



Review of the Financial Plan of the City of New York

December 2008

Report 8-2009

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I. Executive Summary

The financial crisis gripping the nation is the most serious since the Great Depression, and this recession is shaping up to be the worst in the post–World War II era. Events are transforming the Wall Street industry, which accounts for up to 20 percent of State revenue and 12 percent of City tax revenue. By all accounts, New York State and New York City will experience large job losses as the financial services sector restructures and the broader economic slowdown takes hold. Tax collections are expected to fall sharply, and both the State and the City project large budget deficits.

The City’s November 2008 Financial Plan (the “November Plan”) assumes that tax collections will be lower than forecast just five months earlier, by about \$1.6 billion over the course of this year and next, and by about \$1.1 billion in each of fiscal years 2011 and 2012. Since June 2007, the City has lowered its tax forecasts for FY 2009 by \$1.3 billion and FY 2010 by \$3.7 billion.

The economic crisis is also taking a toll on the investments of the City’s pension systems. The systems are required by State law to assume an 8 percent annual return on investments, but last year the systems lost 5 percent. The November Plan assumes an 8 percent loss for FY 2009, but so far the pension systems have lost an estimated 20 percent (through November 30, 2008). Pension contributions, which averaged \$1.5 billion during most of the 1990s, are now projected to reach \$7.5 billion by 2012, reflecting shortfalls in investment earnings and benefit enhancements.

Lower revenues and higher pension contributions have reduced the surplus projected for FY 2009 from \$812 million to \$509 million, and have widened projected budget gaps by \$1.7 billion in FY 2010 and by about \$1.6 billion in each of fiscal years 2011 and 2012. In November 2008, the City faced budget gaps of \$5.6 billion in FY 2010 and about \$8.5 billion in each of fiscal years 2011 and 2012, before taking into account the gap-closing actions proposed by the Mayor.

Since November, the City has made progress in narrowing the projected gaps. The Mayor has begun to implement an aggressive agency program that is expected to generate \$1.5 billion over this year and next, and to reduce planned staffing levels by 4,500 employees by June 2010, including the first layoffs in six years.

In addition, the City Council approved the Mayor’s proposal to rescind, effective January 1, 2009, the 7 percent real property tax cut that was enacted at the beginning of FY 2008. Although the City Council rejected the Mayor’s suggestion to eliminate the \$400 real property tax rebate program for the current year, the rebate has been eliminated for future years. These actions will generate an estimated \$576 million in the current year and about \$1.5 billion annually thereafter.

The Mayor has also proposed using (beginning in FY 2010) \$1.1 billion, or nearly half, of the \$2.5 billion deposited in the Retiree Health Benefits Trust. The trust was established in FY 2006 to help pay down unfunded future liabilities associated with retirement benefits other than pensions, such as health insurance. The initiative was often cited as evidence of the City's efforts to use windfalls from the extraordinary activity on Wall Street and in real estate to improve the City's long-term fiscal outlook. The City also seeks union approval for \$200 million in annual savings (beginning in FY 2010) from restructuring the employee health insurance program.

The November Plan assumes all of the Mayor's proposals will be approved—yet still projects budget gaps of \$1.3 billion in FY 2010 and \$5 billion in each of fiscal years 2011 and 2012. To close these gaps, the Mayor has outlined several potential options, including additional cuts in agency spending and further tax increases.

The size of the budget gaps are likely to grow because the economic outlook has deteriorated since the City prepared the November Plan. The nation is now officially in a recession (since December 2007); consumer confidence is the lowest since 1982; Wall Street is on track to lose more than \$20 billion—twice last year's loss—and profitability is likely to return more slowly than anticipated by the City; and job losses in the City are likely to be greater. Our analysis suggests that tax collections could be lower by \$575 million in the current year and by up to \$950 million in FY 2012.

Moreover, the State is dealing with its own fiscal crisis. The Governor's proposed budget includes actions to close a \$15.4 billion budget gap for this year and next. Our initial assessment finds that, while the Governor's budget includes actions that would aid the City, the net impact would be a loss of almost \$1 billion in State assistance over the remainder of this year and next. The largest impact could come from reducing education aid for next year, and eliminating assistance to the City under the Aid and Incentives to Municipalities program.

The Mayor and the City Council have been proactive in dealing with the developing fiscal crisis, but the budget gaps have continued to grow because the economic outlook continues to worsen. In addition, the State budget could hinder the City's efforts to balance next year's budget. While the City has sufficient reserves to ensure the FY 2009 budget ends in balance, we project budget gaps of \$3.5 billion in FY 2010 and \$8 billion in FY 2011. On December 9, 2008, the Mayor asked its agencies to prepare \$1.4 billion in additional cost reduction actions given the deteriorating economic outlook and the likely impact of the State budget.

While the depth and the length of the recession still have not come into focus, the fiscal crisis now facing the City is shaping up to be the most serious since the 1970s. The federal government is fashioning a stimulus package that may include benefits for New York State and New York City, which could ease the impact of the crisis.

Figure 1
New York City Financial Plan
(in millions)

	FY 2009	FY 2010	FY 2011	FY 2012
REVENUES				
Taxes				
General Property Tax	\$ 13,781	\$ 14,735	\$ 15,673	\$ 16,419
Other Taxes	21,039	19,649	20,845	22,365
Discretionary Transfers	546	546	---	---
Tax Audit Revenue	680	589	589	589
Tax Increase Program	832	1,479	1,554	1,615
Subtotal Taxes	36,878	36,998	38,661	40,988
Miscellaneous Revenue	5,821	5,463	5,506	5,523
Unrestricted Intergovernmental Aid	340	340	340	340
Less: Intra-City Revenues	(1,607)	(1,447)	(1,446)	(1,446)
Disallowances against Categorical Grants	(15)	(15)	(15)	(15)
Subtotal: City Funds	\$ 41,417	\$ 41,339	\$ 43,046	\$ 45,390
Other Categorical Grants	1,075	1,019	1,020	1,023
Inter-Fund Revenues	464	425	420	420
<i>Total City, Capital IFA & Other Cat. Funds Revenues</i>	\$ 42,956	\$ 42,783	\$ 44,486	\$ 46,833
Federal Categorical Grants	5,816	5,299	5,280	5,290
State Categorical Grants	11,668	11,946	12,805	13,108
Total Revenues	\$ 60,440	\$ 60,028	\$ 62,571	\$ 65,231
EXPENDITURES				
Personal Service				
Salaries and Wages	\$ 21,912	\$ 22,725	\$ 24,163	\$ 24,458
Pensions	6,296	6,904	7,277	7,643
Fringe Benefits	6,726	6,877	7,158	7,493
Subtotal – Personal Service	\$ 34,934	\$ 36,506	\$ 38,598	\$ 39,594
Other Than Personal Service				
Medical Assistance	\$ 5,644	\$ 5,756	\$ 5,916	\$ 6,089
Public Assistance	1,191	1,172	1,172	1,172
All Other	18,685	17,936	18,591	19,094
Subtotal – Other Than Personal Service	\$ 25,520	\$ 24,864	\$ 25,679	\$ 26,355
General Obligation, Lease, and MAC Debt Service	3,569	2,049	4,817	5,349
FY 2008 Budget Stabilization & Discretionary Transfers ¹	(4,079)	---	---	---
FY 2009 Budget Stabilization & Discretionary Transfers ²	1,803	(1,257)	---	---
FY 2010 Budget Stabilization ³	---	350	(350)	---
General Reserve	300	300	300	300
Subtotal – Expenditures	\$ 62,047	\$ 62,812	\$ 69,044	\$ 71,598
Less: Intra-City Expenses	(1,607)	(1,447)	(1,446)	(1,446)
Total Expenditures	\$ 60,440	\$ 61,365	\$ 67,598	\$ 70,152
Gap Per November 2008 Plan	\$ ---	\$ (1,337)	\$ (5,027)	\$ (4,921)

Source: NYC Office of Management and Budget

¹ Fiscal Year 2008 Budget Stabilization and Discretionary Transfers total \$4.625 billion, including prepayments of subsidies of \$500 million, Retiree Health Benefits of \$460 million, lease debt service of \$46 million, Budget Stabilization of \$3.073 billion, and a TFA grant which increases FY 2009 revenues by \$546 million.

² Fiscal Year 2009 Budget Stabilization and Discretionary Transfers total \$1.803 billion, including Budget Stabilization of \$1.257 billion and a TFA grant which increases FY 2010 revenues by \$546 million.

³ Fiscal Year 2010 Budget Stabilization totals \$350 million.

Figure 2
OSDC Risk Assessment of the NYC Financial Plan

(in millions)

	<i>Better/(Worse)</i>			
	FY 2009	FY 2010	FY 2011	FY 2012
Surplus/(Gaps) as of November 2008 ⁴	\$ 1,803	\$ (2,790)	\$ (5,377)	\$ (4,921)
Actions Outside the Mayor's Direct Control:				
Rescind \$400 Real Property Tax Rebate	(256)	---	---	---
Restructure Employee Health Insurance	---	(200)	(200)	(200)
Subtotal	(256)	(200)	(200)	(200)
Estimation:				
Tax Revenues	(575)	(450)	(700)	(950)
Special Education Costs	(60)	(60)	(60)	(60)
Overtime	(50)	(50)	(50)	(50)
Agency Actions	(21)	(176)	(164)	(149)
GASB 49	---	---	(500)	(500)
Public Assistance Costs	---	(20)	(10)	---
Prior Years' Payables ⁵	300	---	---	---
Energy Costs	61	89	82	80
Subtotal	(345)	(667)	(1,402)	(1,629)
Potential Impact of the State Budget:				
Education Aid	---	(669)	(1,120)	(320)
Aid and Incentives to Municipalities Program	(328)	(328)	(328)	(328)
Revenue Enhancements	55	356	445	512
Other	(27)	(54)	(34)	(15)
Subtotal	(300)	(695)	(1,037)	(151)
OSDC Risk Assessment	(901)	(1,562)	(2,639)	(1,980)
Projected Surplus/(Gap) Per OSDC	902	(4,352)	(8,016)	(6,901)
Surplus Transfer	(902)	902	---	---
Remaining Gap to be Closed Per OSDC ⁶	\$ ---	\$ (3,450)	\$ (8,016)	\$ (6,901)
Additional Risks and Offsets				
Pension Contributions	---	---	(182)	(335)
Wage Increases at the Projected Inflation Rate	---	---	(60)	(363)

⁴ The November Plan shows budget gaps of \$1.337 billion in FY 2010 and \$5.027 billion in FY 2011. These estimates assume that FY 2009 will end with a surplus of \$1.803 billion, and that \$1.453 billion will be transferred to FY 2010 and \$350 million will be transferred to FY 2011. Figure 2 shows the projected gaps without the benefit of the expected surplus in FY 2009.

⁵ The City has realized an average of \$463 million in savings over the past three years from overestimating prior years' expenses.

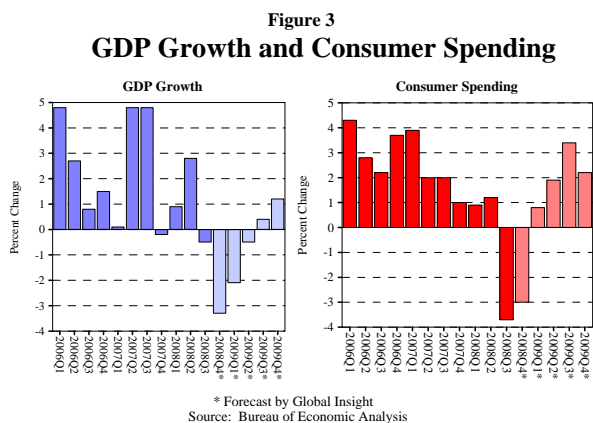
⁶ The November Plan includes an annual general reserve of \$300 million.

II. Economic Trends

The national, State, and local economies continue to be battered by the ongoing credit freeze and financial market meltdown. A series of bank failures, consolidations, and mass layoffs have crushed Wall Street and other financial industries. The damage from the financial crisis has spread to the rest of the economy as consumers and businesses have curtailed spending. Accordingly, the November Plan revises downward the City's economic and revenue forecasts as Wall Street losses mount and the City's once-resilient tourism and real estate markets begin to weaken.

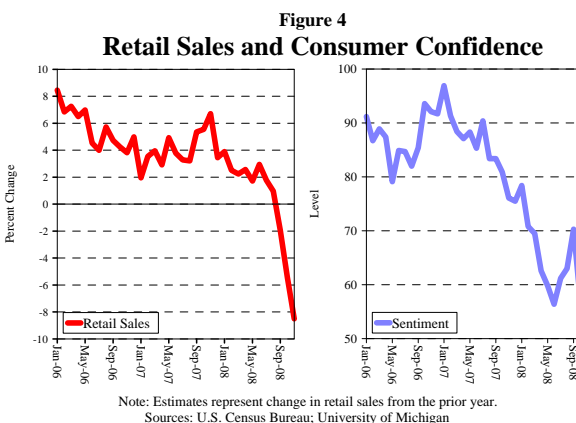
The economic outlook for the nation, State, and City has deteriorated further since the November Plan was prepared. The National Bureau of Economic Research—the group that determines when the nation enters a recession—recently reported that the United States entered into a recession in December 2007. Moreover, the economic forecasting firm Global Insight now expects that the recession will last through the second quarter of 2009, and perhaps continue to the end of 2009. If that occurs, it would be the longest recession experienced since World War II.

The national economy was beginning to slow even before the financial crisis peaked in September 2008. In the third quarter of 2008, Gross Domestic Product (GDP) declined at an annual rate of 0.5 percent, the second quarterly decline in a year (see Figure 3). Consumer spending, constrained by falling housing values, declining personal financial wealth, and job losses, fell precipitously by 3.7 percent—the largest decline since the second quarter of 1980.

