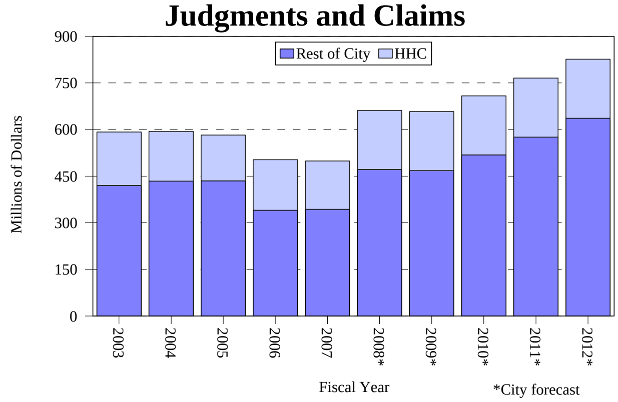


Note: Debt service amounts are adjusted for prepayments.
Sources: NYC Office of Management and Budget; NYC Comptroller; OSDC analysis

5. Judgments and Claims

The cost of judgments and claims remained relatively stable at about $590 million annually during fiscal years 2003 through 2005, but it declined to about $500 million during fiscal years 2006 and 2007 (see Figure 29). The June Plan assumes that these costs will total $661 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 $658 million and to grow by 7.9 percent annually thereafter because of the increasing amount of all settlement awards.

Figure 29
Judgments and Claims



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

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11 Debt service has been adjusted for surplus transfers.

12 We estimate that the Mayor's proposed 20 percent reduction saves $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 capital projects, but expects to provide details in September 2008.

13 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

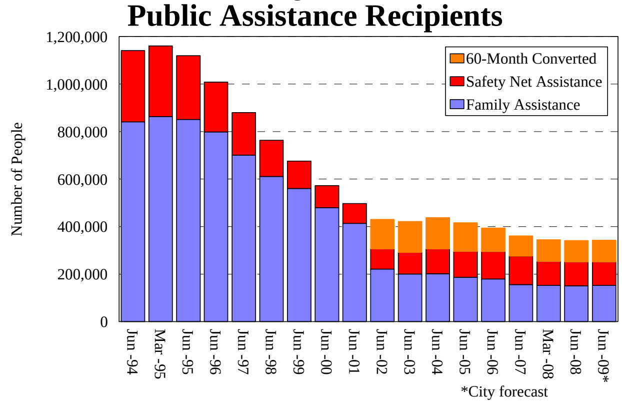
Medicaid costs are projected to decline by $111 million in FY 2009 to $5.5 billion because a supplemental payment made to the Health and Hospitals Corporation in FY 2008 is not expected to reoccur. The June Plan assumes that Medicaid costs will grow at about 3 percent annually, reflecting the State cap on growth in the local share of Medicaid and the State takeover of the Family Health Plus program.

7. Public Assistance

The public assistance caseload has declined by 70.6 percent from 1,160,593 persons in March 1995 to 341,329 persons in June 2008 (see Figure 30). The June Plan assumes that the caseload will decline slightly during the financial plan period, despite the expected economic slowdown. City-funded public assistance costs are projected to total about $437 million annually through FY 2012.

Figure 30

Public Assistance Recipients

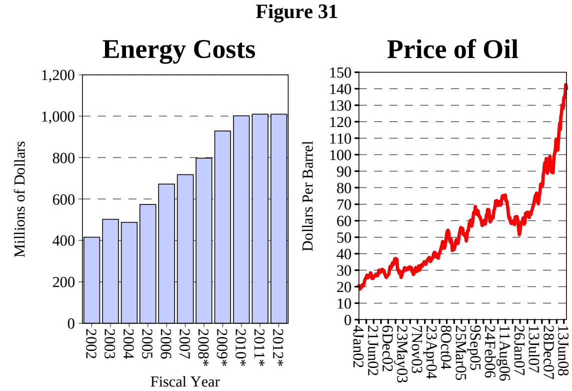


Sources: NYC Human Resources Administration; NYC Office of Management and Budget; OSDC analysis

