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Analysis of the Mayor's Preliminary Budget for 2009

IBO's Reestimate of the Mayor's Preliminary Budget for 2009 and Financial Plan through 2012

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Preface

This report provides IBO's analysis of the Mayor's Preliminary Budget for 2009 and Financial Plan through 2012. The report includes our own economic and revenue forecasts and examines the Bloomberg Administration's key budget proposals. It also highlights some of the fiscal issues facing the city, questions that become increasingly difficult as resources become more scarce.

Because some of the estimates contained in this report were first made available in conjunction with the City Council budget hearings that began March 4th, they do not reflect all of the latest events and information. In particular, IBO's economic and tax revenue forecasts were completed in late February, before much of the recent turmoil in financial markets—evidenced most recently by the collapse of Bear Stearns—had occurred.

As we have since 2002, IBO has also produced a companion volume to this report, Budget Options for New York City. Released in February, the latest report presents more than 60 ways to reduce costs to the city and to raise revenue. For each of the measures we review, IBO discusses its pros and cons along with our projection of savings or revenue.

One note on the report's format: all years refer to city fiscal years unless otherwise indicated.

This Preliminary Budget report is the product of the expertise and dedication of IBO's team of budget analysts and economists. A list of staff contributors and their areas of responsibility are included at the end of the report. The report was written under the supervision of Deputy Directors Preston Niblack, Frank Poscillico, and George Sweeting with the help of Assistant Deputy Directors Nicole Fleming, Paul Lopatto, and Ana Ventura. Tara Swanson coordinated production and distribution and Doug Turetsky provided editorial assistance.

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Overview

Despite a steady deterioration in the national and local economies since the fall, New York City's near-term budgetary picture may not be as dark as one might expect. IBO's projections of revenues and expenditures based on the Mayor's preliminary budget for 2009 and financial plan through 2012 finds that the city has no budgetary shortfall for 2009 and our gap estimate for 2010 is $2.1 billion, roughly half the size of the shortfall anticipated by the Bloomberg Administration.

There are two major reasons for this still positive near-term outlook. One reason is that so far this fiscal year business tax collections have not declined as much as previously expected. In addition, despite Wall Street's huge losses, bonuses barely declined, bolstering personal income tax withholdings.

The other key reason is that the extraordinary budget surpluses amassed during the past few years are helping the city weather the near-term effects of the economic storm. Last year's $4.7 billion surplus will help the city end this fiscal year with a similarly large surplus. Although we project that in 2009 tax revenues will be less than what the city will collect this year, the 2008 surplus will be more than sufficient to fill next year's gap. The remaining surplus will be used to help reduce the 2010 shortfall by $1.7 billion, leaving the expected gap of $2.1 billion. But with expenditure growth projected to exceed revenue growth throughout the financial plan period and no remaining surplus to carry forward, the fiscal picture for 2011 and 2012 darkens considerably, with shortfalls reaching $5.1 billion.

Bad News Rising. Yet there are ample reasons to be concerned that the picture could darken more quickly than our projections indicate. The economic situation is particularly precarious. IBO's economic and tax revenue forecast produced in late February assumes a relatively brief and mild recession. If the problems affecting the financial and housing sectors worsen—the collapse of Bear Stearns after we completed our forecast is a clear indication of the potential for things to get worse— the recession will be deeper, job losses greater, and fiscal pressures on the city will quickly mount.

There are a number of other potential fault lines for the 2009 budget and January Financial Plan. For example, the Mayor's budget plan does not recognize the effects on the city of former Governor Eliot Spitzer's proposed budget. The Bloomberg Administration estimates that the former Governor's budget plan would cost the city more than $545 million in 2009, including nearly $450 million less in state education aid than anticipated in the Mayor's preliminary budget.

Health insurance and pension costs for the city could also be higher than anticipated in the preliminary budget. The Bloomberg Administration currently projects health insurance costs for city employees to rise from $3.4 billion in 2008 to $4.6 billion in 2012. But IBO expects these costs could be as much as 16 percent to 18 percent higher by 2012 due to an underestimate of inflation in health insurance premiums and the number of eligible employees, and potential rate increases from the planned conversion of a merged GHI and HIP to a for-profit insurer, which could cost the city more than $300 million. The Mayor also counts on achieving $200 million in savings from restructuring health benefits, which will have to be negotiated with the municipal labor unions.

The Mayor's projection of the city's contribution to the municipal pension funds, growing from $5.7 billion in 2008 to $6.5 billion in 2012, may also be understated. Further losses in the value of the funds' investments would require the city to increase its annual pension contributions in the coming years.

Total Revenue and Expenditure Projections

Dollars in millions

	2008	2009	2010	2011	2012	Average Change
Revenues	$61,267	$59,790	$62,711	$65,195	$66,712	2.2%
City-funded Revenues						
Taxes	*36,457*	*35,409*	*37,603*	*39,605*	*41,065*	3.0%
Other Revenues	*7,875*	*7,151*	*7,059*	*7,115*	*7,169*	-2.3%
Expenditures	$61,267	$59,790	$64,779	$70,017	$71,804	4.0%
City-funded Expenditures	*44,332*	*42,560*	*46,729*	*51,542*	*53,326*	4.7%
IBO Surplus / (Gap) Projection	**$-**	**$-**	**$(2,068)**	**$(4,822)**	**$(5,093)**	

SOURCE: IBO.

NOTES: IBO projects a surplus of $4.83 billion for 2008, $709 million above the Bloomberg Administration's forecast. The surplus is used to prepay some 2009 expenditures, leaving 2008 with a balanced budget. IBO projects a surplus of $1.74 billion for 2009, $1.39 billion above the Bloomberg Administration's forecast. The surplus is used to prepay some 2010 expenditures, leaving 2009 with a balanced budget. Estimates exclude intra-city revenues and expenditures. May not add due to rounding.

Pricing Differences Between IBO and the Bloomberg Administration

Items that Affect the Gap

Dollars in millions

	2008	2009	2010	2011	2012
Gaps as Estimated by the Mayor	**$-**	**$0**	**$(4,224)**	**$(5,598)**	**$(5,324)**
IBO Pricing Differences					
Revenues					
Taxes					
Property	(79)	(67)	(88)	(83)	40
Personal Income	111	127	51	70	(290)
General Sales	58	173	174	104	(26)
General Corporation	200	59	171	237	177
Unincorporated Business	156	170	172	176	143
Banking Corporation	235	138	234	118	34
Real Property Transfer	7	60	94	132	118
Mortgage Recording	38	17	14	49	52
Utility	39	53	14	(4)	(6)
Hotel Occupancy	9	25	26	36	48
Commercial Rent	(3)	(8)	(10)	(10)	(11)
Cigarette	5	6	7	8	10
	777	752	860	833	287
STaR Reimbursement	1	(3)	(3)	(2)	(0)
Total Revenues	**778**	**748**	**857**	**831**	**286**
Expenditures					
Public Assistance	4	19	23	23	23
Campaign Finance	-	-	(25)	-	-
Overtime - Police	(65)	(65)	(65)	(65)	(65)
Overtime- Corrections	(8)	(20)	(20)	(10)	(10)
Buildings	-	(3)	(3)	(3)	(3)
Total Expenditures	**(68)**	**(69)**	**(90)**	**(55)**	**(55)**
Total IBO Pricing Differences	**709**	**680**	**767**	**776**	**231**
Prepayment Adjustment:					
IBO prepayment Adjustment 2008 / 2009	(709)	709	-	-	-
IBO prepayment Adjustment 2009 / 2010	-	(1,389)	1,389	-	-
IBO Surplus/(Gap) Projection	**$-**	**$-**	**$ (2,068)**	**$ (4,822)**	**$ (5,093)**

SOURCE: IBO.

NOTE: Negative pricing differences (in parentheses) widen the gaps, while positive pricing differences narrow the gaps. May not add due to rounding.

In addition, the credit crisis could also have a direct effect on city spending. Despite New York City's high credit ratings, current turmoil in the municipal bond market may result in higher borrowing costs for the city's capital plan for schools, transportation, affordable housing, and other needs. Rapidly rising construction costs and a tight local construction market are raising project costs beyond projections and may eventually require the city to scale back the scope of the capital program.

Local Economic Woes, Declining Tax Revenues. Problems in the U.S. housing market have spilled over into financial services—the industry that drives New York City's economy. With financial institutions expected to ultimately write-off several hundred billions of dollars of assets, they have sharply reined in lending and other activities. After near-record profits of $20.9 billion in 2006, IBO projects that the final tally of Wall Street profits in 2007 will be $3.2 billion, their lowest level since 1994. This year is not expected to be much better, with Wall Street profits reaching $6.6 billion before rising to $12.2 billion in 2009. Mirroring this weakness, employment in the city's financial services industry will fall by 12,600 jobs (2.7 percent) in 2008 and another 7,600 jobs (1.7 percent) in 2009.

As the financial sector's woes spread through the rest of the local economy, IBO projects that employment growth will stall this year and next. Losses of 8,000 private-sector jobs (a 0.3 percent decline) this year will be roughly offset by private-sector gains of 9,100 jobs (0.3 percent) in 2009. Reflecting this outlook for job losses in the high-paying financial industry and stagnant employment growth overall, IBO expects that personal income growth in New York City will slow sharply from 7.8 percent in 2007 to just 2.9 percent in 2008 and 4.1 percent in 2009.

Based on our economic forecast of a brief recession in the first half of this calendar year, IBO now projects that city tax revenues will decline both this fiscal year and next. To put this in perspective, in the downturn at the start of this decade, the only year in which revenues declined was 2002; in 2003 revenues would have increased even without the 18.5 percent property tax rate hike. Total tax revenues will decline by 2.6 percent to $36.5 billion this fiscal year, and then fall another 2.9 percent to $35.4 billion in 2009. Beginning in 2010, tax revenues will once again begin to rise as the U.S. and local economies rebound.

The biggest revenue declines—in both dollar and percentage terms—are in the property transfer and business income taxes. Property transfer taxes (the real property transfer tax and mortgage recording tax) are expected to end their explosive growth in 2008, with revenues falling by 18.8 percent and then by another 19.8 percent in 2009. These declines would still leave 2009 transfer tax revenues of $2.1 billion, more than double their 2002 total. IBO's property transfer tax forecast assumes that declines in the number of residential transactions will be followed by declines in price, and that the incidence of very large commercial transactions returns to more "normal" levels.

Similarly, 2007 is expected to mark the peak of a period of extraordinary growth in business income taxes (the general corporation tax, the unincorporated business tax, and the banking corporation tax). IBO projects that total business income taxes will fall from $6.0 billion in 2007 to $5.6 billion in 2008 (a decline of 7.3 percent) and $5.0 billion in 2009 (a 10.4 percent decline). This forecast is driven by financial firms' huge losses, along with slower growth in U.S. corporate profits and the economy overall.

In contrast, revenue from the real property tax, the city's single largest tax source, will continue to rise throughout the forecast period. IBO projects property tax revenue will grow 7.2 percent in 2009 and 7.3 percent in 2010—an increase of roughly $1 billion each year. Although we are expecting market values for one- to three-family homes to decline, assessed values for many homes will continue to rise because limits on previous years' assessment increases have left their homes well below the 6 percent target for the ratio of assessed value to market value. For larger residential buildings and commercial buildings, the pipeline of increases being phased-in from years of strong growth will keep assessed values growing faster than market values.

Spending Continues to Grow. Based on the Mayor's January 2008 Financial Plan, IBO projects that spending will rise by more than $10 billion, growing from $61.3 billion this year to $71.8 billion in 2012, an average annual growth rate of 4.0 percent.

One of the primary factors driving the projected growth in spending is the cost of the municipal workforce. Although the Mayor has implemented a partial hiring freeze and headcount (full time and full-time equivalent workers) is expected to fall by about 3,100 to approximately 309,400 in 2009, labor costs are projected to rise by more than $1.5 billion next year. From 2008 through 2012, salaries, wages and benefits for city workers are expected to rise from $33.1 billion to $39.9 billion. Yet city staffing in 2012 is still expected to remain just below the 2008 level.

The reasons for the large projected increase in spending despite the small decline in headcount are twofold: One is the Bloomberg Administration's decision last October to mirror recent settlements with firefighters and several other uniformed services unions and assume 4.0 percent annual salary increases for other city employees with upcoming contract negotiations. The Mayor may still choose not to agree to contract terms at this level of salary increase, particularly in light of the worsening local economic picture. The other reason is the Mayor's anticipation of a large increase in education spending following resolution of the Campaign for Fiscal Equity case. Under the terms of last year's state budget agreement, city funding is to grow by $2.2 billion by 2011 with state funding to grow by at least $3.2 billion over the same period, although former Governor Spitzer's Executive Budget has proposed cutting back on the state's increase for 2009.

Most agency budgets (excluding funds for new labor settlements) are projected to grow only modestly, if at all, under the Mayor's financial plan. For example, IBO projects that under the Mayor's plan, health and social services spending would decline at an average rate of 0.2 percent annually. But there are also exceptions: most notably the Department of Education, with a budget expected to climb from $16.8 billion this year to $19.7 billion in 2012.

To help reduce the city's out-year budget gaps, the January

Financial Plan includes a variety of actions by agencies to reduce spending or increase revenues. The total Program to Eliminate the Gap (PEG) for the current fiscal year is $543.2 million, of which $458.3 is spending reductions. The total PEG program for 2009 is $884.8 million, $808.1 million of which is spending reductions. The largest reductions in dollar terms are in the budget for the Department of Education, with $99.0 million in 2008 and $180.7 million in 2009 targeted to come directly out of school budgets. These cuts have sparked considerable public reaction and may be difficult to maintain. Nonetheless, even with the proposed cuts, education spending would rise in each year of the financial plan.

Maintaining some of the other reductions proposed for 2009 also may prove particularly difficult as the Mayor and City Council negotiate next year's budget. In adopting the city budget for each of the past two years, Council Speaker Christine Quinn has highlighted agreements to "baseline" funding for a number of programs that for years the City Council has had to seek funds for each year. This has been hailed by some Council Members as putting an end to the annual budget "dance" for these programs. But the Mayor's proposed 2009 spending reductions include cuts to some of these very same programs: $16.3 million to libraries, $3.2 million to summer jobs for youth, and $1.4 million for supplemental trash basket collections by the sanitation department.

More Cuts, Higher Taxes, or Both? Since taking office in January 2002, Mayor Bloomberg has repeatedly said he does not intend to leave the next Mayor with the kind of budget shortfalls he inherited upon taking office. As the local economy worsens, meeting that goal may prove increasingly difficult. Neither the Mayor nor IBO currently project any budget surplus after 2010—the last budget that will be adopted under the Mayor's watch—and substantial budget gaps are expected for the following years.

Given the budget situations in Albany and Washington, there is little reason to believe much assistance will come from those levels of government. During the prior downturn, the Mayor, with the City Council's approval, relied on a combination of agency spending reductions and revenue increases, tax hikes, and long-term borrowing to erase budget shortfalls (because of the unprecedented situation following 9/11, the city was granted the unusual ability to borrow for day-to-day operating expenses). So far, with the luxury of a large surplus from last year to help ease the way, the Mayor has primarily relied on spending cuts this time around, keeping recent tax reductions in the financial plan. Whether he can maintain this approach and still meet his goal of not leaving the next Mayor with significant budget shortfalls, and how the City Council will react as the majority of members face the pressures of term limits, remains to be seen.

Economic Outlook

After growing strongly through much of 2007, the U.S. economy experienced a weak fourth quarter. Recent estimates show real gross domestic product (GDP) growth of just 2.2 percent for the year (all years in this section are calendar years). With housing and credit markets still reeling, oil prices at historic highs, and the effect of the federal economic stimulus package and other policy actions yet to unfold, IBO is forecasting a brief and relatively mild national recession for the first half of 2008, followed by moderate growth in the second half. For the year as a whole, real GDP is expected to grow by just 1.5 percent.

The IBO economic forecast discussed in the following paragraphs was completed in late February. Since that time additional information has become available that would alter our forecast if it were generated today. At the national level, total employment declined in February by 67,000 jobs—falling for a second consecutive month and the largest decline since March 2003. Employment news was better at the city level, with revised employment numbers showing somewhat stronger than expected job growth during 2007 (see Newly Revised Jobs Data sidebar). Most critically, the distress in the credit markets has worsened, leading to the collapse and sale of one of the city's major firms, the investment bank Bear Stearns. Concern that credit markets were dangerously short of liquidity prompted the Federal Reserve to allow investment banks, which had never before been allowed direct access to the Federal Reserve's discount or lending window, to borrow unlimited amounts from its reserves using mortgage-backed securities as collateral. Other indicators such as retail sales, consumer confidence, and business inventories, all offer additional confirmation that the recession we were forecasting has actually begun. The question now is its depth and duration, particularly in New York City with its high dependence on the financial industry.

U.S. Economic Outlook. Tightened mortgage requirements and rising mortgage interest rates are exacerbating the housing slump. New home inventories remain high, despite the decline in housing starts and continued plunge of new home prices. The federal Department of Commerce reported that new home sales slowed in January to their lowest annual rate in over a decade, while the median sale price for a new home was 15 percent less than the median price in January 2007.

Existing home values are also down. In fact, for some homeowners values have fallen so far that what they owe on their mortgage is more than what their house is now worth. Moody's Economy.com estimates that about 10 percent of homeowners are now in such a position. Lower home values have many consequences: They reduce homeowners' ability to refinance and thus raise the likelihood of default. They discourage home sales and thus impede geographic mobility for work and personal reasons. They limit homeowners' ability to borrow against home equity. They reduce household wealth, which discourages consumer spending out of current income and savings. Adding to these housing-related drags on consumer spending are a decline in consumer confidence, which some attribute to job cuts and the growing threat of a national recession.

Tightened credit, jumps in energy costs, and uncertainty about the economy are having an impact on business behavior. According to the federal Department of Commerce, new orders for durable goods fell 5.1 percent in January, the first monthly decline since October.

Although some economists are voicing concerns about possible "stagflation" (rising inflation together with slow growth), the Federal Reserve Board currently seems more concerned about an economic slowdown than rising inflation. The Federal Reserve has cut the interest rates it controls several times since last summer. On March 18, the Federal Reserve cut the federal funds rate (the interest rate banks charge each other) by three-fourths of a percentage point, the second cut this size in a month and sixth cut in this rate since September. Early this year, Washington enacted an economic stimulus package which includes tax rebates for individual taxpayers and more generous expense and depreciation tax rules for businesses. Rescue plans for homeowners on the verge of default are also being considered in Washington and by state and local governments.

Data released by the Bureau of Labor Statistics on March 7 already show a loss of 63,000 jobs (0.05 percent) between January and February (after seasonal adjustment), with significant losses in manufacturing, construction and retail trade. Financial activities lost jobs for the seventh month in a row; a loss of 12,000 jobs (0.1 percent) brought its total job loss since July to 99,000 (a 1.2 percent decline).

IBO forecasts a gain of just 550,000 jobs (0.4 percent growth) for the U.S. in 2008, with most of the increase in the fourth quarter. The unemployment rate is expected to jump to 5.4 percent this year, up from 4.6 percent in 2007, while the annual growth rate for personal income falls to 4.0 percent in 2008 from 6.2 percent in 2007. After-tax corporate profits, adjusted for inflation, are expected to be 11.0 percent lower in 2008 than in 2007. With the economy stagnating, inflation is expected to slow slightly to 2.7 percent in 2008.

IBO versus OMB Economic Forecasts

	2007	2008	2009	2010	2011	2012
National Economy						
Real GDP Growth						
IBO	2.2	1.5	3.4	3.5	2.8	2.7
OMB	2.2	1.8	2.7	2.8	3.0	2.6
Non-farm Employment Growth						
IBO	1.3	0.4	0.9	1.7	1.4	0.8
OMB	1.3	0.8	1.1	1.2	1.3	1.1
Inflation Rate (CPI-U)						
IBO	2.9	2.7	2.0	1.9	1.9	2.2
OMB	2.9	2.6	1.7	1.9	1.8	1.7
Personal Income Growth						
IBO	6.2	4.0	4.9	5.3	4.9	4.5
OMB	6.2	4.6	4.8	5.1	5.2	5.2
Unemployment Rate						
IBO	4.6	5.4	5.8	5.4	4.9	4.8
OMB	4.6	5.1	5.2	5.1	4.9	4.8
10-Year Treasury Bond Rate						
IBO	4.6	4.2	5.4	5.7	5.5	5.5
OMB	4.6	4.0	4.6	5.3	5.3	5.3
Federal Funds Rate						
IBO	5.0	2.6	4.5	4.9	4.5	4.5
OMB	5.0	3.6	3.9	4.7	4.7	4.7
NYC Economy						
Non-farm New Jobs (thousands)						
IBO	54.5	-2.0	9.8	44.9	37.1	34.6
OMB	54.5	5.2	14.6	25.2	29.0	24.4
Employment Growth						
IBO	1.5	-0.1	0.3	1.2	1.0	0.9
OMB	1.5	0.1	0.4	0.7	0.8	0.6
Inflation Rate (CPI-U-NY)						
IBO	2.9	2.3	1.4	2.2	2.4	2.7
OMB	3.0	2.9	1.9	2.1	2.0	2.0
Personal Income *dollars in billions*						
IBO	417.8	430.3	448.8	470.3	491.7	513.6
OMB	398.0	402.0	413.0	432.0	452.0	473.0
Personal Income Growth						
IBO	7.8	2.9	4.1	4.6	4.4	4.3
OMB	7.5	1.0	2.7	4.5	4.7	4.7
Manhattan Office Rents ($/sq.ft)						
IBO	72.56	78.98	81.57	85.76	90.50	95.49
OMB	71.91	78.85	78.31	81.21	81.54	81.96

SOURCES: IBO, Mayor's Office of Management and Budget.

NOTE: Rates reflect year-over-year percentage changes except for unemployment, 10-Year Treasury Bond Rate, Federal Funds Rate, and Manhattan Office Rents. The local price index for urban consumers (CPI-U-NY) covers the New York / Northern New Jersey region. Personal income is nominal.