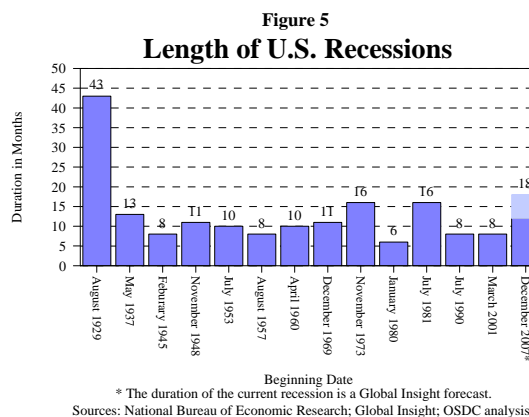


Businesses, facing weak consumption and tight credit, have cut back their investments and hiring, while the housing market continues its downward trend. The Institute for Supply Management's manufacturing index, a closely watched index of the nation's manufacturing activity, fell to a 26-year low in November, and has fallen every month for the past five months.

Consumption, which accounts for two thirds of GDP, is expected to further retrench, as retail sales and consumer confidence have plummeted sharply (see Figure 4). Retail sales declined by 3.2 percent in October 2008—the steepest monthly decline in over 21 years—and by another 2 percent in November. In November 2008, consumer confidence was at its lowest level since May 1980. The weakened dollar, which provided international trade gains, has strengthened as other developed nations have moved into economic recessions. Inflation, which peaked in the summer of 2008 and then dissipated quickly with tumbling energy prices, is no longer a significant concern.



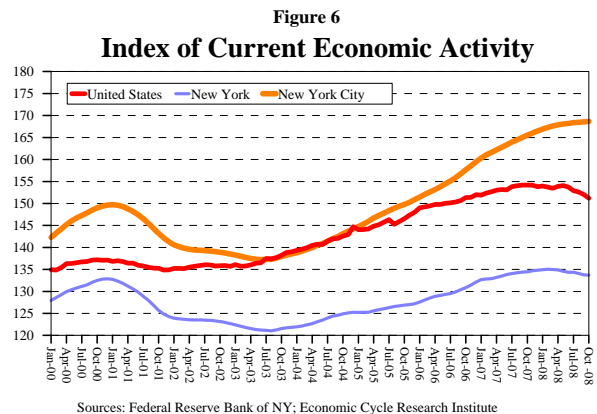
The City’s November Plan assumes that the national economy will experience a mild and brief recession, but others are anticipating a deeper and longer recession. The City expects GDP growth to slow to 0.7 percent in 2009 and then grow by almost 3 percent during the balance of the financial plan period. Global Insight expects the recession to continue until at least through the first half of 2009 and possibly to last until the end of 2009. The recession is already the longest recession in 25 years (see Figure 5). Global Insight predicts that the recovery will be anemic, and that GDP growth will not exceed 2 percent until the second quarter of 2010.



The November Plan assumes that the national unemployment rate will reach 6.2 percent in 2009 and then gradually fall to 5.2 percent by 2012. Yet the unemployment rate reached 6.7 percent in November 2008, and Global Insight expects the unemployment rate to peak at 8.7 percent during the first quarter of 2010 and to remain above 7.5 percent during calendar years 2011 and 2012.

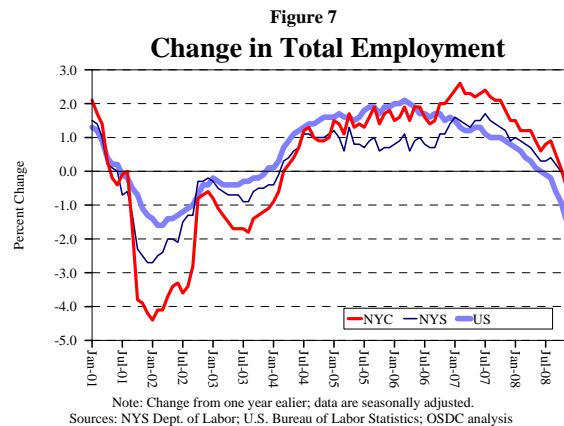
The economies of New York State and New York City have fared better than the nation to date. According to the Federal Reserve Bank of New York’s coincident index—which measures the current strength of the economy—the economic expansion peaked in the nation in September 2007, but continued to grow until May 2008 in New York State, and was still growing in New York City in October 2008, the most recent month for which data are available (see Figure 6).

While the recession has not hit the City as hard as it has hit the rest of the nation, the impact on the City is likely to worsen as the financial crisis works its way through the local economy. The November Plan assumes the Gross City Product will contract by 4.7 percent during 2009 and then grow by 2.0 percent in 2010. We believe these assumptions are overly optimistic given recent developments on Wall Street and current forecasts for the national economy.



Between December 2007 and November 2008, the nation lost 1.9 million jobs and the State lost 21,800 jobs. (In November, the nation lost 533,000 jobs, the largest one-month loss in 34 years.) In November, New York City lost 19,800 jobs, the largest one month job loss since October 2001. Job losses will continue to accelerate as the retrenchment on Wall Street and in other financial services companies ripple through the economy (see Figure 7).

Wall Street has undergone significant losses and changes as the financial crisis intensified during recent months.⁷ The industry was hit hard by the credit market freeze, mortgage securities write-offs, and the equity market plunge. This resulted in large numbers of layoffs, the collapse of Lehman Brothers, and the sales of Bear Stearns and Merrill Lynch. The remaining two prime investment banks, Goldman Sachs and Morgan Stanley, were forced to reorganize and have become commercial banks. These changes are transforming Wall Street from a highly leveraged investment banking business model to a better capitalized commercial banking model.



Despite unprecedented actions by the federal government to stabilize Wall Street and other financial markets, losses in the City's most important industry are expected to have a serious and lasting impact on the economy and tax revenues of the City and of the State. Last year, Wall Street accounted for 12 percent of City tax revenues, and

⁷ For more detailed discussion and analyses, see our report 7-2009, *The Securities Industry in New York City*, released in November 2008.

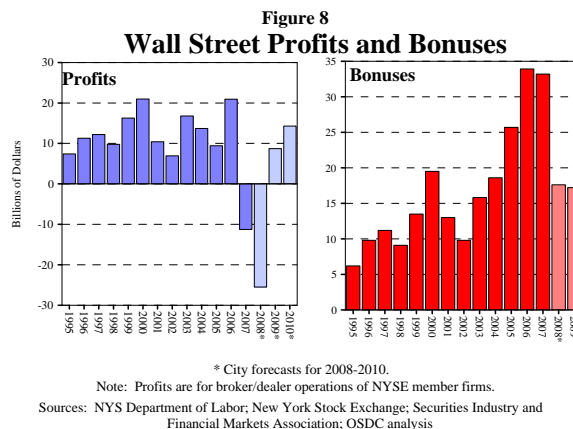
that contribution is expected to drop precipitously. Between fiscal years 2008 and 2010, we estimate that tax collections from Wall Street–related activities could decline by \$2 billion, or more than 40 percent.

Wall Street profitability continues to evaporate due to huge write-offs and a lack of liquidity in the credit markets. The City estimates that Wall Street and the City’s largest commercial banks suffered write-offs of \$307 billion during the first three quarters of 2008, after write-offs of \$142 billion in 2007. Although Wall Street profits were on track to set a new record during the first half of 2007, profitability collapsed during the second half of the year, and Wall Street lost a record \$11.3 billion in 2007.

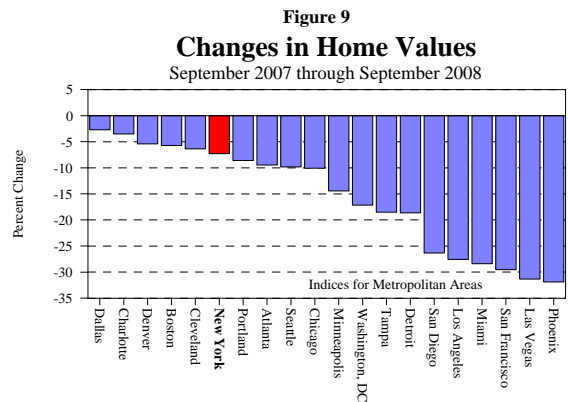
The November Plan assumes that Wall Street will lose \$25.5 billion during 2008 (see Figure 8). Wall Street, however, lost \$20.8 billion during just the first half of the year—and the third quarter included unprecedented developments. Thus, we believe Wall Street losses could exceed \$30 billion in 2008. The November Plan also assumes that profitability will return quickly and profits will total \$8.7 billion in 2009 and \$14.3 billion in 2010. We believe losses could be greater in 2008 and that it may take longer for profits to reach the levels anticipated in the November Plan.

The November Plan assumes that Wall Street bonuses will decline by 47 percent in 2008 to \$17.6 billion in 2008, and then decline by another 2 percent in 2009 (see Figure 8). Declines on Wall Street are expected to hold total City wage growth to only 0.3 percent in 2008, and to reduce wages by 8.0 percent in 2009—the sharpest decline since 1976.

The securities industry has lost 17,600 jobs since employment peaked in October 2007, but the impact has only begun to reach the broader job market in the City. As the impacts of the crisis and the deepening national recession grow, the November Plan expects the City to lose 147,000 private sector jobs, including 31,000 jobs in the securities industry. The Office of the State Comptroller recently released a report on the securities industry that estimates that job losses could total 175,000 over just the next two years, including 38,000 in the securities industry. Moreover, the report noted that job losses could be even greater if the recession is deeper or longer than expected. The City lost 241,400 jobs during the 2000-2003 recession, which lasted two and a half years.



The City's housing market has clearly weakened, although not as much as in other areas of the nation, especially in the West and the South. According to the S&P/Case-Shiller Home Price Index, home prices in the New York metropolitan area have fallen by 7.3 percent between September 2007 and September 2008, whereas the decline in a number of other metropolitan regions have exceeded 25 percent (see Figure 9).

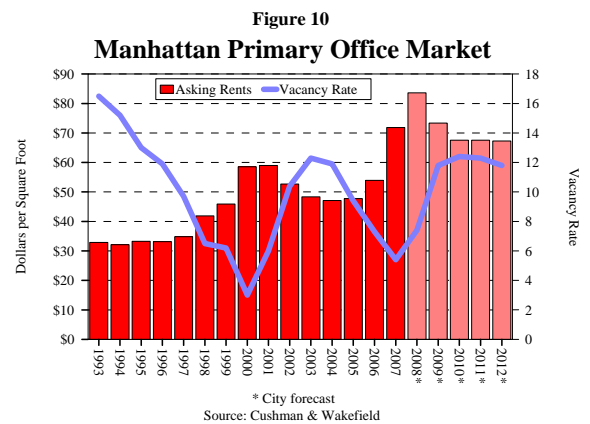


Nationally, home prices have fallen by an average of 18.5 percent during the same period—the largest decline in more than 20 years. Global Insight projects that the downward trend of home prices in the New York metropolitan area will continue into 2009 (by 5.8 percent) and then reverse, while the number of home sales will start to grow in 2009 (by 0.6 percent).

The construction and sales of condominiums and cooperative apartments in Manhattan have cooled. Prudential Douglas Elliman reported that in the third quarter of 2008 (compared to a year earlier), Manhattan sales of condos declined by 22.6 percent and sales of co-ops declined by 25.6 percent. The median sale prices rose, however, by 8.9 percent for condos and 2.9 percent for co-ops—though both were slower rates of growth than a year earlier. Corcoran reported similar results.

The commercial real estate market in New York City has softened since the financial crisis has intensified. Layoffs, mergers, consolidations, and bankruptcies in the financial industry have left rising vacancies and falling rents in the office market. As layoffs in the financial industry continue to spread to other industries, the demand for office space is expected to further ease.

The November Plan assumes that the average rent in the Manhattan primary office market will decline by 12.3 percent in 2009 and by 7.9 percent in 2010, after reaching a record high of \$83.60 per square feet in 2008 (see Figure 10). It also assumes that the vacancy rate will rise from 5.4 percent in 2007 to 12.4 percent in 2010. During the 2000-2003 recession, the average rent fell by 18 percent and the vacancy rate increased to 12.3 percent.



Tourism in New York City has also lost its momentum. After several years of record numbers of visitors (an estimated 46 million, who spent \$28 billion, in 2007), the number of visitors has begun to decline. According to data from the Port Authority of New York and New Jersey, the number of flight passengers traveling to the New York metropolitan area has declined by 1.3 percent in the first nine months of 2008, compared to one year earlier. The number of domestic passengers declined in almost every month in 2008, while growth in international passengers has slowed recently in response to the global recession and the strengthening U.S. dollar. Hotels in the City have reduced rates to attract visitors. After reaching an 86.5 percent occupancy rate with an average daily room rate of about \$300 in 2007, the hotel industry is expected to see a 9 percentage point decline in occupancy by 2009, according to PKF Hospitality Research.

The City's financial plan is based on conservative economic assumptions, but the economic news since the release of the November Plan suggests that the recession may be deeper and last longer than the City has projected. The November Plan assumes the recession will end during the first quarter of 2009, while Global Insight now believes the recession may last until the end of 2009. The national recessions in 1990 and 2001 had a much larger impact on New York City than on the rest of the nation. With the collapse of the financial industry greatly contributing to the current recession, the economic impact may again be greater in New York City than in the rest of the nation.