8. Energy Costs

After remaining relatively stable during the first half of the decade, the rising cost of natural gas and oil pushed City-funded energy expenditures from $487 million in FY 2004 to $797 million in FY 2008—a 63.5 percent increase. With the continued increase in energy prices and the closing of the Poletti power plant in Queens, these costs are projected to reach $929 million in FY 2009 and more than $1 billion by FY 2010 (see Figure 31). The June Plan assumes that oil will average $101 per barrel during the Plan period, but the latest forecast from Global Insight projects an average of $118 per barrel. The City purchases its power from the Power Authority of the State of New York, which includes transmission fees from Con Edison. Using the Global Insight forecast, energy costs could exceed planned levels by $45 million in FY 2009 and $25 million in FY 2010. These additional costs could be reduced if the Public Service Commission approves a smaller rate increase than was recently requested by Con Edison.

Figure 31



Note: Oil price is for West Texas Intermediate Crude Oil.
Sources: Monthly Energy Review; New York City Comprehensive Annual Financial Report; New York City Office of Management and Budget; OSDC analysis

VII. Semi-Autonomous Agencies

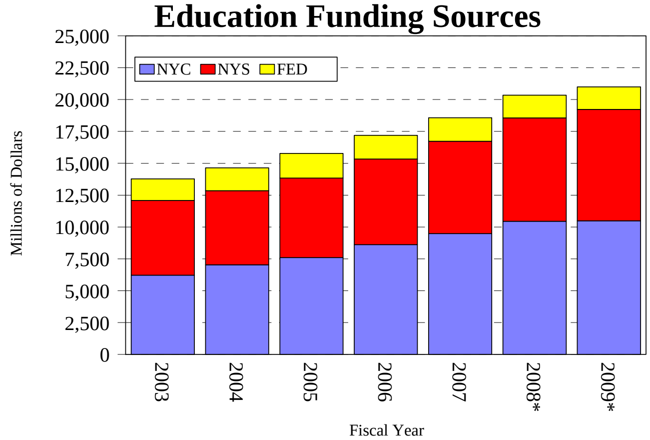
The following public authorities and other entities have a financial relationship with the City that could affect the City during the financial plan period.

A. Department of Education

The June Plan allocates $21 billion to the Department of Education (DOE) in FY 2009, including $3.4 billion for pensions and debt service. Of this amount, the City will contribute $10.6 billion, or 50.4 percent; the State will contribute $8.6 billion, or 40.9 percent; and the federal government will provide nearly $1.8 billion, or 8.4 percent (see Figure 32). The remainder comes from fees, grants, settlements, and restricted sources. The FY 2009 appropriation is $597 million higher than the level forecast for FY 2008.

Figure 32

Education Funding Sources



Sources: NYC Office of Management and Budget; OSDC analysis

Between fiscal years 2003 and 2008, City funding for education increased at an average annual rate of 10.9 percent; State funding increased by 6.7 percent annually. In FY 2009, City funding will increase by $198 million, or 1.9 percent, while the State contribution will increase by $453 million, or 5.6 percent.

Under the settlement of the Campaign for Fiscal Equity lawsuit, the City is obligated to increase education funding by a cumulative total of $2.2 billion by FY 2011. While the June Plan curtails planned increases in education aid that were proposed by the Mayor last year, City funding will still increase by nearly $2.9 billion, including $1.1 billion to cover the higher cost of pensions and debt service.

In recent years, academic performance has improved along with increases in funding from the State and the City. According to the DOE, the four-year high school graduation rate rose by nearly 9 percentage points between the 2001-2002 and 2005-2006 school years, from 50.8 percent to 59.7 percent. The number of high school dropouts declined from 31,899 in the 2002-2003 school year to 21,929 in the 2005-2006 school year. The percentage of high school students who earned a Regents diplomas jumped from 35.4 percent in 2001-2002 to 63 percent in 2005-2006. The DOE also reports that fourth-grade and eighth-grade reading and math test scores have risen substantially since 2002.

