



Review of the Financial Plan of the City of New York

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I. Executive Summary

The nation is slowly emerging from the worst recession since the Great Depression, but the recovery is expected to be slow and uneven. Although the national economy grew at 5.9 percent during the fourth quarter of 2009, the strong growth could not offset the deep contractions that occurred in the first half of the year. As a result, the economy contracted by 2.4 percent in 2009, the largest annual decline in 63 years.

The recession has already cost the nation 8.4 million jobs, a decline of 6.1 percent, and the unemployment rate, which peaked at 10.1 percent, reached its highest level in 27 years. Most economists expect the economy to expand by only about 3 percent during calendar years 2010 and 2011, barely fast enough to support job growth.

The economic downturn has been less severe in New York City than in the nation, but the impact has been painful nonetheless. New York City has already lost nearly 162,000 jobs, a decline of 4.2 percent, and the unemployment rate reached 10.5 percent, the highest level in 17 years. City tax revenues fell by \$2.8 billion in FY 2009, or 7.1 percent—the steepest decline in at least 30 years.

To maintain budget balance in fiscal years 2009 and 2010, the City drew upon reserves accumulated during the last economic expansion, raised property and sales taxes, cut planned spending, curtailed the capital program, and obtained extraordinary federal assistance under the American Recovery and Reinvestment Act of 2009.

The City's June 2009 financial plan for fiscal years 2010 through 2013 was based on conservative economic and revenue assumptions in an effort to minimize downside budget risks. For example, the June Plan assumed that job losses would be far greater than is currently forecast, and that Wall Street would sustain additional losses.

Wall Street, the City's economic engine, has recovered much faster than previously anticipated, aided by taxpayer bailouts and the Federal Reserve's low interest rate policies. The State Comptroller forecasts that Wall Street profits could exceed \$55 billion in 2009, nearly three times greater than the previous record. Wall Street posted record consecutive losses of \$11.3 billion in 2007 and \$42.6 billion in 2008.

With the securities industry's return to profitability, employee compensation is growing again. The State Comptroller estimates that bonuses, excluding deferred compensation, grew by 17 percent in 2009 after a 47 percent decline in 2008. Employment in the industry is also stabilizing after losing 27,000 jobs, a decline of 14.3 percent. These developments will have a beneficial impact across the economy.

The City's January 2010 financial plan (see Figure 1) forecasts a surplus of nearly \$2.9 billion for FY 2010, reflecting the improved revenue outlook (\$1.8 billion); a drawdown in reserves (\$600 million); and agency actions (\$484 million). The Mayor proposes to transfer the surplus to FY 2011 to help balance that year's budget.

To close the remaining budget gap for FY 2011, the Mayor has proposed additional agency actions, which would generate more than \$1.1 billion annually. The actions would reduce services, improve efficiencies, increase revenues, and eliminate nearly 4,300 jobs. In addition, the Mayor is seeking State approval to broaden the mortgage recording tax to cover housing cooperatives and the sales tax to cover aviation fuel.

The Mayor has also revised the City's collective bargaining strategy. The Mayor would rescind proposed cuts to educational programs in FY 2011 (\$316.8 million) if the unions that represent teachers and principals accept 2 percent annual wage increases in place of the 4 percent annual increases negotiated with other municipal unions during the current round of collective bargaining. The Mayor is also calling on the City's unions to fund the next round of bargaining with productivity and savings from restructuring fringe benefits.

New York State is experiencing its own fiscal crisis, and how the State balances its budget will have a direct impact on New York City. The Governor's executive budget, which projected a budget gap of \$8.2 billion for the next State fiscal year, included actions that would reduce State assistance to New York City by an estimated \$1.2 billion over the course of this fiscal year and next. Most of the adverse impact would come from eliminating payments to the City under the Aid and Incentives to Municipalities program (AIM) and from reducing State education aid. The Mayor has proposed a contingency program, which would eliminate 19,000 positions, in the event that the Governor's proposals are enacted. The State now estimates that next year's budget gap has grown by \$850 million to more than \$9 billion, but it has not yet identified actions to close the higher gap.

The Governor and the Mayor are hoping that the federal government extends the extraordinary assistance that has been provided to states and localities during the recession. The federal government provided New York City with a total of \$2.7 billion in operating budget assistance over a three-year period, but that assistance is scheduled to expire next year. The Mayor has indicated that he would lay off 14,190 school personnel when the federal education aid is exhausted.

The City has nearly closed the \$4.9 billion budget gap that it had projected at the beginning of the current fiscal year for FY 2011 (see Figure 2), greatly aided by an improved economic outlook. However, additional budget risks, such as the State budget, could bring the total risk to \$2 billion in FY 2011 and could increase the out-year gaps to more than \$6 billion. A late State budget would further complicate the City's financial planning process. In addition, many economists are concerned that the recovery may experience setbacks. While the City has balanced its budget during the current recession without resorting to large service disruptions, the outcome of the State and federal budgets could test the City's ability to continue on that path.

Figure 1
New York City Financial Plan
(in millions)

	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
REVENUES					
Taxes					
General Property Tax	\$ 16,035	\$ 16,917	\$ 17,536	\$ 17,746	\$ 17,882
Other Taxes	20,063	21,268	22,625	24,008	25,258
Tax Audit Revenue	890	612	611	610	610
Tax Fairness Program	---	219	241	262	284
Subtotal – Taxes	\$ 36,988	\$ 39,016	\$ 41,013	\$ 42,626	\$ 44,034
Miscellaneous Revenue	6,283	5,793	5,853	5,897	5,918
Unrestricted Intergovernmental Aid	340	340	340	340	340
Less: Intra-City Revenues	(1,804)	(1,545)	(1,547)	(1,552)	(1,552)
Disallowances against Categorical Grants	(15)	(15)	(15)	(15)	(15)
Subtotal – City Funds	\$ 41,792	\$ 43,589	\$ 45,644	\$ 47,296	\$ 48,725
Other Categorical Grants	1,372	1,200	1,155	1,152	1,151
Inter-Fund Revenues	497	471	450	450	450
Total City Funds, Capital IFA and Other Categorical Grants	\$ 43,661	\$ 45,260	\$ 47,249	\$ 48,898	\$ 50,326
Federal Categorical Grants	7,943	6,614	5,720	5,680	5,679
State Categorical Grants	11,476	11,766	12,407	13,057	13,195
Total Revenues	\$ 63,080	\$ 63,640	\$ 65,376	\$ 67,635	\$ 69,200
EXPENDITURES					
Personal Service					
Salaries and Wages	\$ 22,310	\$ 21,695	\$ 21,353	\$ 21,993	\$ 22,168
Pensions	6,760	7,268	7,694	7,841	7,949
Fringe Benefits ¹	7,307	7,622	7,921	8,214	8,715
Retiree Health Benefits Trust	(82)	(395)	(672)	---	---
Subtotal – Personal Service	\$ 36,295	\$ 36,190	\$ 36,296	\$ 38,048	\$ 38,832
Other Than Personal Service					
Medical Assistance	\$ 4,951	\$ 5,644	\$ 6,113	\$ 6,293	\$ 6,478
Public Assistance	1,580	1,563	1,603	1,591	1,591
All Other ¹	19,397	18,835	19,485	20,041	20,585
Subtotal – Other Than Personal Service	\$ 25,928	\$ 26,042	\$ 27,201	\$ 27,925	\$ 28,654
General Obligation, Lease and TFA Debt Service ^{1,2,3}	\$ 5,117	\$ 5,536	\$ 6,286	\$ 6,579	\$ 6,815
General Obligation and TFA Debt Defeasances (Net) ³	(2,726)	---	---	---	---
FY 2009 Budget Stabilization & Discretionary Transfers ¹	(2,813)	---	---	---	---
FY 2010 Budget Stabilization ²	2,883	(2,883)	---	---	---
General Reserve	200	300	300	300	300
Subtotal	\$ 64,884	\$ 65,185	\$ 70,083	\$ 72,852	\$ 74,601
Less: Intra – City Expenses	(1,804)	(1,545)	(1,547)	(1,552)	(1,552)
Total Expenditures	\$ 63,080	\$ 63,640	\$ 68,536	\$ 71,300	\$ 73,049
Gap To Be Closed	\$ ---	\$ ---	\$ (3,160)	\$ (3,665)	\$ (3,849)

- 1) Fiscal Year 2009 Budget Stabilization and Discretionary Transfers total \$2.813 billion, including Budget Stabilization of \$1.286 billion, lease debt service of \$110 million, Retiree Health Benefits of \$225 million, subsidies of \$643 million, net equity contribution in bond refunding of \$3 million and TFA grant of \$546 million.
- 2) Fiscal Year 2010 Budget Stabilization of \$2.883 billion.
- 3) FY 2007 GO Debt Defeasance of \$536 million reduced debt service by \$27 million, \$279 million, and \$277 million in FY 2008 through FY 2010, respectively. FY 2008 GO debt defeasance of \$1.986 billion reduced debt service by \$2.036 billion in FY 2010. FY 2007 TFA debt defeasance of \$718 million reduced debt service by \$33 million, \$362 million, and \$382 million in FY 2008 through FY 2010, respectively. FY 2007 JSDC debt defeasance of \$65 million reduced debt service by \$34 million in FY 2009 and \$31 million in FY 2010.

Figure 2
OSDC Risk Assessment of the NYC Financial Plan

(in millions)

Better/(Worse)

	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
Surplus/(Gaps) per January Plan	\$ - - -	\$ - - -	\$ (3,160)	\$ (3,665)	\$ (3,849)
Nonproperty Tax Revenues	- - -	300	275	150	150
GASB 49	- - -	(200)	(200)	(200)	(200)
Extend Sales Tax to Aviation Fuel	- - -	(169)	(183)	(191)	(206)
Overtime	- - -	(150)	(150)	(150)	(150)
Agency Actions	- - -	(71)	(86)	(88)	(90)
Extend Mortgage Recording Tax to Co-ops	- - -	(50)	(58)	(71)	(78)
Qualified School Construction Bonds	- - -	(17)	(36)	(51)	(54)
OSDC Risk Assessment	- - -	(357)	(438)	(601)	(628)
Remaining Gap to be Closed per OSDC ¹	\$ - - -	\$ (357)	\$ (3,598)	\$ (4,266)	\$ (4,477)

Additional Risks and Offsets

Potential Impact of the State Budget ²	\$ - - -	\$ (1,221)	\$ (880)	\$ (880)	\$ (880)
UFT Collective Bargaining	(148)	(350)	(456)	(509)	(512)
Loss of Federal Education Stimulus Aid	- - -	- - -	(1,000)	(1,000)	(1,000)
Pension Fund Investment Earnings	- - -	- - -	111	204	301
Total Additional Risks and Offsets ³	\$ (148)	\$ (1,571)	\$ (2,225)	\$ (2,185)	\$ (2,091)

¹ The January Plan includes a general reserve of \$200 million in FY 2010 and \$300 million in each of fiscal years 2011 through 2014. The Retiree Health Benefits Trust will have \$2.7 billion on deposit even after the City draws down \$477 million to help balance the budget in fiscal years 2010 and 2011. The City also has established reserves of more than \$1.5 billion during the financial plan period to fund recommendations of an independent actuarial consultant, but it remains to be determined whether all of the resources will be needed for that purpose. In addition, the City historically overestimates the amount of prior years' expenses, which has produced annual savings that averaged \$526 million over the past five years. The City also has a \$1.1 billion reserve for disallowances of federal and State aid.