To date, the attempts by the Federal Reserve, the U.S. Treasury, and the central banks around the world have failed to restore liquidity to the credit markets. The Federal Reserve and the U.S. Treasury announced on November 25 a program to pump an additional \$800 billion into the struggling U.S. economy. This program would buy back from the market \$600 billion of mortgage-backed securities issued by Fannie Mae and Freddie Mac, and \$200 billion of asset-backed consumer loans. This effort comes on top of the \$700 billion Troubled Asset Relief Program that was initiated in September 2008. On December 12, 2008, the Federal Reserve lowered interest rates to a historic low—a range of between zero and one quarter percent—and indicated it would expand its efforts to support lending in the economy by buying additional amounts of mortgage-backed securities as well as business and consumer debt. President-elect Obama, working with Congress, is developing a large stimulus package expected to total between \$500 billion and \$700 billion. It is too early to determine whether these efforts will mitigate the course of the recession.

III. Fiscal Year 2009

The City continues to revise downward its tax revenue forecasts for fiscal years 2009 through 2012 in response to a succession of unprecedented events stemming from the global financial crisis and the continuing deterioration of the national economic outlook. Events are transforming the Wall Street industry, which accounts for 12 percent of City tax revenue.

The November Plan assumes that tax collections will be lower than forecast in June 2008 by about \$1.6 billion over this year and next, and by about \$1.1 billion in each of fiscal years 2011 and 2012 (see Figure 11). (Since June 2007, the City has reduced its tax outlook for FY 2009 by \$1.3 billion.) The current economic outlook calls for greater job losses, lower profitability, and further weakness in the real estate industry.

The November Plan reduced the City's forecast for business and personal income taxes by \$399 million in FY 2009 and by about twice that amount in subsequent years. The forecast for collections from real estate transaction taxes has been reduced by \$109 million in FY 2009, by \$219 million in FY 2010, and by slightly lower amounts in subsequent years. While sales tax collections this year remain strong and may even exceed expectations, collections are expected to be lower by an average of \$136 million annually in fiscal years 2010 through 2012 as a result of consumer retrenchment and reductions in tourism.

The economic crisis is also taking a toll on the investments of the City's pension systems. The systems are required by State law to assume an 8 percent annual return on investments, but last year the systems lost 5 percent. The November Plan assumes an 8 percent loss for all of FY 2009, but so far the pension systems have lost an estimated 20 percent (through November 30, 2008). Pension contributions, which averaged \$1.5 billion during most of the 1990s, are now projected to reach \$7.5 billion by 2012, reflecting shortfalls in investment earnings and benefit enhancements.

These revisions reduced the projected surplus for FY 2009 from \$812 million to \$509 million, and widened the projected budget gaps by \$1.4 billion in FY 2010 and about \$1.6 billion in each of fiscal years 2011 and 2012. The City faced baseline budget gaps of \$6 billion for FY 2010 and more than \$8 billion for each of fiscal years 2011 and 2012 before taking into account several actions proposed by the Mayor to narrow the projected gaps.

Figure 11
Financial Plan Reconciliation
June 2008 Plan vs. November 2008 Plan
(in millions)

	<i>Better/(Worse)</i>			
	FY 2009	FY 2010	FY 2011	FY 2012
Surplus/(Gap) per June 2008 Plan ⁸	\$ 812	\$ (4,229)	\$ (7,006)	\$ (6,667)
Revenues				
Real Estate Transaction Tax	(109)	(219)	(167)	(153)
Personal Income Tax	(165)	(363)	(293)	(256)
Business Taxes	(234)	(470)	(523)	(403)
Sales Tax	83	(183)	(74)	(152)
All Other Taxes	<u>40</u>	<u>(37)</u>	<u>(48)</u>	<u>(61)</u>
Subtotal	(385)	(1,272)	(1,105)	(1,025)
Tax Audits	100	---	---	---
Non-Tax Revenues	<u>(1)</u>	<u>(46)</u>	<u>(35)</u>	<u>(17)</u>
Total	(286)	(1,318)	(1,140)	(1,042)
Expenditures				
Reserve for Pension Fund Investment Losses	---	(82)	(395)	(672)
All Other	<u>(17)</u>	<u>(4)</u>	<u>(17)</u>	<u>(18)</u>
Total	(17)	(86)	(412)	(690)
Net Change During FY 2009	(303)	(1,404)	(1,552)	(1,732)
Baseline Surplus/(Gap) as of November 2008	\$ 509	\$ (5,633)	\$ (8,558)	\$ (8,399)

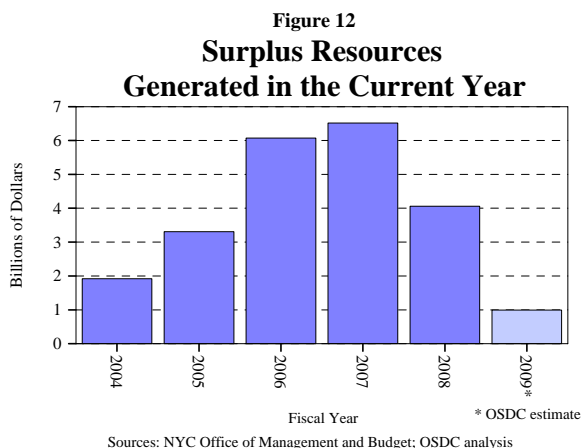
Note: Totals may not add due to rounding.

Sources: NYC Office of Management and Budget; OSDC analysis

⁸ These estimates exclude the impact of the Mayor's proposals to increase real property taxes, which require City Council approval, and savings from restructuring the municipal health insurance program, which requires the approval of the municipal unions.

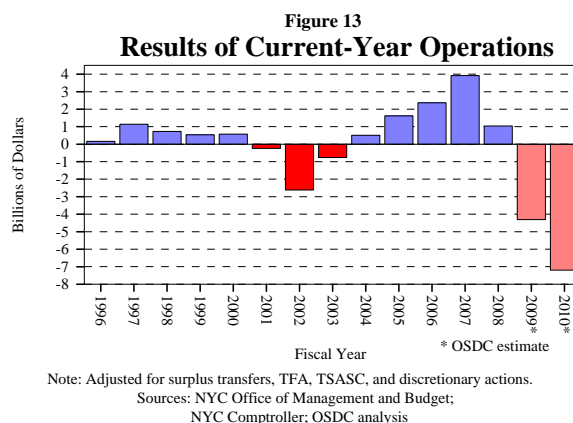
IV. Current-Year Operating Results

In recent years, surging Wall Street profits and rising real estate values and transactions, combined with conservative revenue forecasts, resulted in large amounts of unanticipated resources during the fiscal year. As shown in Figure 12, these resources peaked at \$6.5 billion in FY 2007 and are expected to decline sharply in FY 2009 to just under \$1 billion, reflecting the rapid deterioration in the local economy. The City will transfer these surplus resources, together with resources generated in prior years, to narrow future budget gaps.



This 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 13, the size of the current-year surplus has grown each year since the end of the last recession, and peaked in FY 2007 at \$3.9 billion. The current-year surplus declined sharply in FY 2008 because spending increased rapidly, despite the beginning of the economic slowdown. Spending is projected to exceed current-year resources by \$4.3 billion in FY 2009, and the FY 2009 budget will be balanced using surplus resources accumulated in prior years. The City is on track for a \$7.2 billion current-year deficit in FY 2010, reflecting steeply declining revenues and rapidly rising expenses.



V. Potential Impact of the State Budget

Given the seriousness of the State’s financial situation, the Governor released his executive budget on December 16, 2008—one month earlier than required by law. The Governor projects a budget gap of \$1.7 billion for the remainder of this fiscal year, which ends on March 31, 2009, and gaps of \$13.7 billion for State fiscal year (SFY) 2009-2010, \$17.1 billion for SFY 2010-2011, and \$18.6 billion for SFY 2011-2012. The Governor has proposed actions that would help close the budget gaps, including some that would adversely affect the City’s four-year financial plan.

Our initial assessment indicates that, in the aggregate, the Governor’s proposals would reduce State assistance to the City by a net of \$300 million in FY 2009 and by almost \$700 million next year. As shown in Figure 14, most of the adverse impact would come from reducing education aid by \$669 million, compared with the amount anticipated in the City’s November Plan. In addition, the Governor has proposed eliminating assistance to the City under the Aid and Incentives to Municipalities program, which would take effect this year. The Governor has also proposed initiatives that would mitigate the impact on the City’s budget. These include actions that would broaden taxes, raise fines and fees, and provide mandate relief, including a less costly pension program for new employees. Although the Governor’s proposals are likely to evolve during discussions with the State Legislature, the enacted State budget is likely to have a significant adverse impact on the City.

Figure 14
Potential Impact of the Governor’s Proposed Budget
On New York City’s Financial Plan

(in millions)

	FY 2009	FY 2010	FY 2011	FY 2012
School Aid	\$ - - -	\$ (669)	\$ (1,120)	\$ (320)
Aid and Incentives to Municipalities	(328)	(328)	(328)	(328)
Social Services	(18)	(67)	(83)	(100)
Revenue Enhancements	55	356	445	512
Other	<u>(9)</u>	<u>13</u>	<u>49</u>	<u>85</u>
Total ^{9,10}	\$ (300)	\$ (695)	\$ (1,037)	\$ (151)

Source: NYS Division of the Budget; NYC Office of Management and Budget; OSDC analysis

⁹ These estimates do not reflect the Governor’s proposal to allow the Battery Park City Authority to securitize a revenue stream currently dedicated to affordable housing. This would raise an estimated \$540 million, which would be split evenly between the State and the City. The proposal requires the approval of the Mayor and the City Comptroller.

¹⁰ The City continues to benefit from actions taken by the State in past years that capped the growth in the local share of Medicaid costs at 3 percent and assumed the local cost of the Family Health Plus program. Together, these actions generate an estimated \$500 million in recurring savings for New York City.

The major initiatives proposed by the Governor include the following.

State Education Aid: Reduce education aid by \$598 million for FY 2010 and by \$1 billion for FY 2011, compared with the amounts anticipated in the City's November Plan. Despite the cutbacks, the Governor remains committed to increasing education aid to New York City as per the resolution of the Campaign for Fiscal Equity lawsuit, but it would now take longer to reach that goal given current economic conditions. Whether the State Legislature will restore the proposed cuts, and whether the City will pass along the cuts to the Department of Education or mitigate the impact, remains to be seen. The Governor also would reduce the State's share of the cost of preschool education programs (\$71 million).

Aid and Incentives to Municipalities (AIM) Program: Eliminate assistance to New York City under the AIM program. The November Plan anticipates \$328 million annually.

Social Services: Increase the local share of administering social services programs (\$40 million); raise the public assistance grant by 10 percent annually over a three-year period beginning in January 2010 (\$40 million by FY 2012); and eliminate certain optional child welfare services (\$12 million).

Revenue Enhancements: Broaden the sales tax to cover cable television, entertainment, and transportation, and place limits on exemptions for capital improvements (\$202 million). The Governor also proposed expanding the red light camera program (\$100 million); reducing itemized deductions for high-income earners (\$40 million); and increasing local fees for birth and death certificates, and marriage licenses (\$9 million). Although the State intends to eliminate the sales tax exemption on clothing and footwear that cost less than \$110 per item, the exemption would remain in effect in New York City.

Mandate Relief: Create a new pension plan for future State and local civilian employees that would require employees to contribute 3 percent of their wages as long as they are employed, compared with the current ten-year limit for Tiers III and IV; increase the minimum retirement age from 55 to 62; and increase the amount of time needed to vest from 5 years to 10 years. In addition, at the request of the Mayor, the Governor has proposed a new plan for uniformed employees that would raise the retirement age to 50 with 25 years of service; base benefits on the average salary of the final three years of service; and require higher employee contributions than currently mandated. These proposals would save an estimated \$27 million in FY 2010, and the amount of the savings would increase rapidly in future years.

The Governor also proposes lifting the borrowing cap on the Transitional Finance Authority (TFA), which would permit the City to realize savings from diversifying its financing vehicles (\$5 million); granting the City greater flexibility in the issuance of bond anticipation notes (\$10 million); and raising the Wicks Law threshold from \$3 million to \$10 million, which would generate substantial savings to the capital program.

City-Related Entities: Raise tuition for the City University of New York by \$300 per semester and reduce State operating aid to community colleges. The Governor also has proposed actions that would reduce Medicaid reimbursements to the Health and Hospitals Corporation (HHC) by about \$130 million annually; HHC has sufficient resources in the short term to offset the impact.

VI. Program to Eliminate the Gap

The November Plan anticipates a surplus of \$509 million in FY 2009, but baseline budget gaps of \$5.6 billion in FY 2010, \$8.6 billion in FY 2011, and \$8.4 billion in FY 2012. To narrow the projected gaps, the Mayor has proposed actions that would increase the size of the FY 2009 surplus—which would then be transferred to future years—and that would have recurring benefits. The Mayor’s actions, outlined below, include reducing costs, increasing taxes, and drawing down reserves. If fully implemented, the projected budget gaps would be reduced to \$1.3 billion in FY 2010 and to about \$5 billion in each of fiscal years 2011 and 2012 (see Figure 15).

On December 9, 2008, the City’s budget director asked the agencies to identify additional cost reduction actions due to the deterioration in the economy that had occurred since the November Plan was prepared as well as the potential impact of the State budget. The actions would be expected to generate recurring resources of \$1.4 billion beginning in FY 2010, with the largest cuts in the Department of Education (\$527 million) and the Police Department (\$286 million). The budget director also asked the agencies to identify the potential impacts on services and to prioritize their proposals in order of preferred implementation.

Figure 15
Mayor’s Proposed Gap-Closing Program
(in millions)

	FY 2009	FY 2010	FY 2011	FY 2012
Baseline Surplus/(Gap) as of November 2008	\$ 509	\$ (5,633)	\$ (8,558)	\$ (8,399)
Increase Real Property Taxes by 7 Percent	576	1,223	1,298	1,359
Agency Actions	462	1,083	1,032	991
Eliminate \$400 Property Tax Rebate	256	256	256	256
Restructure Employee Health Insurance	- - -	200	200	200
Draw Down Retiree Health Benefits Trust	- - -	82	395	672
Subtotal	1,294	2,844	3,181	3,478
Surplus Transfer	(1,803)	1,453	350	- - -
Remaining Gap Per November Plan	\$ - - -	\$ (1,337)	\$ (5,027)	\$ (4,921)

Note: Totals may not add due to rounding.