IBO anticipates a national economic recovery to be underway in 2009. Real GDP annual growth rates of 3.4 percent and 3.5 percent are expected for 2009 and 2010, respectively. Strong employment growth is not projected until 2010; the unemployment rate is actually expected to rise in 2009 to 5.8 percent and stay at 5.4 percent in 2010 as firms add workers. IBO estimates that after-tax corporate profits, adjusted for inflation, will grow by 3.4 percent per year in 2009 through 2012—sharply lower than the average annual growth rate of 18.7 percent we had in 2002 through 2006.

New York City Economic Outlook. The problems in the U.S. housing markets have spilled over into financial services—the industry that drives New York City's economy. The unprecedented surge in mortgage loan defaults—especially for subprime and alternative mortgages—has caused the value of mortgage-backed debt to plummet, eroding the capital position of financial firms that own and insure securities backed by such assets. With financial institutions writing off hundreds of billions of dollars of assets, they have been forced to sharply rein in lending and other activities. While the crisis began last summer in the mortgage-backed securities markets, the loss of confidence in the value of other securitized assets and reduced liquidity has spread to other credit markets this winter. The problems have been exacerbated by pressure on firms that sold insurance for many of these bonds.

After Wall Street firms achieved near-record profits of $20.9 billion in 2006, and then performed strongly in the first half of 2007, the credit crisis has dealt a brutal blow to their balance sheets. Securities industry firms posted a collective $3.8 billion loss for the third quarter of 2007, and available data suggest the fourth quarter will result in another loss of $1.9 billion. IBO estimates that securities industry profits were just $3.2 billion for 2007 as a whole, their lowest level since 1994. IBO also forecasts a loss of $0.9 billion for this quarter, but then positive quarterly profits for the rest of 2008. For the full year, IBO's forecast for Wall Street profit is $6.6 billion. These are much lower levels than we forecast only three months ago. Profits are expected to rise to $12.2 billion in 2009.

Because the New York City economy relies so heavily on the financial sector, IBO expects the city to experience a sharper recession than the nation as a whole, starting in the first quarter of 2008 and continuing through the third quarter. Only moderate growth is expected thereafter. The effects on employment growth and personal income will be deeper and longer lasting here in the city than in the nation as a whole. IBO forecasts an overall loss of 2,000 jobs for the city in 2008 (a decline of 0.1 percent), as a private-sector loss of 8,000 jobs (0.3 percent decline) more than offsets a gain of nearly 6,000 government jobs (1.3 percent growth). Losses by Wall Street firms are expected mean significant layoffs in the financial sector. Financial activities is predicted to lose 12,600 jobs (a 2.7 percent decline) in 2008, including losses of 5,300 jobs in securities (a 2.8 percent decline) and 4,100 jobs for credit intermediation and related services (a 4.4 percent decline). Additional losses are expected in some industries outside financial activities, such as information (2,500 jobs, a 1.5 percent decline) and construction (500 jobs, a 0.4 percent decline). As the financial sector contracts, professional and business services is expected to add just 800 jobs (0.1 percent growth) and retail trade is expected to stay essentially flat.

Newly Revised Jobs Data

On March 6, 2008, after IBO had completed the tax revenue and economic forecasts used in this report, the New York State Department of Labor released their annual revision of the prior years' employment data. This annual revision, or benchmarking, updates the prior year data using actual payroll information reported to the state to supplement the survey-based data released each month. Although the data were released too late to be used in the projections in this report, they provide new information about the city's labor market for 2007.

Overall, the new data show that job growth was greater in 2007 than we thought earlier. The benchmarking revealed that the city actually added 78,800 jobs last year, 24,300 more than previously estimated. The new tally showed that private-sector growth for the year was 74,800, about 20,000 more than previously reported. Changes for 2006 were small, as expected.

At the industry level, employment in financial activities now showed a smaller gain of 9,600 jobs for 2007 (down from the prebenchmark estimate of 11,400) and the gain for securities in 2007 was revised to 7,000 jobs (down from 9,300). Leisure and hospitality had the biggest change for 2007-—an addition of 6,000 jobs; with 2006 employment lowered by 1,300 jobs, the revised gain for 2007 is up by 12,100 jobs, 7,400 more than estimated before the benchmarking. The 2007 gain for professional and business services after benchmarking is 20,100 jobs (up from the earlier 14,700 estimate). The benchmarking showed that manufacturing job losses were smaller than previously reported; after benchmarking, the job loss was 5,100, bringing the total number of manufacturing jobs in New York City down to 101,000.

Although the weak dollar has helped to keep the city's tourism industry booming in recent years, the outlook for tourist-related employment during 2008 is less robust. Leisure and hospitality is expected to lose 2,600 jobs (a 0.9 percent decline). IBO expects growth in the noncyclical sectors of health (7,500 jobs, 1.9 percent growth) and social assistance (3,100 jobs, 1.9 percent growth), but private education is expected to have a small loss (300 jobs, a 0.2 percent decline).

The employment forecast for 2009 is a small gain of 9,800 jobs (0.3 percent growth), with 9,100 jobs in the private sector (0.3 percent growth). Financial activities is expected to lose another 7,600 jobs (a 1.7 percent decline), bringing the total loss for the industry to 20,200 jobs–about three-fifths of the job loss for financial activities between 2002 and 2003. The securities industry is forecast to lose another 2,800 jobs (a 1.5 percent decline) and credit intermediation and related services is expected to lose 2,500 jobs (a 2.8 percent decline). Professional and business services, which relies on the financial industry for much of its work, is expected to grow—but by just 5,500 jobs (0.9 percent growth). Modest growth is also forecast for the information sector (800 jobs, 0.5 percent growth) and leisure and hospitality (800 jobs, 0.3 percent growth). Retail trade is expected to lose 600 jobs (a 0.2 percent decline). Growth is expected for the less cyclically sensitive industries of health (5,400 jobs, 1.4 percent growth), social assistance (5,400 jobs, 3.2 percent growth), and private education (600 jobs, 0.4 percent growth).

Reflecting the bleak outlook for employment in the high-paying financial industry, personal income growth is expected to decelerate from 7.8 percent in 2007 to just 2.9 percent in 2008 and then rise only to 4.1 percent in 2009.

Starting in 2010, the local employment picture is expected to improve significantly. Private-sector job gains averaging 40,500 per year (1.3 percent average annual growth) are expected in 2010 through 2012. Slightly slower growth is expected for total employment (38,900 jobs or 1.0 percent average annual growth), as the government sector sheds some jobs. For financial activities, modest average annual growth of 3,900 jobs (0.9 percent growth) is forecast for 2009 through 2012, with securities alone gaining about 2,600 jobs per year (1.4 percent growth). By 2012, securities employment is expected to reach 188,300–a level above its 2000 peak and just under its 2007 level of 188,700. Employment in professional and business services is expected to grow by an average of 4,300 jobs per year (2.4 percent average annual growth). Health, education, and social assistance are expected to add 13,200 jobs per year (1.8 percent average annual growth). Construction employment growth is expected to average 1,200 jobs per year (1.0 percent growth). Healthy growth averaging 3,700 jobs (1.3 percent average annual growth) is forecast for leisure and hospitality.

Personal income growth is expected to move up with employment, but remain at a moderate rate of 4.3 percent to 4.6 percent in 2010 through 2012.

The local inflation rate is expected to fall from 2.9 percent in 2007 to 2.3 percent in 2008, as the economy stagnates, and then drop further to 1.4 percent in 2009. IBO forecasts a jump back up in inflation in 2010, as the economy regains its strength; in 2010 to 2012, the forecast is an average annual inflation rate of 2.4 percent.

Despite projected losses in office employment this year and next, IBO expects the local commercial real estate market to remain strong because the market for modern office space has been tight and the supply will not expand significantly until after 2011. Our forecast for Manhattan office rents is continued growth, although at a slower pace than in the past two years. Unlike the pattern in the last expansion that ended in 2001, we assume that there has not been substantial hoarding of vacant office space that could become available for sublease. New York City residential prices are forecast to decline in 2008—the largest declines are expected in the boroughs other than Manhattan—and then grow at a moderate pace.

Risks. The main risk to IBO's forecast is that the downturn could be deeper or more protracted than we expect. Our forecast assumes that oil prices will drop sharply in 2009, helping to keep inflation down, and allow the economic recovery to proceed. Oil prices could continue to rise, however, despite the U.S. slowdown, as the energy demands of China, India, and other expanding economies continue to climb. The price of gasoline rose above $3 per gallon in February and some are forecasting a jump to $4 per gallon when the weather warms up. Another risk is that the credit crunch could persist, despite policy efforts of the Federal Reserve and Washington. Either rising energy costs or a lengthy credit crunch could exacerbate the national and local recessions IBO has forecast for this year and dampen the economy's recovery.

Taxes and Other Revenue

INTRODUCTION

After several years of very strong growth, the city's revenue outlook, particularly from tax sources, is expected to grow darker beginning with the current year. Some of the city's key tax sources, particularly the business and personal taxes and the property transfer taxes, are expected to show the effects of the crises in credit markets, declining real estate values, and the onset of a recession. IBO projects that city revenues (taxes plus fees, fines, and other city sources) will grow by only 0.4 percent this year to $44.3 billion. There would have been a decline except for a few extraordinary items in the miscellaneous revenue category which will help offset an expected 2.6 percent decline in tax revenues.

With tax revenues expected to decline by another 2.9 next year, total city revenues are expected to fall by 4.0 percent to $42.6 billion. Total revenues, including state and federal categorical grants are expected to total $61.3 billion this year, but then decline to $59.8 billion next year. Beginning in 2010, tax revenue growth is expected to resume, serving as the main driver for total revenue growth, which is expected to average 3.7 percent annually in the last three years of the financial plan. Overall city revenues are expected to equal $48.2 billion by 2012 with total revenues expected to reach $66.7 billion.

The bulk of this section of the report presents IBO's forecast of tax revenues, which is built up from our forecasting models for 11 major tax sources. The section also includes a brief overview of the outlook for revenues from other sources.

IBO Revenue Projections

Dollars in millions

	2008	2009	2010	2011	2012	Average Change
Tax Revenue						
Property	$12,920	$13,852	$14,861	$15,774	$16,699	6.6%
Personal Income	7,609	7,130	7,423	7,910	7,921	1.0%
General Sales	4,762	4,815	5,069	5,246	5,417	3.3%
General Corporation	2,953	2,726	3,021	3,293	3,447	3.9%
Unincorporated Business	1,692	1,636	1,736	1,843	1,933	3.4%
Banking Corporation	931	635	847	797	761	-4.9%
Real Property Transfer	1,482	1,178	1,194	1,216	1,247	-4.2%
Mortgage Recording	1,192	966	946	969	1,011	-4.0%
Utility	399	428	405	403	413	0.9%
Hotel Occupancy	375	412	447	483	519	8.4%
Commercial Rent	547	558	573	591	612	2.9%
Cigarette	126	124	122	120	119	-1.5%
Other Taxes and Tax Audits	1,468	950	958	959	968	-9.9%
Total Taxes	36,457	35,409	37,603	39,605	41,065	3.0%
Other Revenue						
STaR Reimbursement	1,256	1,315	1,356	1,387	1,439	3.5%
Miscellaneous Revenues	4,750	3,952	3,829	3,856	3,854	-5.1%
Unrestricted Intergovernmental Aid	340	340	340	340	340	0.0%
Anticipated Revenue (State & Federal)	-	100	100	100	100	n/a
Other Categorical Aid	1,079	1,026	1,027	1,030	1,034	-1.0%
Inter-fund Revenues	466	434	422	417	417	-2.8%
Disallowances	(15)	(15)	(15)	(15)	(15)	0.0%
Total City Funded Revenue	**44,332**	**42,560**	**44,661**	**46,720**	**48,234**	2.1%
State Grants	11,018	11,580	12,435	12,878	12,880	4.0%
Federal Grants	5,916	5,649	5,614	5,597	5,598	-1.4%
TOTAL Revenues	**$61,267**	**$59,790**	**$62,711**	**$65,195**	**$66,712**	2.2%

SOURCE: IBO.

NOTES: Personal Income Tax includes Transitional Finance Authority (TFA) dedicated personal income tax revenue. Estimates exclude intra-city revenues. May not add due to rounding.

REAL PROPERTY TAX

IBO projects that property tax revenue will grow from $12.9 billion in 2008 to $13.9 billion in 2009, a 7.2 percent increase. Growth in property tax revenue is expected to remain steady from 2009 to 2012, averaging 6.4 percent a year. IBO's forecast for property tax revenue is just slightly below that of the Mayor's Office of Management and Budget (OMB) in 2009 to 2011. In 2012, IBO projects slightly stronger growth than OMB, by 0.2 percent.

Background. The amount of tax owed on real estate in New York City depends on the type of property, its value for tax purposes (as calculated by the city's Department of Finance from estimated market values), and the applicable tax rate.[1]

Under the property tax law, every parcel is assigned to one of four tax classes: Class 1, consisting of one-, two-, and three-family homes; Class 2, composed of apartment buildings, including cooperatives and condominiums; Class 3, made up of the real property of utility companies; and Class 4, composed of all other commercial and industrial property.

How property is assessed and taxed is very different for each tax class.[2] The method of assessing properties and recognizing market value appreciation differs by tax class. Each tax class can have its own assessment ratio (the share of market value actually subject to tax). Lastly, the actual tax rates also vary somewhat from class to class.

With the process for determining assessed value in each class varying so greatly, there are wide differences between classes in terms of shares of total market value, assessed values, and tax burdens (levies). On the 2008 assessment roll, Class 1 homes account for 53.6 percent of market value in the city, but only 10.7 percent of assessed value for tax purposes and 15.1 percent of the tax levy. In contrast, Class 4 properties account for 21.8 percent of market value, but 47.2 percent of assessed value for tax purposes and 41.1 percent of the tax levy. Because the shares of assessed value are also larger than the shares of market value in Classes 2 and 3, these classes bear a disproportionate share of the property tax burden.[3]

Tentative Assessment Roll for 2009. In January, the Department of Finance released the tentative 2009 assessment roll. Because of the timing of the assessment process, the market values on the 2009 roll largely reflect economic conditions in calendar year 2007. Market values on the 2009 tentative roll showed an overall increase of just 2.5 percent over 2008, significantly slower growth than 2005 to 2008, when market values grew an average of 13.5 percent per year. Class 1 saw a decline in market value from 2008 to 2009 of just less than 1 percent. Conversely, Class 2 showed an increase of 7.7 percent (some of which is attributable to a change in assessment practice, discussed below) while Class 4 saw market value growth of 5.8 percent.

Assessed value for tax purposes showed an increase of 7.4 percent overall, with growth in Class 1 at 4.8 percent, Class 2 at 7.8 percent, and Class 4 at 8.2 percent. After taxpayer challenges and other adjustments by the finance department are processed, the values will be finalized in May and used for setting 2009 tax bills.

Change to Gross Income Multiplier to Assess Class 2 Parcels. This year's tentative assessment roll introduced a methodological change for Class 2 assessments, with the finance department switching from net income capitalization to gross income multipliers (GIMs) to value most Class 2 buildings with more than 10 units. The finance department has explained that the task force on 421-a reform highlighted the problem of wide disparities in tax burdens within Class 2, which the DOF's analysis confirmed. The finance department believes that switching to GIMs will help reduce the differences.

The net capitalization method, which had been used by the Department of Finance for many years to assess income producing properties, uses a building's gross income and expenses to arrive at net income and then applies a capitalization rate to estimate the value. For tax assessment purposes, the capitalization rate is intended to result in the price—or market value—that an investor would pay today for the future stream of net income generated by the building, taking into account financing costs and expected appreciation. In the past, the finance department has provided assessors with ranges of appropriate capitalization rates for properties of different types, age, quality, and location.

To value a building with a GIM, the gross income is multiplied by a constant. The finance department developed a set of multipliers with one for each of 10 ranges of gross income per square foot. Using gross income multipliers can simplify the assessment process and make it easier for taxpayers to understand how their market value was determined. They are also less likely to result in corruption, because the assessor has less discretion. Using GIM's also makes mass appraisal methods more feasible.

But there can be a price paid for this simplicity. When using a gross income multiplier, the assessor disregards information about the building's expenses, which can vary greatly and which are integral to the calculation an investor makes in determining what she would pay for the property. While there is no doubt

How "GIM" Changes Tax Burdens

Comparing GIM Values to Capitalized Income Values in 2008. Using income and expense data from last year's final roll, IBO compared what 2008 market values would have been under GIMs to what they were under the net income capitalization approach. Because income and expense data for condominiums were not available, the comparisons focus on rental and cooperative buildings.[4]

For rental buildings, aggregate market values using GIM in 2008 would have totaled $65.3 billion, compared to $67.3 billion under net income capitalization, a decline of 3.1 percent. Rental buildings in the Bronx, however, would have seen aggregate market value increase 3 percent, while Staten Island would have a 5.8 percent increase. The remaining three boroughs would have seen aggregate market values decline by 3.4 percent in Manhattan, 5.1 percent in Brooklyn, and 6.1 percent in Queens.

Switching from net income capitalization to GIMs last year would have a very limited effect on the total citywide market value of cooperative buildings—under GIM, values would have declined by $156 million or 0.4 percent last year. As with rental buildings, however, coop market values would have been higher in the Bronx and Staten Island using GIM by 8.3 percent and 15.9 percent, respectively. Manhattan, Brooklyn, and Queens would have had lower market values.

Comparing Market Value Changes from 2008 to 2009. Unfortunately, there is no cap rate or expense data available for the 2009 roll, so it is not possible to repeat these calculations for 2009 to test how burdens were redistributed on the 2009 roll, nor whether the policy change had a significant effect on aggregate assessed value. But we can compare the year-to-year market value changes for the affected buildings to see how growth rates varied by property type. (Note that these comparisons reflect the interaction of the policy change with underlying market value growth.)

Total market value of rental buildings increased by $3.1 billion from 2008 to 2009 (6 percent). Rental buildings in the Bronx and Staten Island saw aggregate market value increase by 12 percent, compared to 5 percent in Manhattan, less than 3 percent in Brooklyn and Queens. In the same period, median gross income per square foot for rental buildings (one of the drivers of growth in market value) grew less than 3.5 percent citywide.

Looking at building income growth by borough shows some big differences from the pattern of market value growth. In the Bronx median, gross income per square foot *fell* by 2.9 percent although the median market value per square foot grew by 5.7 percent. In Manhattan, the income measure grew by 9.8 percent, with market value growth lagging.

In the Bronx and Manhattan, rental buildings built prior to 1980 saw an aggregate increase in market value while rental buildings built since 1980 saw a decline in aggregate market value. In Queens, only rental buildings built between 1940 and 1980 saw a rise in total market value.

For cooperatives, market value from the final 2008 roll to the tentative 2009 roll increased by $2.7 billion (8 percent). Manhattan and Brooklyn saw increases of 10 percent and 9 percent, respectively, while the aggregate market value of coops in Staten Island declined by 14 percent. Growth in total market value of coops in the Bronx and Queens was just over 1 percent. Median gross income for cooperative buildings in the city slightly lagged the increase in market value of 6.9 percent citywide. Coops built before 1940 saw aggregate market value increase by 12 percent in Manhattan, 7 percent in the Bronx, and 7 percent in Brooklyn, but decrease by 5 percent in Queens and 14 percent in Staten Island.

some inflation of expenses reported by owners to the finance department, there is also evidence that the ratio of expenses to gross income varies systematically by property type and age, with older buildings tending to have higher ratios.[4,5] The finance department argues that their analysis found wide differences in the ratio of taxes to gross income and that use of GIMs will reduce those disparities, although at least some of that variation is presumably due to expected differences in expenses.

Overall, the switch to GIMs appears to have had little effect on aggregate market value, although the finance department has not released enough information to confirm this. Nevertheless, there were significant effects on individual values with some buildings seeing increases and others receiving lower assessments as a result of the change. The variation is correlated to some extent with the age, location, condition, and type of building (see sidebar above).

Changes from Tentative Roll to Final Roll. With this change, there may be a larger than usual change from tentative to final values for Class 2. At a minimum, the final roll will reflect an adjustment to the GIMs that were used on the tentative roll. The values on the tentative roll were assessed using two sets of

GIMs, one for rental buildings and one for coops and condos. The city's Law Department determined that Class 2 buildings should be treated uniformly, so DOF issued a new set of GIMs with a single value for each income range. The finance department has recalculated the values for all Class 2 parcels and notified the taxpayers of their new assessments. IBO's analysis of the 2009 roll reflects these updated values, although they will not be fully reflected until the final roll is released in May. The change in methodology may also prompt more appeals to the tax commission since some parcels got significant assessment increases. At this point we do not know how many appeals will be filed nor how the Tax Commission will view the GIM-based assessments.

Outlook for Market and Assessed Values in 2009. In contrast to previous years, growth in assessed value for tax purposes is expected to be more moderate this year. Total market value in New York City is expected to be $810.1 billion in 2009, a 2.5 percent increase over 2008. IBO projects that total assessed value for tax purposes (billable taxable assessed value) on the final 2009 tax roll will grow to $133.6 billion, 7.5 percent more than the 2008 roll.

As noted above, billable taxable assessed value is expected to show steady growth in Classes 2 and 4, 7.8 percent and 8.2 percent, respectively. The growth in billable taxable assessed value in Classes 2 and 4 is slightly faster than the growth in market value (7.7 percent for Class 2 and 5.8 percent for Class 4). This difference results from the method for capturing increases in market value in these classes. Increases are phased in over a five-year period and even though growth in market value is projected to slow this year, the pipeline of increases from the previous four years of stronger growth will phase in and keep assessed value growing more briskly.

Class 1 is projected to see assessed value growth of 4.8 percent, even though market value is expected to decline by 0.9 percent. This counterintuitive result stems from the procedures for assessing Class 1 property. In Class 1, assessed values move toward a target of 6 percent of market value with assessment increases capped at 6 percent a year or 20 percent over five years. If a parcel is assessed at less than 6 percent of market value, its assessed value can grow until it hits the target ratio of 6 percent of market value or it reaches the cap on annual assessment increases—even if the market value stays flat or declines. The projected decline in market values will allow the billable taxable assessed values to recapture some of the market value growth that was above the cap in the prior years of very strong market growth, though the average assessment ratio will remain well below the 6 percent target.