The legislation that granted the Mayor greater control over the Board of Education will terminate on June 30, 2009, unless it is reauthorized. The Mayor and the Chancellor advocate reauthorization, as they believe the law has improved accountability and performance. Others believe mayoral control has diminished transparency and the role of parents, and resulted in an increase in no-bid contracts. The Public Advocate has established a commission to solicit advice from interested groups to help inform the State Legislature in its deliberations.

B. Health and Hospitals Corporation

The Health and Hospitals Corporation (HHC) will achieve a balanced budget in FY 2008, and projects a closing cash balance of $873 million. In subsequent years expenditures are projected to grow faster than revenues, leading to budget gaps, on an accrual basis, of $770 million in FY 2009, $1.4 billion in FY 2010, $1.5 billion in FY 2011, and $1.6 billion in FY 2012. To help close these gaps, HHC is seeking $560 million annually in additional supplemental Medicaid payments from the federal government. (The City has already allocated $330 million annually for this purpose.)

In the past two fiscal years, HHC successfully negotiated supplemental Medicaid payments. The federal Centers for Medicare and Medicaid Services (CMS), however, have repeatedly proposed rule changes that would reduce or end these payments. Each time, Congress has deferred the implementation of these rule changes, and it recently did so again (until April 1, 2009) for six of seven proposed rules. The CMS have yet to publish the remaining rule in its final form, but HHC estimates that the rule could reduce revenues by $120 million annually.

C. New York City Housing Authority

The New York City Housing Authority (NYCHA) has experienced fiscal stress over the past few years as expenses have outpaced recurring revenues. To balance its operating budget, NYCHA has used $400 million in federal funds intended for capital purposes and has drawn down another $400 million in reserves. NYCHA has also taken actions that generated recurring resources, such as reducing staff, streamlining operations, and raising rents. In FY 2006, the City provided NYCHA with additional operating aid ($120 million) and capital resources ($100 million over four years).

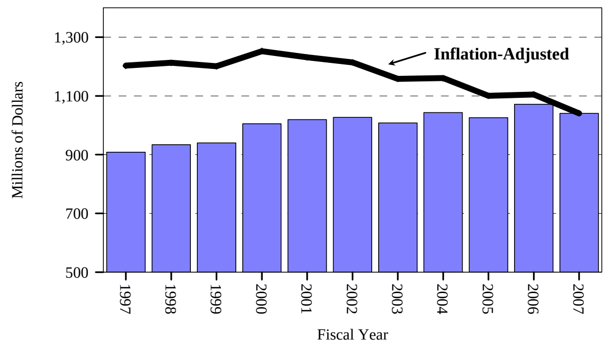
NYCHA projects a budget gap of $195 million for calendar year 2008, and slightly larger gaps in subsequent years. In May 2008, it proposed a gap-closing plan for the current year that includes raising rents for high-income tenants by between 5 percent and 15 percent ($35 million to $45 million), which requires federal approval; closing 136 community centers and 135 senior centers ($76 million); and selling or leasing vacant properties ($50 million). In June 2008, the City Council allocated $18 million to NYCHA to reduce the proposed cuts to senior and community centers. NYCHA has not yet determined how many centers will be closed.

D. Off-Track Betting Corporation

In recent years, the New York City Off-Track Betting Corporation (OTB) has come under fiscal stress because revenue has been unable to cover both OTB expenses and State-mandated payments to localities and to the racing industry. In addition, the OTB's handle (i.e., total funds wagered) has been declining on an inflation-adjusted basis (see Figure 33). In November 2007, the Mayor stated that the City would not subsidize the OTB without fundamental reforms at the State level, and in February 2008, the OTB Board of Directors began implementing a plan to end operations by June 16, 2008.