Sources: NYC Office of Management and Budget; OSD analysis

Real Property Taxes: The City Council recently approved the Mayor’s proposal to rescind, effective January 1, 2009, the 7 percent real property tax cut that was enacted at the beginning of FY 2008. This action will generate \$576 million in FY 2009 and about \$1.3 billion annually thereafter. While the City Council rejected the Mayor’s suggestion to eliminate a \$400 property tax rebate for the current year, raising the tax rate eliminates the rebate for future years, which will raise an additional \$256 million annually beginning in FY 2010.

Agency Actions: The Mayor has proposed agency actions that would generate \$462 million in the current year and about \$1 billion annually thereafter (see Appendix A for additional details). More than three quarters of the resources would come from reducing planned spending, as well as reducing the size of the municipal workforce in FY 2010 by more than 3,000 employees, including the first layoffs in six years. (The Department of Education and the Police Department account for more than half of the anticipated resources.)

Our review has identified several agency actions that require outside approvals or may not succeed for other reasons. In total, these actions have a value of \$21 million in FY 2009 and more than \$150 million annually thereafter (see Appendix A). Some require State approval, such as charging consumers a \$0.06 fee for the use of plastic bags and doubling the tax rate on fire insurance premiums.

Restructure Municipal Employee Health Insurance Costs: In May 2008, the City proposed that the municipal unions agree to changes in the health insurance programs for active and retired City workers, to save the City \$200 million annually beginning in FY 2010. The City, however, has not reported any progress toward achieving the savings target, although in the past the City and the unions have agreed to draw down resources from the Health Stabilization Account, which currently has a balance in excess of \$600 million.

Draw Down From Retiree Health Benefits Trust: In fiscal years 2006 and 2007, the City deposited \$2.5 billion (from a surplus generated by extraordinary activity on Wall Street and in real estate) into a Retiree Health Benefits Trust (RHBT) to pay down unfunded future liabilities arising from retirement benefits other than pensions, such as health insurance. The State Comptroller praised the City for setting aside these resources. The Mayor now proposes to use more than \$1.1 billion, or nearly half, of the resources in the RHBT over a three-year period to offset an increase in future pension contributions arising from poor pension fund investment performance in fiscal years 2008 and 2009. Using the resources in the RHBT to help balance the operating budget would represent a significant setback in the City's efforts to fund health insurance costs for retirees, and would shift the burden to future taxpayers.

In addition, a number of questions remain regarding the Mayor's proposal. He has not indicated whether he intends to use the RHBT to offset higher pension costs in FY 2013 resulting from the investment shortfalls experienced in FY 2008 and anticipated in FY 2009 (estimated at nearly \$1.1 billion) or if investment losses in FY 2009 are even greater than currently anticipated. Nor has the Mayor indicated whether funding to the RHBT should be restored if investment earnings exceed expectations in future years. The Mayor's proposal would be considered by the City Council as part of the budget adoption process.

VII. Revenue and Expenditure Trends

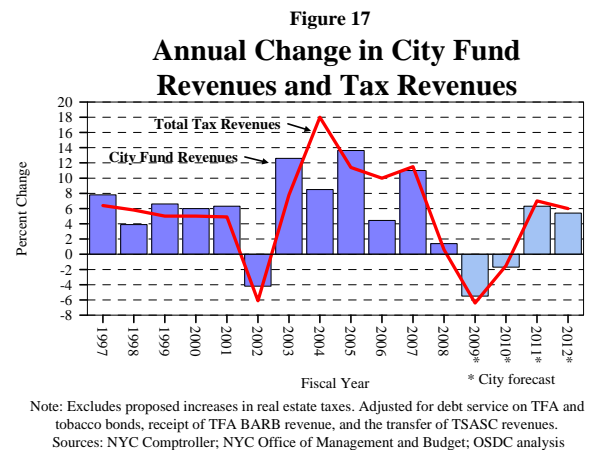
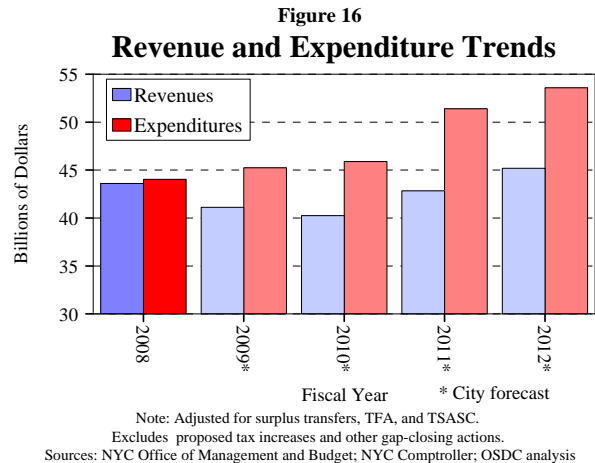
The November Plan assumes that City fund revenues will decline in FY 2009 (as the economic recession takes its toll on collections); stagnate in FY 2010; and resume growth in FY 2011. During the same period, spending is projected to continue to grow steadily (see Figure 16). Overall, City fund revenues are projected to grow at an average annual rate of 0.9 percent during fiscal years 2009 through 2012, while spending is expected to grow at an average annual rate of 5.0 percent. As a result, the City projects large baseline budget gaps.

A. Revenue Trends

Since the City adopted its budget nearly six months ago, economic conditions have deteriorated and the impact of the credit crisis on Wall Street has become more severe. In response, the City reduced its forecast for tax revenues by nearly \$400 million in FY 2009 and by more than \$1 billion annually thereafter.

City fund revenues (excluding proposed tax increases) are now forecast to decline by 5.5 percent in FY 2009 and 1.7 percent in FY 2010, before growth resumes in FY 2011 (see Figure 17). Our analysis, based on more recent economic forecasts, indicates that revenue losses are likely to be even greater. Even if all of the Mayor's tax proposals are approved, revenues are likely to decline by 3.6 percent in FY 2009 and by a slight amount in FY 2010.

The November Plan assumes that nonproperty tax collections will decline by 12.5 percent in FY 2009 (\$3.2 billion) due to large losses at Wall Street firms—as well as fewer real estate transactions and lower employment, wages, bonuses, and capital gains realizations. As job losses mount, nonproperty tax collections are expected to decline by another 6.6 percent (\$1.5 billion) in FY 2010. The November Plan assumes that property tax collections



(excluding the impact of the proposed tax program) will continue to grow—by 5.5 percent (\$719 million) in FY 2009 and by 6.9 percent (\$954 million) in FY 2010—because of provisions in State law that phase in prior increases in the value of real property (see Figure 18).

During fiscal years 2011 and 2012, the November Plan assumes that the economy will bounce back strongly and that nonproperty tax collections will increase at an average annual rate of more than 7 percent. The November Plan also assumes that real property tax collections will grow at an average annual rate of 5.6 percent.

Figure 18
City Fund Revenues
(in millions)

	FY 2008	FY 2009	Annual Growth	FY 2010	FY 2011	FY 2012	Average Three-Year Growth Rate
Taxes							
Property Tax	\$ 13,062	\$ 13,781	5.5%	\$ 14,735	\$ 15,673	\$ 16,419	6.0%
Personal Income Tax	8,748	7,411	-15.3%	6,671	7,414	7,968	2.4%
Sales Tax	4,868	4,749	-2.4%	4,485	4,765	5,012	1.8%
Business Taxes	5,413	4,704	-13.1%	4,440	4,805	5,341	4.3%
Real Estate Transaction Taxes	2,545	1,825	-28.3%	1,664	1,693	1,815	-0.2%
Other Taxes	3,113	3,120	0.2%	3,152	3,282	3,387	2.8%
Audits	1,016	677	-33.4%	579	579	579	-5.1%
Subtotal	38,765	36,267	-6.4%	35,726	38,211	40,521	3.8%
Miscellaneous Revenues	4,719	4,522	-4.2%	4,212	4,302	4,341	-1.4%
Unrestricted Intergovernmental Aid	242	340	40.5%	340	340	340	0.0%
Grant Disallowances	(114)	(15)	-86.8%	(15)	(15)	(15)	0.0%
Total	\$ 43,611	\$ 41,114	-5.7%	\$ 40,263	\$ 42,838	\$ 45,187	3.2%
Real Property Tax Increases	---	832	NA	1,479	1,554	1,615	24.7%
Revenue Gap-Closing Program	---	80	NA	216	185	165	27.3%
Total Incl. Tax and Gap-Closing	\$ 43,611	\$ 42,026	-3.6%	\$ 41,957	\$ 44,577	\$ 46,967	3.8%

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 and the receipt of TFA BARB revenues. Totals may not add due to rounding.

Sources: NYC Office of Management and Budget; OSDC analysis

Since the release of the November Plan, a continued stream of poor economic reports has been issued, the financial markets have remained volatile, and new economic forecasts are indicating a longer and deeper recession than was expected even a month ago. While New York City has been slower to show the effects of the recession, the impact here could be as great, or even greater, than in the nation overall, given the City's dependence on Wall Street. Historically, economic recoveries have usually taken longer to take hold in New York City than in the nation as a whole.

The November Plan assumes that Wall Street will lose \$25 billion in 2008—twice last year's record loss—and that the industry will earn profits of \$8.7 billion in 2009 and \$14.3 billion in 2010. Our own analysis of conditions on Wall Street suggests that

losses could be even greater in 2008 and that it may take longer for profitability to reach the levels anticipated in the November Plan. The securities industry lost more than \$20 billion during the first half of 2008, and a series of unprecedented developments took place during the third quarter. We also believe job losses on Wall Street—and in the rest of the City’s economy—are likely to be greater than assumed in the November Plan. As a result, our analysis indicates that tax revenue collections could be lower by \$575 million in FY 2009, \$450 million in FY 2010, \$700 million in FY 2011, and \$950 million in FY 2012 based on the latest Global Insight economic forecasts and greater weakness in the real estate market.

1. Business Taxes

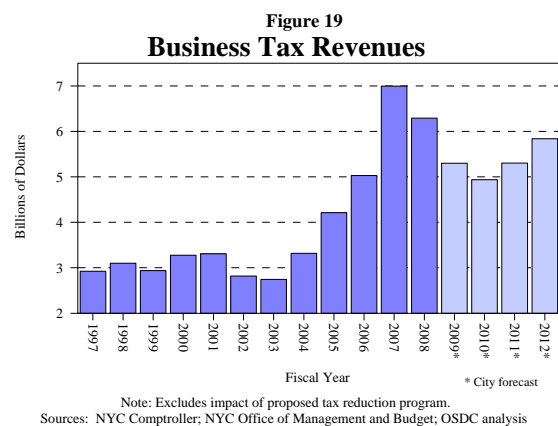
Revenues from business taxes have been severely affected by the credit crisis and the economic downturn (see Figure 19). Excluding audit collections, revenues fell by 10 percent (\$600 million) in FY 2008, and the City expects additional declines of 13.1 percent (\$707 million) in FY 2009 and 5.6 percent (\$264 million) in FY 2010.

The decline reflects falling profits both on Wall Street—where record losses have been posted throughout 2008—and in the rest of the economy. Our analysis indicates that collections could be even lower than the City forecasts, by \$600 million over fiscal years 2009 and 2010.

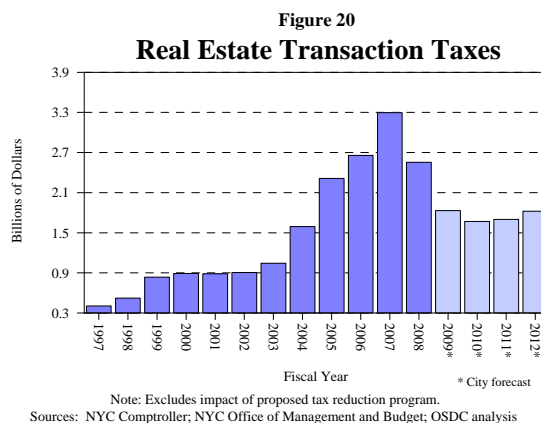
Collections have also been reduced by higher refund payments, with businesses opting for repayment of excess taxes as opposed to carrying forward the credit to reduce future tax liabilities. Cash refund payments for the first ten months of calendar year 2008 have increased nearly 142 percent, to more than \$810 million. The City has raised its forecast of refund payments in each of fiscal years 2009 and 2010. The November Plan expects collections to increase briskly during fiscal years 2011 and 2012 (averaging almost 10 percent annually) based on the assumption that the economy will bounce back strongly beginning in FY 2011.

2. Real Estate Transaction Taxes

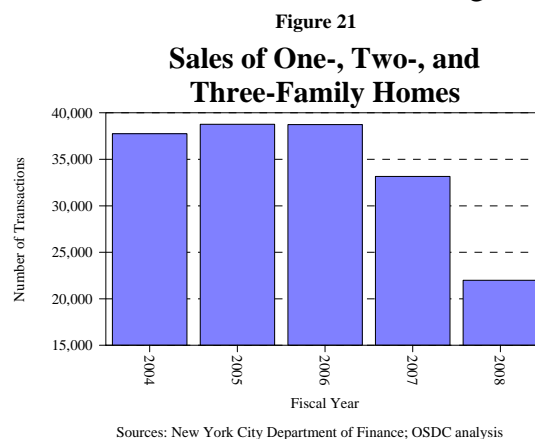
The performance of the City’s real estate transaction taxes—the mortgage recording and real property transfer taxes—parallel developments in the real estate and credit markets. With property values rising steeply along with demand, revenues from these two taxes increased from \$890 million in FY 2000 to more than \$3.2 billion in FY 2007—an average annual growth rate of 20.6 percent. In FY 2008, however, collections suffered as the weakness in the real estate markets began to affect New



York City. Revenues declined by nearly one quarter to \$2.5 billion as the number of large commercial transactions fell sharply and residential sales outside Manhattan softened. The revenue decline is expected to continue through FY 2010, dropping to just under \$1.7 billion—about half of the FY 2007 level. Even though the November Plan assumes growth will resume beginning in FY 2011, revenues are expected to reach only \$1.8 billion in FY 2012 (see Figure 20). Our analysis suggests the City’s estimates for real estate transaction tax collections are reasonable.