Outlook for Market and Assessed Values in 2010-2012. IBO expects market values in Class 1 to continue declining in 2010 and 2011, before rebounding in 2012. The largest decline is projected for 2010, an 11 percent drop in market value, followed by a small decline of 0.4 percent in 2011, with growth of around 4.6 percent projected for 2012. Total billable taxable assessed values in Class 1, on the other hand, are expected to grow an average of 4.9 percent a year, as assessed values inch towards a 6 percent assessment ratio.

IBO expects that market value growth in Class 2 will average 5.3 percent a year, increasing slightly from 4.2 percent in 2010 to 6.2 percent in 2012. As discussed above, the projections of growth in Class 2 market values are uncertain because, in addition to uncertainty in projecting the economic situation in the years to come, the city has switched to a new assessment methodology making forecasting growth an especially difficult prospect.

The continued steady growth in market values for other than Class 1 properties, along with a substantial pipeline of increases from prior years, should translate into healthy growth in billable taxable assessments through 2012. Average annual growth of 5.2 percent is expected for Class 2, declining from 6.7 percent in 2010 to 4.8 percent in 2012. Growth in Class 4 is a little stronger, averaging 8 percent a year. Class 4 also sees a small decline in projected growth in 2012, to 7.3 percent.

For both Classes 2 and 4, the slight dips in 2012 are due to the steady growth in market value combined with a gradual decline in the pipeline that is phasing in; as strong growth from earlier years is replaced with the more modest growth forecast for the financial plan period, the pipeline will decrease. The total pipeline in Class 4 in 2010 is projected to be $10 billion, compared to $8.1 billion by 2012. The Class 2 pipeline declines more rapidly, from $720 million in 2010 to $358 million in 2012.

Revenue Outlook. After the Department of Finance has completed the assessment roll, the actual property tax levy is determined by the City Council when it sets the tax rates for each class. Before raising property tax rates by 18.49 percent in 2003, the City Council had observed an informal freeze in the average tax rate dating back to 1992. Last year, the overall property tax rate was reduced by 7 percent. IBO's baseline property tax revenue forecast assumes that the 2008 average tax rate will be maintained at last year's 11.42 percent of the aggregate assessed value for tax purposes on the assessment roll. The revenue impact of the 7 percent tax cut is discussed below.

The amount of property tax revenue in a fiscal year is determined not only by the levy, but also by the delinquency rate, abatements granted, refunds for disputed assessments, and collections from prior years. Taking these other factors into account, IBO projects that property tax revenue for 2008 will total $12.9 billion, 0.8 percent below revenues for 2007, when the overall tax rate was 7 percent higher. For 2009, revenue is forecast to grow by 7.2 percent to $13.9 billion. In 2010 through 2012, growth is projected to average 6.4 percent, with revenue totaling $16.7 billion by the last year of the forecast period.

IBO's property tax revenue forecast is just $79 million (0.6 percent) below OMB's for 2008. For 2009 to 2011, the difference between OMB's and IBO's property tax revenue forecasts remains steady, with IBO slightly below OMB's projection. In 2012, IBO's property tax revenue forecast exceeds OMB's by $39.7 million.

Tax Policy Changes. There are a number of tax policy issues that could affect revenue estimates.

Tax Rate Cut. The Mayor proposed a 5 percent property tax rate reduction last year. Due to the city's robust fiscal condition, the City Council enacted a 7 percent, one-year reduction. In the current financial plan, OMB assumes that the tax rate reduction remains in effect. IBO estimates that the cut cost $1.0 billion in foregone tax revenue in 2008, with the cost increasing to $1.3 billion in 2012.

Homeowner Rebate. The Mayor's financial plan assumes that authorization for the $400 tax rebates for owners of houses and apartments, provided they reside in these properties, will be extended. More than 650,000 homeowners received the rebate in 2008, at a total cost of $256 million. IBO expects the cost of the rebate to be about $256 million again in 2009.

The Mayor's proposal to extend the rebate (initially authorized for only three years, 2005-2007) is reflected in the 2009 Preliminary Budget. In the current plan, it would be extended through at least 2012. The state law authorizing the rebate requires that any extension of the program beyond its first three years be accompanied by a reduction in the property tax burden for all taxpayers, not just the homeowners currently eligible for the rebate. The Bloomberg Administration has argued that last year's cut in property tax rates for all tax classes satisfies this requirement.

With the city facing a projected decline in tax revenue during the economic downturn, the Mayor and City Council may consider ending the 7 percent tax cut and/or homeowner rebate. The cost in foregone revenue of the 7 percent tax rate cut is about four times that of the homeowner rebate. The benefits of the tax rate cut are shared across all properties in the city, including rental buildings and business with increasing expenses, while the rebate benefits is targeted to New Yorkers in owner-occupied houses, cooperative apartments, and condominiums.

STAR Enhancement. Former Governor Spitzer's 2008-2009 Executive Budget for the state calls for more limited expansion of the Middle Class STAR program than proposed last year, when it was first enacted as a direct rebate to homeowners. The Governor delayed for one year a scheduled 17 percent increase for the basic Middle Class STAR rebate. The budget does preserve the scheduled 40 percent increase in the Enhanced STAR Rebate for senior citizens. While the proposal would increase the value of some rebates, it would not have any effect on New York City property tax revenue, since the rebate flows directly to homeowners as an offset of the property taxes paid to the city.

The Executive Budget proposes to slow the rate of growth of the STAR property tax exemption due to growth in assessed or market value. According to the state budget division, the average taxpayer would see exemption savings of $40 less than they would without the change. As with Middle Class STAR, since the state reimburses the city for property tax revenue lost to STAR, these changes are revenue neutral for New York City.

Coop-Condo Abatement. The coop-condo abatement provides a reduction in property taxes for owners of cooperative and condominium units. Established in 1997, the abatement is intended to reduce some of the disparities in tax burdens between owners of apartments and houses. It was conceived of as a temporary fix while the Department of Finance resolved technical challenges and considered ways to permanently address the disparities. The abatement has been extended since then and is due to expire again this year. The Bloomberg Administration has assumed the extension of the abatement in the financial plan.

IBO has documented shortcomings of the abatement[6]—it was supposed to be temporary, does not address disparities among apartment owners, and is inefficient (if the goal was to equalize apartment and homeowners, the abatement provides more relief than needed to some owners and less to others). The legislation creating the abatement directs the city to prepare a report with recommendations for addressing the disparities between owners in Class 1 and owners of coop and condo apartments in Class 2. The city missed the initial deadline of June 30, 1999, and several set since then. During the March 5, 2008 City Council hearing on the preliminary budget, Finance Commissioner Martha Stark indicated that the finance department will soon complete a study that would serve as the basis for the required report.

MORTGAGE RECORDING AND REAL PROPERTY TRANSFER TAXES

Revenues from the mortgage recording tax and the real property transfer tax (collectively referred to as the transfer taxes or the MRT and RPTT) reached an all-time high of $3.3 billion in 2007, more than double the level of just three years earlier. The past year, however, has seen a significant decline in real estate activity, and IBO projects that revenues from the transfer taxes will fall to $2.7 billion in 2008, a decline of around 19 percent from the 2007 peak. IBO projects an additional decline of 19 percent in 2009, followed by a small drop in 2010, and a slow recovery beginning in 2011. The cumulative impact of the decline is very large: over the five-year period 2008-2012, during which IBO expects transfer tax revenues to be almost $5.1 billion less than if real estate activity had continued at its 2007 levels. But the decline is much less dramatic when calculated against 2006 (a decline of $1.8 billion) or 2005 (a decline of $0.1 billion).

Compared with the Mayor's budget office, IBO projects a smaller overall decline in transfer tax revenues, and a somewhat faster recovery. IBO forecasts that RPTT revenue will fall to $1.2 billion in 2009, and then increase by a total of about $70 million (6 percent) over the next three years. OMB, on the other hand, projects that RPTT revenue will decline each year through 2011, and then increase by $45 million (4 percent) in 2012. For the MRT, we project that revenue will decline through 2010, while OMB expects revenue to reach bottom in 2011. IBO's forecasts for the combined taxes are about $15 million (2 percent) above OMB's estimate in 2009 and 2010, and about $50 million (5 percent) above OMB's projections for 2011 and 2012.

Background. The MRT and RPTT are levied at opposite ends of residential and commercial real estate transactions. The real property transfer tax is levied directly on the sale price and is typically paid by the seller. The MRT is levied on mortgages used to finance the purchase of real property (usually the sales price less the down payment) and is paid by the buyer. The portion of a mortgage refinancing that involves new money ("cash out") is always subject to the MRT. Refinancing activity that involves a change of lender is usually subject to the MRT in its entirety, unless the first lender agrees to "assign" the mortgage to a second lender, in which case the tax is levied only on the new money.

Refinancing is exempt from the RPTT, as no transfer of property is involved. Sales of coop apartments are subject to the RPTT but are exempt from the MRT because coop financing loans are not technically mortgages.

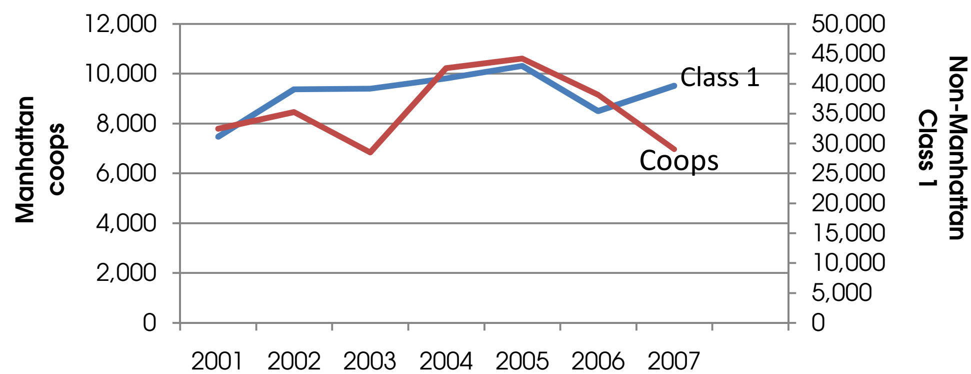
While sensitive to general business cycle changes, the two transfer taxes are also highly sensitive to actual and anticipated changes in mortgage rates. Low mortgage rates effectively decrease housing costs, and thus increase incentives to purchase property. Low rates also provide incentives for mortgage refinancing. Conversely, higher mortgage rates deter mortgage refinancing, and discourage purchases by effectively raising property costs. During the past year mortgage rates have fluctuated considerably. While the weakening economy and the recent moves by the Federal Reserve to lower the Federal Funds target rate have put downward pressure on mortgage rates, the underlying turmoil in credit markets has actually pushed rates up. The 30-year fixed rate is currently around 6.3 percent, not unusually high by historical standards, but above the levels reached during the real estate peak of 2005.

During the 1990s, RPTT revenues consistently exceeded MRT revenues. Beginning in 2002, and continuing through 2006, high levels of mortgage refinancing pushed MRT collections above those of the RPTT. In 2007 the RPTT again took the lead, and both IBO and OMB expect this trend to continue through 2012.

Real Estate Trends. Transfer tax revenues are affected by both the number of transactions and the value per transaction. In a declining real estate market, the number of transactions typically begins to fall before there is a noticeable decline in price. As more and more sellers fail to find buyers for their properties at their initial asking price, there is downward pressure on prices. Eventually the number of transactions begins to recover, due to a combination of lower prices and/or a cyclical upturn in the economy.

IBO has examined trends in property sales, focusing on

Residential Real Estate, Number of Transactions



SOURCES: IBO; New York City Department of Finance.

Residential Foreclosures

The problem of residential foreclosures has attracted significant attention in recent months. The increase in foreclosures is symptomatic of disequilibrium in the residential market, as buyers are unable to make monthly mortgage payments, cannot refinance at a lower rate, and do not have enough equity in the property to be able to sell it and pay off the existing mortgage.

Foreclosures have multiple negative consequences, not the least of which is the hardship inflicted on owners who lose their property. But the direction of the effect of foreclosures on RPTT and MRT revenues is uncertain. On the one hand, when a lender sells a foreclosed property, additional transfer tax revenue is generated. On the other hand, foreclosure is symptomatic of a broader affordability problem, and likely associated with declining volume and prices, particularly when concentrated in particular neighborhoods.

According to the research firm RealtyTrac, the number of foreclosures in the New York Metropolitan Statistical Area (MSA) in 2007 was 74 percent higher than in 2006. Yet the number of foreclosures per 1,000 households was only 5.18, compared with 10.33 for the country as a whole. The New York MSA ranked 76 out of the 100 metropolitan areas with the highest foreclosure rates, and was far below first-place Detroit (49.18 foreclosures per 1,000 households). One reason the foreclosure rate in New York is below average is that the share of households who own their home is relatively low (less than one-third in New York City). In addition, New York City is neither in economic decline like Detroit or Cleveland, nor characterized by the simultaneous overbuilding and price bubbles of areas such as Stockton, Las Vegas, and Miami.

While foreclosure is a much less serious problem in New York City than elsewhere in the country, the fact that it has increased during the last year is of concern. In general, the neighborhoods most affected by foreclosures have been areas where there was substantial subprime lending in recent years. In retrospect, the burst of sales activity and sharp increases in prices that these neighborhoods experienced were unsustainable in the long run, given the income levels of the buyers.

While policymakers debate ways to prevent further foreclosures, the sharp curtailment in subprime lending has contributed to a dramatic decline in sales activity in some parts of the city. Jamaica, Queens (zip code 11434) and Canarsie/Flatlands in Brooklyn (zip code 11236) are representative of neighborhoods that have experienced high levels of subprime lending, followed by a wave of foreclosures and a sharp contraction in sales activity.

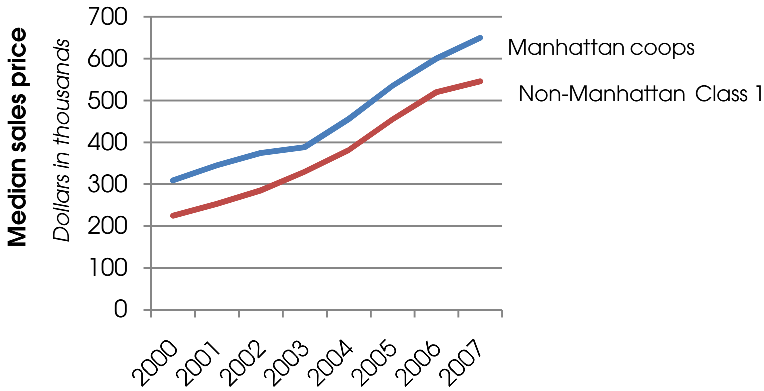
In Jamaica, which according to data from the Federal Reserve Bank of New York had 1,415 properties with subprime mortgages in October 2007—13.8 percent of which were in foreclosure—there were 631 Class 1 sales in 2007, compared with 955 in 2006 and 917 in 2005. During the fourth quarter of 2007 there were only 107 sales, barely half the number a year earlier. The median sales price—which had been growing by more than 17.5 percent annually from 2001 to 2006—increased by only 3.8 percent in 2007. (These numbers reflect only "arms-length" transactions.)

In Canarsie the Federal Reserve data showed 1,930 subprime mortgages in October 2007 with 12 percent in foreclosure. The number of sales, which had been as high as 1,003 in 2004, declined to 791 in 2006 and then to 483 in 2007. There were only 96 sales in the fourth quarter, half the number in the prior year. The median sales price was essentially unchanged in 2007, growing by only 1.9 percent, after averaging more than 15 percent annually from 2001 to 2006.

Foreclosures are one aspect of the broader decline in sales of Class 1 properties outside Manhattan. As the Class 1 market stalls, a greater share of RPTT and MRT revenue is being generated by other segments of the property market, in particular Manhattan coops and condos, and commercial properties. Between 2005 and 2007, the total value of Manhattan coop sales increased by around 17 percent, while the value of commercial sales increased roughly 56 percent. The value of Class 1 sales outside Manhattan, however, declined by around 22 percent. In 2005, the dollar value of commercial real estate sales was about 1.5 times the value of non-Manhattan Class 1 sales. By the second half of 2007 (first half of fiscal year 2008), the ratio of commercial to non-Manhattan Class 1 sales revenue was greater than 3.0.

Manhattan coops, Class 1 residential properties (one-, two-, and three-family houses) outside Manhattan, and large commercial transactions. The data show that the number of residential transactions peaked in 2005. Since then the annual number of Class 1 sales outside Manhattan has declined by more than one-third. Sales of Manhattan coops dropped around 20 percent in 2006 and then rebounded in 2007 with most of the pickup occurring in the first half of the year.

Residential Real Estate, Median Sales Price



SOURCES: IBO; New York City Department of Finance.

While the number of residential transactions peaked in 2005, prices continued to rise through 2007, albeit at a somewhat slower pace than in previous years, particularly for non-Manhattan Class 1 sales. In contrast, the median price for Manhattan coops continues to rise, but at a much slower rate than during the market frenzy of 2004-2006.

Commercial real estate transactions have been generating an increasing share of total transfer tax revenue over time. The share of real estate sales revenue generated by commercial properties has increased markedly in recent years, and the impact on tax revenues is further magnified by the fact that RPTT and MRT rates are higher for commercial transactions than for similarly valued residential transactions. Almost all commercial transactions are valued at more than $500,000, and thus pay the highest RPTT and MRT rates (1.625 percent in both cases).

In recent years, a small number of very large commercial transactions have brought in significant amounts of both taxes, but especially the RPTT. In 2007, while residential real estate activity stagnated or declined, there were 17 commercial transactions of $500 million or more. This compares with just nine such sales in 2006, and only five in 2005. Seven of the 2007 "mega" deals occurred during the second half of the year and therefore generated tax revenues for fiscal year 2008. The expected sale of the General Motors Building, at a price which will likely exceed $3 billion, should take place before the current fiscal year ends on June 30.

COMMERCIAL RENT TAX

IBO expects commercial rent tax (CRT) revenue to total $547 million in 2008, a 6.8 percent increase over 2007, and 23.0 percent since 2005. Surging commercial rents driven by four years of increasing job growth and a limited supply of available space are responsible for much of the increase. With the economy now expected to shed jobs this calendar year, we project much slower CRT growth for the current fiscal year (2.0 percent) and the coming year (2.7 percent), when revenues are expected to reach $558 million.

Background. The CRT is paid by commercial tenants, with liability based on the amount of annual rent paid. Between 1994 and 2002, a series of tax policy changes significantly altered the incidence of the CRT and reduced revenue from more than $700 million in 1994 to $380 million in 2002. As of June 1, 2001, the tax is now only assessed on commercial tenants in Manhattan south of 96th Street, with annual rents over $250,000; liability is phased in for rents between $250,000 and $300,000. Tax liability is computed using an effective rate of 3.9 percent of the rent. Given the $250,000 threshold in place since 2001, many former CRT payers with lower rents have been removed from the tax rolls. In 2003, about 7,300 businesses (some with more than one lease) remained subject to the tax. The median rent for these remaining taxpayers was approximately $525,000 per year.

Despite the decline in commercial occupancy during the post-2000 downturn, CRT revenue remained surprisingly strong, with annual growth averaging 5.2 percent from 2001 through 2007. This was due in large part to the 18.49 percent property tax rate increase enacted in November 2002, which was passed through to many commercial tenants who have tax escalation clauses in their leases. CRT revenue grew from $377 million in 2002—the last year before the rate increase—to $512 million in 2007.

Beginning in 2006, additional targeted CRT cuts were enacted as part of the city and state aid package for lower Manhattan. These new benefits, which replaced some expiring benefits dating from the mid-1990s, have reduced 2008 CRT revenue by an estimated $13.0 million, with the cost expected to grow to $40.2 million by 2012.

Forecast. With the impact of the property tax rate increase for most commercial tenants now fully reflected in existing rents and with rents for new leases for office and retail space expected to grow by about 5.0 percent annually in the next few years, IBO projects slower growth in CRT revenue. After 2008, CRT revenue growth will average 2.9 percent annually, with revenue reaching $612 million in 2012. By comparison, CRT revenue grew by 6.6 percent, annually, over the previous four years ending in 2007.

IBO's commercial rent tax forecast differs only slightly from

OMB's with IBO's outlook between $3 million and $11 million lower than OMB's each year. OMB's forecast for the coming year is $556 million, which would be an increase of 2.9 percent over their 2008 estimate.

PERSONAL INCOME TAX

IBO's personal income tax (PIT) forecast for 2008 is $7.6 billion, 1.1 percent ($80 million) less than the amount collected last year. (This and other figures for PIT collections in this section are net—gross collections minus refunds—and include PIT receipts dedicated to the Transitional Finance Authority.)

Wall Street's troubles and the slowing of the economy have not yet led to a fall-off in PIT receipts, and so far this year withholding and estimated payments are unexpectedly high. But refunds being paid out to taxpayers for 2007 liability are higher than had been anticipated and are expected to accelerate in the spring. As a result, PIT revenue will decline in 2008 for the first time since 2003.

With a decline in city employment and much slower income growth expected in calendar year 2008, we forecast a steeper, 6.5 percent decline in PIT revenue in fiscal year 2009, to $7.1 billion. Employment and income growth will quicken beginning in calendar year 2009, with the strongest growth expected in 2011. This will fuel moderate PIT growth at an annual average rate of 5.2 percent from 2009 to 2011. PIT collections in these years will also be boosted by a run-up of capital gains realizations in calendar year 2010, in anticipation of the end of preferential federal tax rates, and by 2011 revenue from the PIT will equal $7.9 billion. With the expected shifting of capital gains realizations from calendar years 2011 into 2010, a slight decline of PIT is forecast for 2012.

While IBO expects PIT revenue to fall this year, our forecast for 2008 is $112 million higher than OMB's. IBO and OMB both expect an even greater decline in the PIT in 2009 followed by moderate growth in 2010 and 2011. IBO's forecast remains higher than OMB's in all years but 2012, when OMB predicts continued PIT growth in contrast to the IBO forecast of a decline.