² We estimate that the Governor's proposed State budget would reduce aid to New York City by \$341 million in FY 2010 and \$880 million in FY 2011, which would widen the FY 2011 budget gap by \$1.2 billion.

³ Wage increases at the projected inflation rate would increase the City's costs by \$233 million in FY 2011, \$565 million in FY 2012, \$898 million in FY 2013, and \$1.1 billion in FY 2014.

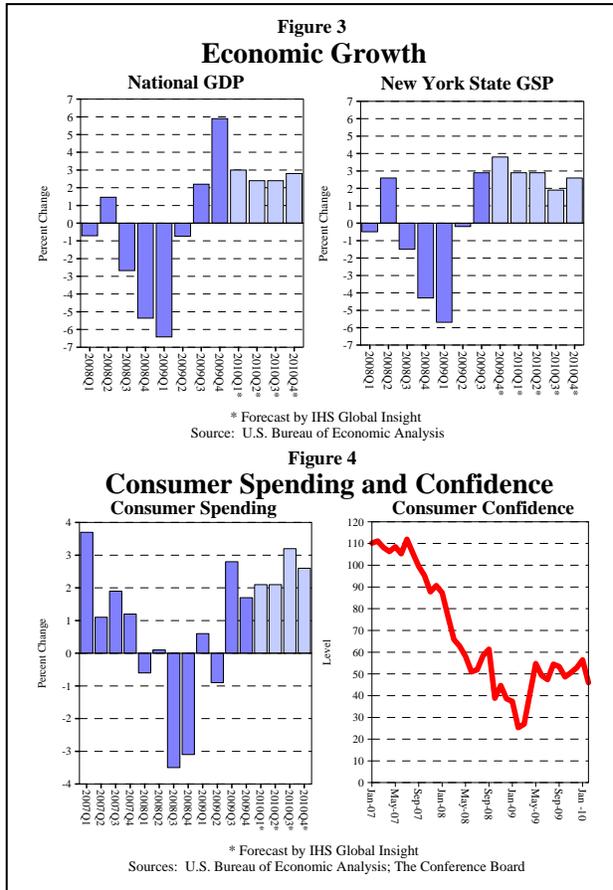
II. Economic Trends

The national economy continues to recover from a recession that many consider to be the worst since the Great Depression. The real Gross Domestic Product (GDP) grew at an annualized rate of 5.9 percent in the fourth quarter of 2009 (see Figure 3)—the fastest rate in six years—driven mainly by increased business spending, a slower reduction in inventories, and higher exports. Nevertheless, this strength could not compensate for the sharp declines in the economy in the first half of the year—for all of 2009, the GDP declined by 2.4 percent, the largest annual decline in 63 years.

Consumer spending, which accounts for two-thirds of economic activity, has risen with the help of government stimulus efforts, but the improvement in consumer confidence has stalled (see Figure 4). Consumers remain concerned about jobs and high debt burdens, and tight credit may have changed consumer behavior. In addition, concerns over government spending and deficits may limit future fiscal actions, and the Federal Reserve has begun the long process of removing the liquidity it added to support the financial system.

As a result, the recovery is expected to be uneven and protracted. According to the February 2010 forecast by IHS Global Insight, the GDP growth will slow, and will not exceed 3 percent until the third quarter of 2011. On an annual basis, the GDP is forecast to grow by 3 percent in 2010 and 2.8 percent in 2011.

The economic slowdown was less pronounced in New York State than in the nation. IHS Global Insight estimates that New York's real Gross State Product (GSP) contracted by 1.7 percent in 2009. As with the nation, the recovery is expected to weaken as 2010 progresses. Annual GSP growth is forecast to be 2.7 percent in 2010 and 2.6 percent in 2011.



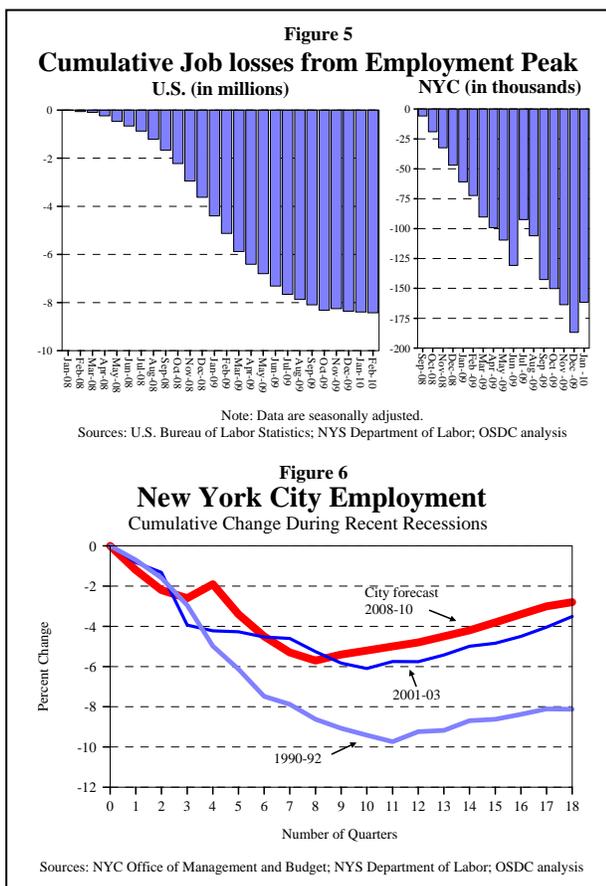
Jobs are now the main economic focus of both consumers and policy makers. Recent revisions significantly raised the number of jobs lost during the recession, and data now show that the nation lost 8.4 million jobs between December 2007 and February 2010. Job losses were reported for every month except November 2009, though the pace has moderated considerably since the late summer of 2009 (see Figure 5). The consecutive monthly job losses through October 2009 were the largest and longest losses on record. Although more sustainable job creation is expected to begin in the first quarter of 2010, gains are expected to remain weak until the beginning of 2011.

The City's economy has weathered the recession better than previously feared, and the local downturn has been less severe than the national downturn. Recent revisions show that between August 2008 and January 2010, New York City lost 161,600 jobs (see Figure 5). This represents a decline of 4.2 percent, compared with a 6.1 percent decline in the nation.

During the summer of 2009, a short period of unexpected job gains occurred in the City as a result of federal stimulus programs, but then declines resumed. Employment losses have been heaviest in professional and business services, finance, and the trade, transportation, and utilities sector, though job gains continue in educational and health services.

The January Plan assumes that the City will continue to lose jobs through the third quarter of 2010, with total losses reaching 215,000 jobs (compared to the decline of nearly 330,000 jobs that was projected in the June 2009 Plan). Losses of this magnitude would be slightly lower than in the past two recessions (see Figure 6). When job growth resumes, however, the pace of gains in the City is expected to be slower than in the nation.

The unemployment rates in the nation and the City have risen (see Figure 7) to their highest levels in 27 years and 17 years, respectively. Although both are expected to begin falling slowly in the near future, neither the City nor the national unemployment

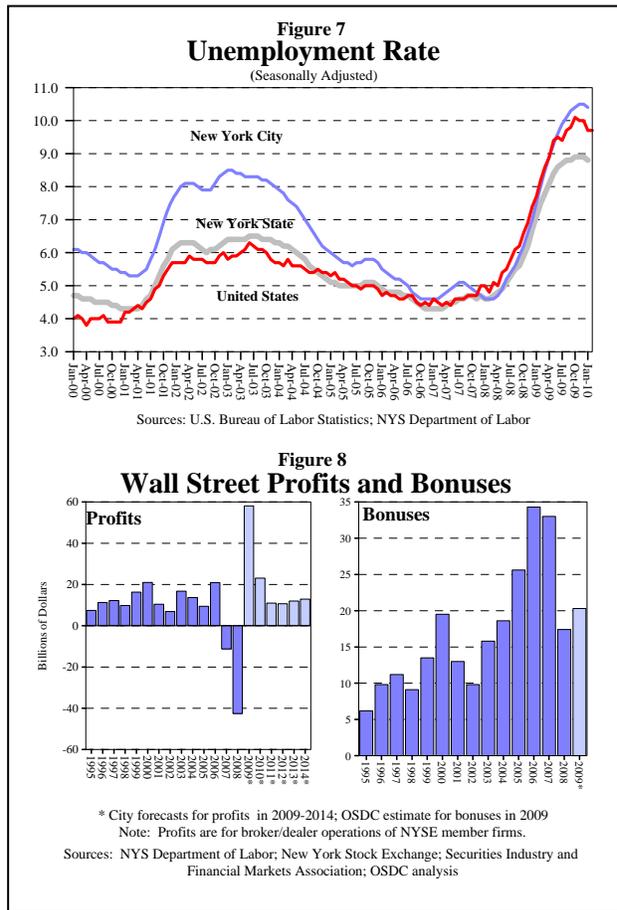


rates are projected to fall below 7 percent during the financial plan period. Initial claims for unemployment insurance benefits in both the nation and New York State have eased considerably since peaking in the spring of 2009, but both remain higher than pre-recession levels. Recently these claims have rebounded slightly, reflecting the continued weakness in the labor markets.

Wall Street is the economic engine of New York City, and has recovered faster than anticipated. During the financial crisis, the broker/dealer operations of New York Stock Exchange member firms experienced consecutive record losses of \$11.3 billion in 2007 and \$42.6 billion in 2008 (see Figure 8). Aided by taxpayer bailouts, government support programs, the Federal Reserve's low interest rate policy, and changes in accounting rules, Wall Street swung to record profits of \$49.7 billion in the first three quarters of 2009.

The January Plan assumes that securities industry profits will reach \$58.1 billion for all of 2009—nearly triple the previous record of \$21 billion earned in 2000. Profits are then expected to return to much lower levels of \$23.1 billion in 2010 and \$11 billion in 2011, as the industry returns to more normal operations, interest rates rise, and federal support programs are ended. The industry also faces potential regulatory reforms and tax increase proposals.