Figure 33

OTB Handle



Note: Handle is defined as the amount of funds wagered at OTB facilities.
Sources: OTB; OSDC analysis

On June 17, 2008, the State approved legislation that shifts the financial responsibility and management of the OTB to the State. OTB employees will still be covered by the New York City Employees' Retirement System and New York City's health insurance plan. The five members of the board will be appointed by the Governor, with one member recommended by the State Senate Majority Leader and another by the Speaker of the State Assembly. The OTB will no longer be subject to the New York State Financial Emergency Act.

To stabilize the OTB's finances over the next two years while a task force recommends reforms, the State will increase the OTB's take by 1 percentage point to an average of 21 percent on bets that are made on races held at New York Racing Association (NYRA) tracks as well as on bets made on out-of-state thoroughbred races. The OTB estimates that the increase will generate an additional $3.5 million in annual revenue over the next two years. The new law also permits the State to use the OTB's Capital Acquisition Fund to cover operating expenses. As of June 30, 2007, the Capital Acquisition Fund held $6.2 million.

In FY 2007, the City received a total of $19 million in surcharge payments and residual profits from the OTB. The City will continue to receive surcharge revenue only from bets placed at the Aqueduct and Belmont racetracks (this revenue totaled $4.25 million in 2007). Under a separate agreement with the State, the City will also receive $3.25 million annually for three years for allowing the OTB to broadcast races on television channels dedicated to City use.

E. West Side Development

As part of the City's effort to redevelop the far West Side of Manhattan, the City created the Hudson Yards Infrastructure Corporation (HYIC). The HYIC is authorized to issue up to $3.5 billion in bonds to finance the No. 7 subway line extension and other improvements on the far West Side.

The HYIC issued $2 billion in bonds in December 2006, with interest payments beginning in FY 2008. As development within the Hudson Yards Special District is not expected to generate sufficient revenues to cover both principal and interest payments in the near term, the City Council has agreed to support, subject to annual appropriation, the interest costs on up to $3 billion of HYIC bonds to the extent that project revenues are insufficient to cover principal and interest costs.

In FY 2008, revenue from investment earnings on unused bond proceeds, the receipt of tax equivalency payments (i.e., the property tax generated by improvements to residential properties), and the sale of development rights were sufficient to fully fund interest payments on the HYIC bonds, and thus a payment from the City was not needed. The City's interest liability is expected to be reduced from $85 million to $27 million in FY 2009 based on the receipt of additional revenue, but the June Plan assumes that the City will fund the full interest cost in subsequent years.

The Metropolitan Transportation Authority (MTA) is constructing the $2 billion extension of the No. 7 subway line from the existing terminus at 41st Street and 8th Avenue to 34th Street and 11th Avenue. A planned station at 41st Street and 10th Avenue is not currently funded but could be included in the final project if funding is made available. Costs on large construction projects in New York City are growing faster than expected, and there is currently no agreement on whether the MTA, the HYIC, or the City would fund any cost overruns on the extension.

Other City- and State-sponsored projects on the far West Side of Manhattan have experienced delays and higher costs. The cost of the planned expansion and renovation of the Jacob K. Javits Convention Center grew from $1.8 billion to $3 billion. The State now plans to scale down the original expansion from 500,000 square feet to 100,000 square feet and concentrate on repairs of the existing space, at a cost of $1.6 billion. In addition, efforts to transform the Farley Post Office into Moynihan Station were set back when the owners of Madison Square Garden announced that they would renovate the existing arena rather than move into Moynihan Station, which was a key element of the station plan. The MTA recently reached an agreement with another private developer to construct a mixed-use project over the eastern and western rail yards on the West Side of Manhattan after the initial developer withdrew from the project. (See "Metropolitan Transportation Authority" in this section of the report for further details.)

F. Lower Manhattan Redevelopment

On June 11, 2008, the Governor called on the Port Authority of New York and New Jersey (PA) to review the timetables and cost estimates for the redevelopment of the World Trade Center (WTC) site. A few weeks later, the PA released an initial assessment that concluded that "while significant progress has been made, the schedule and cost estimates of the rebuilding effort that have been communicated to the public are not realistic."