Background and Recent Changes. The personal income tax is levied on the incomes of city residents. PIT liability is generally determined by two components: a base with a progressive rate structure, in which income in higher tax brackets is taxed at higher rates, and a 14 percent surcharge.[7] Currently, the combined tax rate (incorporating both the base rate and surcharge) is 2.907 percent for the lowest of the four brackets, compared with 3.648 percent for the highest bracket.[8]

These rates have been in effect since January 2001, although during calendar years 2003 through 2005 a temporary increase on high-income households was enacted, which created two additional upper tax brackets, with the taxable income in the highest bracket (above $500,000) having a tax rate of 4.45 percent. This tax hike boosted city revenue by an estimated $1.7 billion over the course of its existence. Prior to the 2003 increases, several major rate reductions and credits—the STAR program, the removal of a separate 12.5 percent surcharge, the elimination of the commuter tax, the credit to payers of the unincorporated business tax—together reduced collections by 29 percent from what they would have been in the absence of the cuts. The establishment of a city earned income tax credit in 2005 has reduced revenue by an additional $70 million annually.

In spite of this substantial loss of revenue, PIT collections grew by an average of 3.7 percent annually from 1998 to 2001, buoyed by the prolonged economic expansion and a soaring stock market that continually surpassed expectations. Stock market increases fueled PIT revenue by boosting both the capital gains realizations of city residents and the profits of securities firms which in turn increased their year-end bonus compensation to employees.

Before this year, the last downturn in the PIT came in 2002 and 2003, in response to the weakening of the national economy in the first half of calendar year 2001, the end of Wall Street's bull market, the decline in local employment, and the September 11 attack on the World Trade Center. PIT receipts plummeted 20.5 percent from 2001 to 2002, to $4.5 billion. And in 2003, as the local economy continued to lag behind the nation's anemic recovery and Wall Street's slump largely continued, PIT receipts edged down to their lowest level since 1997.

PIT growth resumed in 2004, when receipts increased by 23.3 percent over the previous year. This strong upturn resulted from the resumption of local employment growth, the doubling of Wall Street profits from 2002 to 2003, and, most significantly, the tax increase enacted in the middle of 2003. PIT revenue again grew strongly in 2005, by 17.6 percent, followed by growth of 11.9 percent and 5.1 percent in 2006 and 2007, respectively. The growth in the last two years was significant because it came in spite of the phase-out of the three-year tax increase. Had the three-year increase continued after December 31, 2005, collections would have grown by almost 30 percent from 2005 to 2007. From 2003 to 2007 revenue from withholdings grew steadily from 2003 to 2007, reflecting general economic growth plus a surge in the financial sector's bonus compensation. At the same time, estimated payments tripled, primarily fueled by large increases in capital gains realizations that began in calendar year 2004.

Revenue in the Current Year. PIT collections to date this fiscal year are about 7.8 percent greater than collections in the comparable period last year, reflecting continued employment and, especially, income growth in the city economy. Revenue from withholding is up 8.0 percent, fueled largely by record levels of collections in December, January, and February, the months when year-end bonuses are typically paid out. The securities industry has been paying large bonuses to employees even as many firms' large write-downs on mortgage-related assets have shrunk or eliminated profits. Withholding collections are expected to level off now that the bonus period has ended, and withholdings for 2008 are projected to be 4.4 percent greater than in 2007.

Estimated payments of PIT liability by investors and the self-employed are also up so far in 2008, by 23.7 percent over the previous year, due to capital gains realized in real estate and financial markets in spite of the troubled mortgage market. The high level of payments so far, made as down payments against expected liabilities for calendar year 2007, also reflects the high liabilities incurred for calendar year 2006, since many taxpayers determine the amount to be paid each quarter simply as one-fourth of the previous year's liability. In turn, the quarterly payments to be made in the rest of 2008, mostly in April and June, are likely to be lower because they will reflect calendar year 2007 liabilities. Moreover, the estimated payments to be made in April by those filing for deadline extensions will not equal the record amount received last year. On balance, estimated payments are forecast to grow by only 4.2 percent in 2008.

But refunds paid so far in 2008 are more than double the amount paid in the comparable period in 2007. This surge was initially fueled by taxpayers who filed for extensions on their 2006 returns, and now it is being fueled by taxpayers who overpaid their liability during calendar year 2007 and are now filing for refunds. Through the first week in March, refunds of 2007 liabilities are roughly 50 percent greater than refunds of 2006 liabilities made during the same period last year.

With more and larger refunds projected, plus expected declines in withholding revenue after the bonus period and in estimated payments for the rest of the fiscal year, the IBO forecast for PIT revenue is $7.6 billion, 1.1 percent ($80 million) less than 2007 revenue.

IBO's forecast of 2008 PIT revenue is $112 million greater than OMB's. While IBO projects far more refunds than does OMB, we also expect far more from estimated payments. OMB completed its forecast for the 2009 Preliminary Budget before the record-high level of estimated payments in January was evident.

The Forecast for 2009 and Beyond. With job losses and income growth of only 2.9 percent forecast for calendar year 2008 and minimal employment gains forecast for the following year, IBO expects a much larger decline in PIT revenue in the coming fiscal year. Collections will fall to $7.1 billion in 2009—6.3 percent less than in 2008. Revenue from withholding will fall a projected 2.7 percent, due to job losses and an expected cutback in Wall Street bonuses. A 13.3 percent decline in estimated payments is forecast because of the projected softening of real estate and financial markets. Also, taxpayers are expected to reduce the amount paid each quarter for calendar year 2008 liability in response to overpayment of 2007 liability. The PIT decline from 2008 to 2009 will be dampened, however, by a lower level of refunds.

The decline in PIT revenue that OMB expects from 2008 to 2009—6.6 percent—is only slightly steeper than IBO's (6.3 percent), but it is based on a lower 2008 forecast. IBO's forecast for 2009 is $126 million greater than OMB's. Both IBO and OMB expect substantial declines in estimated payments and smaller declines in withholding, but OMB forecasts less income growth in calendar year 2008 and its withholding decrease is steeper than IBO's. IBO predicts $149 million more in refunds in 2009 than does OMB, offsetting a good deal of its higher withholding and estimated payments relative to OMB.

With employment gains returning in the beginning of calendar year 2009 and accelerating in 2010, IBO expects a resumption of growth in the PIT in fiscal year 2010, but only at a moderate, 3.8 percent rate. Revenue is projected to reach $7.4 billion, less than the amounts collected in 2007 and forecast for 2008. Withholdings are expected to increase solidly, by 5.9 percent, with estimated payments increasing by 4.1 percent. Expected declines in revenue from state audits and the accounting adjustment between the city and state plus a forecast increase in refunds limit the increase in PIT collections in 2010.

OMB expects similar changes in the various components of PIT receipts with one exception, final returns payments. OMB projects that final returns will rise almost a third, a huge (but not unprecedented) increase, in contrast to IBO's forecast of more moderate growth. As a result, there is faster PIT growth from 2009 to 2010 in the OMB forecast than in IBO's, and IBO's 2010 forecast is only $51 million greater than OMB's.

The IBO forecast for 2011 is $7.9 million, 6.6 percent higher than 2010 PIT revenue. IBO's economic and revenue forecasts assumed that the Bush Administration's tax cuts—most importantly for our purposes, the preferential rates for capital gains income—will expire at the end of 2010, as they are scheduled to do under current law. With this assumption, taxpayers are expected to take advantage of the preferential rates while they can, shifting much of the realizations of capital gains from calendar year 2011 to the end of calendar year 2010, boosting final returns in fiscal year 2011. The shift in the timing of capital gains realizations will also depress final returns and estimated payments after 2011, in turn limiting PIT growth in 2012. Overall, IBO expects little change in collections from 2011 to 2012, with revenue remaining at $7.9 billion.

OMB's forecast is $70 million less than IBO's in 2011, but it is much higher in 2012, by $290 million. In contrast to IBO's projections, the OMB forecast includes faster withholding growth in 2012 relative to IBO, plus increases in final returns and estimated payments revenue.

BUSINESS INCOME TAXES

Business income tax revenues are expected to total almost $5.6 billion (without audits) in 2008, almost unchanged from the amount anticipated when the budget was adopted last summer but 7.3 percent below the revenues for the prior year. Revenues are expected to decline further in 2009 (falling another 10.4 percent to $5.0 billion) before resuming relatively moderate growth over the remainder of the January 2008 Financial Plan.

Background. New York City levies three entity-level taxes on business net income: the general corporation tax (GCT), the banking corporation tax (BCT), and the unincorporated business tax (UBT). These three taxes were established (along with now defunct city insurance and transportation corporation taxes) in 1967, replacing the city's previous taxes on general and financial business gross receipts. New York City is almost unique among localities in imposing substantial business income taxes at the local level.

More than four-fifths of the GCT is collected through an 8.85 percent tax on entire net income allocated to New York City; the remainder is collected through alternative tax bases: income plus compensation (which starting this year is being partially phased out), capital allocated to the city, and a minimum tax. The principal rate and base of the BCT is similar to that of the GCT. Over nine-tenths of collections are derived from a 9.0 percent tax on entire net income allocated to the city, the remainder from alternative tax bases. The city's UBT imposes a 4.0 percent tax on the income of partnerships, proprietorships, and (since 1994) limited liability corporations. Excluding audit revenue, in 2007 GCT net collections topped $3.12 billion, BCT revenue was $1.22 billion, and UBT revenue $1.67 billion.

Today about half of total city business tax revenues are derived from "flow-through entities" (S-corporations taxed under the GCT, and limited liability corporations, partnerships, and proprietorships taxed under the UBT) whose net income is for the most part subject only to personal income taxation at the federal and state levels. The city taxes this income at the personal level as well, but somewhat mitigates double-taxation by providing a partial credit in its personal income tax for UBT liabilities of city residents. There is currently no comparable relief for resident shareholders of city-taxed S-corps. The Mayor proposed establishing such a credit in last year's Executive Budget but it was not enacted. In January, the City Council Speaker again called for such a credit in her State of the City address.

The distribution of city business tax liabilities reflects, albeit imperfectly, the composition of the city's economy, particularly the leading role played by the densely interrelated finance, real estate, legal, and other professional business services in generating income, and to a lesser extent employment. These sectors generate around two-thirds of overall business tax liabilities (compared to a little over a quarter of private-sector city employment). Manufacturing and trade together account for about one-eighth of liabilities (and a sixth of private jobs). On the other hand, health care yields less than 4.0 percent of business tax liabilities, despite providing some 17.5 percent of private jobs, and the leisure and hospitality sectors (arts, entertainment, accommodations, and food services) generate less than 3 percent of liabilities compared to more than 9 percent of private employment. In the case of former it is probably the nonprofit status of the major health care institutions that limits the exposure of this sector to business taxation.

The city's business income taxes are highly pro-cyclical, meaning that their revenues tend to grow very strongly during an economic upswing and fall sharply during a downswing. In the bank tax this volatility is exacerbated by very large fluctuations in refunds, the result of adjustments for overpayments and underpayments based on losses and gains not recognized until a year or more after they are incurred. There has never been, however, a period of business tax revenue growth like the one witnessed after the city emerged from its post-9/11 recession. During a period of relatively low inflation, all three taxes reached new highs in 2005—and topped them in 2006, and then again (by wide margins) in 2007. Capped by a one year $1.67 billion, 38 percent jump in 2007, combined business tax revenues nearly tripled between 2003 ($2.28 billion) and 2007 ($6.01 billion). This explosive growth increased the business income tax share of total city tax revenues from 9.8 percent to 16.1 percent.

The business taxes differ from the city's other tax sources in that audits account for a significant portion of revenues. With audit revenue included, business income taxes yielded $7.0 billion in 2007, 18.7 percent of total city tax revenues. (Note that all the revenue figures below exclude audits.)

Forecast. Business income tax revenues are projected to fall $436 million, or 7.3 percent, during the current fiscal year. This includes declines of 5.5 percent in the GCT and 23.6 percent in the BCT; UBT revenue is expected to post a small (1.3 percent) nominal gain in 2008. Business tax net collections to date (through January) are actually up 5.3 percent over the same period last year, but are projected to run 16.7 percent below last year's blistering pace for the rest of the fiscal year. This is mostly due to slowing economic activity and weakening profits, especially on Wall Street. But about a tenth of the projected overall 2008 revenue decline ($42 million) stems from tax policy changes: a partial phasing out of the income-plus-compensation base for the GCT (costing $26 billion), and a doubling of the partnership deduction for the UBT ($16 billion).

Steeper revenue declines are forecast for 2009: minus 7.7 percent for the GCT, minus 31.9 percent for the BCT, and minus 3.3 percent for the UBT, resulting in an overall $580 million (10.4 percent) drop in net collections. Nearly half of the fall is due to a projected $272 million jump in GCT and BCT refunds. Another $38 million will result from the increased effect of the phase out the GCT's income-plus-compensation base.

The combined business tax revenue decline in 2008 and 2009 is $1.02 billion, offsetting a little more than a fourth of the $3.73 billion growth of the previous four years. (Note that adjusted for inflation, the 2008-2009 decline will erase 40 percent of 2004-2007 revenue growth.)

Business tax revenues are expected to resume growing in 2010, albeit at a much more modest pace than during the 2004-2007 boom. IBO projects growth of 12.2 percent in 2010, 5.9 percent in 2011, and 3.5 percent in 2012. Only in the last year of the financial plan (2012) are business income tax revenues expected to finally pass the peak reached in 2007. Adjusted for inflation, however, 2012 revenues will still be well below that peak.

IBO's business income tax forecast is significantly higher than OMB's, which assumes an even greater decline in revenues in 2008 through 2012. The differences average $483 million for the five years, with the largest gap in 2008 when IBO's estimate exceeds OMB's by $591 million. This reflects the much sharper slowdown in net collections projected by OMB for the rest of the current fiscal year: whereas, as noted above, IBO's forecast calls for a shift from 5.3 percent actual growth for the first half of the current year to a projected 16.7 percent decline for the second half, OMB's forecast encompasses a second-half decline of nearly 34.0 percent. In 2009 on the other hand, IBO forecasts a deeper drop in overall business tax revenues (10.4 percent) than OMB (7.1 percent). Some of these differences, particularly for the GCT, are driven by the expected timing of collections and refunds.

GENERAL SALES TAX

IBO's forecast for sales tax revenue in 2008 is $4.8 billion. This is an increase of 3 percent from the 2007 level. In 2009, revenue is expected to remain essentially unchanged from the 2008 amount. The slowdown in 2009 reflects IBO's forecast for sluggish growth in disposable income and employment. Sales tax revenue growth is expected to resume in later years with annual growth projected to average 4.0 percent in 2010 through 2012. By 2012, IBO expects that sales tax revenue will reach $5.4 billion. With the exception of 2012, when the two forecasts are nearly equal, IBO's sales tax revenue estimates are slightly higher than those of OMB (by about 2.6 percent on average from 2008 through 2011).

Background. Sales in the city of most retail goods, utility charges, and a variety of personal and business services are subject to a combined sale and use tax rate of 8.375 percent. The tax is composed of a 4.0 percent city tax, a 4.0 percent state tax, and a 0.375 percent Metropolitan Commuter Transportation District surcharge.

City sales tax revenue is broadly a function of household spending of city residents along with consumption expenditures by businesses, commuters, and tourists. Household spending, in turn, is primarily determined by disposable income and the level of consumer confidence.

Recent Trends. In 2004 through 2007, sales tax revenue grew at an annual average of about 7 percent, after accounting for tax policy changes. A confluence of factors explains this healthy growth. In recent years, the level of consumer expenditure rose in conjunction with higher profitability in the financial industry and record-breaking Wall Street bonuses. Sales tax revenue was further bolstered by the strong performance of the tourist industry. As the number of domestic and foreign visitors increased, the city has reaped the economic benefits—evident from near-capacity hotel occupancy rates and increasing room rates, strong Broadway ticket sales, and tourist-oriented retail activity.

In the upcoming years, continued strength in the tourist industry will help offset the negative effects of slowing national and local economies. While nationwide retailers are struggling as consumers begin to feel the effect of higher food and gas prices and a housing slump, the weaker dollar has made the city and its stores more attractive to international tourists. Bargain-seeking foreign tourists armed with strong currencies are expected to help stave off a decline in retail sales and city's sales tax collections.

Tax Policy. During the fiscal crisis of the 1970s, an extra percentage point was added to the city's sales tax with the additional revenues committed to provide funds to pay for Municipal Assistance Corporation (MAC) debt that was issued on the city's behalf. The additional percentage point on the sales tax generated more than enough revenue to cover the MAC obligations, with the extra revenue available for general budget purposes. In 2003 the state took on the responsibility for paying the remaining MAC debt service. On June 30, 2008 the Financial Emergency Act is set to expire and along with it the authority to impose the extra sales tax.

Absent authorization from the state to keep the tax at 4 percent, the city sales tax rate would revert to its original 3 percent on July 1, 2008. The Mayor has urged state lawmakers to prevent this sales tax reduction and provisions to keep it were included in former Governor Spitzer's budget plan. IBO's revenue forecast assumes that the 4 percent rate is extended; failure to do so would reduce 2009 sales tax revenue by $1.2 billion.

HOTEL OCCUPANCY TAX

IBO expects hotel tax revenue to reach $374 million in 2008 and $412 million in 2009. From 2008 to 2012 annual revenue growth is expected to average 8.4 percent. IBO's estimates are above OMB projections, particularly in the later years of the January 2008 Financial Plan, with the difference reaching 10 percent in 2012 when IBO expects the city to collect $518 million in hotel tax revenues.

Background. Since 1970, New York City has imposed a hotel occupancy tax, which is levied in addition to the combined city, state, and transportation district sales taxes. The hotel tax is currently 5.0 percent of room charges plus a flat fee of $2.00 per night for rooms renting for $40.00 or more, with lower fees for less expensive rooms.

Recent Trends. The recent robust hotel tax revenue growth reflects the recovery in the city's tourism industry from a sharp contraction in the wake of September 11. Both domestic and foreign visitors continue to flock to the city as it remains a relatively cheaper destination when compared to Paris or London, combined with a greatly improved reputation for safety. The number of international and domestic visitors totaled about 45 million in 2007, up about 2 percent from the prior year, and 9 million more than the number of visitors the city hosted in 2000.

This increase in the number of visitors is reflected in the rising number of arrivals at the three major airports serving New York City: annual passenger volume in 2007 increased by 1.6 percent over 2006, to a record 109 million passengers (of them 69 percent were domestic passengers, and the remaining 31 percent were international travelers) While domestic traffic decreased by about 3 percent in 2007, international traffic saw a jump of more than 8 percent.

In 2007, the influx of visitors led to record-low hotel vacancy rates. Manhattan occupancy nearly reached 80 percent last year—the highest level in almost a decade and a percentage point higher than in 2006. This high demand has in turn allowed hotels to continue raising room rates. The average daily rate jumped by 12.9 percent, rewarding hotel owners with an average of nearly $300 per available room, 75 percent above 2000 levels.

In recent months, NYC & Company has stepped up its efforts in promoting the city as a tourist destination, opening tourism and merchandise offices in Canada, Australia, Brazil and other countries. The declining value of the U.S. dollar against world currencies coupled with the city's marketing campaign and other favorable factors are expected to have a continuing positive impact on the local tourism and hotel industry and to sustain the steady growth in hotel tax revenues.

OTHER REVENUES AND CATEGORICAL GRANTS

Other Revenues. IBO's estimate of revenue from sources other than taxes for 2008 totals $6.8 billion. Other revenues include funds from unrestricted intergovernmental aid, STAR reimbursements, other categorical grants, inter-fund capital transfers, and miscellaneous revenues from recurring and nonrecurring sources. Some of these sources, particularly miscellaneous revenues, can fluctuate due to unusual or one-time transactions, and indeed those sources are expected to decline by about $797 million next year. Much of the large change is attributable to a few items such as an unusually large amount of tobacco settlement revenue this year and healthy interest income on overnight deposits thanks to the city's strong cash balances this year. This year's tobacco revenue includes some proceeds that were deferred through a restructuring of tobacco settlement debt in 2006. Overall, other revenues are expected to decrease next year to $6.0 billion and then remain near that level through 2012.

Categorical Grants. Categorical grants received from the state and federal governments to fund specific programs account for approximately 30 percent of all funds spent by the city each year. IBO projects that state and federal categorical grants will total $11.6 billion and $5.6 billion, respectively, in 2009. For some types of categorical grants, such as education and welfare, IBO has developed forecasts based on changes in programs and caseloads. IBO's forecast of categorical grants in other parts of the budget is based on a methodology that takes the grant level in the current year and adjusts for historical trends and programmatic changes.

ENDNOTES

[1]When IBO refers to market values and assessments, the reference includes only taxable property. The assessed value for tax purposes (also referred to as billable taxable value) reflects the required phase-in of assessment changes for apartment, commercial, and industrial buildings. In this report the billable taxable values are shown before applying the STAR exemptions.
[2] For additional information, see *Twenty-Five Years After S7000A: How Property Tax Burdens Have Shifted in New York City*, Independent Budget Office for New York City, December 2006.
[3]For additional information see IBO, *Twenty-Five Years After S7000A.*
[4]For example, using DOF data, IBO found that the median expense ratio for rental buildings in the Bronx built before 1940 was 0.50, while thoswe built since 2000 in the Bronx have a median ratio of 0.40. The same categories in Manhattan had median ratios of 0.39 and 0.25.
[5]The finance department argues that there analysis found wide differences in the ratios of taxes to gross income and that the use of GIMs will reduce these disparities. Some of that variation is presumably due to expected fifferences to expenses.
[6]See IBO, *Twenty-Five Years After S7000A.*
[7]A separate PIT surcharge equal to roughly 12.5 percent of base liability was instituted in 1990 but allowed to expire at the end of 1998. For much of its history, revenue from this second surcharge had been dedicated to criminal justice spending.
[8]For example, for a married couple filing jointly, the lowest bracket ends at $21,600. The highest bracket begins at $90,000. For other types of filers, the income thresholds are lower.

Expenditure Outlook

IBO projects that under the Mayor's 2009 Preliminary Budget and January Financial Plan, spending will grow from $61.3 billion in 2008 to $71.8 billion in 2012, an average annual increase of 4.0 percent. Some of the largest areas of growth in terms of average annual change are the same as in recent years, such as debt service and health and other fringe benefits for city employees. A considerable portion of the growth is fueled by the Mayor's decision to fund the city's labor reserve at a level based on the assumption that upcoming contracts with municipal unions will be settled with 4.0 percent annual salary increases, as in recent settlements with several uniformed services unions. That does not mean, however, that the Mayor will agree to settlements at that level, particularly in light of the city's worsening economic outlook.