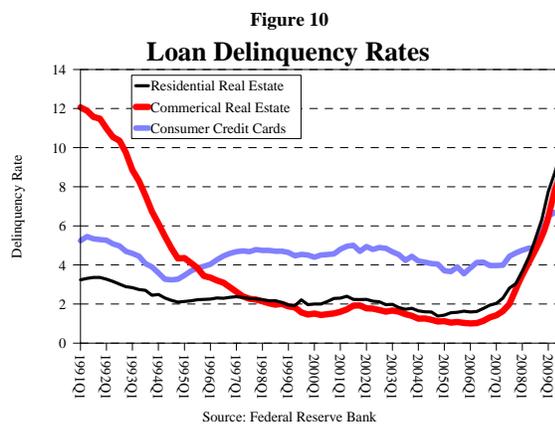
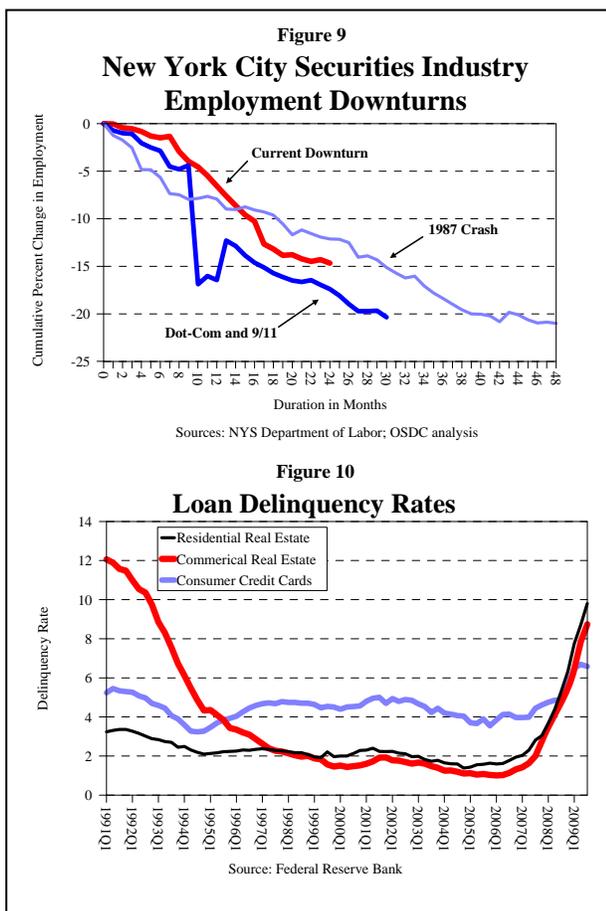
Employment in the securities industry has declined less than originally expected. Between January 2008 and January 2010, the industry lost 27,000 jobs on a seasonally adjusted basis. Compared to the last two major financial downturns, the current job losses have been much milder (see Figure 9). Overall, industry employment declined by 21 percent in the early 1990s and by 20.5 percent in the early 2000s, compared to 14.3 percent in the current downturn. With the industry reporting record profits in 2009, the City now forecasts that Wall Street will lose 33,000 jobs in this recession rather than the 47,000 jobs projected in June 2009.



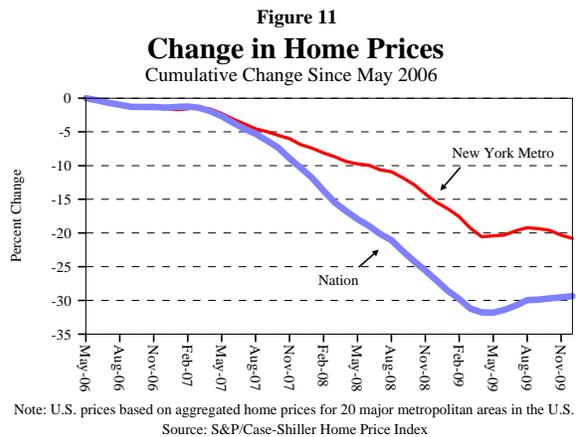
For 2008, the State Comptroller estimated that Wall Street's losses caused year-end bonuses to decline by 47 percent to \$17.4 billion. That decline had a detrimental effect on City and State revenue collections, and the loss of income affected many businesses in the City and surrounding suburbs.

With the industry's return to profitability in 2009, bonuses are poised to recover. Nevertheless, in response to public outcry over the industry's compensation practices, proportionally less of those 2009 bonuses will be paid in cash, and more will be paid through stock or other deferred compensation. The State Comptroller has estimated that bonuses paid by Wall Street to New York City-based employees rose by 17 percent in 2009, to \$20.3 billion. The January Plan forecasts that the rebound in bonuses, coupled with the resumption of job growth in the City, will enable the total amount of wages paid in the City to rise by 2.8 percent in 2010 and by 4.5 percent in 2011, following a record decline of 10.3 percent in 2009.

The financial sector still faces serious risks from the problem of rising loan delinquencies. Delinquency rates for residential mortgages continue to rise, fueling foreclosure activity. Consumers are also facing increased difficulty in meeting their other debt burdens, as delinquencies on consumer loans have also increased (see Figure 10). Commercial real estate owners are facing problems similar to those of residential owners. Properties are not generating sufficient cash flow because of lower occupancy and rental rates, and owners are struggling with the high debt burdens taken on to fund building acquisitions in recent years. Commercial mortgage delinquencies have risen sharply, reaching 8.8 percent in the fourth quarter of 2009.



Nonetheless, conditions in the housing markets are stabilizing. The sharp decline in home prices has attracted new buyers for whom homes are now more affordable. Mortgage rates are low, and the federal government is offering tax credits for home purchases. As a result, both home sales and prices have recovered since the summer of 2009. The S&P/Case-Shiller Home Price Index shows that the average national home price fell by 29.4 percent between May 2006 and December 2009 (see Figure 11).



During the same period of time, home prices in the New York City metropolitan area fell somewhat less—by 20.8 percent.

The City’s residential apartment market has showed some improvement as Wall Street profitability has returned and job losses have slowed. Prudential Douglas Elliman reported that Manhattan cooperative apartment sales increased by 28.3 percent in the fourth quarter of 2009, compared to one year earlier—the first growth in three years. The rate of decline in the median sales price also moderated (to 6.7 percent). During the same period of time, sales of Manhattan condominium apartment sales fell by 11.2 percent while median prices fell by 6.8 percent. In general, existing units are selling better than newly constructed units.

The January Plan assumes the sales volume and median price of cooperative apartments in the City will decline by 7 percent and 12 percent, respectively, in 2010. While the median condominium price is expected to drop by 14 percent in 2010, sales are expected to rebound by 20 percent as Wall Street continues to recover. The City also projects that the volume of single-family home sales in the City will increase by 11 percent in 2010, even as the median price falls by 12 percent.

Conditions are more serious in Manhattan’s commercial property market, where credit conditions remain tight and building values are eroding as demand for space remains soft. Colliers ABR reports the vacancy rate in the primary office market in Manhattan rose to 12.2 percent in November 2009—the highest rate since April 1997. Meanwhile, the average asking rent declined to \$62.42 per square foot—a drop of nearly \$20 from one year ago. Some commercial borrowers have begun to default on their loans, as Tishman Speyer recently did on its \$4.4 billion debt for the Stuyvesant Town/Peter Cooper Village complex. The property was turned over to the creditors.

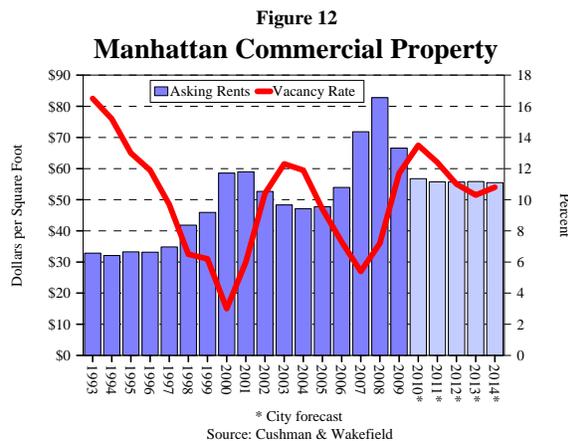
The January Plan assumes that the local commercial property market downturn will be relatively short and moderate, but given market conditions this assumption may prove to be overly optimistic. The January Plan assumes, for example, that the vacancy rate in Manhattan’s primary office market will peak in 2010 at 13.5 percent and then gradually taper off (see Figure 12). The average asking rent is forecast to decline to \$56.78 per square foot in 2010 and then \$55.74 in 2011, after which rents are expected to remain relatively stable.

Although tourism generally suffered during the downturn as consumers cut back their spending, New York City was less affected than many other cities, and tourism has remained a bright spot in the local economy. Over 45 million visitors traveled to the City in 2009, just 1.7 million short of the record number of visitors in 2008. Tourism contributed an

estimated \$28 billion in spending to the local economy. New York City also surpassed Orlando, Florida, to become the number one destination for both domestic and international visitors. The City estimates that the number of visitors will rebound to 46.7 million in 2010 and continue to grow in subsequent years, boosted by an expected decline in the value of the dollar as the economic crisis ebbs.

Despite the successful efforts by the federal government to revive the financial system and stimulate the economy, many risks remain. Consumers are still cautious, waiting for the job market to improve. Without a rebound in spending, the recovery will be weak. Given current political conditions, additional government support will be difficult. The Federal Reserve will aim to avoid igniting inflation as it continues to raise interest rates (beyond the modest increases in the discount rates made in February 2010) and remove its other support from the economy.

The financial sector, the engine of the City’s economy, continues to face its own risks. Commercial and consumer lending losses continue to grow, placing pressure on earnings in the financial sector. Investors have become increasingly concerned with the possibility of a new crisis developing over the heavy debt burdens carried by some nations. More importantly, there are new regulatory proposals for the financial industry, such as proprietary trading restrictions, compensation reforms, and new bank taxes, which could have a significant impact not only on Wall Street but on the rest of the City’s economy.



III. Fiscal Year 2010

The June 2009 four-year financial plan projected a balanced budget for FY 2010, budget gaps of \$4.9 billion for each of fiscal years 2011 and 2012, and a gap of \$5.6 billion for FY 2013. Since then, tax revenue growth has been stronger than expected, which permitted the City to raise its forecasts in November and again in January. In addition, the City drew down some of its reserves, initiated agency cost-reduction initiatives, and refunded debt to take advantage of low interest rates.

The City now forecasts a surplus of nearly \$2.9 billion in FY 2010, and the budget gap projected for FY 2011 has been reduced by \$900 million to \$4 billion (see Figure 13). The City plans to use the FY 2010 surplus, in combination with other actions, to balance the FY 2011 budget.

The January Plan assumes that revenues will be higher than forecast in June 2009 by \$1.8 billion in FY 2010 and an average of nearly \$1 billion in subsequent years. The higher estimates are due mostly to the City's revised economic outlook. Job losses are now expected to be much lower than previously forecast, and Wall Street profits and bonus payments will be higher than assumed in the June Plan. The January Plan also assumes higher business tax collections, additional revenue from tax audits, and State approval of two tax proposals. Property tax collections, however, are now forecast to be lower than projected in the June Plan, beginning in FY 2011, because property assessments were lower than anticipated by the City.

The City's expenditure estimates for fiscal years 2010 and 2011 are essentially unchanged on a net basis from the beginning of the fiscal year, but reflect significant developments. The June Plan had assumed the City and the municipal unions would reach agreements that would generate annual savings of about \$600 million beginning in FY 2011 from restructuring health insurance for all employees and with State approval of lower-cost pension plans for new employees. The City has revised its strategy for achieving these savings, and now assumes that the next round of collective bargaining will be funded exclusively from a combination of productivity savings and savings in health insurance and pension costs. As a result, the City eliminated funding from the January Plan for a two-year wage increase of 1.25 percent that had been planned for fiscal years 2010 and 2011, which generated the savings the City had anticipated from restructuring health insurance and pension benefits. The City also took advantage of low interest rates and refinanced outstanding general obligation bonds and Transitional Finance Authority (TFA) bonds.