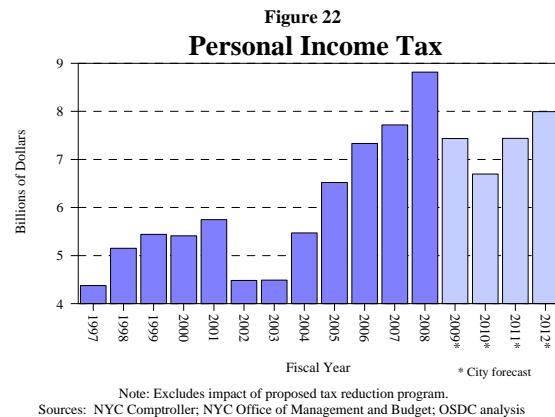
The decline in collections from real estate transaction taxes is more closely related to slumping demand and tighter credit than to declining property values. Data from Case-Shiller on housing trends show that homes in the metropolitan New York City area have held their value better than in many metropolitan areas across the country. Similarly, sales data from the City’s Department of Finance show that average home sales prices have declined only moderately over the past year. However, sales data also show that the number of transactions involving one-, two-, and three-family homes declined by 43.3 percent between fiscal years 2005 and 2008 (see Figure 21).



The sale prices for some other types of properties have been stronger. In particular, demand for cooperative apartments and condominiums in Manhattan remained strong through the first half of calendar year 2008. Sales for Manhattan offices, however, declined sharply during this period. During the third quarter of 2008, the value of sales fell across all commercial and residential categories in the City, with preliminary data showing a 39.1 percent reduction in sale values during this period compared to the same period in 2007. While government efforts to deal with the credit crisis have begun to reduce residential mortgage rates, the crisis has raised credit standards. Both residential and commercial mortgage financing remain difficult to obtain, which will depress transaction activity into FY 2010.

3. Personal Income Tax

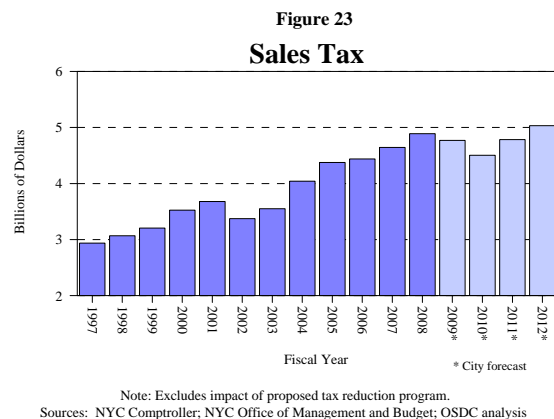
Unlike the business and real estate transaction taxes, where collections began to decline last year, the personal income tax is only just beginning to show weakness. Even as the financial crisis was coming into focus, personal income collections grew by 13.8 percent to \$8.7 billion in FY 2008, supported by rising employment, wages, capital gains realizations, and near-record bonuses on Wall Street. As the financial crisis worsened and the national slowdown deepened into a recession, the City began lowering its forecast of personal income tax revenues. The November Plan assumes that personal income tax collections will decline by 15.3 percent to \$7.4 billion in FY 2009—\$1.3 billion less than last year—and collections will decline by another 10 percent in FY 2010, or \$740 million (see Figure 22). The November Plan assumes that the economy will bounce back strongly and that personal income tax collections will increase at an average annual rate of 9.3 percent in fiscal years 2011 and 2012.



We believe that the continued deterioration in the national economy and the likelihood of higher local job losses (we forecast losses of 175,000 private sector jobs compared to the City’s forecast of 147,000 jobs) will lead to lower personal income tax collections—\$250 million less in FY 2009, and as much as \$450 million less by FY 2012. In addition, there could be an even further falloff in tax collections if this recession ultimately proves to be the worst in the post–World War II era, as some forecasters are projecting. Such a severe downturn could result in significantly higher local job losses—and therefore lower personal income tax collections—than are currently forecast by the City.

4. Sales Tax

The November Plan assumes that sales tax collections will decline by 2.4 percent in FY 2009 to \$4.7 billion—the first decline since FY 2002 (see Figure 23). Throughout FY 2008 and into the early part of FY 2009, collections have remained strong, helped by continued strength in the City’s tourism industry. The impact of the financial

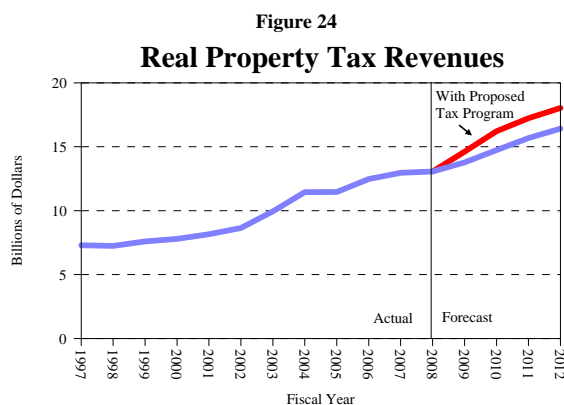


crisis, global recession, and the recent rise in the value of the dollar is expected to reduce the number of visitors to New York City next year. National data also indicate that consumers are hoarding cash (instigated by falling home values, tighter credit conditions, job losses, and economic insecurity). As a result, the November Plan expects sales tax collections to decline by another 5.6 percent in FY 2010. The November Plan expects sales tax growth to resume in FY 2011, with gains of 6.2 percent in FY 2011 and 5.2 percent in FY 2012. While revenue could be higher by \$75 million in FY 2009 based on the strength of current sales tax collections, we believe revenues could be lower by \$125 million in FY 2011 and by \$75 million in FY 2012 based upon recent economic forecasts.

5. Real Property Tax

The real property tax is the only major tax that the November Plan assumes will increase each year during the financial plan period, growing by nearly \$3.4 billion between fiscal years 2008 and 2012. Revenues will increase by another \$1.5 billion now that the City Council approved the Mayor's proposal to rescind, effective January 1, 2009, the 7 percent real property tax cut enacted for FY 2008, which will also eliminate the \$400 home owner rebate beginning in FY 2010 (see Figure 24).

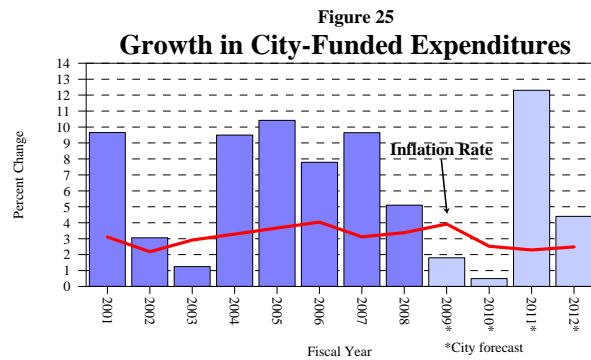
Property tax collections are driven by the tax rate and by changes in assessed values. Assessed values reflect changes in market values as modified by restrictions stipulated in State law. Although the growth in market values has been slowing, State law is still phasing in increases from the past five years, when values grew by more than 10 percent annually. Our analysis indicates that property tax collections could be lower by \$125 million in FY 2010, \$225 million in FY 2011, and \$425 million in FY 2012 as a result of weaker growth. If market values decline, however, as they did in the early 1990s, the revenue shortfall could be substantially higher.



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

B. Expenditure Trends

City-funded expenditures grew at average annual rates of nearly 10 percent during fiscal years 2004 and 2005, and 8.6 percent during fiscal years 2006 and 2007 (see Figure 25).¹¹ 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 (\$1 billion in FY 2006 and \$1.5 billion in FY 2007), and retired nearly \$1.3 billion in outstanding debt in FY 2007 that was due in fiscal years 2009 and 2010. Excluding these discretionary actions, spending would have grown more slowly (by 2.5 percent in FY 2006 and by 7.4 percent in FY 2007).



Note: Estimates reflect the benefit of the proposed gap-closing program.
Sources: NYC Comptroller; NYC Office of Management and Budget; OSDC analysis

In FY 2008, expenditures increased by 5.1 percent, including amounts set aside by the City to pre-fund \$2 billion of FY 2010 debt service. In fiscal years 2009 and 2010, spending is projected to grow more slowly than the projected local inflation rate, but the low growth rate reflects the benefit of discretionary actions in prior years, agency gap-closing actions, and planned staff reductions (see Appendix B).¹² During fiscal years 2011 and 2012, City-funded spending is projected to grow at an average annual rate of 8.1 percent.

Nondiscretionary spending (i.e., debt service, pension contributions, Medicaid, 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 54.3 percent of City fund revenues by FY 2012, up from 32.7 percent in FY 2000.

¹¹ Adjusted for surplus transfers and for debt service on bonds issued by the Transitional Finance Authority, which are backed by the personal income tax and building aid revenue, and by TSASC.

¹² In the aggregate, the agency gap-closing program approved by the City Council last year and the agency program proposed by the Mayor in November 2008 would reduce planned spending by \$1.6 billion in FY 2009, \$2.2 billion in FY 2010, \$2 billion in FY 2011, and \$1.9 billion in FY 2012.

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

Figure 26
Estimated City-Funded Expenditures
(Adjusted for Surplus Transfers, TFA PIT, TFA BARBs, and TSASC)
 (in millions)

	FY 2008	FY 2009	Annual Growth	FY 2010	FY 2011	FY 2012	Average Three-Year Growth Rate
Salaries and Wages	\$11,210	\$12,609	12.5%	\$13,535	\$14,277	\$14,326	4.3%
Debt Service	6,739	4,325	-35.8%	2,757	5,879	6,459	14.3%
Medicaid	5,304	5,492	3.5%	5,643	5,803	5,977	2.9%
Pension Contributions	5,574	6,127	9.9%	6,727	7,107	7,482	6.9%
Health Insurance	2,888	3,253	12.6%	3,600	4,072	4,622	12.4%
Other Fringe Benefits	2,560	2,574	0.6%	2,701	2,825	2,886	3.9%
Judgments and Claims	664	658	-1.0%	708	765	826	7.9%
Public Assistance	446	441	-1.1%	433	433	433	-0.6%
General Reserve	---	300	NA	300	300	300	0.0%
Energy	797	929	16.6%	1,002	1,010	1,010	2.8%
Other	7,865	8,532	8.5%	8,489	8,924	9,265	2.8%
Total	44,048	45,240	2.7%	45,896	51,395	53,585	5.8%
Health Insurance Restructuring	---	---	NA	(200)	(200)	(200)	NA
Retiree Health Benefits Trust Offset	---	---	NA	(82)	(395)	(672)	NA
Agency Gap-Closing Program	---	(381)	NA	(867)	(847)	(825)	NA
Total Including Gap-Closing	\$44,048	\$44,859	1.8%	\$44,747	\$49,953	\$51,888	5.0%

Note: Totals may not add due to rounding.

Sources: NYC Office of Management and Budget; OSDC analysis

1. Salaries and Wages

Salaries and wages costs, including overtime, are projected to grow from \$10.8 billion in FY 2007 to \$14.3 billion in FY 2012, an increase of \$3.5 billion, or 32.5 percent. The growth reflects the cost of actual and anticipated labor agreements (see Figure 27); and the May 2008 arbitration award for the Patrolmen's Benevolent Association (PBA), which has been extended to all other uniformed employees.

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 PBA. The award called for retroactive wage increases of 4.5 percent in 2005 and 5 percent in 2006. Most unions representing other uniformed employees received wage increases of 3 percent and 3.15 percent during the 2005-2006 round of collective bargaining. The unions also negotiated side letter agreements, however,

Figure 27		
Wage Increase Patterns		
(Percent Change)		
	Civilian	Uniformed
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

which permit them to reopen negotiations with the City if another uniformed union receives wage increases that are higher than the pattern. In May 2008, the City's financial plan assumed that the terms of the PBA award would be extended to all uniformed employees.¹³

In July 2008, the Sergeants Benevolent Association (SBA) reached a six-year settlement with the City. The first two years of the contract follow the wage pattern set by the PBA award (wage increases of 4.5 percent in 2005 and 5 percent in 2006), and the next two years follow the pattern set by the agreement with the Uniformed Firefighters Association (wage increases of 4 percent in 2007 and 4 percent in 2008). The last two years of the contract set the pattern for uniformed unions in the 2009-2010 bargaining round, granting annual wage increases of 4 percent, and a 1.59 percent increase in additional compensation funds. Since the SBA agreement was reached, other uniformed employee unions have negotiated similar agreements following the same wage pattern. The PBA approved a four-year deal, ending July 2010, with compounded annual wage increases of 4 percent. Other unions with similar agreements include the Correction Officers' Benevolent Association, the Detectives' Endowment Association, and the Uniformed Firefighters Association.

In early October 2008, members of Teamsters Local 237 were the first to ratify a new labor contract for non-uniformed employees for the 2009-2010 collective bargaining round. The agreement follows the pattern anticipated by the City. Since then, the United Probation Officers Association, the Communications Workers of America, and District Council 37 (which alone represents more than 100,000 City employees) have reached tentative collective bargaining agreements for the 2009-2010 round.