For many city agencies projected spending (not including labor) under the Mayor's financial plan remains relatively flat. The January Financial Plan also includes the first substantial Program to Eliminate the Gap in several years: $543.2 million in the current fiscal year and $884.8 million in 2009. The Department of Education has the largest PEG in dollar terms, with much of the cuts coming directly from school budgets. Nonetheless, the education department budget is projected to rise from $16.8 billion in 2008 to $19.7 billion in 2012.

IBO Expenditure Projections

Dollars in millions

	2008	2009	2010	2011	2012	Average Change
Health & Social Services						
Social Services:						
Medicaid	$5,841	$5,646	$5,800	$5,959	$6,133	1.2%
All Other Social Services	2,835	2,722	2,710	2,710	2,710	-1.1%
HHC	40	90	92	92	92	22.9%
Health	1,649	1,556	1,581	1,591	1,602	-0.7%
Children Services	2,751	2,702	2,709	2,709	2,709	-0.4%
Homeless	751	661	664	664	664	-3.0%
Other Related Services	677	522	519	518	518	-6.5%
Subtotal	14,544	13,900	14,075	14,244	14,428	-0.2%
Education						
DOE (excluding labor reserve)	16,801	17,726	18,868	19,672	19,684	4.0%
CUNY	601	547	549	553	553	-2.1%
Subtotal	17,401	18,273	19,418	20,225	20,237	3.8%
Uniformed Services						
Police	3,957	3,945	4,063	4,148	4,150	1.2%
Fire	1,550	1,536	1,537	1,545	1,546	-0.1%
Correction	985	989	994	990	996	0.3%
Sanitation	1,266	1,295	1,367	1,448	1,456	3.6%
Subtotal	7,758	7,764	7,960	8,132	8,148	1.2%
All Other Agencies	6,700	5,940	6,382	6,395	6,474	-0.9%
Other Expenditures:						
Fringe Benefits (excluding DOE)	3,599	3,633	3,912	4,231	4,543	6.0%
Debt Service	4,321	2,003	3,197	6,104	6,697	11.6%
Pensions	5,625	6,113	6,412	6,406	6,421	3.4%
Judgments and Claims	635	688	738	795	856	7.8%
General Reserve	100	300	300	300	300	n/a
Grant to TFA	546	-	-	-	-	n/a
Labor Reserve:						
Education	28	76	367	630	630	n/a
All Other Agencies	510	1,030	1,799	2,225	2,656	n/a
Expenditure Adjustments	(500)	70	219	331	413	n/a
TOTAL Expenditures	$61,267	$59,790	$64,779	$70,017	$71,804	4.0%

SOURCE: IBO.

NOTES: Debt service expenditures, if adjusted for prepayments, would grow at an annual average rate of 10.5 percent from 2008-2012. Debt service includes Transitional Finance Authority (TFA) debt service expenditures. The city shifted Medicaid funds from HHC to HRA in 2008 and later years to consolidate all city Medicaid funding in a single agency. The shift is being carried out to simplify transactions with New York State under the new state cap on local Medicaid spending. Expenditure adjustments include energy, lease, prior year payable adjustments and non-labor inflation estimates. Estimates exclude intra-city expenses. May not add due to rounding.

Education

BUDGET CHALLENGES FACING CUNY

The City University of New York (CUNY) is the nation's largest urban public university. Over the last several years, efforts by CUNY administrators to upgrade the quality of its academic programs have won the praise of outside observers and increasing numbers of applicants to its various colleges. The recent preliminary report by the New York State Commission on Higher Education, appointed by former Governor Spitzer, includes several proposals for improving both the CUNY and the State University of New York (SUNY) systems. Key proposals include plans to hire 2,000 additional full-time faculty members statewide over the next five years, and upgrade and expand university infrastructure.

Under the commission's proposals, funding for ongoing operating expenses and investments in quality upgrades would come from a proposed "New York Stare Compact for Public Higher Education," which is closely based on the "CUNY Compact," a financing plan developed in 2005 by CUNY administrators. Under this plan the new revenues needed for continued improvements at CUNY would come from steady increases in state and city funding, cost-saving efficiency moves by the university, philanthropic sources, student enrollment growth, and regular, relatively modest tuition increases.

Whether this financing plan will be implemented remains an open question. The economic downturn is making it more difficult to secure increases in government funding. Moreover, last year's request by CUNY for a 2.5 percent tuition increase was denied by the state, and this year's request for a 5.0 percent increase to put the plan back on schedule is not included in the former Governor's budget proposal.

State Budget. The state and city have different areas of financial responsibility within the CUNY system. The state funds the four-year degree programs plus the graduate and professional schools, while both the state and city contribute funds to the community colleges.

In recent years CUNY's quality improvement initiatives have been aided by a significant uptick in state funding support. From state fiscal year 1988–1989 to 2003–2004 total state aid to CUNY actually decreased from $725 million to $719 million in spite of rising costs. In inflation-adjusted dollars this represented a 43 percent decline in state funding over this period. Over the last four years, however, state aid has increased by significant amounts each year, reaching $1.179 billion in 2007-2008. During this period inflation-adjusted year-over-year growth averaged about 10 percent.

The former Governor's Executive Budget for 2008-2009, reflecting a more difficult fiscal outlook, would increase state funding for CUNY by a more modest 3.2 percent to $1.217 billion, well below the levels requested by CUNY to fulfill the goals laid out in the CUNY Compact and in its Master Plan. The $38 million increase proposed in the Governor's Executive Budget would cover only part of the increase in mandated costs (covering such items as salaries, fringe benefits, energy, rent, and supplies) at the four-year and community colleges, and none of the investment dollars needed to carry out the scheduled quality improvement initiatives.

In addition, the proposed state budget does not include any of the tuition increases requested by the CUNY administration. Along with steady increases in public and private funding, the CUNY Compact assumes there will be regular tuition increases. Since last year's request for a 2.5 percent tuition increase was denied by the state, this year CUNY has requested a 5.0 percent increase to put their plan back on schedule. If enacted this would increase tuition for full-time, resident undergraduate students by $100 per semester at the senior colleges and $70 at the community colleges. Failure to approve this tuition increase or to substitute additional state aid would leave CUNY with a $42 million shortfall in its financial plan for the coming year.

While falling short of CUNY's budget request for the next fiscal year, the Governor's Executive Budget does include proposals that could provide longer term support for the university's quality improvement plan. One proposal would create a $4 billion Higher Education Endowment by selling a share of future proceeds from the state's lottery system. Once established the endowment would be expected to provide more than $200 million in additional operating aid to CUNY and SUNY each year. The budget also proposes a significant increase in funding for CUNY's five-year capital plan, although still well below the amount requested by university officials.

City Budget. The Mayor's 2009 Preliminary Budget includes budget cuts that reduce city funding for CUNY by $5.8 million in the current city fiscal year 2008 and $9.7 million in 2009. The reductions would eliminate 145 positions in a variety of administrative areas at the university. These reductions come on top of $14 million in previous baselined reductions. Last June funds were added to the 2008 budget to cover these prior reductions, but they remain in place for 2009 and later years. In addition each year CUNY relies on the City Council to add funds during the budget adoption process for a number of programs, such as the Vallone Academic Scholarships, that historically have been funded one year at a time. Last year the City Council added about $25 million for these programs for 2008 only.

Largely as a result of these actions, the level of city funding for CUNY for 2009 is about $40 million below that for the current year. (Note that this comparison excludes funds for Center for Economic Opportunity programs, which are expected to be funded at a later date.) This situation is not that unusual for this point in the budget cycle; CUNY is generally not fully funded until the adopted budget. Given the city's current budget difficulties, however, it is not clear whether city funding in 2009 will ultimately match 2008 levels, let alone the increases requested by university officials to achieve the goals of the CUNY Compact.

GROWTH IN PUBLIC SCHOOL SPENDING SLOWS

The New York City Department of Education (DOE) provides primary and secondary education to roughly 1 million students in more than 1,400 public schools. The preliminary budget includes $17.8 billion for the DOE in 2009, $853 million more than in 2008. City funds account for about $7.2 billion of that total, roughly 41 percent. Similar to last year, 77 percent of these funds will be spent on services to schools during fiscal year 2009, while 15 percent will be spent on systemwide costs and another 8 percent on nonpublic schools.

The 2009 budget will see growth driven by special education costs (up by $240 million or 10.9 percent) and payments to nonpublic schools (charter school, contract school, and foster care payments) which will grow by $125.6 million, or 9.8 percent. Another large driver of growth will be the higher fringe costs which are expected to increase by $165 million (7.9 percent) from 2008 to 2009. Classroom instruction for general education services will grow by $246 million (3.9 percent) and categorical programs are expected to show little change.

While the overall DOE budget will grow under the Mayor's 2009 Preliminary Budget, his financial plan includes reductions that will slow the growth in city support for the DOE, with much of the cut coming directly from school budgets. At the same time, former Governor Spitzer proposed a state Executive Budget that would deliver less state aid than had been anticipated by the city, including funding that had been promised just last year as part of the resolution to the long-running Campaign for Fiscal Equity lawsuit.

Background. The current school year has brought another round of changes in budget policy and restructuring for the DOE. The education department began to phase in its new school funding methodology, fair student funding (FSF), which is designed to provide a more equitable and transparent distribution of city tax levy dollars for New York City students. The FSF formula allocates funds based on student need and added $110 million to the budgets of schools whose FSF spending was below the amount resulting from the new formula. In other schools, where their spending exceeded the formula amount, $237 million was used as a "hold harmless" allocation to avoid wild budget swings under the new formula calculation. Additionally, over $230 million that resulted from administrative regional restructurings was allocated to individual school budgets. With the dismantling of the regional offices—which had been created under a previous "Children First" restructuring in 2003—schools were allowed to choose from a menu of support networks to provide some of the services that had previously been provided by the regions. Principals also had the option of having their schools become empowerment schools, with greater resources, greater autonomy, and greater accountability.

The current school year also marks the first year operating under the state agreement that ended the Campaign for Fiscal Equity (CFE) litigation. The state has agreed to increase support for city schools over a four-year period while also mandating significant new city funding, although the Governor's Executive Budget proposed slowing the scheduled increases (see below). As part of the resolution of the case, the city, along with other districts receiving new aid, are required to enter into "Contracts for Excellence" which constrain the use of some of the new money to five specific areas: reducing class sizes, increasing student time on task, improving teacher and principal quality, restructuring middle and high schools, and expanding prekindergarten programs. The city's initial proposed allocation of the Contracts money among these five areas had to be approved by the New York State Education Department, and contentious negotiations dragged on into the fall. The city was forced to shift resources towards class size reduction and away from other areas. Thus, some spending priorities have shifted in the middle of the current school year.

City Funding Cuts in the Preliminary Budget. This year, after having been protected from budget trimming exercises since 2003, the Mayor's preliminary budget includes cuts to DOE's budget along with those of most city agencies. DOE's reductions are roughly equal in percentage terms to the citywide average, although given the size of the DOE budget those proportionate cuts are the largest in dollar terms. All city agencies were asked to cut 2.5 percent from their budgets in the current year and to cut 5 percent for the upcoming year. For 2008 the education department will absorb the full 2.5 percent PEG reduction, which amounts to $180 million. For 2009, the cut is somewhat less than the target at 4.4 percent or $324 million. For 2008, school budgets will shoulder $113 million of the PEG cuts, 62.7 percent of the total. In 2009, the impact on school budgets will be $224 million or 69.0 percent of the total PEG. The bulk of the cuts to schools are direct cuts to their budgets ($99 million this year and $181 million in 2009) as well as other school-based changes that will affect spending by schools.

Direct Cuts to Schools. A 1.75 percent across-the-board cut has already been imposed to pull $99 million from school budgets for 2008. The percentage reduction was applied to a base that consisted of tax levy instructional programs plus spending allocated through the fair student funding formula and the Children First allocations for each school.[1] The cuts to individual school budgets ranged from as little as $10,000 to as large as $447,000, with an average cut of roughly $72,000.

It was left to the principals to decide how to take the direct school-level cuts. Principals are allowed to spread the reduction to other allocations that may have had unscheduled or uncommitted balances. Particularly for 2008, when the reductions are occurring mid-year after staffing and class organization is largely set, it is unlikely that there will be actual reductions in the number of classes. Instead, schools are likely to turn to other areas such as restraining purchases of supplies and instructional materials, letting go of nonessential vacancies, paring noncore classes, cutting back on substitute teachers, reducing extended day programming (either before or after school), and cutting back summer school programs. Programmatic cuts in schools this year are not likely to be restored next year because the direct school-level cut for 2009 increases by $83 million to a total of $181 million.

Other School-Based Cuts. While the action to pull $99 million out of school budgets has drawn the most attention this year, there are other items among the PEG program that will also affect spending at the schools. Unlike the direct school cuts, principals have less control over how these will be implemented. These other school-based cuts include recouping more in school lunch payments from students, reduction of reserves for summer school and English Language Learner (ELL) programs, and shifting the cost for school-based information technology purchases to the schools. These initiatives will have direct policy implications for schools and are expected to produce $14 million in savings for 2008 and $43 million dollars in savings for 2009. In the following paragraphs we focus on the 2009 savings.

DOE Preliminary Budget Cuts

Dollars in millions

	2008	2009
Direct School Cuts		
School Spending	$99.0	$180.7
	99.0	180.7
School Based Cuts		
Food Efficiencies	0.0	5.0
Lead Teachers	0.0	10.0
Assessments	1.0	2.0
ELL Reserves	5.0	10.0
School DIIT	2.0	10.0
Summer School	4.0	4.0
Tech Support	2.0	2.0
Total, School Based Cuts	***14.0***	***43.0***
Central Based Cuts		
Central DIIT	4.0	4.0
Facility Efficiencies	1.0	2.0
FIT	1.0	0.7
Hiring Freeze	6.8	10.6
Vacancy Reduction	0.9	6.4
Repairs/Maint	1.0	2.0
Transportation	5.5	5.0
Purch Efficiencies	0.0	23.0
High Cost Aid (swap)	47.0	47.0
Total, Central Based Cuts	***67.2***	***100.8***
TOTAL	**$180.1**	**$324.5**

SOURCES: IBO, Mayor's Office of Management and Budget.

The city is asking schools to initiate policies to do a better job collecting the lunch fees owed by students who do not qualify for fully subsidized lunches. This initiative is expected to generate $5 million in savings and will probably have the greatest impact in elementary and middle schools.

The 2009 Preliminary Budget included a proposal to force schools to fund their own lead-teacher programs in order to save $10 million. Lead teachers are experienced teachers who spend part of their work day doing professional development for less experienced colleagues. They work additional hours and are paid a higher salary than a regular teacher. The right to have the position was established in the last collective bargaining agreement with the teachers union. Currently, the central administration subsidizes 40 percent of the cost of these positions. Under the preliminary budget proposal, schools will now have to absorb the full cost of the program, if they want to continue it. At the recent City Council hearing on the DOE budget, Chancellor Joel Klein indicated that he was working to avoid this particular cut.

There will be fewer periodic assessment tests, which will lead to a $2 million savings. Summer school reserves and ELL reserves will be eliminated, saving $10 million and $4 million, respectively; these will continue but without any reserve cushion. If service demands exceed projections it is unclear how the shortfall will be addressed.

The PEG for school based-information technology (IT) will save $10 million in the central IT budget by requiring schools to pay for some of their own IT purchases, although they are not being given any additional resources. In addition, contracts for technology support services at individual schools will not be renewed, saving $2 million. Because the savings will be generated from a reestimate of the original support costs to schools, DOE expects this will be achieved without an actual reduction in service to schools.

Centrally Based Reductions for 2009. The remaining $101 million in PEGs for 2009 will more generally affect central administration and include a hiring freeze and the elimination of some administrative vacancies. The latter two items are expected to save $16.8 million. One part of these savings stems from the elimination of 472 positions in the regional offices—where responsibilities had been greatly diminished during last year's reorganization. Current employees in those positions will be offered posts elsewhere in the education department as they become open.

The Department of Education expects to generate $23 million in savings through purchasing efficiencies. Certain commodities will be centrally managed in order to capitalize on the greater purchasing power of the entire school system to reduce prices. The centrally based information technology PEG will postpone the expansion of the High School Scheduling and Transcript system to middle schools, yielding $4 million in savings. The system currently provides for data entry, student scheduling, grade reporting and transcripts.[2] Another initiative "saves" the city $47 million in city funds due to a reestimate of the amount of high cost aid that will be available from the state. High cost aid supports programs for students with disabilities.

School facilities efficiencies are expected to reduce custodial staffing levels and generate $2 million in savings. Additionally, central facilities operations and maintenance will provide service to schools on an as-needed basis with the aim of generating $2 million in savings by reducing unnecessary repairs and maintenance. An anticipated $5 million transportation savings reflects a reestimate of the cost of busing special education students based on ridership levels. The remaining $0.7 million will be saved by reducing contributions to the Fashion Institute of Technology, the only SUNY-managed community college in New York City and the Department of Education is the college's local sponsor.

State Budget Proposals. The Governor's Executive Budget for 2008-2009 would provide $20.7 billion for elementary and secondary education statewide, an increase of $1.4 billion over the 2007-2008 level. With the state facing significant budget deficits, former Governor Spitzer proposed slowing the rate of growth in school aid when he released his Executive Budget in January. While estimates from the state's Division of the Budget indicate that the city will see an overall increase in aid of $547 million to $8.1 billion, this increase is less than the city had anticipated by more than $300 million.[3]

Much of the shortfall is in "foundation aid, which is at the core of the CFE resolution. Foundation aid consolidated almost 30 disparate formulas into a single aid flow. Last year's state budget legislation included a four-year path that would ultimately increase foundation aid by $5.5 billion, statewide, over the amounts previously allocated by the formulas it replaced. The increase in the first year (2007–2008) was $1.1 billion, with another $1.25 billion to be added for the coming year (2008–2009). This year, the Governor's Executive Budget proposed scaling back the increase for 2009 to $899, statewide. This smaller increase in foundation aid would reduce the city's incremental foundation aid to $335 million, which—according to state estimates—is about $193 million less than the $528 million increase that would have occurred without the slower phase-in.

The shortfall in foundation aid as measured by the city is considerably larger, however. The preliminary budget revenue estimates assumed that foundation aid would grow by $804 million from 2008 to 2009. It is likely that some of the difference in foundation aid cited by the Mayor's office results from a feature of the original foundation aid legislation that updated the calculation used to determine school districts' relative ability to support education with local resources. Applying the most recent data on property wealth and income in the formula works to reduce the city's allocation.

The Contracts for Excellence were the other core item in resolving the CFE litigation. Under the guidelines established last year, any school district gaining a foundation aid increase greater than 10 percent (or $15 million) signed a "contract" to increase district accountability for student performance and spending. The Governor's Executive Budget recommended that for the coming year, districts falling into this category and districts with contracts during 2007–2008 have the contract term extended for a three year period.[4] Additionally, the

Governor's Executive Budget would add a sixth programmatic area to the contracts, targeting effective programs for English language learners. With about 140,000 students currently enrolled as English language learners in New York City schools, this new target could have an impact on city spending priorities.

Academic Achievement Grants. Last year's state budget brought a new form of state aid targeted to New York City known as academic achievement grants. They are intended to be used to help address some of the educational deficiencies identified during the CFE case. Last year the grant was $89 million. This year, the Governor's Executive Budget proposed increasing that amount by $90 million. The grant would be split into two pieces, one for $100 million and a second for $79 million. But the proposed state budget does more than just increase the amount of the academic achievement grants. The terms are changed so that in the case of the $100 million grant, its value is reduced dollar-for-dollar as the city's building aid increases over a base amount. Given that building aid is expected to increase substantially as the city takes advantage of the 2006 authorization to use building aid to expand Transitional Finance Authority debt capacity for school construction, it is quite likely that most or all of the $100 million grant would be recaptured by the state. Similarly, the $79 million grant would be offset if transportation aid increases, although because that aid grows more slowly, the city sees less risk that the grant will be subject to recapture.

Universal Prekindergarten. The Governor's Executive Budget recommends increasing funding for universal prekindergarten to $452 million statewide, up from last year's budget of $363 million. The higher request represents an ongoing initiative to expand the program to provide full-day programs in high-need and low-performing districts, although the target has been trimmed back somewhat, with the state budget now projecting the program will ramp up to $633 million when fully implemented in 2010-2011. New York City's share of available state pre-k funds would grow by $35 million next year.

The additional state aid would bring the total amount of state universal prekindergarten funding in the city to more than $248 million for 2009. While the bulk of prekindergarten funding (71 percent) comes from state sources, city (17 percent) and federal dollars (8 percent), as well as private tuition (4 percent) also support the program. In the current school year, DOE allocated $156 million dollars to fund its prekindergarten classroom teachers from all revenue sources including state aid, federal Title I funds, city tax levy, and tuition.

Although Contract for Excellence guidelines allow matching of half-day state funds with Contract for Excellence money in order to create full-day prekindergarten seats, only a small handful of schools agreed to dedicate contract funding for this purpose. This year only a very small amount of Contract for Excellence money (less than $200,000) was allocated for pre-k expansion in New York City schools. Going forward, the city is requesting more funding flexibility from the state with regard to reimbursement and movement of money in order to facilitate start-up of pre-k sites.

FUNDS FOR SCHOOL CONSTRUCTION REMAIN IN PLACE

The city's January 2008 Capital Commitment Plan, which covers 2008 through 2011, would provide $11.6 billion for the Department of Education's capital plan. Close to 43 percent ($5.0 billion) of the plan total is city-funded, financed with city-backed bonds. The remaining balance is comprised of state and federal grants.

The commitment plan provides sufficient funds to complete the current five-year education capital plan, relying on both city funds and substantial amounts of new state funding resulting from the resolution of the Campaign for Fiscal Equity litigation. The Executive Budget proposed by former Governor Spitzer would provide sufficient resources to meet the state's obligations under the capital plan, but it does include a provision that could interrupt the delivery of some funding the city is counting on for up to 18 months.

Rising Investment in Education Infrastructure. The city capital commitment plan provides $3.3 billion (all funds) each year for 2008 and 2009 and about $2.5 billion annually for 2010 and 2011. These amounts reflect very large investments in the city's education infrastructure and account for a significant share of the commitments for all purposes. Capital commitments for education show substantial year-to-year fluctuation, but there has been a general upward trend; the current level is nearly three times larger than the amount committed in 2000. Education capital commitments spiked in 2001 and then plummeted from 2002 through 2004, partly in response to tougher fiscal conditions, although the declines exceeded the slowdown in the commitments for all purposes.