Figure 13
Financial Plan Reconciliation
January 2010 Plan vs. June 2009 Plan
(in millions)

	<i>Better/(Worse)</i>			
	FY 2010	FY 2011	FY 2012	FY 2013
Surplus/(Gap) as of June 2009 Plan	\$ - - -	\$ (4,925)	\$ (4,994)	\$ (5,633)
Revenue Reestimates				
Personal Income Tax	830	434	507	566
Property Tax	(38)	(233)	(205)	(383)
Tax Audit Revenue	285	- - -	- - -	- - -
Other Taxes	<u>590</u>	<u>527</u>	<u>335</u>	<u>359</u>
Subtotal	1,667	727	637	542
Proposed Tax Initiatives	- - -	219	241	262
Non-Tax Revenues	<u>110</u>	<u>44</u>	<u>78</u>	<u>78</u>
Total	1,777	990	956	882
Drawdown of Reserves				
General Reserve	100	- - -	- - -	- - -
Prior Years' Expenses	<u>500</u>	<u>- - -</u>	<u>- - -</u>	<u>- - -</u>
Total	600	- - -	- - -	- - -
Agency Cost-Reduction Initiatives	484	- - -	- - -	- - -
Expenditure Reestimates				
Two-Year Wage Increase of 1.25 percent	35	190	469	730
Debt Service	124	286	12	(3)
Restructuring Health Insurance Savings	- - -	(357)	(386)	(418)
Lower-Cost Pension Benefits for New Employees	- - -	(200)	(200)	(200)
Other	<u>(137)</u>	<u>17</u>	<u>(172)</u>	<u>(214)</u>
Total	22	(64)	(277)	(105)
Surplus/(Gap) as of January 2010	\$ 2,883	\$ (3,999)	\$ (4,315)	\$ (4,856)

Note: Totals may not add due to rounding.

Sources: NYC Office of Management and Budget; OSDC analysis

IV. Current-Year Operating Results

After the recession of the early 2000s, 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 14, these resources peaked at \$6.5 billion in FY 2007.

Even though the City has been contending with the worst recession in decades, it has still realized substantial amounts of unanticipated resources in recent years because its financial plan was based on very conservative economic and revenue assumptions, and because it raised taxes and cut planned spending. In FY 2010, the amount of unanticipated resources is expected to reach nearly \$2.9 billion because job losses are not likely to be as high as previously feared and because Wall Street recovered much faster than anticipated.

As it has in past years, the City intends to transfer these unanticipated resources to the following year, to help close that year's budget gap. 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 earned and expenditures incurred in the current year. This entails adjusting for surplus transfers and other factors that impede transparency, such as certain discretionary actions.

As shown in Figure 15, the size of the current-year surplus grew each year after the end of the last recession, and peaked in FY 2007 at \$3.9 billion. The surplus then declined sharply in FY 2008 as revenues fell due to the economic slowdown. Despite tax increases and agency cost-cutting, spending exceeded current-year resources by \$2.5 billion in FY 2009, and that year's budget was balanced using surplus resources accumulated in prior years.

Figure 14
Surplus Resources
Generated in the Current Year

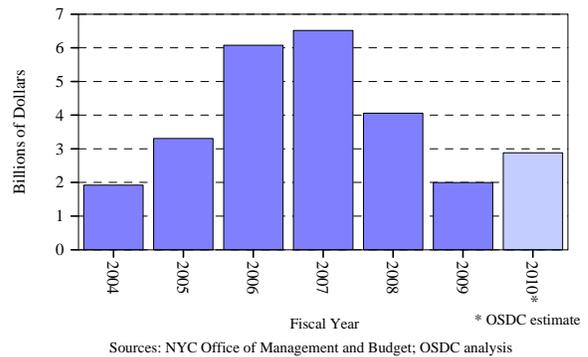
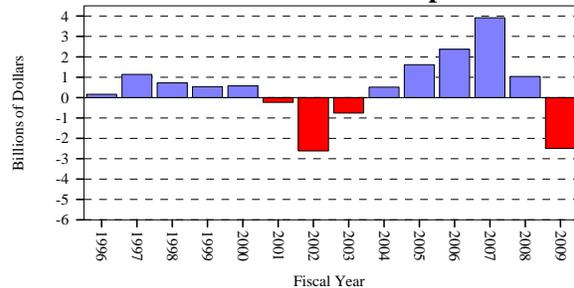


Figure 15
Results of Current-Year Operations



Note: Adjusted for surplus transfers, TFA, TSASC, and discretionary actions.
Includes benefit of proposed and enacted gap-closing actions.
Sources: NYC Office of Management and Budget; NYC Comptroller; OSDC analysis

Fiscal years 2010 and 2011 are each balanced with an average of \$4.9 billion in nonrecurring resources (see Figure 16). The FY 2010 budget will benefit by \$2.7 billion from debt defeasances effected during fiscal years 2007 and 2008, when the City had large budget surpluses. Fiscal years 2010 and 2011 will be balanced with large sums from federal stimulus assistance and resources from the Retiree Health Benefits Trust.

Figure 16
Nonrecurring Resources
(in millions)

	FY 2010	FY 2011
Debt Prepayments and Defeasances	\$ 2,726	\$ - - -
Federal Education Aid	1,177	834
Federal Medicaid Assistance	850	295
Restitution Agreement	129	- - -
TFA Transfer	100	- - -
Drawdown of Retiree Health Benefits Trust	82	395
FY 2010 Projected Surplus	- - -	2,883
Debt Refundings	- - -	330
Total	\$ 5,064	\$ 4,737

Source: OSDC analysis

V. Impact of the State and Federal Budgets

The Governor's executive budget projected a budget gap of \$8.2 billion for the next State fiscal year (SFY 2010-2011), and gaps of \$14.5 billion, \$18.5 billion, and \$20.9 billion in each of the following three State fiscal years. To balance the SFY 2010-2011 budget, and to narrow projected future gaps, the Governor has proposed a series of actions, some of which would adversely affect New York City. More recently, the State has indicated that next year's budget gap has grown by \$850 million to more than \$9 billion. The State has not yet indicated how it will close the additional gap.

Our analysis indicates that, if enacted, the Governor's executive budget could reduce State assistance to New York City by \$341 million in FY 2010 and by \$880 million in subsequent years (see Figure 17), which would widen the FY 2011 budget gap by \$1.2 billion. Most of the adverse impact would come from reducing State education aid and from eliminating payments to the City under the Aid and Incentives to Municipalities program (AIM). The Mayor has proposed a contingency program, which would reduce staffing by 19,000 positions (largely through layoffs), in the event that the Governor's proposals are enacted.

Figure 17
Potential Impact of the Governor's Proposed State Budget
(in millions)

	<i>Better/(Worse)</i>	
	FY 2010	FY 2011
Aid and Incentives to Municipalities ⁴	\$ (328)	\$ (328)
Education Aid	---	(493)
Social Services and Health	(12)	(43)
Revenue Initiatives ⁵	---	(11)
Other	(1)	(5)
Total	\$ (341)	\$ (880)

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

The Governor's proposal to eliminate funding to New York City under the AIM program in next year's State budget would take effect in the current City fiscal year due to the accounting treatment of these funds, which will effectively double the impact on the City to \$656 million in FY 2011.

⁴ Due to the accounting treatment, the City lost \$26 million in AIM funding attributable to FY 2009.

⁵ The January Plan already includes additional revenues from the Governor's proposal to broaden the mortgage recording tax to cover cooperative apartments, which the City estimates would generate about \$50 million beginning in FY 2011.

The Governor has proposed reducing unrestricted education aid (i.e., Foundation Aid) to the City by \$442 million and reducing State reimbursement for certain mandated special education costs by \$51 million, which will shift the financial burden from the State to the City. According to the State Division of the Budget, the cut in State education aid would be even greater if the State had not drawn on funding from the federal American Recovery and Reinvestment Act of 2009 (ARRA) that had been planned for use in SFY 2011-2012.

In his 21-day amendments, the Governor proposed increasing the payroll tax from 0.34 percent of payroll for all counties within the Metropolitan Commuter Transportation District to 0.54 percent for New York City employers, while reducing the rate to 0.17 percent for employers elsewhere in the district, to help the MTA balance its budget and to shift the burden from the suburbs to the City. This proposal, if enacted, would increase the City's costs by \$10 million in FY 2010 and by \$20 million annually thereafter.

Both the Governor and the Mayor are hoping that the federal government extends the extraordinary assistance that has been provided to states and localities to help them maintain services and jobs during the worst recession in decades. The ARRA provided New York City with a total of \$2.7 billion in operating budget assistance over a three-year period, mostly in the form of additional education and Medicaid funding. The assistance, however, is scheduled to expire next year. The President and both houses of Congress have made proposals to help sustain the economic recovery, including extending the ARRA for another six months. For example, the House passed a bill that could provide New York City with more than \$400 million in additional Medicaid funding, which could be used to help balance the budget.

There are also a number of proposals under consideration that would provide states with additional federal education aid, which could mitigate planned cuts in education funding. New York State, for example, was recently picked as one of 16 finalists for additional education funding under the Race to the Top program. The President's proposed budget, however, includes proposals that could reduce aid to New York City.

The Bipartisan Tax Fairness and Simplification Act would eliminate the federal tax exemption for municipal bonds issued after December 31, 2010, and replace it with a tax credit equal to 25 percent of interest costs. This proposal, which appears unlikely to be enacted, would increase the City's borrowing costs because investors would seek a higher interest rate to obtain similar returns to those currently received on tax-exempt bonds. Also, the bill would prohibit the advance refunding of tax-exempt bonds, which the City uses to effectively refund bonds that are not callable.

VI. Agency Actions

To help balance the FY 2011 budget, the Mayor has proposed agency actions valued at \$484 million in FY 2010 and \$1.1 billion annually thereafter (see Figure 18), which would reduce staffing by 4,286 positions, including 834 layoffs. Our review has identified four initiatives, with a value of \$27 million in FY 2011, which may not receive necessary outside approvals. The FY 2011 budget also counts on savings of \$44 million from three other initiatives that have not received necessary approvals.

Figure 18
Agency Actions

(in millions)

	FY 2011	FY 2012	FY 2013	FY 2014
Department of Education	\$ 316.8	\$ 316.8	\$ 316.8	\$ 316.8
Police Department	128.0	165.4	195.4	197.5
Sanitation	62.7	62.7	57.0	- - -
Social Services	55.8	55.6	54.7	54.9
Procurement Savings	55.5	55.5	55.5	55.5
Correction	51.9	52.6	53.0	53.4
Administration for Children's Services	51.9	45.2	43.7	43.8
Transportation	43.0	43.0	29.6	29.7
Health & Mental Hygiene	33.9	33.3	33.5	33.8
Parks and Recreation	33.8	26.8	26.6	26.7
Homeless Services	22.1	25.6	25.7	25.7
Libraries	22.1	22.1	22.1	22.1
District Attorneys & Prosecutors	22.0	22.0	22.0	22.0
Finance	21.5	21.8	21.9	21.9
Fire Department	19.5	35.3	38.6	41.3
Citywide Administrative Services	18.5	15.2	15.2	15.2
Information Technology	17.0	17.3	18.6	20.4
City University of New York	15.4	15.4	15.4	15.4
Youth	14.0	14.0	14.0	14.0
Cultural Affairs	10.5	10.5	10.5	10.5
Aging	10.3	10.3	10.3	10.3
Elected Officials	7.0	7.0	7.0	7.0
Other	82.7	81.2	104.4	110.8
Total	\$1,115.9	\$1,154.6	\$1,191.5	\$1,148.7

Source: NYC Office of Management and Budget

The following discussion identifies the agencies with the largest savings targets, the largest initiatives, and the impact on staffing.

- The Mayor would rescind cuts to educational programs if the unions that represent teachers and principals accept 2 percent annual wage increases in place of the 4 percent increases provided to other municipal workers (annual savings of \$316.8 million).
- The Police Department would reduce the police force to 32,817 officers by June 30, 2011—2,376 fewer officers than in December 2009—and would reduce overtime costs (\$128 million; reduction of 1,292 police officers).