The November Plan also assumes that wages will increase by 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 additional costs of \$60 million in FY 2011 and \$363 million in FY 2012.

2. Overtime

Between fiscal years 2003 and 2008, overtime for both uniformed and civilian employees has grown from \$839 million to over \$1 billion. During these years, most of the growth was concentrated in the Police, Fire, Transportation, and Environmental Preservation departments. The November Plan assumes that overtime will decline by \$206 million in FY 2009, and then remain at about \$830 million in subsequent years. Our analysis indicates that overtime could be higher by an average of \$200 million during the financial plan period. Most of the cost, however, will be covered by capital funds and federal and State grants, leaving a City-funded risk of \$50 million annually.

¹³ The award and the extension of its economic terms to other uniformed employees increased costs by \$520 million in FY 2008, including retroactive payments, and by about \$280 million annually thereafter.

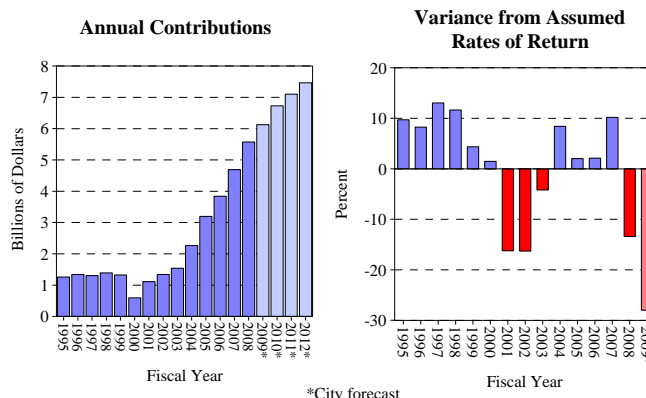
3. Pension Contributions

In recent years, City contributions to the five actuarial pension systems have grown rapidly (see Figure 28), reflecting the impact of poor investment performance, benefit enhancements, labor settlements, and the creation of a \$200 million annual reserve beginning in FY 2010 to fund the recommendations of a City Charter–mandated biennial audit. Annual pension contributions have grown from about \$1.5 billion in the late 1990s to \$6.1 billion in FY 2009, and are projected to reach \$7.5 billion by FY 2012.

Current State law requires the actuarial pension systems to assume an 8 percent annual rate of return on investments. As shown in Figure 28, the pension systems earned significantly more than the assumed rates of return that was in effect during the second half of the 1990s, but investment returns fell far short of expectations during fiscal years 2001 through 2003 as the recession took hold. Investment returns exceeded the actuarial rate of return during fiscal years 2004 through 2007 with strong growth in the equity and real estate markets, but the pension funds lost 5 percent during FY 2008—a shortfall of 13 percentage points from the expected rate of return.

Since the beginning of the current fiscal year, the equity and real estate markets have declined sharply. As a result, the November Plan assumes that the pension funds will lose 8 percent on their investments.¹⁴ Our analysis indicates that pension fund investments have lost 20 percent through November 30, 2008. If this trend continues through the end of the fiscal year, future City contributions to the pension funds could increase by \$182 million in FY 2011 and by \$335 million in FY 2012.

Figure 28

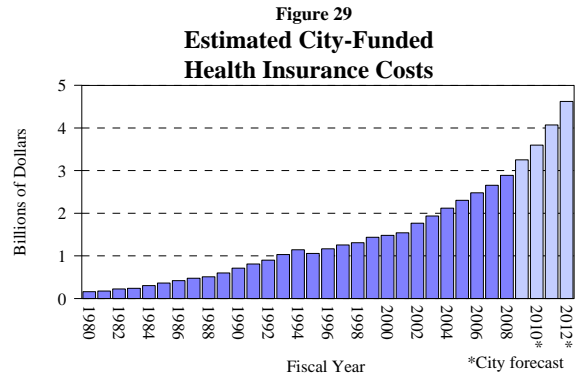


*City forecast
Sources: NYC Comptroller; Office of Management and Budget; OSDC analysis

¹⁴ The November Plan assumes that the City Council will agree to draw down nearly half of the resources in the Retiree Health Benefits Trust (\$82 million in FY 2010, \$395 million in FY 2011, and \$672 million in FY 2012) to fund higher pension contributions that would arise from an 8 percent loss in FY 2009 and to help fund the higher contributions that arose from a 5 percent loss in FY 2008.

4. Health Insurance

Health insurance costs for active municipal employees and retirees are projected to grow from \$3.3 billion in FY 2009 to \$4.6 billion in FY 2012—an increase of 39 percent (see Figure 29).¹⁵ The November Plan assumes that health insurance premiums will increase by 9.4 percent in FY 2009 (based on the rate increase enacted by the Health Insurance Plan of Greater New York, or HIP), and 8 percent annually in subsequent years.



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

The cost of municipal health insurance could be affected by the outcome of the State’s review of a proposed conversion of the not-for-profit health insurers HIP and Group Health Incorporated (GHI) to a for-profit entity. Together, these insurers cover 93 percent of the municipal workforce.

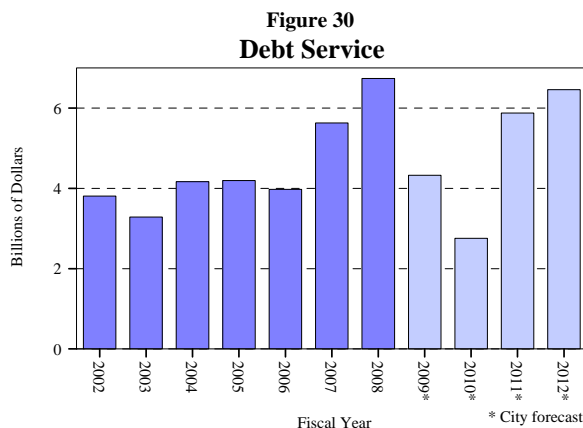
The Mayor opposes the conversion on the premise that a for-profit entity would drive up the cost of health insurance premiums and lower the quality and extent of coverage for municipal employees. Previously, the Mayor has stated that the City should receive some of the proceeds from any conversion.

The conversion requires the approval of the Superintendent of the New York State Insurance Department, who is still reviewing comments from stakeholders. The State’s financial plan assumes a conversion would generate \$1.2 billion for the State over a four-year period, which is half the amount anticipated before the economic slowdown.

¹⁵ These estimates exclude savings anticipated from the Mayor’s proposal to restructure the municipal health insurance program, which is expected to generate savings of \$200 million beginning in FY 2010. In addition, the estimates have been adjusted to exclude a drawdown from the Retiree Health Benefits Trust to help fund the cost of health insurance for retirees during fiscal years 2010, 2011, and 2012.

5. Debt Service

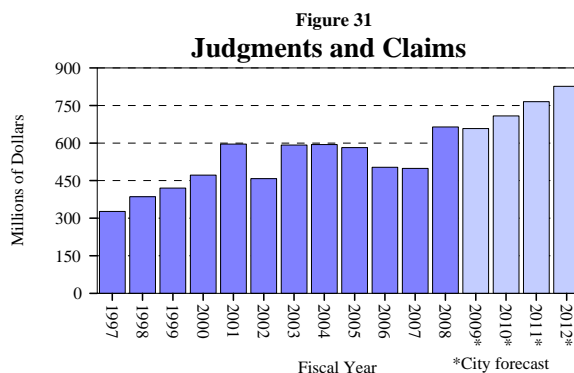
Debt service in fiscal years 2009 and 2010 has been reduced primarily through the use (in FY 2007) of nearly \$1.3 billion in resources to pay down debt, and the use (in FY 2008) of nearly \$2 billion in surplus resources to pre-fund FY 2010 debt service (see Figure 30).¹⁶ In addition, interest earnings on the unused bond proceeds from the Hudson Yards Infrastructure Corporation are sufficient to pay the FY 2009 interest costs of \$85 million and reduce FY 2010 costs by \$11 million. The Mayor has scaled back the City’s capital program by 20 percent starting in FY 2009, but debt service costs are still projected to increase from \$4.3 billion in FY 2009 to \$6.5 billion by FY 2012.¹⁷ The debt service burden (i.e., debt service as a percent of City fund revenues) will rise from 10.5 percent in FY 2009 to 14.2 percent in FY 2012.



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

6. Judgments and Claims

Judgments and claims costs are projected to increase from about \$500 million during each of fiscal years 2006 and 2007 to \$826 million by FY 2012 (see Figure 31). The growth is attributed to an increase in the average cost and number of settlements, including those that cost more than \$1 million. Expenditures for FY 2009 include a \$31 million settlement (in September 2008) to four plaintiffs in the Staten Island Ferry crash of October 15, 2003.



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

¹⁶ Debt service has been adjusted for surplus transfers.

¹⁷ We estimate that the Mayor’s proposed 20 percent reduction will save \$259 million during the financial plan period and \$440 million annually beginning in FY 2020.

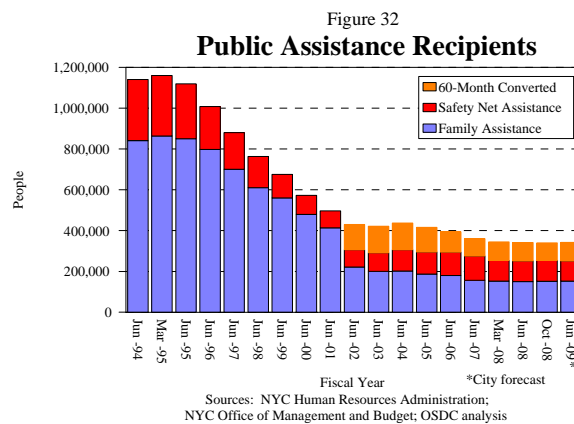
7. Medicaid

City-funded Medicaid expenditures are projected to total \$5.5 billion in FY 2009, and then to grow at an average annual rate of 2.9 percent to reach \$6 billion by FY 2012. This growth rate is low because in January 2006 the State capped the annual growth in the local share of Medicaid at 3 percent. In contrast, the State's share of the Medicaid program is projected to increase by 31 percent over the next three years, reflecting the rising cost of health care, higher enrollment, and increased utilization.

8. Public Assistance

The public assistance caseload continues to decline, though at a much slower rate than in years past (see Figure 32). In October 2008, 339,936 people received public assistance in New York City—5,607 more than in the prior month, but still a 71 percent decline from the peak in March 1995. The November Plan forecasts that the caseload will remain close to its current level and that costs will average \$435 million annually through FY 2012.

The recession of the early 2000s added nearly 16,000 people to the City's public assistance caseload, following nine consecutive years of caseload decline. Our analysis indicates that the caseload could rise above the level projected in the November Plan by about 15,000 people by the end of FY 2010—which could increase the City's costs by \$20 million in FY 2010 and \$10 million in FY 2011.



9. Energy Costs

Rising costs for natural gas and oil pushed City-funded energy expenditures from \$487 million in FY 2004 to \$797 million in FY 2008. Energy costs are projected to increase by \$132 million during FY 2009 and to reach \$1 billion by FY 2010, reflecting higher energy costs and the closing of the Poletti power plant in Queens.

The November Plan assumes that oil will average \$101 per barrel during the financial plan period, but fuel prices have fallen precipitously in recent months. Oil has remained below \$50 per barrel recently, down from the peak price of \$147 per barrel on July 11, 2008. If oil were to average \$75 per barrel during the financial plan period, energy costs could be lower by \$61 million in FY 2009, \$89 million in FY 2010, \$82 million in FY 2011, and by \$80 million in FY 2012. These savings could be offset if the Public Service Commission approves Con Edison's request for a rate increase to cover the higher cost of electrical transmission.

VIII. 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. Metropolitan Transportation Authority

In July 2008, the Metropolitan Transportation Authority (MTA) projected budget gaps of \$1.1 billion in 2009, \$1.9 billion in 2010, and more than \$2 billion in each of calendar years 2011 and 2012. In September, the State Comptroller issued a comprehensive review of the MTA's finances that concluded that the MTA had presented reasonable estimates of its projected budget gaps in July, but that the gaps had widened because the State had subsequently lowered its estimates of dedicated transit taxes due to the weakening economy. The report also found that the MTA's gap-closing program, which counted on \$3 billion in additional intergovernmental aid, was too risky because it relied so heavily on outside assistance at a time when the State and the City are facing their own fiscal crises.

The report also cautioned that recent Wall Street developments had increased the potential for future revenue shortfalls and job losses that could ripple through the regional economy, resulting in lost ridership. Given these developments, the report recommended that the MTA increase the size of its general reserve, which stands at only \$75 million for 2009.

In November, the MTA released a revised four-year financial plan, which showed that the projected budget gaps had grown by about \$300 million in 2009, \$500 million in 2010, and about \$600 million annually thereafter, largely because the State has lowered its forecast of dedicated transit taxes and because real estate transaction tax collections have weakened more than expected due to the economic slowdown and difficulties in obtaining financing. The budget gaps now total \$1.4 billion in 2009, \$2.4 billion in 2010, \$2.6 billion in 2011, and \$3 billion in 2012.

The MTA's November Plan relies far less on intergovernmental aid than its July Plan did. Instead, the MTA has proposed a mid-year fare and toll hike that would raise revenues by 23 percent, compared with 8 percent in the July Plan, and deep cuts to customer services. The MTA would raise fares and tolls in January 2011 to raise revenues by another 5 percent. Even with two fare increases and substantial cuts in services, the November Plan forecasts remaining gaps of \$266 million in 2010, \$454 million in 2011, and \$608 million in 2012.