The report finds that 15 key outstanding issues must be resolved before new deadlines and cost estimates can be developed. Given the number of stakeholders involved in rebuilding Lower Manhattan, the PA Executive Director has proposed the establishment of a steering committee that can make final decisions about these critical issues. If issues are resolved quickly, the PA could complete its assessment by September 30, 2008—seven years after the attack on the WTC.

Based upon the report and press accounts, the following is the status of the major development projects planned for the WTC site.

- The Freedom Tower (Tower 1), originally scheduled to be completed in 2008, will not be completed before 2012; the memorial museum will not be completed before 2011. Towers 2, 3, and 4 (to be built by Silverstein Properties) are scheduled to be completed by 2012.
- JPMorgan Chase is scheduled to build Tower 5 on the site of the former Deutsche Bank building.[14] Construction will begin once the former building has been deconstructed, which is now scheduled for mid-2009 rather than this year as originally planned.
- The PATH train station will not be completed before 2011—two years later than planned—and the estimated cost has grown from $2.2 billion to $3.4 billion. The PA is exploring options to hold the cost to $2.5 billion.
- The Vehicle Screen Center depends on dismantling the former Deutsche Bank building, acquiring the site of the former St. Nicholas Greek Church, and reaching a security agreement with the Police Department.

Delays of the planned completion of the PATH station and implementation of a security plan by 2010 could reportedly cost the State and the City $321 million in lost revenue from Goldman Sachs, which is building its headquarters adjacent to the WTC site. The City and State hope to negotiate with Goldman Sachs to minimize any potential lost revenue. The PA has already paid Silverstein Properties $14.4 million in penalties due to delays, and is also responsible for a $300,000-per-day penalty for each day that the excavation of the site for Tower 2 continues beyond July 1, 2008.

[14] JPMorgan Chase agreed to pay the PA $290 million for development rights as part of a 92-year lease, and will be eligible to receive up to $230 million in incentives.

G. Metropolitan Transportation Authority

The budget gaps projected by the Metropolitan Transportation Authority (MTA) have grown by more than $400 million because collections from real estate transaction taxes have been weak and because energy costs have grown faster than expected. The budget gaps now total $1.1 billion in 2009, $1.9 billion in 2010, $2.1 billion in 2011, and $2.3 billion in 2012. To balance the 2009 budget, the MTA is proposing to raise fares and tolls in July 2009 by 8 percent and that the State and City increase operating assistance. The MTA has also proposed an amendment to the current five-year capital program because of cost overruns and project delays. In addition, the Governor has appointed a commission, chaired by former MTA Chairman Richard Ravitch, to identify new sources of funding for the MTA's operating and capital budgets for the next ten years. The commission is scheduled to issue its report by December 5, 2008.

In May 2008, the MTA Board approved a tentative deal with Related Companies/Goldman Sachs to construct a mixed-use development on a platform at the developer's expense over the eastern and western rail yards in Manhattan. The project calls for constructing 13 buildings (11 million square feet, divided nearly equally between commercial and residential space), and additional space dedicated to retail use, community space, a cultural center, and a school. While the eastern rail yard has already been rezoned, the western rail yard cannot be developed until it is rezoned under the City's land use review process.

The MTA Board also authorized the Executive Director to come to final terms with the developer by November 3, 2008. According to the tentative deal, the developer will receive a 99-year ground lease (with options to purchase land parcels) for each of the rail yards, and will pay an initial base rent of about $50 million.[15] The net present value of the ground leases is valued by the MTA at slightly more than $1 billion over the lease period, but actual payments could be accelerated based on the pace of development. Thus, it remains to be seen how much this transaction will benefit the 2005-2009 capital program, which anticipates $700 million from the deal.

Importantly, the development deal is contingent upon the completion of the extension of the No. 7 subway line. According to the tentative deal, the developer will receive "base rent holidays" if the subway extension project is not completed by January 2014. In addition, the developer will have the right to terminate the transaction, with deposit and all base rent refunded, if the subway extension is terminated or not completed by January 2020. The MTA's independent engineering consultant has already indicated that the No. 7 extension "could trend beyond mid-2014 absent any mitigation."