- The Sanitation Department would achieve most of its planned savings from delays in opening four marine transfer stations, and lower-than-planned costs for exporting solid waste (\$62.7 million; 302 positions).
- The Department of Social Services would increase Medicaid reimbursement, implement administrative efficiencies, and reduce some services, such as a job training program (\$55.8 million; 299 positions).
- The City would eliminate an inflation adjustment for other-than-personal-service costs, forcing agencies to find efficiencies or reduce services (\$55 million).
- The Department of Correction would reduce the number of uniformed personnel through various staffing efficiencies and would lease beds to other jurisdictions (\$51.9 million; 363 positions).
- The Administration for Children’s Services would close and consolidate 15 child care centers; increase adoptions and family reunifications; and increase child protective caseloads (\$51.9 million; 250 positions).
- The Department of Transportation would increase parking rates and reduce the cost to maintain traffic signals by improving the contracting process (\$43 million; 76 positions).
- The Department of Health and Mental Hygiene would reduce funding for public health services, including the number of nurses working in the City’s schools (\$34 million; 174 positions).
- The Department of Parks and Recreation would reduce staffing and the number of participants in its job training program (\$33.8 million; 377 positions).
- The Department of Homeless Services would reduce the use of hotel facilities, reduce staffing, and obtain federal funding for veterans (\$22 million; 57 positions).
- Subsidies to libraries and the Department of Cultural Affairs would be reduced by \$32.6 million annually, which could lead to 485 layoffs.
- The Fire Department would eliminate the fifth firefighter post at 60 engine companies, which requires union approval; eliminate staffing at four engine companies and at 20 posts citywide; and deactivate street alarm boxes, which requires court approval (\$19.5 million; 409 positions).
- The Mayor has proposed reducing the budgets of district attorneys and other elected officials by \$29 million annually.

VII. Revenue Trends

The City's revenue outlook is improving. The City moved aggressively in the early stages of the financial crisis and the recession to lower its revenue forecasts in response to deteriorating economic conditions. The local economic downturn, however, has proved less severe than originally feared (and less severe than the national downturn). With the start of the economic recovery and Wall Street's rapid return to profitability, the City has raised its revenue forecasts. Our analysis indicates that business and personal income tax collections could be slightly higher throughout the Plan period, beginning in FY 2011, although we remain concerned that property values could be lower than anticipated during the Plan period.

The City has increased its revenue forecast for FY 2010 by \$1.8 billion since June 2009. Although the City reduced its property tax forecast by more than \$200 million annually for fiscal years 2012 through 2014, it still had a net revenue gain of \$700 million annually during this period. Tax collections are expected to return to the pre-crisis level in FY 2011.

The January Plan assumes that City fund revenues will grow by 1.4 percent in FY 2010 after falling by 5.5 percent in FY 2009 (see Figure 19)—the largest percentage decline in at least 30 years. Revenues are projected to grow by 3.7 percent in FY 2011 and 4.7 percent in FY 2012, and then slow in subsequent years as the recent declines in property values are more fully phased in to real property tax collections.

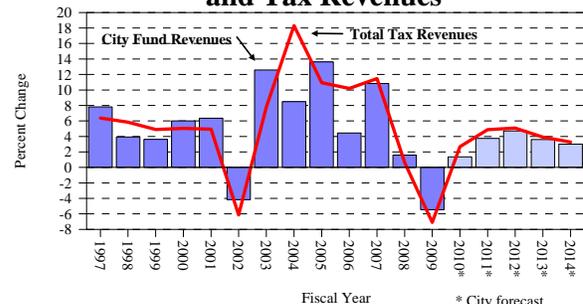
Details of the City's revenue trends are discussed below and shown in Figure 21.

A. Real Property Tax

In January 2009, the City enacted a 7 percent increase in the average real property tax rate and rescinded the \$400 home owner rebate beginning in FY 2010. Together, these actions generated more than \$900 million in recurring revenue.

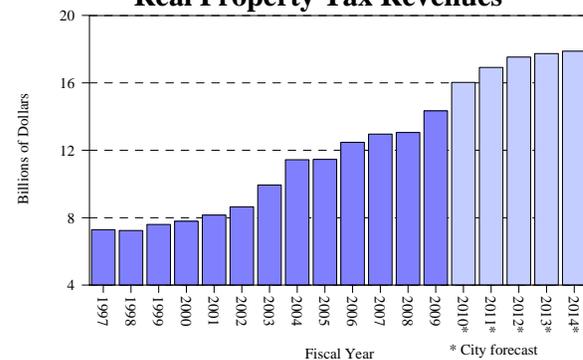
State law includes provisions that minimize the impact of large market value

Figure 19
Annual Changes in City Fund Revenues and Tax Revenues



Note: Excludes proposed tax program and agency program. Adjusted for debt service on TFA and tobacco bonds as well as the transfer of TSAC revenues.
Sources: NYC Comptroller; NYC Office of Management and Budget; OSD analysis

Figure 20
Real Property Tax Revenues



Sources: NYC Comptroller; NYC Office of Management and Budget

fluctuations on assessments by phasing in these changes over several years (i.e., creating a the pipeline), thereby allowing assessments to continue to rise even as market values fall. The tentative roll for FY 2011, which was lower than expected, reduced the value of the pipeline. As a result, the City has lowered its projected rate of growth in assessed values, resulting in a reduction in projected property tax collections compared to the June 2009 forecast—by \$233 million in FY 2011 and \$383 million by FY 2013. Nonetheless, revenues are still expected to rise by 5.5 percent in FY 2011 (see Figure 20). The growth in assessed values is expected to slow during the balance of the Plan period, but a faster erosion in the pipeline could result in additional revenue shortfalls.

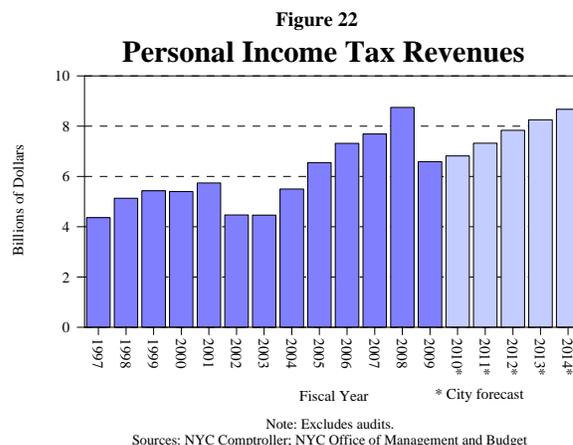
Figure 21
City Fund Revenues
(in millions)

	FY 2010	FY 2011	Annual Growth	FY 2012	FY 2013	FY 2014	Average Three-Year Growth Rate
Taxes							
Real Property Tax	\$ 16,034	\$ 16,915	5.5 %	\$ 17,533	\$ 17,742	\$ 17,879	1.9 %
Personal Income Tax	6,817	7,320	7.4 %	7,833	8,251	8,667	5.8 %
Sales Tax	4,881	5,122	4.9 %	5,361	5,660	5,975	5.3 %
Business Taxes	4,600	4,949	7.6 %	5,380	5,791	6,103	7.2 %
Real Estate Transaction Taxes	970	1,105	13.9 %	1,229	1,416	1,593	13.0 %
Other Taxes	2,794	2,772	-0.8 %	2,822	2,891	2,920	1.7 %
Audits	881	596	-32.3 %	595	594	594	-0.1 %
Subtotal	36,977	38,778	4.9 %	40,753	42,345	43,731	4.1 %
Miscellaneous Revenues	4,488	4,251	-5.3 %	4,316	4,355	4,381	1.0 %
Unrestricted Intergovernmental Aid	340	340	0.0 %	340	340	340	0.0 %
Grant Disallowances	(15)	(15)	0.0 %	(15)	(15)	(15)	N.A.
Subtotal	41,790	43,355	3.7 %	45,393	47,025	48,437	3.8 %
Proposed Gap-Closing Program	76	90	18.6 %	83	84	78	-4.7 %
Proposed Tax Program	- - -	219	NA	241	262	284	9.0 %
Total Including Programs	\$ 41,866	\$ 43,663	4.3 %	\$ 45,718	\$ 47,370	\$ 48,799	3.8 %

Note: Miscellaneous revenues include debt service on tobacco bonds. Totals may not add due to rounding.
Sources: NYC Comptroller; NYC Office of Management and Budget; OSDC analysis

B. Personal Income Tax

Personal income tax collections are projected to rise by \$503 million (7.4 percent) to \$7.3 billion in FY 2011, boosted by an expected surge in capital gains realizations in anticipation of the expiration of the Bush tax cuts and a resumption of employment growth. Collections are expected to grow at an average annual rate of 5.8 percent in later years and reach \$8.7 billion by FY 2014, only slightly less than the peak reached in FY 2008 (see Figure 22).



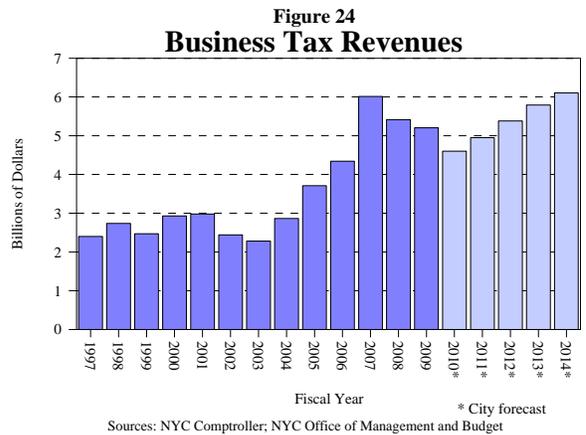
C. Sales Tax

The January Plan assumes that sales tax collections will grow to \$4.9 billion in FY 2010 (see Figure 23)—about the same as the peak reached in FY 2008—reversing last year’s decline. The January Plan assumes that the economy will improve next year and that tourism will rebound, fueling a 4.9 percent increase in sales tax collections. Collections are projected to grow at an average annual rate of 5.2 percent during fiscal years 2011 through 2014. The Plan also assumes the State will extend the sales tax to aviation fuel, which would generate \$169 million in FY 2011 and more than \$200 million by FY 2014.



D. Business Taxes

Business tax collections are projected to resume growth in FY 2011, although the bank tax is still expected to decline. Collections are not projected to reach the FY 2007 peak until FY 2014 (see Figure 24).



Wall Street’s quick return to record profitability will cause the industry to exhaust its credits from prior losses at a faster rate, contributing to faster general corporation tax growth. Despite the decline in the bank tax, total business tax collections are forecast to grow by 7.6 percent in FY 2011. Business tax collections are projected to grow at an average annual rate of 7.2 percent during the balance of the financial plan period.

Collections from business taxes declined by 11.6 percent in FY 2010, falling to \$4.6 billion (including audits, the decline is 10.5 percent)—the third consecutive year of decline. Reflecting the impact of the recession on the financial industry, the City’s bank tax is forecast to decline by \$405 million or 36.8 percent in FY 2010 (including audits, the decline is \$500 million). This is greater than the declines in the other business taxes.