Besides large operating budget gaps, the MTA's capital program has a large funding gap. In February 2008, during the debate over congestion pricing, the MTA proposed a \$32 billion capital program for the 2008-2013 period to continue restoring the

transit system to a state of good repair; complete existing expansion projects, such as East Side Access and the first phase of the Second Avenue Subway; and to begin new expansion initiatives. The proposed program, however, had a funding gap of \$13.8 billion. While proceeds from congestion pricing would have reduced the gap to \$9.3 billion—still too large for the MTA to finance on its own—the program did not progress after congestion pricing failed to win approval. The next five-year capital plan, to be released in January 2009, could have a funding gap of up to \$15 billion.

The Governor 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's report, which was issued on December 4, 2008, makes a number of recommendations. The Governor and the Mayor have expressed their support for the recommendations, but the proposals require the approval of the State Legislature and perhaps the City Council.

The commission recommends imposing a payroll tax on employers within the 12-county MTA region. This initiative would raise an estimated \$1.5 billion per year and would cost employers an average of \$330 per \$100,000 of payroll. The resources would be used in the first year to “support the operating needs of the Authority and its funding partners.”¹⁸ The commission recommends that the MTA use these resources to reduce the proposed fare and toll increase from 23 percent to 8 percent, and to rescind the cuts in services supplied to the public. In the second year, the resources would be transferred to a new MTA subsidiary (the MTA Capital Finance Authority) and the proceeds would be dedicated to funding capital improvements.

The commission also recommends imposing tolls on the bridges over the East River and Harlem River. This initiative would raise an estimated \$1 billion each year, but only \$600 million would be used to improve mass transit, such as expanding bus service. The balance would be used to maintain the bridges and to fund the costs of installing an electronic toll system. A number of issues still need to be resolved, including ownership of the bridges.

B. Department of Education

The November Plan allocates \$21 billion to the Department of Education (DOE) for use in FY 2009, including \$3.4 billion for pensions and debt service. Of this amount, the City is contributing \$10.5 billion, or 50 percent; the State's contribution totals \$8.7 billion, or 41.4 percent; and the federal government will contribute \$1.8 billion, or 8.4 percent. The remainder comes from fees, grants, settlements, and restricted

¹⁸ The commission's report does not indicate whether any of these resources would supplant State or City subsidies.

sources. Between fiscal years 2003 and 2008, City funding for education increased at an annual rate of 9.9 percent; State funding increased by 7.2 percent annually.

The allocation to the DOE in FY 2009 is \$860 million more than last year. City funding will increase by \$547 million, or 5.5 percent, while the State contribution will increase by \$403 million, or 4.9 percent, partly offset by a reduction in federal aid. Although the November Plan assumes large increases in State education aid, these increases may not materialize in the amounts anticipated given the impact of the economic slowdown on the State's finances. The Governor's executive budget, for example, would reduce education aid to New York City. While the State Legislature may restore some of the proposed cut, the amount of education aid in the enacted State budget will still likely be less than assumed in the November Plan, which could require the City to increase its funding or to cut services.

The City has already cut back on planned increases in education aid to its public schools. The June Plan incorporated a \$303 million reduction in funding for FY 2009 and an average of \$247 million in subsequent years. The November Plan calls for further reductions in planned funding for education: \$181 million in FY 2009 and \$385 million in subsequent years. The Chancellor has instructed the schools to minimize the impact on educational programs and to concentrate on reducing material and supplies, extracurricular programs, school-based contractual services, and professional development programs. Other cuts include reducing maintenance and repair work.

In addition, the City may have to increase funding or the DOE may have to reallocate resources to fund unplanned costs associated with special education students who are placed in private schools. The DOE spent \$89 million on these services in FY 2008, but the November Plan allocates only \$35 million for this purpose in FY 2009 and in subsequent years. Given current spending trends, these costs are likely to exceed planned levels by at least \$60 million annually beginning in the current fiscal year.

The legislation that granted the Mayor greater control over the DOE will terminate on June 30, 2009, unless it is reauthorized by the State Legislature. 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 has resulted in an increase in no-bid contracts.

C. New York City Housing Authority

The New York City Housing Authority (NYCHA) has experienced growing fiscal stress as expenses have outpaced recurring revenues. Even though NYCHA's budget situation has been evident for years, NYCHA's actions have not brought spending in line with recurring resources. As a result, NYCHA has diverted more than

\$400 million in capital funds since 2002 to cover operating expenses. With less than one month remaining in its fiscal year, NYCHA projects an operating budget gap of \$170 million for 2008, which it intends to close by drawing upon capital funds and other unspecified resources.

NYCHA projects a budget gap of \$150 million in 2009 and similar amounts in subsequent years. As discussed below, NYCHA has identified a number of actions that could help balance the 2009 budget.

- Reserve 8,400 apartments for prospective tenants with Section 8 vouchers, which is expected to bring in \$17 million in 2009 and \$75 million annually by 2011 by permitting NYCHA to raise rents on these units.
- Obtain federal approval to raise rents on higher-income tenants, which could raise \$50 million to \$60 million by 2012. NYCHA raised rents between 15 percent and 30 percent in 2006.
- Close 18 community centers, in addition to 15 that were recently closed, and eliminate 200 positions (mostly in social services), for annual savings of \$50 million. NYCHA expects City social services agencies to provide some of these services.

D. Health and Hospitals Corporation

The Health and Hospitals Corporation (HHC) ended FY 2008 with a cash balance of \$880 million, reflecting past efforts to obtain supplemental federal Medicaid payments, but the HHC could deplete its cash reserves during FY 2011. The Governor's executive budget includes actions that would reduce Medicaid reimbursements to the HHC by about \$130 million annually. Although the HHC has sufficient cash resources to offset the impact in the near term, these actions would exacerbate the structural imbalance between recurring revenues and expenditures.

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 extension of the No. 7 subway line 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 and so far in FY 2009, payments from the City have not been needed because enough revenue has been generated—from the 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—to fully fund interest payments on the HYIC bonds. Revenues are currently sufficient enough that the City expects its interest liability to be reduced to \$74 million from \$85 million in FY 2010, but the November Plan assumes that the City will fund the full interest cost in subsequent years.

On May 22, 2008, the Metropolitan Transportation Authority (MTA), the Long Island Rail Road, and a joint development venture of Related Companies and Goldman Sachs Group signed an agreement that called for a contract to be signed by November 3, 2008, regarding development over the eastern and western rail yards located at the southern end of the Hudson Yards Special District. The parties have agreed to extend the deadline for finalizing the agreement covering the eastern and western rail yard by 90 days (until January 31, 2009), as the MTA has been unable to complete the required documentation. Final agreement on the western rail yard will not be reached until the City's land use review process is completed.

The 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. Currently, no agreement exists regarding whether the MTA, the HYIC, or the City would fund any cost overruns on the extension if they were to occur.

F. Lower Manhattan Redevelopment

On October 2, 2008, the Port Authority of New York and New Jersey released a major reassessment of rebuilding at the World Trade Center (WTC). As expected, the reassessment extends completion deadlines and raises project cost estimates, noting that previous deadlines and budgets were established before the complex construction reality was fully known and the degree of project interdependence was understood. In addition, commodity and construction prices have continued to climb.

The reassessment provides updates on the status of major development projects under the Port Authority's direction, as discussed below.

- The Freedom Tower (One World Trade Center), originally scheduled for completion in 2008, is now scheduled for completion in 2013, and the cost has risen from \$2.9 billion as of June 2008 to \$3.1 billion.

- The WTC Transportation Hub is now scheduled for completion between 2013 and 2014, at least four years later than originally planned, and the cost estimate has risen from \$2.2 billion a year ago to \$3.2 billion. To reduce construction risk and prevent costs from rising even further, the building design was simplified by, among other things, substituting a fixed roof for a retractable roof.
- A construction solution was devised to allow completion of the Memorial Plaza by September 11, 2011, something that was not expected in the initial assessment. Also, the Museum will not be completed until 2013—two years later than was anticipated earlier this year.
- JPMorgan Chase is scheduled to build Tower 5 on the site of the former Deutsche Bank building, but the current fiscal crisis could affect those plans.¹⁹ Construction was scheduled to begin once the former Deutsche Bank building has been deconstructed, which is expected by mid-2009 rather than this year.
- Planning of the Vehicle Security Center (VSC), set to be completed in 2012, can move forward because the Port Authority resolved several issues that were blocking progress on the project. The Port Authority settled a seven-year-old land claim with the St. Nicholas Greek Orthodox Church; concluded a security agreement with the City; and gained control over the VSC's design and construction. The construction of the VSC still depends on the timely demolition of the former Deutsche Bank building.

As part of a 2006 master development agreement between the major WTC stakeholders, Silverstein Properties committed to meet strict deadlines for the completion of Towers 2, 3, and 4, while the Port Authority agreed to deliver construction-ready sites by appropriate deadlines or pay \$300,000-per-day in liquidated damages. The Port Authority delivered the partial sites for Towers 3 and 4 in February 2008 and paid \$14.4 million in liquidated damages. It turned over the partial site for Tower 2 and the retained area of Tower 4 to Silverstein on October 5, 2008, three months after the June 30 deadline, incurring \$29.4 million in additional liquidated damages. However, in an arbitration decision made in early December 2008, the Port Authority was found not to have completed the work necessary to have the sites “construction ready,” and the panel reinstated the liquidated damages retroactive to October 5, 2008. On the same day, the Port Authority announced that it will not meet a December 31, 2008, deadline for completing site preparation work for properties that abut the No. 1 subway line and WTC PATH train station.

¹⁹ JPMorgan Chase agreed to pay the Port Authority \$290 million for the development rights as part of a 92-year lease, and will be eligible for \$230 million in incentives.

IX. 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), such as health insurance, 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 September 2008, the City reported that its accrued liability for past OPEB services was \$63.3 billion, and estimated that the present value of its future OPEB obligations was \$41 billion. Overall, the present value of projected OPEB benefits totaled \$104.3 billion, an increase of \$2.3 billion from the FY 2006 level. 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 \$3.1 billion, about \$130 million less than estimated in 2006 due to lower forecasts of health insurance costs.

To address the growing cost of OPEBs, the City created its own Retiree Health Benefits Trust (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. The City contributed \$2.5 billion to the RHBT during fiscal years 2006 and 2007 when the local economy was booming. The Mayor, however, now proposes to use \$1.1 billion of these resources over a three-year period to pay a portion of the City's retiree health care expenses in order to help balance the operating budget. As we noted in our July 2008 report, using the RHBT to fund ongoing operating budget expenses "could be interpreted as a sign of serious fiscal stress."

B. Governmental Accounting Standards Board Statement No. 49

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 had 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.²⁰ These costs would have hit the expense budget at the same time the City was dealing with the revenue losses anticipated from the economic slowdown and the Wall Street credit crunch. In addition, the City had difficulty identifying the environmental remediation component of larger capital projects, such as school renovations. Pursuant to the FEA, the City would have been unable to move forward with these capital projects until the environmental remediation costs were 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 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 on 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. The City has not yet reported on its progress to the Financial Control Board.

C. Financial Emergency Act

The Financial Emergency Act (FEA) was scheduled to terminate on July 1, 2008, but was effectively extended until 2033 when the State assumed responsibility (in 2003) for the outstanding 1970s fiscal crisis debt of the Municipal Assistance Corporation. Even though the Financial Control Board's authority to impose a control period terminated on July 1, 2008, it still annually reviews the five conditions that have been identified in the FEA as indicating serious stress for New York City that could jeopardize the orderly functioning of the City's fiscal affairs. One of those conditions relates to access to the credit markets. Although the City has had to reduce the size of planned debt issuances in response to a lack of liquidity in the financial markets, it has gone to the market more frequently to satisfy its cash needs. The Governor, at the City's request, has proposed changes to the FEA to permit the City to issue bond anticipation notes for one year rather than the current limit of six months to provide greater flexibility given current limitations in the municipal credit market. The City previously proposed legislation that would restore the Financial Control Board's authority to impose a control period and grant additional discretionary authority to waive new accounting regulations, such as GASB 49 for budgeting purposes.

²⁰ The City now states that compliance with GASB 49 for budgeting purposes would result in "significant increased costs to the City's expense budget."

D. New York City's Credit Rating

Since the summer of 2007, the City's credit ratings have been the highest ever ("AA" from Standard & Poor's, "Aa3" from Moody's Investors Service, and "AA-" from Fitch Ratings). The ratings reflect the City's comprehensive financial planning process and the proactive steps the City has taken to address risks to its budget. Although the current credit outlook remains stable, the rating agencies have recently expressed concern. A number of factors could affect the City's credit rating, including the national recession; liquidity problems in the municipal credit markets; the City's heavy reliance on Wall Street; the rising cost of debt service and pension contributions; and post-employment benefits other than pensions (e.g., health insurance).

E. Litigation

The City and its contractors face more than 10,000 claims that allege injuries ensuing from rescue and cleanup work at the World Trade Center (WTC) site. The November 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. The Mayor and members of Congress have previously proposed legislation that would mitigate the City's liability.

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 paid \$58 million to settle 132 lawsuits and another \$18.3 million in a trial award. Another 39 lawsuits remain to be resolved.

As of December 11, 2008, 116 claims were filed against the City and other parties related to the March 15, 2008, construction crane collapse on East 51st Street in Manhattan. In addition, the City has received 44 claims from a second crane collapse, which occurred on East 91st Street on May 30, 2008. Four cases are currently in litigation and the City's liability has not yet been established. In response to the two incidents and federal and State inquiries and investigations, the City has tightened its policies relating to crane maintenance, documentation, component labeling, and testing.