Increased investment in the city's education infrastructure over the past few years can be attributed to the Campaign for Fiscal Equity litigation, which was resolved two years ago. As part of the resolution, state legislation was enacted to provide capital assistance for New York City public schools to help address major deficiencies in school capacity and building conditions—deficiencies that had been highlighted during the litigation. This

Education Capital Commitments as Share of Total City Commitments

Dollars in millions

	City Funds			All Funds		
Fiscal Year	Education	Total	Education Share	Education	Total	Education Share
2000	$1,123	$3,721	30.2%	$1,160	$3,974	29.2%
2001	2,178	6,094	35.7%	2,429	6,775	35.9%
2002	1,337	5,832	22.9%	1,340	6,214	21.6%
2003	890	5,389	16.5%	963	5,799	16.6%
2004	571	4,539	12.6%	593	5,034	11.8%
2005	2,188	7,288	30.0%	2,188	7,769	28.2%
2006	1,411	5,911	23.9%	1,990	6,814	29.2%
2007	1,143	8,171	14.0%	3,216	10,546	30.5%
*2008**	*1,174*	*15,434*	*7.6%*	*3,253*	*19,344*	*16.8%*
*2009**	*1,254*	*12,691*	*9.9%*	*3,287*	*15,602*	*21.1%*
*2010**	*1,241*	*7,131*	*17.4%*	*2,481*	*8,829*	*28.1%*
*2011**	*1,283*	*7,230*	*17.7%*	*2,565*	*8,708*	*29.5%*

SOURCES: IBO; Capital Commitment Plans.
NOTE: *Figures for 2000-2007 represent actual commitments and figures for 2008-2011 represent planned commitments.

outcome has significantly altered the funding picture for the capital program.

Prior to 2006, the education department's capital plan was almost entirely city-funded. (It is important to note that state building aid flows to the DOE operating budget and therefore does not show up as state capital assistance.) The city's annual share of education capital plan funds exceeded 90 percent each year between 2000 and 2005, it then declined to about 70 percent in 2006, and 35 percent in 2007, and it is projected to remain below 50 percent through 2011. The city's share of education funding for 2005 and 2006 was larger than DOE had projected when its five-year capital plan covering 2005-2009 was developed. As part of the CFE resolution, the city anticipated receiving equal installments of $1.3 billion each year from the state beginning with city fiscal year 2005. In reality, state funding did not materialize until city fiscal year 2006 and the amount provided in 2006 and in subsequent years has varied. Additional city funds were added in 2005 to cover the shortfall in anticipated state money for that year.

Between 2000 and 2007 capital commitments for education represented a large share of the city's total capital commitments—an average of roughly 25 percent on all funds basis. This average share is slightly lower (about 23 percent) if only city funds are considered. In 2008 education commitments will comprise 16.8 percent of the total city capital commitment plan and thereafter the education share of the plan will range from 21 percent to nearly 30 percent.

State Assistance for DOE Capital Plan. The state budget proposal for 2008-2009 continues the CFE-related capital assistance initiatives. Beginning with its 2006-2007 budget, the state pledged to provide approximately $6.6 billion in capital assistance over the next several years for the city's education capital plan. The capital assistance comes in two forms: $1.8 billion in state EXCEL (Expanding our Children's Education and Learning) program grants and $9.4 billion in increased bonding authority for the New York City Transitional Finance Authority, and allowing the city to assign new building aid revenue to TFA to pay debt service on bonds issued with the new capacity. Using the full $9.4 billion in new capacity will allow the city to generate about $4.8 billion in additional building aid revenue from the state.

State EXCEL Program. A total of $1.8 billion will be made available through the state EXCEL program for New York City with an additional $800 million for other school districts. The Dormitory Authority of the State of New York (DASNY) is in charge of selling the state-backed bonds that will provide the EXCEL aid to the districts. The EXCEL aid is in addition to annual building aid that is distributed to districts throughout the state.

All districts in the state can submit claims to obtain reimbursement for their EXCEL project costs, and assuming their documents are in order, EXCEL funds are disbursed. Districts must enter into a grant disbursement agreement with DASNY and provide DASNY with documentation substantiating the costs of EXCEL projects. Project eligibility is determined by the State Education Department. Eligible EXCEL projects must fall under one or more of the following categories: education technology, health and safety (for example, addressing building code violations), accessibility, capacity expansion, and energy conservation.

The first EXCEL bond issue occurred during state fiscal year 2006-2007 and it was specifically for projects in New York City; approximately $790 million of the city's $1.8 billion portion of EXCEL proceeds was disbursed from that initial issuance. It was decided after the first EXCEL bond issue that it would be more cost effective to issue these bonds if all EXCEL projects in the state were grouped together. During the current 2007-2008 state fiscal year, DASNY has issued a combined total of $121.4

million in bonds to finance EXCEL projects throughout the state. The state budget proposal for 2008-2009 includes $135 million to cover DASNY's debt service requirements related to the EXCEL aid, including $109 million for New York City. As additional EXCEL bonds are sold, up to the $2.6 billion that was authorized, state debt service costs will increase to $191 million.

TFA School Bonds. In 2006 the state also increased the bonding authority for the Transitional Finance Authority by $9.4 billion in order to provide additional resources for the city's education capital plan. To provide a revenue source to back these new bonds made possible by the expanded capacity, the state assigned the city's annual appropriation of future state building aid to the TFA. Once the TFA has met its annual debt service obligations for the new bonds, any remaining building aid is then passed on to the city. Under this arrangement, the TFA has begun to sell school bonds known as "Building Aid Revenue Bonds" or BARBs. The building aid is subject to annual appropriation by the state Legislature. Because the state building aid formula reimburses the city for slightly more than 50 percent of the debt service costs for eligible projects, the expanded TFA bonding authority will actually provide about $4.8 billion in new state resources for the city.

During 2007, TFA issued a total of $1.3 billion in BARBs to help finance the city's education capital plan. According to its annual report, TFA retained $62.2 million in state building aid revenue received in 2007 to cover debt service payments related to the BARBs and remitted a balance of $443.6 million to the city for the Department of Education's operating budget. In 2009, 2010, and 2011, approximately $81 million will be needed annually to cover debt service requirements related to these school bonds. Annual debt service requirements will grow, however, as additional BARBs are issued.

This complex arrangement is not without cost or risk for the city. In the past, building aid, even though it is calculated based on the debt service costs of approved projects, was received by DOE as part of its general operating aid allocation from Albany. The city's debt service costs for education projects were paid from the citywide debt service accounts rather than by DOE. Under the new arrangement, building aid will first be sent to TFA to service the BARBs rather than directly to DOE. Even though there is new building aid being generated as a result of the enhanced TFA bonding authority, the need to divert a growing portion of total building aid to service the BARBs leaves less available for the DOE operating budget than previously assumed.

This creates a gap in the DOE operating budget which has to be filled with city tax levy dollars. Last year, the Mayor's preliminary budget projected a shortfall of $56.2 million for fiscal year 2007 and $39.8 million for 2008. Actual debt service requirements for the BARBs have been lower than originally anticipated, so the shortfall for 2007 stands closer to $18.5 million and for 2008, no gap in the education department's operating budget is anticipated at this time.

An additional risk to the city is the reliance on future generations of state leaders to continue appropriating sufficient building aid each year to meet the annual debt service costs on the BARBs. In some future year, if it were determined that the TFA did not have sufficient resources to meet its current obligations, then other school aid would be assigned to the authority to cover debt service. To mitigate this risk somewhat, the state and city have entered into agreements in which the state commits to make no substantial change to the building aid system while approved projects are being reimbursed.

State Building Aid. The state budget proposal for 2008-2009 provides $2.0 billion statewide in building aid and building reorganization incentive aid, an increase of $174.1 million or 9.5 percent, compared to the prior year. (This does not include the state EXCEL aid mentioned above). New York City's allocation is $692.2 million, $18.5 million (2.8 percent) more than in 2007-2008. The city's share of total building aid and building reorganization incentive aid (excluding EXCEL) decreased by 2.2 percentage points to 34.6 percent in the proposed 2008-2009 budget, compared to the prior year.

The Governor's Executive Budget includes legislation that would amend state education law to align the processing of building aid reimbursement for New York City with that of other school districts in the state. Outside the city there is an 18-month gap between when claims are submitted and when the state begins reimbursement for approved projects. Former Governor Spitzer had proposed making the city subject to the same 18-month delay. The exact impact of this proposed change is not clear at this time, but it seems certain there would be some effect, at least in the short term.

Most other districts in the state submit their claims early in the project planning process, well before bids are sought and contracts awarded. Therefore, the 18-month-lag has little fiscal consequence since few, if any, bills have come due during that period. The city on the other hand, currently submits its claims after a contract is signed and therefore almost immediately must begin paying contractors. The process followed for the city would seem to offer the advantage of greater certainty as to project costs for the state in processing claims. Moreover, an abrupt shift to a system with an 18-month lag threatens to create a gap in building aid receipts that at least in the short-term would threaten the city's ability to continue building at its planned pace. The longer-term effect is harder to assess until more information becomes available about how the city would adjust its claiming process to work with the new rules.

The Governor's Executive Budget also proposed to expand an operating grant program, the Academic Achievement Grants, but did so in a way that linked it to increases in building aid to the city. The grant is discussed in on page xx.

Changes in DOE Five-Year Capital Plan. For most agencies, the city Capital Commitment Plans and 10-year strategy are the only sources of information for understanding an agency's capital program, its changing needs and priorities. In contrast, the Department of Education has a separate five-year capital planning process that is mandated by state education law. Planning for city public school construction and repairs is guided by the education department's five-year capital plan, which is developed and implemented by the School Construction Authority.

The 2005-2009 Capital Plan, the education department's current five-year plan, called for an initial investment of $13.1 billion when it was adopted in June 2004. Between June 2004 and February 2008, the budget for DOE's capital plan has increased by $227.2 million (1.7 percent). This excludes funding for additional projects sponsored by the Mayor, Borough Presidents, and Council Members, which are outside the scope of the five-year plan. Funding for such projects, which are allocated by elected officials for school capital projects in their respective districts or for boroughwide or citywide initiatives, totaled to $440.0 million over the same period. The combined changes increase the total budget for the department's capital plan over fiscal years 2005-2009 to approximately $13.8 billion. (Note the $13.8 billion figure is slightly lower—by $0.14 million—than what is reflected in the city's Capital Commitment Plans and the table above. This variance is largely due to different publication schedules for the city and agency capital plan documents.)

The education department's capital plan has been formally amended each year as required under a memorandum of understanding signed by the Chancellor, the Mayor, and the Speaker of the City Council which requires that all changes to the plan be examined once a year and approved by the Panel for Education Policy and the City Council. The panel approved the amendment by a vote of 11 to 1 on February 25, 2008. City Council consideration of the amendment is the next step in the review process.

For a detailed review of how resources in the five-year plan have been re-allocated since 2004, and how project costs and schedules for capacity and major repair projects have changed, please see IBO's recent report *Higher Costs, Delays in Amended School Construction Plan*.

ENDNOTES

[1]The reductions were actually withdrawn from the FSF allocations, alone.
[2]The system also allows for the reporting of class size by course, which is the only useful class size metric in schools where students move from class to class. Deferring the expansion of the High School Scheduling and Transcript system to middle schools will delay plans to improve reporting on middle school class sizes.
[3]This comparison is based on the set of aid types that the state uses in its standard summary reports of school aid, which differs from the city's standard report. While there was a big shortfall from the city's expected amount of foundation aid, there are some offsetting increases that the city was also not expecting. Two items with offsetting increasing are related to building aid which the city maintains should not be considered when discussing operating assistance. The EXCEL grants are the proceeds of bond sales undertaken by the Dormitory Authority of the State of New York which are used to support the DOE capital program under the terms of an agreement forged in 2006 to address the capital deficiencies in the city schools that were identified during the CFE litigation. The second is regular building aid, a portion of which is now being used to support a greatly expanded borrowing capacity of the city's Transitional Finance Authority to also support the DOE capital plan. These two streams have grown as a result of the 2006 agreement.
[4]Districts with no remaining schools in need of academic improvement would not have their contracts extended. New York City does not qualify.

Health and Social Services

FUNDING SHIFTS TRIPLE CITY EARLY INTERVENTION SPENDING

The Mayor's DOHMH budget includes a $70 million increase in city funds for the Early Intervention (EI) program, from $41.7 million in the current modified 2008 budget to $111.3 million in the proposed 2009 budget. This is the only substantial change in city health spending for 2009.

Early Intervention is a program to provide free health services to infants and toddlers with developmental disabilities, regardless of income. There are approximately 125 EI providers in the city, mostly specialized nonprofit agencies but some affiliated with hospitals, schools, or other institutions. With the limited exception of public hospitals (2 percent to 3 percent of total EI spending), the city does not directly provide EI services. While the program was established under state law in 1992, it was not until the end of the 1990s that significant numbers of children were enrolled. Today, approximately 19,000 New York City children under the age of 3 receive EI services.

The near-tripling of city funds for Early Intervention in 2009 is not the result of the program becoming more costly—enrollment is stable and overall spending is expected to increase by just 8 percent, from $417 million in 2008 to $453 million in 2009. Rather, it represents an increase in the share of the program's costs borne by the city. After a period in which the city was able to use increased Medicaid payments to reduce its share of the program's costs, the city and state are now returning to an equal division.

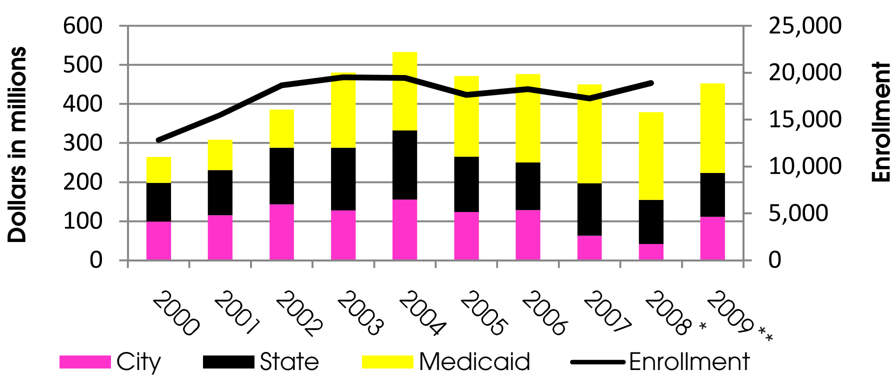
Early Intervention is funded from a mix of private, city, state, and federal sources. For children with private health insurance, payment from the insurer is sought first, but relatively few such claims are paid; only $3.8 million came from private insurance in 2007. Medicaid and Child Health Plus pay the full cost for children enrolled in those programs. The remaining costs are split equally between the city and the state. Historically, the share of costs covered by Medicaid have increased over time, first from 2000 to 2004 as a result of the creation of Child Health Plus, and then in 2006 and 2007 as a result of more aggressive Medicaid billing by the city, including resubmitting rejected claims from earlier years. The resulting retroactive Medicaid payments were applied solely against the city share. As a result, the city's share of EI costs, which had been stable at around a third through most of the program's history, dropped below 15 percent in 2007.

Since the stock of old denied Medicaid claims has now been exhausted, starting in 2009 the city will again have to pay its half of unreimbursed EI costs. But since the new, more aggressive Medicaid billing practices will be maintained (and greater efforts are being made to submit claims to private insurers), the city share of overall EI costs is expected to remain around 25 percent, with the state paying a like amount.

So the jump in city spending on EI in the 2009 budget is not a danger sign, but a one-time increase bringing the city's share of program costs back into line with its legal and historical norms. Barring a surge in EI enrollment, there is no reason to expect future cost increases to exceed 5percent or 10 percent a year annually, or less if efforts to increase payments from private insurers bear fruit. As a result, it will be a number of years before city spending again reaches the $150 million of 2004.

The proposed 2009 state budget would result in a further reduction of EI costs by eliminating the adjustment of EI service rates for inflation. Legislation adopted in 2006 provided for three adjustments, the last in April 2008, totaling approximately 10 percent. These adjustments were never implemented, however, and former Governor Spitzer proposed canceling them. This would reduce payments to EI providers by approximately $40 million a year. City savings from these reductions would be $17 million in 2009 (including retroactive payments for the earlier adjustments) and $10 million a year in 2010 and beyond. It is unclear how the elimination of inflation adjustments would affect EI providers; in any case, since this measure depends on

Early Intervention Funding And Enrollment, 2000-2009



SOURCES: IBO; *Mayor's Management Report, various years.*
NOTES: State, city, and Medicaid in millions of dollars on left axis. Medicaid includes very small amounts of private insurance. *2008 Estimated. **2009 projected,.

action by the state legislature it is not reflected in the Mayor's budget or in the chart on page 33.

While the reduction in EI costs is good news on the budget side, it does raise the question of why enrollment has stagnated, especially since the number of children referred to the program has continued to rise. Despite efforts at outreach, the number of children with active service plans has remained a bit below 20,000 since 2002, while many advocates believe the eligible population is potentially much larger. But for the moment, the combination of flat enrollment and a smaller share of costs borne by the city means that the program no longer raises the budgetary concerns that it did in the first half of the decade.

RETHINKING SERVICES FOR SENIORS

The Department for the Aging (DFTA) supports a wide range of senior services, both directly and through contracts with community-based organizations, including 323 senior centers. The services provided include case management, home care, respite services for caregivers, meals, legal counseling, health promotion services, home energy and weatherization assistance, employment opportunities, and transportation. Seniors can access most of these services, including meals, through DFTA-contracted senior centers. The 2009 preliminary budget for the Department for the Aging is $244 million, $44 million less than the budget for the current year. IBO's projection of federal funding for the agency in 2009 is slightly higher than the Bloomberg Administration's by $1.7 million, raising IBO's forecast of the agency's 2009 budget to $245 million.

The preliminary budget also includes a Program to Eliminate the Gap totaling $3.5 million in 2008 and $5.5 million annually for 2009 through 2012. This proposed PEG reduces the contract agency budgets for senior centers, meal programs, and home care by 3 percent. It is not yet known if this will affect services, but at a City Council hearing on the preliminary budget DFTA Commissioner Edwin Mendez-Santiago said that providers have been told "to implement the reductions by reducing administrative costs.." Providers will be asked to submit revised budgets for DFTA's approval to implement the 3 percent reduction.

Restructuring Senior Services. Early this year Mayor Bloomberg announced a new effort designed to improve the city's capacity to provide services for New York's growing population of seniors. By 2030 one-fifth of New York City's population is projected to be over the age of 60, with seniors outnumbering school-aged children. This effort to expand the agency's ability to serve a growing number of seniors will focus on DFTA's three core services—case management, home delivered meals, and senior centers. DFTA has already awarded contracts for a new case management system and requests for proposals (RFPs) for restructuring home delivered meals are expected to be issued next month and for senior centers in June. Whether these efforts can expand capacity while eliminating redundant and underutilized services remains to be seen.

Last May DFTA released a concept paper describing the goals for revamped case management contracts and followed this up with an RFP in October. DFTA has now awarded 23 contracts for the new case management system, designed to assist older adults to age in place and to be engaged in their communities. The new contracts are set to begin July 2008. The Department for the Aging has also released two concept papers, describing proposed changes to the home-delivered meals programs and senior congregate services (senior centers).

The goal of the home delivered meal proposal is to provide "greater efficiency, flexibility and choice to frail homebound seniors." Currently the home delivered meals program provides for more than 15,000 homebound seniors through a network of 96 community-based providers. Eighty-three of these contracts are at senior centers and 13 are stand-alone providers not affiliated with a center. (All stand-alone home-delivered meals contracts will end September 7, 2008). DFTA's reimbursement to the providers varies from $2.60 to $26.04.

Under the new proposal DFTA will cap the funds available for each contract at a set cost per meal; the number of citywide meals contracts will be reduced to between 10 and 20. Similar to the Senior Options Pilot program in the Bronx, senior centers that are not awarded one of the new contracts to provide home-delivered meals will lose funding directly attributable to the home-delivered meals they have been providing. Another significant component of this proposal is giving seniors the option of choosing between hot meals and frozen meals, which was also a feature of DFTA's Bronx pilot program.

The home-delivered meals concept paper was released in January 2008 and all comments were due by March 14, 2008. The release of the RFP is scheduled for March 31, 2008 and the expected start date for the new contracts is September 2008.

The senior center proposal looks to change their current centers to "Healthy Aging Centers" where they will continue to offer seniors meals and a support system, but will also offer "disease prevention programs, exercise classes, provide opportunities for meaningful volunteerism and civic engagement activities, and present creative opportunities, such as courses and lectures, performing and visual arts and career resources." The concept paper was released in January 2008 with comments due by March 14, 2008. The expected date for release of the RFP is June 2008, with the new contracts to start in March 2009.

Currently, DFTA funds 323 senior centers throughout the five boroughs with annual budgets totaling $94 million. According to DFTA, 44 percent of the senior centers are underused.[1] DFTA defines centers that operate below 90 percent capacity as underutilized, with utilization based on the number of congregate lunches served. According to the *Mayor's Management Report* there were 6.8 million lunches served in 2007, a decline from the 7.1 million served in 2006. According to the agency, last year senior centers had the capacity to serve 1 million more meals than they actually did serve.[2] This decline in center utilization appears to be a key motivation for DFTA to release the senior center concept paper. (The paper also mentions the need to find additional ways to measure utilization at the centers.) DFTA is also considering setting up regions for senior centers, where they hope to reach a greater number of seniors in the fairest possible way. This structure would be similar to the service areas in the new case management system.

SUMMER YOUTH AND AFTER-SCHOOL PROGRAMS FACE CUTS

The Department of Youth and Community Development (DYCD) supports youth and adults through contracts with community-based organizations located in neighborhoods throughout New York City. These organizations provide programming in areas such as the arts, recreation, youth leadership, education, and summer jobs. In addition, DYCD provides support services for low-income families, including adult literacy programs and assistance for immigrants to help them become naturalized citizens.