E. Real Estate Transaction Taxes

The January Plan assumes that collections from the real estate transaction taxes (the mortgage recording and real property transfer taxes) will resume growth in FY 2011 after three consecutive years of decline. Collections fell from a peak of \$3.3 billion in FY 2007 to an expected \$970 million in FY 2010 (see Figure 25), a drop of more than 70 percent. Collections are now projected to rise by \$135 million in FY 2011, to reach \$1.1 billion, and then reach \$1.6 billion by FY 2014. During 2009, there was a significant decline in commercial real estate transactions throughout the City, in particular for Manhattan office properties. Citywide, the number of commercial property transactions declined by 20.8 percent, and the total values of transactions fell by 55.7 percent.

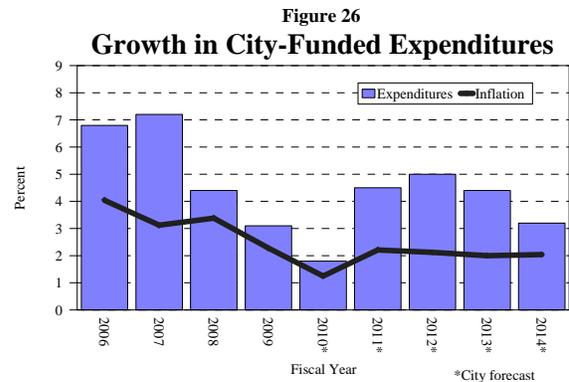


The residential market is showing signs of improvement. Nationally, home prices have been increasing, and although monthly home prices in the New York area declined toward the end of 2009, there were several months in which prices showed small increases. Recent data on Manhattan’s apartment markets also show smaller price declines and some modest increases for sales in certain categories.

The City’s financial plan estimates also assume the enactment of the Governor’s recommended extension of the mortgage recording tax to cooperative apartments. If approved by the State Legislature, the City estimates that this provision would increase collections by \$50 million in FY 2011, rising to \$78 million in FY 2014.

VIII. Expenditure Trends

City-funded spending is projected to rise by 11.4 percent in FY 2011, but after adjusting for surplus transfers and past debt defeasances that benefited FY 2010 by \$2.7 billion, the growth rate is reduced to 4.5 percent, which is still faster than the projected inflation rate (see Figure 26). Growth will be driven by the loss of temporary federal ARRA Medicaid funding (\$711 million) and rising costs for pensions (\$492 million), health insurance (\$388 million), and debt service (\$249 million), partly offset by savings from the agency cost-reduction program. The agency program would reduce spending by \$409 million in FY 2010 and by more than \$1 billion annually in subsequent years, and would reduce staffing by 4,286 positions in FY 2011. In total, the City-funded workforce would decline by 7,629 employees between December 2009 and June 30, 2011 (see Appendix).



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

Figure 27
Estimated City-Funded Expenditures
(Adjusted for Surplus Transfers and Debt Defeasances)
(in millions)

	FY 2010	FY 2011	Annual Growth	FY 2012	FY 2013	FY 2014	Average Three-Year Growth Rate
Salaries and Wages	\$ 12,021	\$ 11,721	-2.5 %	\$ 11,674	\$ 11,923	\$ 12,098	1.1 %
Debt Service	5,177	5,426	4.8 %	6,178	6,474	6,716	7.4 %
Medicaid	4,798	5,509	14.8 %	5,978	6,159	6,343	4.8 %
Pension Contributions	6,595	7,087	7.5 %	7,512	7,657	7,765	3.1 %
Health Insurance	3,405	3,793	11.4 %	4,057	4,402	4,785	8.1 %
Other Fringe Benefits	2,457	2,500	1.7 %	2,801	2,746	2,865	4.6 %
Judgments and Claims	663	717	8.2 %	775	835	898	7.8 %
Public Assistance	549	569	3.6 %	569	607	607	2.2 %
General Reserve	200	300	50.0 %	300	300	300	0.0 %
Energy	844	913	8.1 %	953	979	994	2.9 %
Drawdown Retiree Health Benefits Trust	(82)	(395)	NA	(672)	---	---	NA
Other	7,896	8,407	6.5 %	8,754	8,953	9,278	3.3 %
Subtotal	44,523	46,546	4.5 %	48,878	51,035	52,649	4.2 %
Savings from Past Debt Defeasances	(2,726)	---	NA	---	---	---	NA
Total	\$ 41,797	\$ 46,546	11.4 %	\$ 48,878	\$ 51,035	\$ 52,649	4.2 %

Note: Debt service includes bonds issued by TSASC. Totals may not add due to rounding.

Sources: NYC Office of Management and Budget; OSDC analysis

The January Plan is based on the trends shown in Figure 27, as discussed below.

A. Collective Bargaining

One of the major City unions, the United Federation of Teachers (UFT), is currently without a contract for fiscal years 2009 and 2010, and agreements with some of the City's other major unions have either expired or are about to expire in the next few months. The agreement with District Council 37, which represents most civilian workers, expired on March 2, 2010, and the agreement with the Patrolmen's Benevolent Association (PBA) expires on July 31, 2010. These three unions represent more than 75 percent of the City's workforce.

The City has reduced its wage offer to the UFT and the Council of School Supervisors and Administrators (CSA) for the current round of collective bargaining, from 4 percent annually to 2 percent annually (limited to the first \$70,000 of an employee's salary), even though the City negotiated 4 percent annual wage increases with the City's other civilian employees. The New York State Public Employment Relations Board (PERB) has declared an impasse in the negotiations between the UFT and the City, and has appointed a mediator to begin nonbinding arbitration.

The change in the City's collective bargaining position will free up \$148 million in FY 2010, \$350 million in FY 2011, and higher amounts in subsequent years. The City plans to use the anticipated savings to take the place of a previously planned cut in funding for educational programs, and to fund unplanned special education costs.

The City has also changed its strategy for the next round of collective bargaining. The June Plan had assumed the City and the municipal unions would reach agreements that would generate annual savings of about \$600 million beginning in FY 2011 from restructuring health insurance costs and pension benefits for new employees. The January Plan no longer assumes these savings, but instead assumes that the next round of collective bargaining will be funded with savings from productivity, and from restructuring municipal employee fringe benefits. If wages were to rise at the projected inflation rate without offsetting savings, the City would incur costs of \$233 million in FY 2011, \$565 million in FY 2012, \$898 million in FY 2013, and \$1.1 billion in FY 2014.

In 1998, the State transferred responsibility for handling police officer contract disputes from the City's Office of Collective Bargaining to the PERB. According to State law, any arbitration award made by the PERB to the PBA is binding on the City. Prior to the current labor agreement, the past three agreements between the City and the PBA were based on PERB awards. The current agreement, which was negotiated by the City and the PBA without PERB mediation, provided for four annual wage increases of 4 percent, which follows the pattern set by other uniformed unions.

B. Debt Service

After adjusting for debt service prepayments and debt defeasances, debt service is projected to rise from \$4.7 billion in FY 2009 to \$5.4 billion in FY 2011, an increase of \$728 million.⁶ (The FY 2011 estimate reflects savings of \$330 million from debt refundings in the current fiscal year as the City took advantage of low interest rates.) Debt service is forecast to increase to \$6.7 billion by FY 2014, an average three-year growth rate of 7.4 percent—much faster than the projected local inflation rate.

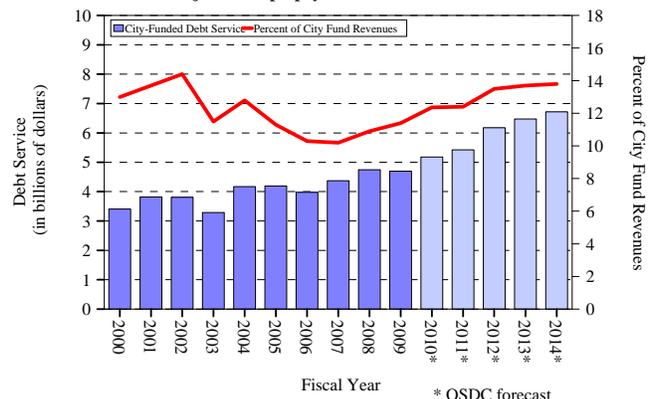
Debt service is expected to consume 12.4 percent of City fund revenues in fiscal years 2010 and 2011, compared with 10.2 percent in FY 2007. This ratio, which measures the burden that debt places on the operating budget, will reach 13.8 percent by FY 2014—the highest since FY 2002 (see Figure 28). The January Plan assumes that the City will reenter the short-term market in FY 2011, after a

six-year absence, when it plans to borrow a total of \$2.4 billion to meet its cash flow needs—as the current economic downturn has exhausted the large cash balances the City had accumulated during the last economic expansion.

The City has issued nearly \$2.7 billion in Build America Bonds (BABs), which are authorized under the federal economic stimulus program and carry a federal subsidy of 35 percent of the interest cost.⁷ In current market conditions, the subsidy has provided effective interest rates that are lower than the rates on City tax-exempt bonds, which are not subsidized.

The January Plan also assumes the issuance of \$1.7 billion in Qualified School Construction Bonds (QSCBs). QSCBs were authorized under the ARRA to provide interest-free financing to issuers by providing tax credits to investors. The City was authorized to issue \$699 million in calendar year 2009, and anticipates a similar authorization in 2010. Although the program expires in 2010, the City assumes an additional authorization of \$300 million. The City has not issued any QSCBs to date, citing limited investor acceptance for tax credit bonds, and is awaiting federal

Figure 28
City-Funded Debt Service
Adjusted for prepayments and defeasances



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

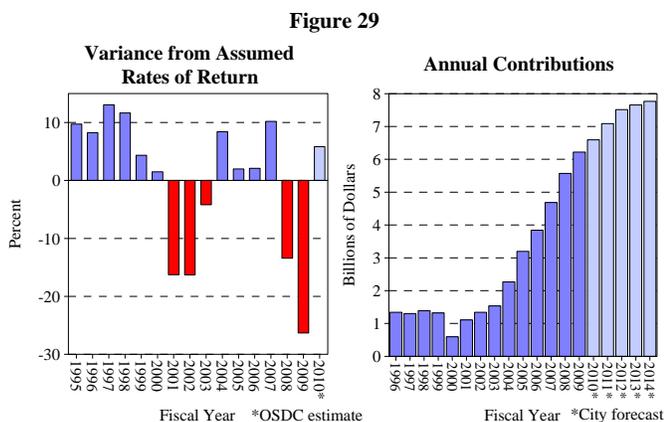
⁶ The City used surplus resources in fiscal years 2007 and 2008 to prepay and defease debt due in fiscal years 2009 and 2010. These nonrecurring actions reduced debt service by \$675 million in FY 2009 and by \$2.7 billion in FY 2010.

⁷ The Municipal Water Finance Authority (MWFA), an autonomous agency that finances capital projects for the City's water and sewer system, has issued an additional \$504 million in BABs thus far in FY 2010.

legislation to make the bonds more marketable. The Senate and the House have both made proposals that would make the bonds more marketable, but the Senate proposal would reduce the amount of savings anticipated in the January Plan by \$17 million in FY 2011, \$36 million in FY 2012, \$51 million in FY 2013, and \$54 million in FY 2014.

C. Pension Contributions

City contributions to the pension systems are projected to rise from about \$1.5 billion in the late 1990s to \$7.1 billion in FY 2011, and reach \$7.8 billion by FY 2014, reflecting past investment performance and benefit enhancements (see Figure 29). Through February 28, 2010, the pension funds have earned 15 percent on their investments, or six percentage points more than the assumed rate of return. If investment earnings are maintained through June 30, 2010, contributions could be lower by \$111 million in FY 2012, \$204 million in FY 2013, and \$301 million in FY 2014.