[15] The base rent would increase by 10 percent every five years.

VIII. Other Issues

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

A. Other Post-Employment Benefits

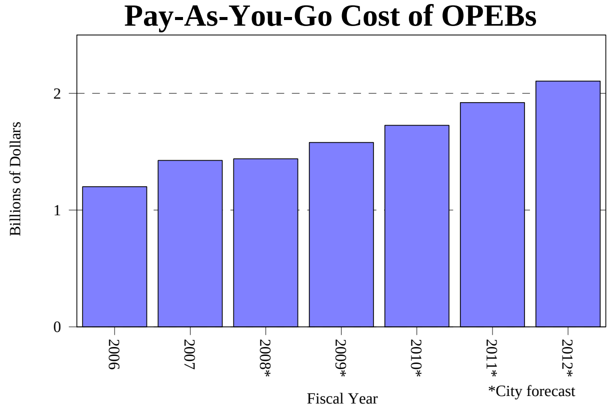
In June 2004, the Governmental Accounting Standards Board (GASB) issued Statement No. 45, which establishes standards for measuring and reporting the expense and related liabilities of other post-employment benefits (OPEBs) on an actuarial basis. Although GASB does not require entities to fund these 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—or an increase of $300 million.

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 future costs 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 (on a pay-as-you-go 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 34).

Figure 34

Pay-As-You-Go Cost of OPEBs



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

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. Drawing upon these resources, however, could be interpreted as a sign of serious fiscal stress.

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 35).[16] 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 those negotiated with other uniformed unions. The PERB award also raises the starting salaries for new recruits from $25,100 to $35,881. (Salaries have been an obstacle to meeting hiring targets.) The award reduces the number of annual leave days from 20 to 10 and includes other provisions, such as increased schedule flexibility, with a savings value of 2.81 percent. 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 35
Wage Increase Patterns
(Percent Change)

	Civilian	Uniform
2005	3.00	3.00
2006	3.15	3.15
2007	2.00	4.00
2008	4.00	4.00
2009	4.00	4.00
2010	4.00	4.00
2011	1.25	1.25
2012	1.25	1.25

Most of the unions that represent other uniformed employees 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 June Plan assumes that the terms of the PBA award will be extended to all uniformed employees.[17] As of July 21, 2008, four unions have already reached agreements, and several others have reopened negotiations.

The City's contract with District Council 37—the largest municipal union, which represents most civilian employees—expired on March 2, 2008.[18] The City expects a new agreement to follow the pattern set in the June Plan. The June 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 instead, the City would incur unplanned costs of $136 million in FY 2011 and $363 million in FY 2012.

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16 The City will 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.

17 The award and the extension of its economic terms to other uniformed employees will increase City costs by $520 million in FY 2008, including retroactive payments, and by about $280 million in ensuing years.

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

C. Governmental Accounting Standards Board Statement No. 49

The Governmental 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, it has 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. Financial Emergency Act

The Financial Emergency Act was scheduled to terminate on July 1, 2008, but was effectively extended until 2033 when the State assumed responsibility (in 2003) for the outstanding fiscal crisis debt of the Municipal Assistance Corporation. The Financial Control Board's authority to impose a control period did terminate on July 1, 2008. The City has proposed legislation that would restore that authority and grant the Financial Control Board the additional discretionary authority to waive new accounting regulations for budgeting purposes.

E. Litigation

The City and its contractors face more than 11,000 claims that allege injuries ensuing from rescue and cleanup work at the World Trade Center (WTC) site. The June Plan assumes that no liability will arise from these claims. In 2004, the WTC Captive Insurance Company was formed to cover such claims using $1 billion in federal aid—but the City cannot assure that the insurance will be sufficient to cover all the liability that could arise. To avoid litigation, the Mayor asked Congress to use the $1 billion allocated to the insurance company to reopen the federal September 11th Victim Compensation Fund, which Congress established in 2001 to provide financial relief to victims in exchange for agreeing not to sue.