The 2009 preliminary budget for DYCD is $290 million, $117 million less than the budget for the current year. Federal and state funding are expected to make up 24.3 percent and 4.5 percent, respectively, of the agency's 2009 budget. City funds will make up 63.3 percent and the rest (7.9 percent) is intra-city funds. IBO's projections of federal and state funding for the agency in 2009 are greater than the Bloomberg Administration's by $10.3 million, raising IBO's forecast of the agency's 2009 budget to $300 million, still well below the level of this year's budget. Typically, funds are added to DYCD's budget later in the budget process, so some, or even all, of the decline may be erased.

The preliminary budget for DYCD includes a Program to Eliminate the Gap that totals $9.7 million in 2009. Proposed reductions in city funding for the Summer Youth Employment Program (SYEP) would eliminate 2,100 slots (roughly 5 percent of last summer's total). Reductions in city funding for the Beacon Schools program will affect the budget of 66 sites with a loss of funding of $34,850 per site and a reduction in the number of participants for both community events and drop-in services. Additionally, proposed reductions in the Out-of School-Time (OST) program limits payment for a number of underutilized slots in middle schools and high schools. The preliminary budget also proposes a pilot program to use federal Food Stamp Employment and Training funds to replace some city tax-levy funds supporting DYCD's Adult Literacy Program.

Summer Youth Employment Program. The Summer Youth Employment Program provides New York City youth with summer employment and educational experiences. During last spring's budget negotiations, the Mayor and the City Council agreed to increase the city's baseline funding for SYEP from $26.6 million to $32.4 million to help accommodate a state minimum wage increase to $7.15 an hour. The Governor and Legislature included $35 million in statewide funding for SYEP with the city receiving $20.2 million, down from $21.1 million the year before.

The current program provides seven weeks of summer employment for young people between the ages of 14 and 21. Participants work up to 25 hours a week while earning the minimum wage in settings that include government agencies, hospitals, summer camps, nonprofit organizations, and small businesses.

Last summer, more than 41,000 youth were enrolled in the summer jobs program. The number of applicants was far larger: 93,750 applied, a significant increase from 2006 due to a new online application system. DYCD's 2007 Annual Summary report for SYEP shows that 55 percent of the participants were female. Most of the youth in the program were minority: 43 percent black, 25 percent Latino, 19 percent white, 7 percent Asian/ Pacific Islander, and 5 percent American Indian or other.

The total funding for the SYEP in 2008 is $56.4 million ($32.4 city funds, $20.2 state Temporary Assistance for Needy Families, and $3.8 federal Work Investment Act, or WIA). The 2009 Preliminary Budget eliminates $3.2 million in city funding in each year from 2009 through 2012. Assuming the cost per slot remains the same (the minimum wage has not changed since last summer), this would eliminate funding for 2,100 slots for the summer of 2008. As of February 2008 SYEP has a total budget of $56.1 million.

Although the Governor's Executive Budget for 2008-2009 maintains funding for the Summer Youth Employment

Program at last year's level, federal funding is less certain. Federal WIA funds for youth activities for this year have been cut by approximately 2 percent nationwide. If WIA funding for New York City's SYEP declines proportionately, another approximately 35 slots for this summer's program could be lost.

Out of School Time. The OST program provides activities for school-age youth during after-school hours and on weekends and during school vacations. All OST programs are offered at no cost and provide a mix of academics, recreational activities, and cultural experiences for elementary, middle school and high school students. OST service providers operate mostly in public schools and in facilities of the Department of Parks and Recreation and the New York City Housing Authority.

The OST initiative has 644 programs serving an estimated 80,000 children during the 2007-2008 school year, up from 69,000 in 2006-2007. Total funding for OST in 2008 is $107.5 million, an increase of about $40 million from 2007. The 2009 Preliminary Budget includes a total budget of $120 million for an expansion of OST, creating 10,000 new elementary year-round slots in 2008 and growing to 14,000 new slots in 2009.

The 2009 Preliminary Budget reduces funding for the Out-of-School-Time program by $3.8 million in 2008 (3.4 percent of the total budget) and $2.6 million annually in 2009 through 2012 (2 percent of the total budget). The OST contracts are performance based, with payment dependent on enrollment and attendance. Under OST's performance-based contracts, if a program's youth participation targets are not met, up to 10 percent of that year's budget is withheld, limiting payment for underutilized slots. The failure to achieve attendance targets at many middle school and high school program sites enables DYCD to withhold some funding and meet some its spending reduction for 2008. The $2.6 million reduction annually for 2009-2012 assumes that attendance will remain below the contracted targets.

Beacon Services. The youth services department's Beacon Schools program funds school-based community centers that offer a mix of educational and recreational activities and family-support services. Beacons offer a range of activities in six core areas: academic enhancement, life skills, career awareness/school to work transition, civic engagement /community building, recreation/health and fitness, and cultural /arts. Beacons also provide adult programming such as parenting skills, English classes for speakers of other languages, and GED (general education diploma) preparation. Beacons operate a minimum of six days a week during nonschool hours including weekends, holidays, and during the summer.

The January financial plan eliminates $2.3 million a year in city funds for 2009 through 2012 by reducing funding for drop-in services and community events provided by Beacon after-school programs. There are currently 80 Beacon schools throughout New York City; each Beacon has a total budget of approximately $575,075. The reduction will affect the 66 sites that are funded solely with city funds, with a loss in funding of $34,850 per site bringing their total budget to $540,225. Additionally if a City Council initiative providing $4 million to cover facility fees charged by the Department of Education during the current year (2008) is not extended when the 2009 budget is adopted, Beacons could face losing an additional $50,000. For the 66 sites affected by the PEG, the combined effect of the two changes would be a loss of $84,850 (about 15 percent of each sites' budget). The other 14 sites, which are either Administration for Children Services-related or Community Development Block Grant-funded, will not be affected by the PEG but each would lose $50,000 (9 percent of their total budgets) if the City Council initiative is not extended.

Each Beacon school is currently required to provide drop-in services to a minimum of 300 participants. The proposed PEG will reduce this number by 50 participants per site to 250.These services can range from regularly scheduled activities such as homework help, computer tutoring, and photography to less scheduling-rigid activities such as discussion groups, recreational activities, and activities designed to be completed in one session. Generally, the Beacon schools utilize the "drop-in" participant cohort as a means to provide activities to elementary and high school aged participants. The scale of services provided to these age populations are determined based on a needs assessment conducted by each Beacon school.

Each Beacon school is also currently required to plan and implement community events serving a minimum of 500 participants. The proposed PEG will reduce that number by 150 participants per site. Community events range from health fairs and rallies, to large scale sporting events, awareness activities, and community service activities. As part of the Beacon model, community events are designed to include all of the populations within the community with an emphasis on civic engagement.

Adult Literacy. DYCD is a partner in the New York City Adult Literacy Initiative (NYCALI), which serves more than 50,000 New Yorkers each year at more than 150 sites throughout New York City. The purpose of NYCALI is "to provide opportunities for adults and older youth with limited reading, writing, math, and English language abilities to improve their capacity to succeed as workers, family members, and community residents."

DYCD's total budget for adult literacy is $14 million in 2008, with an increase of 11 percent for 2009 ($15.4 million.) The Preliminary Budget for 2009 also includes an initiative to obtain Food Stamp Employment and Training funds for eligible clients attending adult education programs. The pilot program would replace $800,000 of city tax levy funding with federal funding for adult literacy in 2008 and $1.2 million for each year from 2009 through 2012. DYCD will work with the Human Resources Administration to claim Food Stamp Employment and Training revenue for literacy and English as a second language programs.

Federal dollars could pay for up to 50 percent of the cost of literacy services to any food stamp recipient. The estimate of the savings—for the city—from this pilot is based on an assumption that 30 percent of clients in city-funded literacy and English as a second language programs are eligible for the food stamp training funds. DYCD providers would have to ask applicants whether they receive food stamps, and if so, obtain their case identification number. The case number would be sent to the Human Resources Administration, which would conduct a match, and arrange for reimbursement from the federal government. If not enough literacy program participants qualify for the federal program, then DYCD would need to have sufficient city funds restored to the agency budget to maintain the same level of service.

CHILDREN'S SERVICES: CHILD CARE CHANGES LIKELY TO HAVE LARGEST SERVICE EFFECT, ALTHOUGH BUDGET SAVINGS IS SMALL

The Administration for Children's Services (ACS) administers a broad range of programs designed to protect and advance the interests of children. ACS investigates allegations of child abuse and neglect, provides preventive services to families and children, and when necessary provides foster care or adoption services for children who cannot safely remain in their homes. ACS provides early childhood education through the federally funded Head Start program and subsidized child care programs for eligible families. The agency also provides assistance with the establishment, enforcement, and collection of child support.

The agency has experienced overall growth in its budget in recent years, increasing by a total of 17.6 percent between 2003 and 2007. At the same time there has been a shift in the spending priorities as the agency has shifted its focus away from institutional foster care towards more family-based care. Prompted by the tragedies in the child welfare system, additional resources have been added for child protection services, preventive services such as family counseling or parenting skills classes, and family court legal services. Finally, ACS has absorbed more responsibility for the child care system. Prior to 2007, child care services were provided through ACS and the Human Resources Administration; since 2007, ACS alone has been responsible for providing these services. Total spending for child care grew by 17.9 percent between 2003 and 2007. While the January plan shows a 6.5 percent decrease for 2008 and an additional 0.7 percent decrease in 2009, there is no indication that child care spending will be reduced in these years. Due to a one-time variance, there were additional state and federal Child Care Block Grant funds in 2007. Moreover, the 2008 and 2009 child care budgets are still incomplete; additional funds will be added by either the state or the city.

The 2009 Preliminary Budget includes adjustments to the agency's budget that net to $21.8 million (2.5 percent) in city fund savings for 2008 and $37.3 million (4.5 percent) for 2009 ($40.3 million (1.4 percent) and $55.4 million (2.0 percent) in total funds for 2008 and 2009, respectively). Many of these result from allowing staff vacancies to remain unfilled and various management efficiencies that are not expected to result in service changes.

But there are a number of changes proposed for the ACS budget that do have the potential to affect services. These include a shift in how child care center services are reimbursed, changes in programs providing special education services to children under ACS supervision, and an increase in resources for protective services. They are discussed below.

Changing Reimbursement for Child Care in Effort to Spur Utilization. One of the more significant modifications to ACS in the preliminary budget involves a change in reimbursement for child care services. ACS estimates that in 2007, the city spent $40 million—out of a total child care budget of $787 million—for vacant child care seats. To improve the efficiency

Child Care Spending

Dollars in millions

	2003 Actual	2004 Actual	2005 Actual	2006 Actual	2007 Actual	2008 Current Modified
HRA	$173.4	$214.6	$241.1	$257.0		
ACS	494.1	464.3	484.3	514.3	787.2	736.2
Total	**$667.5**	**$678.9**	**$725.4**	**$771.3**	**$787.2**	**$736.2**

SOURCE: IBO, Office of Management and Budget
NOTE: As of 2007, the child care funding from HRA was moved to ACS

of this system, ACS proposes to pay child care centers for the slots filled rather than the center's budgeted capacity. ACS characterizes this change as a necessary step towards its goal of reaching full enrollment in child care and Head Start programs. If no applicants qualified for subsidized center-based care are waiting for a contractor's unused slots, the city is asking the child care centers to fill the seats by bringing in children who receive subsidies in the form of child care vouchers or private-pay families. The city has organized a task force of 11 key stakeholders, including advocates, providers, and union representatives, to offer guidance through the implementation of the new system. The initiative is scheduled to begin phasing in in September 2008.

A per-child reimbursement rate will be determined for each center based on each center's budget and its enrollment capacity; the formula for these calculations has not yet been determined. Budgets vary across centers throughout the city. Initially, centers with fixed costs such as lease and insurance payments that are managed centrally through ACS will only be responsible for their provider-administered budgets. For providers who manage their own leases and other such costs, however, these costs will be included in their budgets when the per-child rate is determined. As ACS transfers leases to sponsors in the future, these costs will be factored into their budgets along with their programming costs. Enrollment is determined based on the number of care-days during the month times the number of children enrolled and in attendance on each day. There will be excused absences for which the city will pay a center for a child who is not present.

As the goal of this initiative is to achieve full enrollment, centers that are enrolled to capacity will continue to receive their full reimbursement. The preliminary budget assumes that reduced reimbursements for centers that are below capacity will save the city $4 million for 2009. As part of this initiative, ACS will reinvest $2 million of those savings in training and technical assistance efforts to provide centers with additional tools to increase enrollment and fill unused child care slots. Training programs will cover areas such as board governance, management, finance, and marketing and recruitment strategies. The training and technical assistance curriculum and roll-out schedule are currently under development. In addition to training and technical assistance, ACS is developing a Web-based enrollment and attendance system through which centers will be able to access enrollment reports and make real-time adjustments to their enrollment records.

Underutilization. There are a number of explanations for why particular child care facilities are underutilized even while there is believed to be a citywide shortage of child care capacity, as suggested by long waiting lists for slots. One explanation is geographic. While child care slots may be available systemwide, they may not be in a convenient location for families who need to access services. Even centers that appear on a map to be in a nearby community may be difficult to reach due to lack of public transportation or geographic barriers. Another issue is the rapid change in many city neighborhoods in the last decade. As the demographics of a community change, demand for services can change; gentrification in one community may reduce the need for subsidized child care, while the needs of another community increase. The location of child care centers is slower to change, however. Finally, many families who qualify for services may be unaware of their eligibility for subsidized child care. Alternatively, parents may not be able to navigate through the enrollment process, or the procedures may be too burdensome for them to undertake.

Full Capacity Concerns. There are some concerns regarding how full capacity will be defined. Child care needs will vary among families and children, depending on factors such as the age the child and whether the parents work full or part time. Centers can now hold a slot for a child even if it is not used every day, resulting in days during which the center is at capacity and days when it would be considered underutilized. Some advocates worry that encouraging centers to schedule to full capacity at all times will result in temporary overcrowding as unexpected changes in a family's needs—for example a parent must work overtime—results in children staying at the center longer than scheduled.

If centers cannot recruit the children to achieve full capacity or cannot cut fixed costs such as rent, they will be forced to cut back on staff or programs which may impact the quality of the services provided. Another concern is that centers that cannot reach full capacity will have to close, which would reduce local child care options, as well as system-wide capacity.

Changes to Special Education for ACS Clients. There are two PEGs that affect special education costs within the ACS budget. The first depends on efforts to reduce placements of children into congregate foster care settings. The number of children with special education needs placed in congregate foster care settings has decreased consistently over the last five years, with 2,226 children placed in such settings in 2003, and only 1,744 in 2007. The city expects this trend to continue for 2008 and beyond. In addition, as outlined in their Residential Care Plan, ACS is increasingly making efforts to provide preventive services which allow children to stay in their own homes, or to place children within foster families, further decreasing the number of children in congregate foster care settings. With fewer children placed in residential settings, the tuition expenses for special education services for these children will continue to decrease. Projected savings for this PEG total $9.1 million in 2008, $20.1 million in 2009, and $22.7 million a year in 2010 and beyond.

In the second PEG related to special education, ACS will look to reduce the number of children with severe special needs who are placed in residential facilities by other agencies such as the courts or the Department of Education. ACS pays for services at these residential facilities which serve both an educational and a social service purpose; ACS does not pay for placements of day students. The education department and ACS are currently reviewing the cases of 41 children. They are discussing the possibility of placing these children in facilities closer to their families' homes so that they can attend as day students, returning home in the evenings. At an average annual rate of $104,168 per child, this PEG is estimated to save ACS $4.27 million starting in fiscal year 2009. Sixty percent of these savings would accrue to the city budget, and the remaining 40 percent would go to the state.

Adding Staff to Improve Child Protective Investigations. ACS will hire 42 additional investigative consultants, 10 school social workers and seven certified alcohol and substance abuse counselors in response to a Department of Investigations report released in August 2007. The Department of Investigation's principal recommendation was that ACS hire 100 additional investigative consultants to train, support, and work with caseworkers and supervisors who are investigating reports of child abuse or neglect. This support is necessary as caseworkers must sometimes conduct investigations of parents accused of child abuse and who may have criminal histories as well. Investigative consultants who can train and assist frontline caseworkers may improve their investigative skills and provide them with the tools necessary to assess the conditions of a home that they are investigating, including improving their ability to probe explanations given by parents, children, and other key witnesses. ACS hired 20 investigative consultants prior to the release of the investigation department report, and the January 2008 Financial Plan provides additional funding of $2.3 million in fiscal year 2009 and $1.9 million in 2010 and beyond for these staff. The January plan also transfers to the Department of Investigations $147,000 in fiscal year 2009, $131,000 in the out-years, and two of the investigative consultants who will train ACS caseworkers.

ENDNOTES

[1]Testimony on "Modernizing Aging Services: Senior Center Concept Paper" February 14, 2008

[2]"Modernizing Aging Services," DFTA's PowerPoint presentation for public forums on senior centers and home delivered meals.

Housing and Homeless

HOUSING AUTHORITY FACES CONTINUING GAPS

In its preliminary calendar year 2008 budget, adopted by its Board of Directors in January, the New York City Housing Authority (NYCHA) is projecting a deficit of $195.3 million (6.9 percent of expenditures). Projected deficits for 2009 through 2012 are estimated at roughly the same level. The estimates assume that a transition of 8,400 state and city units to Section 8 funding will be fully approved and accomplished. Currently the authority has received policy approval from the federal Department of Housing and Urban Development (HUD) and is now working to submit a detailed management plan for HUD's approval. The Section 8 transition is projected to increase revenue for the authority by $2.2 million in 2008, $17.2 million in 2009, $50.3 million in 2010, and $75.1 million in 2011 and 2012.

In October 2007, NYCHA cut 73 management positions. The housing authority has recently announced plans to cut an additional 427 positions in April, for a total reduction of 500 positions. To achieve the reduction of 500 positions, NYCHA will lay off 190 staff, which the authority projects will save approximately $21.5 million this year and $30.3 million in 2009. The housing authority also plans to consolidate 19 community centers, saving $4.5 million a year. At the City Council's preliminary budget hearing, held jointly with the Committee on Housing and Buildings and the Subcommittee on Public Housing, NYCHA estimated its 2008 deficit to be approximately $169 million after the recent reductions.

The housing authority continues to lobby state and federal officials for increased funding. The state Legislature included $3.4 million for NYCHA in the budget adopted for fiscal year 2008, but former Governor Spitzer's 2008-2009 Executive Budget does not include any funding for NYCHA.

Moreover, the federal government has underfunded the housing authority. NYCHA applied for reimbursement of approximately $935 million of eligible costs at federal developments. Congress provided $780 million of funding, or roughly 83 cents on the dollar, in the federal 2008 budget. President Bush's 2009 budget proposal asks for an increase for public housing that would keep pace with inflation, but would continue the trend of providing less than public housing authorities are eligible for under the operating subsidy formula.

HOMELESS FAMILY SHELTER BUDGET MAY BE INSUFFICIENT UNLESS CASELOAD FALLS

The 2009 preliminary budget for the Department of Homeless Services (DHS) is $656.5 million, $129.3 million less than the 2008 current modified budget. The 2008 current modified budget for the Department of Homeless Services is $785.7 million, an increase of $53.1 million from fiscal year 2007 actual spending.

The homeless services department's 2009 family shelter budget is $313.7 million, which will not be enough to serve the family shelter population if it remains at its current level.

Family Shelter 2009 Budget May Be Insufficient. The 2008 family shelter budget was also $313.7 million when the budget was adopted last June. At that time, the family shelter population was roughly the same level that it is now—approximately 9,200 families on average each month. The city added $86.2 million to this year's budget in the January Financial Plan, including $40.8 million from city funds, to meet the cost for the family shelter population.

In June 2004 the Mayor announced a five-year plan to reduce homelessness by two-thirds. Following the announcement, the family shelter census decreased to a low of 7,707 families in December 2005. Since then, the family shelter population has increased 18 percent, to 9,111 families in January 2008.

Although the family shelter population is variable, IBO believes that the current funding level for emergency

New York City Housing Authority Budget
Dollars in millions

	2008	2009	2010	2011	2012
Preliminary Operating Budget	$2,839.4	$2,869.6	$2,901.7	$2,936.1	$2,936.1
Preliminary Operating Revenue	2,644.1	2,671.2	2,703.7	2,728.5	2,728.5
Preliminary Projected Deficits	**($195.3)**	**($198.4)**	**($198.0)**	**($207.6)**	**($207.6)**
New Savings Options					
Staff Reduction	$21.5	$30.3	$30.3	$30.3	$30.3
Consolidating Community Centers	4.5	4.5	4.5	4.5	4.5
Revised Projected Deficit	**($169.3)**	**($163.6)**	**($163.2)**	**($172.8)**	**($172.8)**

SOURCES: IBO; New York City Housing Authority.

Department of Homeless Services Budget

Dollars in millions, all funds

	2006	2007	2008	2009
Family Shelter	$360.0	$376.6	$408.7	$313.7
Adult Shelter	227.4	226.9	226.9	219.2
Rental Assistance and Housing Placement	37.2	26.4	46.9	27.7
Administration	60.0	56.3	60.1	57.5
Outreach, Drop-in and Reception Services	24.4	26.1	22.6	18.4
Prevention and Aftercare	16.4	20.3	20.5	20.0
Total	**$725.4**	**$732.6**	**$785.7**	**$656.5**

SOURCES: IBO; Mayor's Office of Management and Budget

NOTE: Fiscal Years 2006 and 2007 actual spending, 2008 current modified budget, 2009 preliminary budget

shelter for families is optimistic and that the city will have to add funding during 2009. The 2009 preliminary budget for family shelters is $46.3 million less than actual spending on family shelters in 2007 when the average family shelter population was considerably lower, averaging 7,928 per month.

The Bloomberg Administration believes that its new Advantage rental assistance programs will decrease the family shelter population. The Advantage programs include Work Advantage, Children Advantage, and Fixed Income Advantage. Work Advantage provides one year of rental assistance, with the potential to extend for a second year, to families who work full or part time. It replaces the Housing Stability Plus program, which provided rental assistance to families on public assistance, but the rental benefits ended if families lost public assistance benefits, either from working or sanctions. The Children Advantage program targets families with open Administration for Children's Services (ACS) cases, and Fixed Income Advantage is for families that the Human Resources administration identifies as receiving fixed-income assistance such as Social Security Disability Insurance.