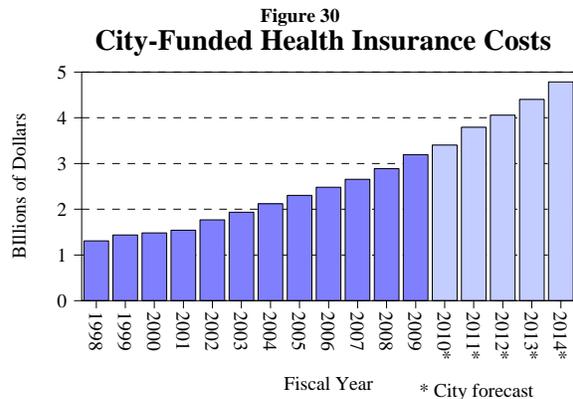
Sources: NYC Comptroller; NYC Office of Management and Budget; OSDC analysis

In December 2009, the State created lower-cost pension plans for new State and local government employees (excluding New York City) and for New York City teachers. City teachers will still be able to retire at age 55 with 27 years of service, but will now be required to contribute a higher percentage of their salaries (4.85 percent) for a longer period of time (27 years instead of 10 years). The revised pension plan for new teachers will reduce costs by \$19 million in FY 2010, and these savings will rise to \$30 million in FY 2014. The State has not acted on the Mayor’s proposals for lower-cost pension plans for the City’s uniformed or other civilian employees.

The January Plan includes reserves of \$200 million in FY 2011 and \$450 million annually in subsequent years to fund recommendations contained in City Charter-mandated biennial audits of the City’s pension systems. According to these audits, additional funding may be needed to cover the increasing costs of longer life expectancies and rising salaries. The City Actuary is still reviewing the recommendations and there is no timeline to implement the recommendations. Any excess reserves could be used to help close the City’s projected budget gaps.

D. Health Insurance

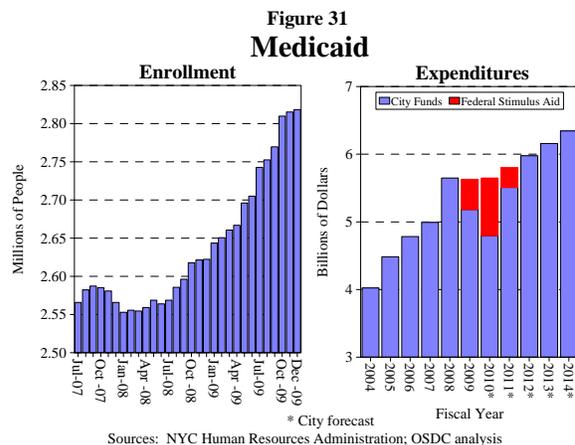
A June 2009 agreement between the City and its unions reduced City health insurance costs by \$200 million in each of fiscal years 2010 and 2011, and by \$150 million annually in future years. Despite the agreement, premiums continue to rise and are expected to increase by 11.5 percent in FY 2010, 9.8 percent in FY 2011, and by 8 percent annually in subsequent years. City spending on health insurance will increase from \$3.4 billion in FY 2010 to \$4.8 billion in FY 2014 (see Figure 30).



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

E. Medicaid

The Medicaid caseload reached 2,818,225 in December 2009 (see Figure 31), 7.5 percent higher than the December 2008 level. Even though State law limits the annual growth in the local share of Medicaid to 3 percent, the City's costs will increase by 25 percent from \$4.8 billion in FY 2010 to \$6 billion in FY 2012, when federal stimulus aid expires.⁸ In subsequent years, the growth in spending is expected to return to the State's statutory rate.



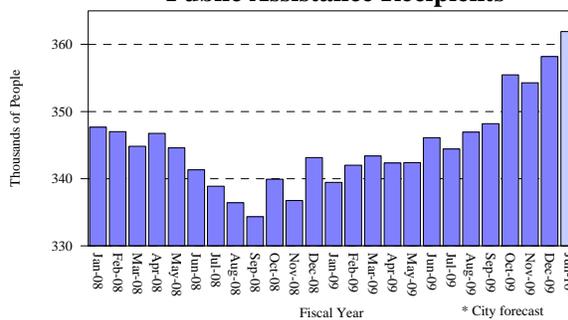
F. Public Assistance

The public assistance caseload reached 358,190 in December 2009 (see Figure 32), 4.4 percent higher than the December 2008 level. The January Plan assumes that the caseload will increase slightly to 361,900 by June 2010. In April 2009, the State raised benefit levels. In January 2010, the Governor proposed to delay implementation of the increase. If enacted, the City would incur \$11 million in additional costs in FY 2014 and \$43 million annually thereafter.

⁸ Receipt of federal stimulus aid reduced these costs by \$447 million in FY 2009, \$850 million in FY 2010, and \$295 million in FY 2011.

Congress is expected to reauthorize the federal public assistance program, Temporary Assistance for Needy Families (TANF), by September 2010. Federal block grant funding has not increased since 1996, despite caseload increases and state budget deficits. States are seeking to index the TANF block grant to inflation, and are requesting more flexibility and discretion with work requirements in order to better meet existing needs for assistance, given states' budgetary stress and constraints.

Figure 32
Public Assistance Recipients

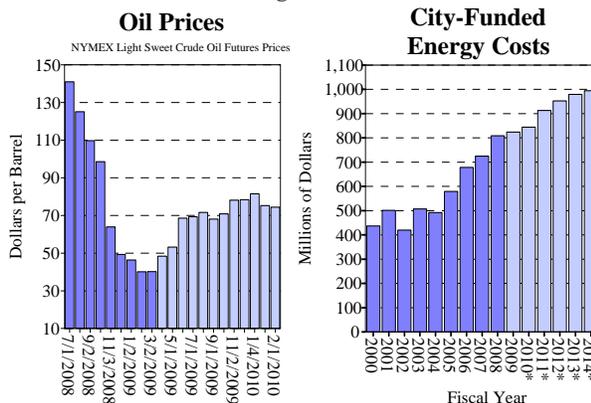


Sources: NYC Human Resources Administration; NYC Office of Management and Budget; OSDC analysis

G. Energy Costs

Prior to FY 2004, the City's energy costs totaled about \$500 million annually. In later years, rising oil and natural gas prices along with higher rates and charges from utility companies nearly doubled the City's annual costs. Energy expenditures are projected to total \$913 million in FY 2011, an increase of \$69 million over the current year due to electric, gas, and steam rate increases, and higher oil prices. These costs will remain at about \$1 billion annually through FY 2014 (see Figure 33).

Figure 33



* City forecast
Sources: NYC Comptroller; NYC Office of Management and Budget; U.S. Energy Information Administration; OSDC analysis

The City's energy forecast is lower than last year's due to the falling price of oil, which peaked at \$147 per barrel on July 1, 2008, and has since declined to \$74 per barrel on February 1, 2010.

H. Judgments and Claims

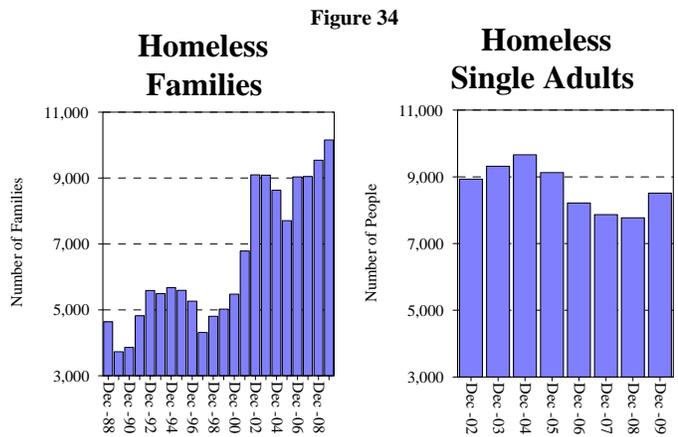
Judgments and claims are expected to total nearly \$900 million in FY 2014, an increase of 35 percent over the current fiscal year. In an effort to hold down the growth in these costs, the City has proposed reforms that require State approval. The City could face liabilities from 11,900 claims that allege injuries ensuing from rescue and cleanup work at the World Trade Center site.

I. Overtime

Overtime is projected to decline next year to \$788 million and then essentially remain at that level. Nearly 85 percent of overtime is expected to occur in the uniformed agencies—Correction, Fire, Police, and Sanitation. Since June, the City increased funding for overtime by \$136 million in FY 2010; these costs could be higher than planned by \$150 million annually beginning in FY 2011. In addition, snowstorms in December 2009 and February 2010 exhausted the City’s snow budget, which could require additional funding of \$20 million in the current year.

J. Homeless Services

The annual number of people seeking shelter in the City rose from 98,239 in FY 2005 to 120,381 in FY 2009. An even greater number of people could seek shelter during FY 2010 than in FY 2009. In December 2009, 10,157 families resided in municipal shelters—the highest level reached in over 20 years. Another 8,500 single adults resided in municipal or faith-based shelters, special housing programs for veterans and the long-term homeless, and drop-in centers—a rising trend after several years of declines (see Figure 34).



Sources: NYC Department of Homeless Services; OSD analysis

IX. Other Issues

The following section discusses the financial condition of certain public entities that have a financial relationship with the City, and other issues that could affect the City during the financial plan period.

A. Department of Education

The Chancellor has testified that the Department of Education could face a funding shortfall of \$900 million in FY 2011. More than half of the projected shortfall comes from the impact of the State budget, which would reduce State education aid to the City by \$493 million. In addition, teachers are not retiring as quickly as the department had anticipated because of the recession. As a result, average salaries are higher than planned because senior teachers generally earn higher salaries. In addition, the department will have to address, beginning in FY 2012, the scheduled loss of federal stimulus aid that supports about \$1 billion in recurring spending. The Mayor has indicated that he would lay off 14,190 school personnel when the aid expires. Congress and the President are negotiating another economic stimulus package that could include new resources for education to help avert layoffs and service reductions.

In January 2007, the Governor announced that the State would increase education aid to New York City by \$3.2 billion over a four-year period in an effort to resolve the Campaign for Fiscal Equity (CFE) litigation. The City had agreed to increase its funding to education by \$2.2 billion over the same period. The City met its target, but the State has fallen far short of its goal as a result of the recession. The State now plans to meet its target over a ten-year period.

B. Metropolitan Transportation Authority

The Metropolitan Transportation Authority (MTA) faces a projected budget gap of \$761 million in calendar year 2010 due mostly to a projected shortfall in receipts from the mobility tax (\$436 million); reestimates and reductions in State taxes and subsidies (\$233 million); and unanticipated labor costs (\$91 million). To help close the gap, the MTA plans to reduce services, reduce administrative costs, and phase out free transportation for students over the next two years. These actions will close only half of the projected budget gap. The MTA is considering additional cost-saving actions and other measures to ensure a balanced budget in 2010, but is not, at this time, considering fare and toll hikes in the current year. The MTA currently plans to raise fares and tolls by 7.5 percent in each of calendar years 2011 and 2013.

The MTA is constructing the \$2 billion extension of the No. 7 subway line from its existing terminus at 41st Street and 8th Avenue to 34th Street and 11th Avenue, with funding provided by the Hudson Yards Infrastructure Corporation (HYIC). A station

at 41st Street and 10th Avenue is no longer part of the project because of insufficient funding, although the business community would like to see it built. 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.