In June 2008, the State Legislature expanded a presumptive accidental disability retirement benefit to cover first responders who participated in rescue and cleanup efforts, but who were not previously deemed eligible. (Workers must suffer from a WTC-related illness specified in the legislation, and must prove that they were exposed to WTC contaminants.) The actuary for the New York State and Local Employees' Retirement System estimated that this benefit would increase the City's costs by $3.2 million annually. The Governor has not yet signed the bill.

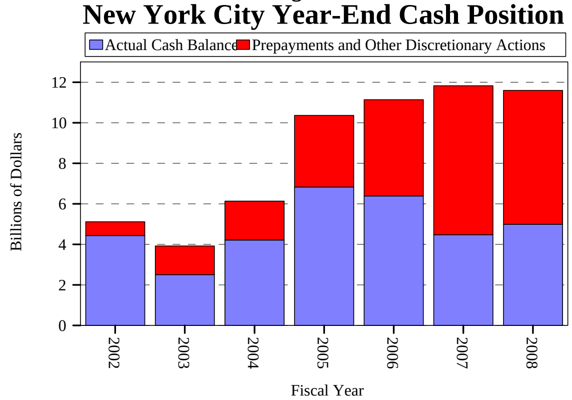
In March 2008, the U.S. Court of Appeals rejected the City's appeal to cap its liability from the Staten Island Ferry crash of October 15, 2003, because the City was found to be negligent in enforcing safety rules. The City has agreed to pay $37 million to settle 126 claims, out of a total of 191 claims filed.

As of June 30, 2008, 46 claims totaling $500 million have been filed against the City and other parties related to the March 15, 2008, construction crane collapse on East 51st Street in Manhattan. The City expects to receive more claims from a second crane collapse, which occurred on East 91st Street on May 30, 2008. The City expects its liability to be limited, but at this point the judicial process has just begun.

F. Cash Flow

Since FY 2003, the City's year-end cash balances have grown, reflecting the strength of the economy. The year-end cash balance effectively averaged $11.2 billion for fiscal years 2005 through 2008 when adjusted for surplus transfers and other discretionary actions (see Figure 36). As cash reserves have grown, the need for short-term financing has been reduced. The City met its cash needs during fiscal years 2005 through 2008 without such borrowings, and it does not plan to borrow in FY 2009.

Figure 36
New York City Year-End Cash Position



Note: Adjusted for surplus transfers and other discretionary actions.
Sources: NYC Comptroller's Office; NYC Office of Management and Budget; OSDC analysi

Appendix:

City-Funded Staffing Levels

Over the past three years, the City increased the size of its workforce by 11,523 employees, and added another 6,055 employees through May 2008. Most of the FY 2008 additions were concentrated in the Department of Education (5,251). The City had planned to hire another 1,401 employees (mostly in social services and in the uniformed agencies), but most of those positions remained unfilled at the end of the fiscal year because many agencies are currently below the levels planned for the end of June 2008.

The June Plan assumes that staffing will decline by a net of 932 employees between May 31, 2008, and June 30, 2009 (see Figure 37), based on the following actions.

- The Department of Education will reduce staffing by 1,272 employees (379 pedagogues and 893 nonpedagogues), reflecting the impact of budget cuts.
- The City University of New York will reduce staffing by 1,110 employees (825 pedagogues and 285 nonpedagogues).
- The Police Department will reduce staffing by 621 employees (277 police officers and 344 civilians). The police force is expected to total 35,284 officers at the end of FY 2009, which is 12.4 percent lower than the peak June 2000 level.
- The Fire Department will reduce the number of firefighters by 396 through attrition, and will add 134 civilians.
- The City's district attorneys and prosecutors will reduce staffing by 295 employees.
- The Department of Social Services will add 731 employees, but it has not met its hiring targets in recent years.
- The Department of Correction will add 491 officers and 104 civilians.