Appendix A

Agency Program Detail

Agency actions proposed by the Mayor are expected to generate \$462 million in FY 2009 and about \$1 billion in later years, as discussed below (see Figure 33).²¹

Figure 33
Proposed Agency Program

(in millions)

	FY 2009	FY 2010	FY 2011	FY 2012
Department of Education	\$180.5	\$385.4	\$385.4	\$385.4
Police Department	45.4	167.2	170.9	132.7
Fire Department	31.7	61.9	61.9	61.9
Sanitation	25.0	67.0	32.2	34.2
Admin. for Children's Services	19.3	38.4	41.6	41.6
Transportation	12.0	22.3	22.3	22.3
Social Services	15.3	29.9	30.0	30.0
Health & Mental Hygiene	10.3	18.2	18.2	18.3
Information Technology	10.3	15.8	12.1	11.4
Elected Officials	9.8	28.2	23.1	3.1
Correction	9.4	31.6	32.4	38.4
Libraries	8.0	15.1	15.1	15.1
Homeless Services	7.9	15.3	15.3	15.2
Finance	7.6	9.9	11.1	11.1
Parks	6.7	13.2	11.6	11.7
CUNY	6.1	9.5	9.5	9.5
Youth	5.7	9.1	9.1	9.1
Citywide Admin. Services	5.6	7.7	5.5	5.5
Cultural Affairs	3.8	7.2	7.2	7.2
District Attorneys & Prosecutors	3.0	10.8	10.9	11.0
Pension Contributions	---	---	6.6	16.0
Fleet Reduction	---	20.0	2.0	2.0
Procurement Savings	---	55.5	55.5	55.5
Other	38.2	43.9	42.4	42.4
Total	\$461.6	\$1,083.1	\$1,031.9	\$990.6

Source: NYC Office of Management and Budget

Department of Education (DOE): Two thirds of the DOE's program relies on reducing schools' other-than-personal-services budgets. The DOE will eliminate administrative positions, including layoffs of administrative and field support staff. The DOE will also scale back spending on professional development, repair and maintenance contracts, custodial work, transportation, and overtime.

²¹ On December 18, 2008, the City Council approved a temporary increase in the hotel tax from 5 percent to 5.875 percent, effective March 1, 2009, which was not anticipated in the November Plan. The increased tax rate will generate \$15 million in FY 2009 and about \$62 million in each of fiscal years 2010 and 2011, which will be used to rescind some of the budget cuts included in the November Plan. Most of these resources will be used to reduce, by half, the size of the planned reduction in the police force. In addition, the City Council substituted some of its own actions, with value of \$18 million, for those proposed by the Mayor in the November Plan. These changes will be reflected in the January Plan.

Police Department: Savings will be achieved by reducing staffing through attrition and canceling the January 2009 recruit class, hiring more civilians to issue summonses for “block the box” violations, and other actions. (Recent actions by the City Council will reduce, by half, the planned reduction in the police force.)

Fire Department: Three engine companies and one ladder company will be closed overnight and the Governor’s Island facility will be closed. Insurance billing rates for EMS services and collections of a tax on fire insurance premiums will be increased. The department also seeks to double the fire insurance premiums tax rate, to 4 percent.

Department of Sanitation: The department proposes to tax the use of plastic bags by retail consumers, increase the sale of recyclable materials, increase fees charged to contractors, cut back on street cleaning services and recycling outreach and public education, and delay waste export contracts.

Administration for Children’s Services: Payments to institutions and schools for children with special needs will be reduced by 10 percent annually. The length of stay for foster children in congregate care will also be reduced. Families not receiving public assistance will be charged higher co-payments for child care and child protective supervisors. These actions account for three quarters of the agency’s savings.

Department of Transportation: Nearly 80 percent of the department’s savings will come from installing a new wireless traffic signal communication network, which eliminates the need for contractors; replacing single-space parking meters with multi-space parking meters; and shifting signal maintenance costs to the federal government. Other actions include reducing weekend non-emergency ferry maintenance and ferry terminal cleaning overtime, and implementing energy-efficient street lighting.

Department of Social Services: About 75 percent of the agency’s savings come from closing the Hamilton Job Center; increasing the caseloads of social workers serving people with HIV/AIDS; recognizing savings from lower spending on substance abuse and employment services as a result of caseload decline; claiming 100 percent reimbursement for emergency public assistance grants; and assisting senior citizens who receive public assistance with obtaining federal social security benefits.

Department of Health and Mental Hygiene: Lower costs in this agency mostly will be achieved by closing 44 child dental health clinics, cutting funding for mental hygiene contracts, increasing the collection of fines for public health code violations, and shifting certain costs to the State.

Department of Information Technology and Telecommunications: Most of this agency's savings result from additional revenue from cable franchises based on increased cable subscriptions and rate structure increases, expected revenue from a new franchise agreement with Verizon for fiber-optic service (FiOS), and delays in an emergency communications improvement project.

Elected Officials: The Mayor's office proposes to hire consultants to improve billing and collections processes, which will generate \$2 million in FY 2009, \$25 million in FY 2010, and \$20 million in FY 2011. The City Comptroller will generate \$6 million in additional revenue in FY 2009 through agency audits. The borough presidents will reduce personal services spending.

Department of Correction: Savings will be achieved primarily through not filling vacant positions and reorganizing personnel, and through transferring City detainees to State-operated jails.

Department of Homeless Services: Expenses will be reduced primarily by reducing payments to shelter operators, shifting shelter costs and aftercare services to the federal government, closing the Bellevue homeless intake center, requiring homeless families with earned income to contribute to the cost of their shelter stays, and replacing contracted shelter security guards with agency peace officers.

Department of Finance: The department proposes to increase revenue by \$7 million in FY 2009 and by as much as \$10 million by 2011 by using new data mining software to cross-reference existing databases as a way to detect non-filing and underreporting of taxes and by collecting payments for outstanding environmental violations. The department will also save about \$1 million annually by hiring six information technology workers to replace outside consultants.

Other: Other savings will be achieved by cutting subsidies to libraries and cultural institutions, youth after-school programs, summer youth employment hours, district attorney and prosecutor staffing, the use of municipal vehicles, and other actions.

Our review of the proposed agency program has identified a number of actions that are at risk of falling short of targets because they may not receive needed State approvals or because of difficulties in implementation. The risks we identified total \$21 million in FY 2009, \$176 million in FY 2010, \$164 million in FY 2011, and \$149 million in FY 2012 (see Figure 34).

Figure 34
Risks to the Agency Program
(in millions)

Agency	Action	FY 2009	FY 2010	FY 2011	FY 2012
Finance	Data mining for tax underpayment	(1.4)	(8.3)	(9.7)	(9.7)
Sanitation	Recycled bulk and paper sales	(1.7)	(6.8)	---	---
	Methane gas concession	(2.0)	(3.1)	---	---
	Plastic bag fee	---	(16.0)	(16.0)	(16.0)
Mayoralty	Consultants to increase collections	(2.0)	(25.0)	(20.0)	---
Fire	Increase fire insurance premium tax	-	(21.0)	(21.0)	(21.0)
Correction	Transfer city detainees to state jails	(3.4)	(18.9)	(19.5)	(25.3)
Children's Services	Cut institutional care reimbursement	(5.0)	(10.1)	(10.1)	(10.1)
	Child care consolidation	-	(62.0)	(62.0)	(62.0)
Homeless Services	Graduated family shelter payments	(5.4)	(5.4)	(5.4)	(5.4)
TOTAL		(20.8)	(176.4)	(163.5)	(149.3)

Note: Totals may not add due to rounding.

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

A number of actions have not yet received needed State approvals. These include reducing reimbursement for institutional care to special needs children, restructuring payments to family shelters, transferring City detainees to State jails, charging fees for consumers' use of plastic bags, and raising taxes on fire insurance premiums.

Some actions have not yet developed a management plan that would aid implementation, such as the Department of Finance's proposal to generate additional tax revenue through data mining: the agency did not provide a timeline to implement its plan and has not purchased needed software. The Mayor's Office has proposed hiring consultants to improve billing and increase collections, but it is uncertain whether the desired savings could be achieved.

Proposals to generate higher revenue from the sale of paper and methane gas from landfills are now unlikely to be realized, as natural gas prices have declined and the market for recycled paper has collapsed.

The Administration for Children's Services (ACS) also anticipates savings of \$62 million from a consolidation of child care services, which is not reflected in the proposed gap-closing program. This action would eliminate subsidized day care for 3,300 slots in 21 day care centers, which could lead to the closing of some centers beginning in FY 2010. The ACS has not finalized a plan to ensure the transfer of these children to Department of Education programs. In addition, this proposal could require City Council support because some day care subsidies are 100 percent City-funded through the City Council's action.

Appendix B

City-Funded Staffing Levels

Between fiscal years 2003 and 2008, the size of the municipal workforce increased by 22,822, to reach 269,598 full-time and full-time-equivalent employees. More than half of the growth occurred in the Department of Education and in the Police Department, with significant additions in the Parks Department, the Department of Social Services, and the Department of Health and Mental Hygiene.

As of September 30, 2008, City-funded staffing was at 270,041, and the November Plan forecasts that City-funded staffing will decline by 2,890 by the end of June 2009, and by another 1,666 by the end of June 2010 (see Figure 35). While most agencies are above the levels planned for the end of the current fiscal year, they should be able to meet their targets through attrition.

- The Police Department will reduce staffing by 1,446 employees (1,171 officers and 275 civilians) by the end of June 2009, and by another 578 employees (a loss of 661 officers and a gain of 83 civilians) by the end of June 2010. The police force is expected to decline to 34,217 officers by the end of FY 2010—the lowest level since FY 1991.
- The Department of Education will reduce staffing by 1,430 employees (831 pedagogues and 599 non-pedagogues) by the end of June 2009, and plans to hire 598 pedagogues by the end of June 2010.
- The City University of New York will reduce staffing by 781 pedagogues and 130 non-pedagogues by the end of June 2009, and by another 79 pedagogues and 211 non-pedagogues by the end of June 2010.
- The Fire Department will reduce the number of firefighters by 562 through attrition, and will add 187 civilians by the end of June 2009.
- The Department of Correction will reduce uniformed staffing by 532 employees and will add 181 civilian employees by the end of June 2010.
- The Department of Sanitation will eliminate 407 uniformed positions (220 by June 2009 and 187 by June 2010) and will add 87 civilian employees by the end of June 2010.
- The Parks Department will reduce staffing by 375 employees by June 2010.
- The City's district attorneys and prosecutors will reduce staffing by 364 employees by the end of June 2009.

Figure 35
City-Funded Staffing Levels
(Full-Time and Full-Time-Equivalents)
Increase/(Decrease)

	Actual				Projected		Sept. 2008 to June 2010
	FY 2006	FY 2007	FY 2008	Sept. 2008	FY 2009	FY 2010	Change
Public Safety	81,764	82,879	83,016	83,801	82,149	80,890	(2,911)
Police Dept. Uniformed	35,773	35,548	35,405	36,049	34,878	34,217	(1,832)
Police Dept. Civilians	15,365	16,331	16,467	16,464	16,189	16,272	(192)
Fire Dept. Uniformed	11,633	11,513	11,578	11,784	11,222	11,222	(562)
Fire Dept. Civilians	4,484	4,670	4,770	4,669	4,856	4,856	187
Correction Uniformed	8,451	8,466	8,413	8,422	8,646	7,890	(532)
Correction Civilians	1,293	1,323	1,411	1,374	1,476	1,555	181
District Attys. & Prosecutors	3,428	3,544	3,582	3,657	3,293	3,293	(364)
Probation Department	850	1,019	931	909	925	923	14
Other	487	465	459	473	664	662	189
Health and Welfare	24,307	24,718	25,208	24,964	25,970	25,794	830
Social Services	10,982	11,003	10,478	10,211	11,109	11,054	843
Children's Services	6,319	6,605	7,101	6,990	6,867	6,863	(127)
Health and Mental Hygiene	4,516	4,797	5,298	5,237	5,369	5,256	19
Homeless Services	2,194	2,042	2,055	2,070	2,227	2,257	187
Other	296	271	276	456	398	364	(92)
Environment & Infrastructure	19,051	19,759	19,736	19,304	18,786	18,415	(889)
Sanitation Uniformed	7,581	7,605	7,556	7,672	7,452	7,265	(407)
Sanitation Civilians	1,836	1,898	1,943	1,942	2,032	2,029	87
Dept. of Transportation	2,218	2,307	2,345	2,369	2,326	2,313	(56)
Parks & Recreation	6,968	7,489	7,417	6,850	6,643	6,475	(375)
Other	448	460	475	471	333	333	(138)
General Government	8,556	8,824	9,167	8,979	9,328	9,261	282
Finance	2,229	2,199	2,203	2,092	2,187	2,185	93
Law Department	1,352	1,370	1,370	1,342	1,312	1,309	(33)
Citywide Admin. Services	1,277	1,335	1,387	1,343	1,540	1,604	261
Taxi & Limo. Commission	445	422	422	423	462	462	39
Investigations	245	265	241	239	270	255	16
Board of Elections	421	415	550	604	377	377	(227)
Info. Technology & Telecomm.	866	978	1,057	1,067	1,168	1,162	95
Other	1,721	1,840	1,937	1,869	2,012	1,907	38
Housing	1,744	1,873	1,937	1,927	2,110	2,075	148
Buildings	1,093	1,181	1,240	1,233	1,351	1,335	102
Housing Preservation	651	692	697	694	759	740	46
Department of Education	113,454	116,240	121,083	121,173	119,743	120,340	(833)
Pedagogues	89,369	92,491	97,189	97,520	96,921	97,519	(1)
Non-Pedagogues	24,085	23,749	23,894	23,653	22,822	22,821	(832)
City University of New York	6,436	6,600	6,931	7,412	6,501	6,211	(1,201)
Pedagogues	4,052	4,154	4,406	4,907	4,126	4,047	(860)
Non-Pedagogues	2,384	2,446	2,525	2,505	2,375	2,164	(341)
Elected Officials	2,441	2,513	2,520	2,481	2,564	2,499	18
Total	257,753	263,406	269,598	270,041	267,151	265,485	(4,556)

Sources: NYC Office of Management and Budget; OSDC analysis