In May 2008, the MTA and a joint development venture of Related Companies and Goldman Sachs Group signed an agreement regarding development over the eastern and western rail yards located at the southern end of the Hudson Yards Special District. (Both yards have now been rezoned for development.) The agreement was expected to provide the MTA with more than \$1 billion over the life of the deal, but the economic downturn has delayed new office construction in the City. A contract was originally expected to be signed in November 2008, but the signing was delayed due to the economic downturn. Goldman Sachs has since pulled out as a financing partner, and the MTA and Related have agreed to delay the contract signing until March 31, 2010. The MTA has already received a \$14 million down payment, and would receive another \$22 million if the contract is signed.

C. Health and Hospitals Corporation

The Health and Hospitals Corporation (HHC) is expected to end FY 2010 with a cash balance of \$805 million, reflecting efforts by New York City and New York State over the past three years to obtain federal Medicaid supplemental payments for hospitals that provide a disproportionate share of their services to uninsured and Medicaid patients compared with other hospitals in New York State. The HHC could exhaust its cash reserves by FY 2012 due to restricted access to these supplemental payments beginning in FY 2011. The HHC is considering actions to balance its budget, including layoffs.

D. New York City Housing Authority

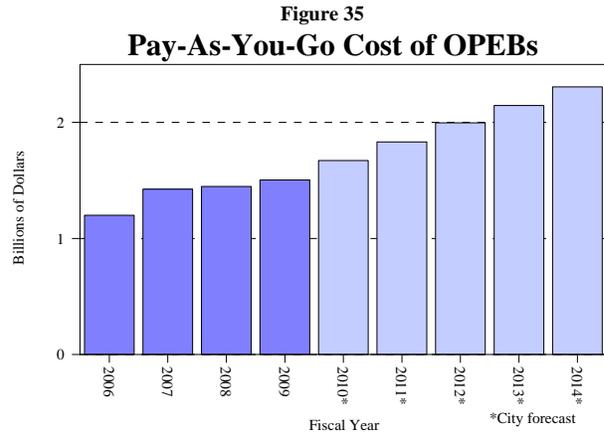
The New York City Housing Authority (NYCHA) continues to face a structural deficit because rents and government subsidies have not kept pace with rising costs. We estimate that NYCHA, which operates on a calendar-year basis, faces a \$167 million budget gap in 2010 and gaps totaling \$183 million annually in 2011 through 2013. In the past, when gap-closing plans did not succeed, NYCHA used capital funds and operating reserves to balance its budget. NYCHA has not yet released a gap-closing plan to close the current projected budget gaps.

NYCHA is seeking federal authorization to rehabilitate 21 City and State developments, which are currently ineligible for federal operating assistance, using private and stimulus program funds. Under federal law, buildings rehabilitated with federal funds become eligible for federal operating assistance. If successful, the plan could generate \$100 million annually in new federal operating aid. A response from the federal government is expected by the end of March 2010.

E. 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 45 does not require entities to fund these costs on an actuarial basis, entities could realize significant long-term savings if they did so. The State Comptroller has proposed legislation that would permit localities to create OPEB trusts for this purpose.

In September 2009, the City reported that its accrued liability for past OPEB services was \$65.1 billion as of the June 30, 2008, valuation, and estimated that the present value of its future OPEB obligations was \$35.9 billion. Overall, the present value of projected OPEB benefits totaled \$101.1 billion, an increase of \$9.1 billion from the FY 2006 level of \$92 billion. 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 \$2.7 billion. OPEB costs (on a pay-as-you-go cash basis) are projected to rise from \$1.2 billion in FY 2006 to \$2.3 billion by FY 2014, an average annual increase of 8.6 percent (see Figure 35).



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

To address the growing cost of OPEBs, the City created its own Retiree Health Benefits Trust (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. In the current recession, however, the Mayor has proposed using \$1.1 billion of these resources over a three-year period (\$82 million in FY 2010, \$395 million in FY 2011, and \$672 million in FY 2012) to help balance its operating budget, which will increase taxpayers’ future OPEB liability.

F. Governmental Accounting Standards Board Statement No. 49

GASB's Statement No. 49 requires certain pollution remediation costs to be accounted for as expense items. Pursuant to the Financial Emergency Act, 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 (FCB). Given the potential impact on the operating budget, the FCB approved a resolution on April 30, 2008, which defers the City's implementation of GASB 49 for budgeting purposes until July 1, 2010. The City identified pollution remediation obligations of \$173 million in FY 2008 and \$176 million in FY 2009. Under the temporary waiver granted by the FCB, the City was able to transfer capital funds to pay for certain pollution costs of \$176 million in FY 2009. We estimate that after the waiver expires, the City could incur operating budget costs of about \$200 million annually starting in FY 2011.

G. New York City's Credit Rating

New York City's general obligation (GO) credit is rated "AA" by Standard & Poor's, "AA-" by Fitch Ratings, and "Aa3" by Moody's Investors Service. The ratings have been in place since the summer of 2007 and are the highest in at least 70 years. The City's Transitional Finance Authority (TFA) credit is rated higher by the three agencies ("AAA" by S&P, "AA+" by Fitch Ratings, and "Aa1" by Moody's.) The TFA's higher rating enables the City to assume that half of its City-funded capital program can be financed at interest rates that are lower than those of GO debt. The January Plan assumes a spread of 20 basis points between budgeted interest rates for GO debt versus TFA debt. The TFA's credit rating benefits from strong statutory revenue streams used to secure its bonds (i.e., personal income tax and, if needed, sales tax), while both the TFA and GO ratings reflect the City's broad economic base and sound financial planning practices. Although all three agencies affirm a stable outlook, the agencies have expressed concern over the City's reliance on the volatile financial services and real estate sectors, a high debt burden by many measures, and rising nondiscretionary costs, including pensions and retiree health care.

H. Federal Health Care Reform

The congressional debate on federal health care reform, which had stalled, resumed in late February 2010. Congress is considering a wide range of health care reforms as part of an effort to expand coverage, improve services, and reduce costs. A major objective of the reform was to reduce the nation's uninsured population, which would be accomplished in large part by expanding Medicaid eligibility; this could increase the State's costs. The State estimated that the Senate bill would increase its costs by \$1 billion. It remains to be seen how any reforms, if enacted, would affect the New York City health care industry and the City budget.

I. Lower Manhattan Redevelopment

The current economic recession, along with tight credit markets, have delayed plans for construction of Towers 2, 3, and 4 by Silverstein Properties Inc., (SPI) at the World Trade Center (WTC) site. In a recent arbitration decision the arbitration panel rejected SPI's requests for rent abatement and schedule realignment, as well as the request that the panel find that the Port Authority of New York and New Jersey (Port Authority) was in material breach of the master development agreement (MDA). The panel did grant SPI's request for the elimination of the cross default in the MDA, and denied the Port Authority's request that SPI begin construction on Towers 2 and 3 immediately. The panel also issued a supplemental order requiring the Port Authority and SPI to meet and agree, if possible, on a new schedule—focusing first on the structures to be constructed by SPI, and when—and to report back to the panel within 45 days regarding their progress. That period is still pending.

In the meantime, the Port Authority continues to make progress on the public projects on the site. The Port Authority has moved forward with work on One World Trade Center, which has reached the 20th floor. The steel for the National September 11 Memorial & Museum, which the Port Authority is in charge of building, is 95 percent complete. The WTC Transportation Hub is taking shape, and the Vehicle Security Center and Tour Bus Parking Facility and other infrastructure projects are also moving forward. The delayed deconstruction of 130 Liberty Street (formerly the Deutsche Bank building, now owned by the Lower Manhattan Development Corporation), which is being supervised by the Lower Manhattan Construction Command Center, resumed in November 2009 with an expected completion date at the end of 2010.

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

Increase/(Decrease)

	Actual			City Forecast		Variance	
	June 2008	June 2009	Dec. 2009	June 2010	June 2011	Dec. 2009 to June	June 2010 to June 2011
Public Safety	83,016	83,089	82,617	79,397	77,450	(3,220)	(1,947)
Police Uniformed	35,405	35,641	35,193	33,217	32,817	(1,976)	(400)
Police Civilians	16,467	16,567	16,613	16,030	16,103	(583)	73
Fire Uniformed	11,578	11,454	11,256	11,174	10,374	(82)	(800)
Fire Civilians	4,770	4,735	4,843	4,776	4,798	(67)	22
Correction Uniformed	8,413	8,344	8,379	7,940	7,419	(439)	(521)
Correction Civilians	1,411	1,410	1,395	1,543	1,596	148	53
District Attys. & Prosecutors	3,582	3,610	3,665	3,293	2,989	(372)	(304)
Probation	931	862	828	803	837	(25)	34
Other	459	466	445	621	517	176	(104)
Health & Welfare	25,208	24,778	23,856	24,123	23,567	267	(556)
Social Services	10,478	10,489	10,404	10,414	10,450	10	36
Children's Services	7,101	6,652	6,111	6,135	5,775	24	(360)
Health & Mental Hygiene	5,298	5,170	5,028	5,200	4,931	172	(269)
Homeless Services	2,055	2,000	1,928	2,005	2,046	77	41
Other	276	467	385	369	365	(16)	(4)
Environment & Infrastructure	19,736	19,269	17,594	17,587	16,488	(7)	(1,099)
Sanitation Uniformed	7,556	7,482	7,312	7,238	7,075	(74)	(163)
Sanitation Civilians	1,943	1,948	1,915	2,008	2,000	93	(8)
Transportation	2,345	2,436	2,275	2,129	2,210	(146)	81
Parks & Recreation	7,417	7,190	5,885	5,983	4,974	98	(1,009)
Other	475	213	207	229	229	22	- - -
General Government	9,167	9,179	9,133	9,375	9,168	242	(207)
Finance	2,203	2,058	2,008	2,154	2,105	146	(49)
Law	1,370	1,392	1,345	1,326	1,247	(19)	(79)
Citywide Admin. Services	1,387	1,654	1,698	1,751	1,763	53	12
Taxi & Limo. Commission	422	435	436	481	482	45	1
Investigations	241	234	235	249	221	14	(28)
Board of Elections	550	411	491	374	374	(117)	- - -
Info. Tech. & Telecomm.	1,057	1,130	1,109	1,152	1,118	43	(34)
Other	1,937	1,865	1,811	1,888	1,858	77	(30)
Housing	1,937	1,870	1,810	1,986	1,905	176	(81)
Buildings	1,240	1,227	1,208	1,322	1,257	114	(65)
Housing Preservation	697	643	602	664	648	62	(16)
Department of Education	121,083	120,828	119,116	120,858	120,387	1,742	(471)
Pedagogues	97,189	97,901	96,474	97,578	97,563	1,104	(15)
Non-Pedagogues	23,894	22,927	22,642	23,280	22,824	638	(456)
City University of New York	6,931	7,281	8,271	6,195	5,929	(2,076)	(266)
Pedagogues	4,406	4,694	5,517	3,956	3,909	(1,561)	(47)
Non-Pedagogues	2,525	2,587	2,754	2,239	2,020	(515)	(219)
Elected Officials	2,520	2,449	2,389	2,350	2,263	(39)	(87)
Total	269,598	268,743	264,786	261,871	257,157	(2,915)	(4,714)

Sources: NYC Office of Management and Budget; OSDC analysis