Figure 37
City-Funded Staffing Levels
(Full-Time and Full-Time-Equivalents)

Increase/(Decrease)

		Actual				Projected		May 2008 to June 2009
		FY 2005	FY 2006	FY 2007	May 2008	FY 2008	FY 2009	Change
Public Safety		**80,487**	**81,764**	**82,879**	**83,139**	**83,621**	**82,748**	**(391)**
Police Dept.	Uniformed	35,489	35,773	35,548	35,561	35,284	35,284	(277)
	Civilians	14,343	15,365	16,331	16,639	17,075	16,295	(344)
Fire Dept.	Uniformed	11,475	11,633	11,513	11,618	11,264	11,222	(396)
	Civilians	4,410	4,484	4,670	4,726	4,723	4,860	134
Correction	Uniformed	8,741	8,451	8,466	8,225	8,864	8,716	491
	Civilians	1,271	1,293	1,323	1,369	1,502	1,473	104
District Attys. & Prosecutors		3,342	3,428	3,544	3,583	3,288	3,288	(295)
Probation Department		948	850	1,019	947	955	946	(1)
Other		468	487	465	471	666	664	193
Health and Welfare		**24,016**	**24,307**	**24,718**	**25,077**	**26,407**	**26,163**	**1,086**
Social Services		11,103	10,982	11,003	10,444	11,323	11,175	731
Children's Services		6,052	6,319	6,605	7,103	7,275	6,995	(108)
Health and Mental Hygiene		4,358	4,516	4,797	5,268	5,408	5,359	91
Homeless Services		2,234	2,194	2,042	1,988	2,067	2,224	236
Other		269	296	271	274	334	410	136
Environment & Infrastructure		**18,736**	**19,051**	**19,759**	**18,766**	**19,487**	**19,021**	**255**
Sanitation	Uniformed	7,472	7,581	7,605	7,580	7,604	7,456	(124)
	Civilians	1,800	1,836	1,898	1,931	2,088	2,044	113
Dept. of Transportation		2,127	2,218	2,307	2,282	2,348	2,315	33
Parks & Recreation		6,906	6,968	7,489	6,520	6,981	6,740	220
Other		431	448	460	453	466	466	13
General Government		**8,388**	**8,556**	**8,824**	**8,947**	**9,404**	**9,139**	**192**
Finance		2,250	2,229	2,199	2,128	2,279	2,176	48
Law Department		1,359	1,352	1,370	1,319	1,320	1,314	(5)
Citywide Admin. Services		1,304	1,277	1,335	1,326	1,455	1,407	81
Taxi & Limo. Commission		436	445	422	420	467	462	42
Investigations		245	245	265	240	277	262	22
Board of Elections		378	421	415	541	384	377	(164)
Info. Technology & Telecomm.		785	866	978	1,058	1,138	1,122	64
Other		1,631	1,721	1,840	1,915	2,084	2,019	104
Housing		**1,600**	**1,744**	**1,873**	**1,899**	**2,142**	**2,138**	**239**
Buildings		979	1,093	1,181	1,205	1,359	1,375	170
Housing Preservation		621	651	692	694	783	763	69
Department of Education		**111,897**	**113,454**	**116,240**	**121,491**	**120,576**	**120,219**	**(1,272)**
Pedagogues		89,154	89,369	92,491	97,300	96,860	96,921	(379)
Non-Pedagogues		22,743	24,085	23,749	24,191	23,716	23,298	(893)
City University of New York		**6,575**	**6,436**	**6,600**	**7,656**	**6,614**	**6,546**	**(1,110)**
Pedagogues		4,115	4,052	4,154	4,965	4,155	4,140	(825)
Non-Pedagogues		2,460	2,384	2,446	2,691	2,459	2,406	(285)
Elected Officials		**2,410**	**2,441**	**2,513**	**2,486**	**2,611**	**2,555**	**69**
Total		**254,109**	**257,753**	**263,406**	**269,461**	**270,862**	**268,529**	**(932)**

Sources: NYC Office of Management and Budget; OSDC analysis