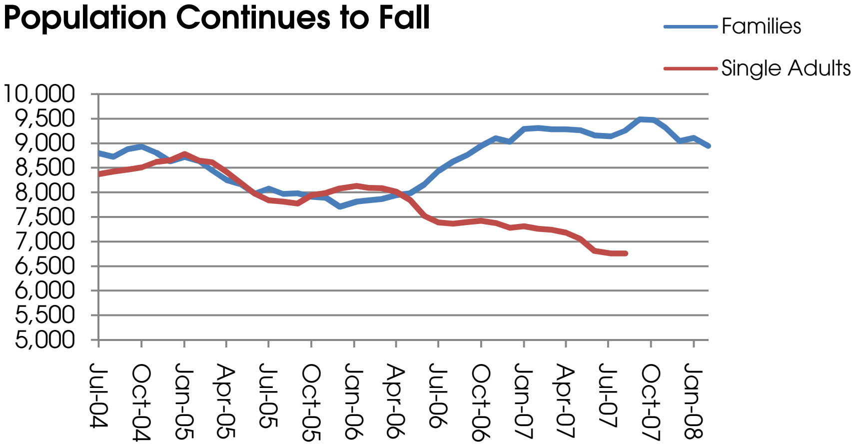
The Bloomberg Administration, however, does not believe that the family shelter population will decrease enough to avoid increasing the family shelter budget. In his testimony before the Committee on General Welfare's preliminary budget hearing, DHS Commissioner Robert Hess said that the city is committed to fully funding the family shelters and will not have to cut other areas of the DHS budget to fund an increase for family shelters.

Single Adult Shelter Need Decreasing. The Mayor's five-year plan to reduce homelessness by two-thirds covers the single adult shelter population as well, and, in contrast to the family shelter population, more progress has been made toward achieving the goal. The population was 6,762 in August of 2007 (the latest date for which data is available), a decrease of 23 percent from January of 2005, when the population was 8,783. The adult shelter budget for 2009 is $219.2 million, $7.7 million less than the current budget for 2008. The budget will only decline beginning in 2009 because DHS is locked into its current contracts for the remainder of 2008. Due to the declining single adult shelter population, DHS was also able to save $16.8 million for fiscal year 2008 and $3.6 million starting in fiscal year 2009 through the closing and sale of the Camp LaGuardia Adult Shelter in upstate New York.

Service Interruptions Possible? The homeless services department has eliminated funding for decentralizing men's intake, which will save the city $7.2 million in 2008 and $6.2 million starting in 2009. The decentralized intake centers were originally proposed because the centralized intake center is considered by some to be a barrier to entry. The Bloomberg Administration believes that outreach services offset some of the need for decentralized intake.

The budget for outreach and drop-in centers decreases by $4.2 million in fiscal year 2009. The homeless services department is converting drop-in centers to Safe Haven programs, saving $4.6 million in 2009 during the transition as drop-in centers close but before Safe Haven programs open. This suggests that there will be some service interruptions during this time.

Progress on Mayor's Five-Year Plan: Families in Shelter Have Risen While Single Adult Population Continues to Fall



SOURCE: IBO; Departmnet of Homeless Services.

Public Safety and Criminal Justice

STATE CUTS TO DETENTION MAY THREATEN ALTERNATIVES

Several new and proposed state policies could have an effect on the New York City juvenile justice system.[1] First, the former Governor's Executive Budget proposed eliminating state funding for detention of youth who are awaiting trial (the equivalent of jail in the criminal justice system). Second, the state Office of Children and Family Services (OCFS) has proposed the closure of several underutilized upstate residential facilities which house juvenile delinquents, 60 percent of whom on average are from New York City. Finally, the state has increased the cost of upstate placement of juvenile delinquents (the equivalent of prison in the criminal justice system) and retroactively billed the city for five years during which the state did not adjust the reimbursement rate.

According to the state, these policies are intended to increase incentives for localities to reduce the use of detention and placement. The state may be working at cross-purposes, however. In 2009 these policy changes would cost the city roughly $46 million. Many are worried that, in the current fiscal environment, finding city funds to replace the lost state detention funding will instead reduce the funding available for alternatives to detention (ATD), for which the city bears the entire cost. The Senate and Assembly have both listened sympathetically to these arguments and have supported restoring funding for juvenile detention.

Detention. Currently, the state reimburses New York City and other local governments for 50 percent of the cost of pre-adjudication detention. The state Executive Budget would eliminate all state funding for detention. This would result in an estimated $38 million reduction in state funding for the Department of Juvenile Justice (DJJ) in 2009, which represents more than one-quarter of the entire DJJ operating budget. The state has asserted that the elimination of state funding for detention will encourage localities to utilize alternatives to detention. There are several reasons why eliminating detention funding may not decrease the use of detention, however, at least in the short run:

First, some youth must be detained for public safety reasons, so the city will always need to maintain and operate detention facilities. There are relatively high fixed costs associated with operating the city's three secure detention facilities in particular. Second, Family Court judges make the final decision on whether or not a youth awaits trial in detention. Judges are unlikely to make cost a primary consideration in their decisions.

Finally, the current capacity of the city's new alternative-to-detention continuum was informed by the city's analysis of how many youth with delinquency cases were "moderate risk" and, therefore, good candidates for ATD. Unless there are significant changes in the number of youth with delinquency cases and/or the nature of these cases, there is no reason to believe that the ATD continuum—one of several local initiatives intended to reduce the use of detention and placement—has not been sized to accommodate the appropriate number of youth. The city's ATD program provides varying levels of supervision and allows moderate-risk youth to await the adjudication of their cases in their homes and communities.

Other New City Initiatives to Reduce Detention. The city has also recently introduced a Risk Assessment Instrument (RAI). A one-page questionnaire used by probation officers when youth are arrested, the RAI provides objective input to the decision on where a youth awaits adjudication of his or her case—in

Effect of State Actions on City Department of Juvenile Justice Spending

Dollars in millions

	2008	2009	2010	2011	2012
Budgeted City Funds Before State Actions	**$85.9**	**$86.8**	**$86.5**	**$86.6**	**$86.5**
Projected Increase in City Funds Due to State Actions					
Increase in OCFS Payments	5.2	8.4	10.9	12.6	16.5
Proposed Elimination of State Detention Funding*	10.2	37.5	37.4	37.4	37.4
Total Projected Impact of State Actions	$15.2	$45.9	$48.3	$50.0	$53.9
Projected City Funds Budget	**$101.1**	**$132.7**	**$134.8**	**$136.6**	**$140.4**

SOURCE: IBO.

NOTES: *Cut would take effect April 1st, 2008. **Other than city and state funding, DJJ projects $688,000 in federal grant funding annually.

detention, in an ATD program, or at home.

In addition to providing services as part of the ATD continuum, the Department of Probation, working with the Law Department, has effectively increased the number of youth who are diverted from Family Court before trial. According to the 2008 Preliminary Mayor's Management Report, the number of cases diverted from court has increased to 31 percent, a 7 percentage point increase from the same period in 2007. Most recently, the city has devoted funds to keeping Family Court open on the weekends. Currently, police may bring youth directly to detention when Family Court is closed. Starting in 2009, youth from all five boroughs will be brought by the police or DJJ to Family Court in Manhattan for weekend arraignments. Keeping Family Court open on the weekends may decrease the number of youth in detention by decreasing the number of police admits to detention.

All of the Bloomberg Administration initiatives designed to reduce the use of detention are entirely city-funded. While the new programs demonstrate that the city is committed to reducing the use of detention, the number of youth in detention is not wholly within the control of the city. In a darkening fiscal environment, scarce resources will need to be redistributed to cover the gap created in DJJ's budget and pay for necessary detention services. There is concern among advocates and Bloomberg Administration officials that eliminating detention funding may disrupt programs, such as the ATD continuum. The Assembly bill would earmark $5.4 million statewide for ATD programs.

Placement. Further straining the DJJ budget is the state's policy on reimbursement for post-adjudication placement of juvenile delinquents in state-run facilities. DJJ reimburses the state for 50 percent of placement costs for youth placed in facilities operated by the New York State Office of Children and Family Services (OCFS). From 2001 through 2005 the state suspended audits that determined the cost of placement, and the cost was frozen at $100 per day. Audits recommenced, however, and the rate increased to $155 per day. The rate increase has had a two-fold impact on DJJ's budget: (1) the current cost of placement has increased and (2) the state is retroactively billing the city for years during which the state billed the city at the old rate. As a result, in 2009 the city will increase spending for OCFS placement by $8.4 million.

These increases in city payments to OFCS come at a time when the state has announced its intention to close six juvenile facilities, a move that has been applauded by advocates. According to the OCFS report *Empty Beds, Wasted Dollars*, the state anticipates that the closure of these facilities will generate $16 million in annual savings. The state has announced that it will direct $863,000 of these savings to community-based programs to divert youths from placement, but it is unclear how much of these funds will be directed to programs based in the city. These closures are possible because of the decreased number of youth in placement, which in part may be attributed to the city's alternative-to-placement programs run by the Department of Probation, Esperanza and the Enhanced Supervision Program. Even though these programs may be responsible for some of the savings the state will realize, they do not receive state funding.

Legislation introduced in the Senate would keep three of the upstate facilities open. If ultimately approved, the city and state would both bear the higher costs of keeping underutilized facilities open through higher per diem costs.

The one bright spot for local juvenile justice programs in New York City is that the former Governor's budget would increase open-ended funding for child welfare services. This funding may be used to finance community-based preventative services that avert placement of children in foster care or juvenile justice facilities, such as the Juvenile Justice Initiative, an alternative-to-placement and aftercare program run by the Administration for Children's Services. The state funds 65 percent of eligible services. These funds will be distributed by the children's services agency.

POLICE DEPARTMENT DEFERS HIRING 1,000 OFFICERS UNTIL 2010

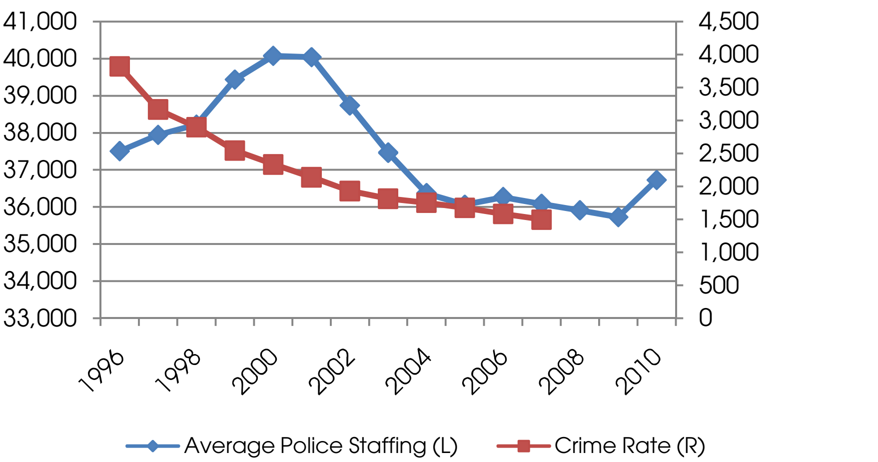
The January Financial Plan would defer the planned hiring of 1,000 new police officers until the beginning of fiscal year 2010 saving $14.2 billion this year and $37.3 billion in 2009.

Prior to the January plan, the police department (NYPD) planned on hiring two classes of new police recruits each year, with a twice-yearly peak uniformed headcount of 37,838 on January 1st and July 1st of each year. The January 2008 plan calls for peak staffing in 2009 of 1,000 fewer, or 36,838. Planned attrition would then reduce police staffing over the course of each six-month period to a low of 34,624 on the final day of June 2008, December 2008, and June 2009, just before the hiring of the next new class of recruits.

Average daily NYPD uniformed staffing declined to 35,913 during the first four months of the current fiscal year, lower than the annual average going back at least as far as 1996. Despite the combination of a decrease in police staffing and the agency's increased antiterrorism responsibilities, serious crimes (reported felony crimes per 100,000 population) have continued to drop

Police Staffing and Felony Crime Rate

Average annual police staffing; Reported felony crimes per 100,000 population



SOURCES: IBO; *Mayor's Management Reports*; Comptroller's *Annual Financial Reports*.
NOTE: Staffing figures for 2008 through 2010 are as budgeted.

since 2000, when average daily police staffing peaked at 40,078. The relationship between the size of the city's police force and the crime rate remains imprecise, particularly given the many demographic and economic factors as well as changes in police tactics that can contribute to shifts in the rate of reported crime.

Police Department Losing More Recruits During Training

Police Academy Class Entry Date	Number of New Hires	Resignations Prior to Completion of Police Academy*	Police Academy Resignation Rate*
Jan-08	1,129	N/A	N/A
Jul-07	1,139	191	16.80%
Jan-07	1,408	226	16.10%
Jul-06	1,646	226	13.70%
Jan-06	1,400	146	10.40%
Jul-05	1,906	142	7.50%
Jan-05	1,731	99	5.70%
Jul-04	1,710	62	3.60%
Jan-04	730	52	7.10%
Jul-03	1,467	82	5.60%
Jul-02	2,549	195	7.70%
Jul-01	1,644	125	7.60%
Sep-00	1,333	131	9.80%
Mar-00	1,542	103	6.70%

SOURCES: IBO, Police Pension Fund.
NOTES: Shaded rows indicate recruit classes paid at reduced rate of pay of $25,100. Immediately preceding class (entering Police Academy in July 2005) was paid at $40,658 annual rate of pay. *Voluntary resignations only.

Difficulties in Police Recruitment and Retention. The plan to allow budgeted police staffing to decline at least temporarily will take some of the pressure off of the police department, which in recent years has had difficulty in recruiting enough new police recruits to meet its hiring goals. The problem has become particularly pronounced in the wake of a June 2005 arbitrator's decision to lower the pay for new recruits to an annual rate of $25,100 during their first six months of employment, which took effect with the January 2006 recruit class. Most recently, a class of only 1,129 police recruits entered the Police Academy in January 2008, leaving the size of the police force almost 1,400 officers below the budgeted staffing level at the time of 37,838.

The NYPD's police staffing difficulties have been further exacerbated by the rise in the number of recruits who leave voluntarily before completing their initial six-month training at the Police Academy. The resignation rate for the class that entered the Police Academy in July 2007 was 16.8 percent, the highest rate since at least as far back as 2000. Furthermore, the fact that each recruit class admitted since the reduction in the starting salary for police recruits (effective with the January 2006 class) has exhibited a resignation rate in excess of 10 percent lends support to the argument that the lower rate of pay for new recruits is affecting retention.

ENDNOTE

[1]For additional information on the city's juvenile justice system, see IBO's *The Rising Costs of the City's Juvenile Justice System* (January 2008).

Other Agency Issues

CULTURAL AFFAIRS: LARGER INSTITUTIONS BEAR LARGEST CUTS

The Department of Cultural Affairs (DCA) provides two broad categories of operating support to cultural organizations. The department provides subsidies to the Cultural Institutions Group (CIG), 34 organizations housed within city-owned property, ranging from such large, world renowned institutions as the Metropolitan Museum of Art to small organizations such as the Queens Theater in the Park, that primarily serve local communities. Through the Cultural Programs Unit, grants are given to more than 850 nonprofit arts and cultural organizations offering citywide and community-based programs.

The preliminary budget shows a one-time spending increase of 10.5 percent between 2007 and 2008, from $150.0 million to $165.8 million. This increase is largely due to a change made to the funding process in the Cultural Programs Unit. Prior to 2008, most funds were given through line items to predetermined cultural groups. This year, the bulk of funding was moved from the line items to the competitively distributed Cultural Development Fund (CDF). To provide a smooth transition, organizations that previously received line item funding were granted the larger of either their CDF or their line item allocations in 2008. In 2009 this line item funding will no longer be available and the budget levels off closer to the 2007 totals.

The 2009 preliminary budget and January Finacial Plan include spending reductions in line with the citywide targets set by the Mayor. The 2008 budget was reduced by 2.7 percent ($4.5 million), while funding in fiscal year 2009 and beyond will fall by 5.0 percent ($7.7 million). It is common practice for Mayors to propose cuts to cultural programming in the preliminary or executive budget, only to agree to restore them during negotiations with the City Council as the budget is adopted. The reductions in this budget may remain as they reflect cuts that are being made across the board to nearly all city agencies. While the decrease in funding for 2009 and beyond reflects declining subsidies to the CIGs and the CDF, two CIGs bear the entire cost of subsidy reductions in 2008.

Subsidy Reductions. Reduced subsidies to cultural organizations account for most of DCA's PEG program. These subsidy reductions affect the operating budgets of the CIGs and the funding available through the CDF, with a higher percentage taken from the CIG budget. As it can be destabilizing for many cultural institutions and programs to lose funding midyear, two of the largest members of the Cultural Institutions Group, the Metropolitan Museum of Art, and the American Museum of Natural History, agreed to bear the entire burden of the cuts for the remainder of fiscal year 2008. Their reductions come to 16.3 percent and 15.9 percent of their operating subsidies, respectively. The heat, light, and power payments for cultural institutions were not affected by the PEG reductions.

The subsidy reductions for 2009 and beyond are tiered in an effort to mitigate the impact on organizations with smaller budgets. To meet the requested budget reduction, DCA would have had to reduce the subsidies to the operating budgets of each of the 34 members of the Cultural Institutions Group by 7.2 percent. In order to minimize the impact on smaller institutions, larger institutions took a cut of 8.2 percent to their subsidies, allowing DCA to cut the remaining institutions' subsidies by 3.5 percent. The largest cut to any institution was $1.03 million to the Metropolitan Museum of Art, while at $6,893, the Bronx County Historical Society received the smallest reduction. In addition, the annual new needs fund to which CIGs may apply for funding on a competitive basis was reduced by 30.6 percent. Lastly, the budget for the CDF was reduced by 5.2 percent, or $1.4 million, starting in 2009.

Department of Cultural Affairs
Dollars in millions

	2006	2007	2008 Current Modified	2009 Projected
General Administration and Other	**$3.8**	**$4.1**	**$4.1**	**$3.9**
Total Cultural Programs	**21.4**	**25.0**	**36.8**	**26.9**
Development Funds	2.1	3.8	24.2	26.0
Program Services	0.3	0.4	0.7	0.7
Line Item Funds	19.0	20.8	11.9	0.2
Cultural Institutions	**111.1**	**121.0**	**124.9**	**116.0**
TOTAL	**$136.3**	**$150.0**	**$165.8**	**$146.8**

SOURCES: IBO; Mayor's Office of Management and Budget.

CITY REGISTER FEE REVENUE MAY FALL SHORT OF NEW GOALS

The Department of Finance (DOF) is responsible for activities related to New York City revenues—both taxes and non-tax sources of revenue. Most of the taxes DOF collects are formally part of the responsibility of the Mayor's office, but the finance department also has its own revenue budget, comprising non-tax receipts from many sources. The amount of non-tax revenue collected by DOF—$1.4 billion in 2006 and almost $1.8 billion in 2007—dwarfs its expenditure budget, which has hovered in the range of $201 million to $221 million in the last four years. Not surprisingly, DOF has realized budgetary savings in recent years by increasing revenue, rather than though spending cuts as most agencies do.

Taxpayer audits and parking violation fines account for the vast majority of DOF's revenue—93 percent in 2007. The third largest source of DOF revenue comes from the City Register, which provided $42.5 million in fee revenue in 2007. The city's January Financial Plan projects that City Register fees will total $36.8 annually from 2009 on, an increase of $7.7 million a year over the projections made in June. While this is below the levels of City Register fees realized in the last several years, deepening problems in the markets for real estate—the main driver of these fees—suggest this forecast may prove too optimistic.

City Register Fee Revenue. The City Register records and maintains real property records such as deeds, mortgages, co-op financial statements, certification by the Surveyor's Office of properties' city blocks and lots, and other documents relating to real estate transactions, charging different fees for various services. (It also administers the city's real property transfer and mortgage recording taxes, though receipts from these taxes—$3.2 billion in 2007—like those from other taxes are budgeted to the Mayor's office.) A number of factors such as fee schedules for different services and the length of documents filed influence the total amount of fee revenue collected, but the most important factor is the number of real estate transactions. The city's booming real estate market in recent years has swelled City Register fee revenue, which averaged $46.0 million from 2004 through 2007, compared with an average of $23.5 million in the previous four years.

Revenue at the end of each year has been much greater than the amount budgeted at adoption, in spite of the general increases in short-term and baseline projections the Mayor's Office of Management and Budget has made in recent years. The January Financial Plan incorporated new and substantial increases in projected City Register fee revenue—by an additional $6.2 million for the current year and $7.7 million annually for 2009 and beyond. The larger increases for 2009 and beyond reflect a restructuring of fees charged by the Surveyor's Office. The revised projections of City Register fee revenue—$35.4 million in 2008 and $36.8 million for each year after—are below the amount of revenue actually received in recent years, so they allow for some of the effects of the expected slowing of real estate activity in the city. But if the decline in residential and commercial transactions exceeds expectations, City Register fee revenue may fall short of the Bloomberg Administration's goals.

CONTINUED BUDGET INCREASES TO FUND BUILDINGS DEPARTMENT SAFETY AND ENFORCEMENT INITIATIVES

When the Bloomberg Administration took office in 2002, the Department of Buildings (DOB) was widely viewed as badly "broken": one-third of its authorized positions were vacant, there were large backlogs of work, and the buildings department was plagued with allegations of corruption. Commissioner Patricia Lancaster developed a strategic plan to rebuild DOB, and the department has regularly received increases in budget and staffing to implement change.

The City Council has also focused its attention on DOB, notably through the creation of a special Task Force on Operations and Improvements of the Department of Buildings, which was charged with identifying systemic problems and proposing solutions for the department. The task force held public forums in all five boroughs to determine specific local problems. The City Council has passed a new building code and, following recommendations of the task force, passed new legislation to strengthen enforcement and safety in the booming construction market, including substantially increasing penalties

DOB Special Enforcement Plan Funding

Dollars in thousands

		Budget	
	Staffing	2008	2009
Phase I			
Special Enforcement Teams	21	n.a.	n.a.
Professional Certification Review	29	n.a.	n.a.
Excavations Inspections	14	n.a.	n.a.
Total, Phase I	64	$5,942	$4,768
Phase II			
Prequalifying Professional Certification	3	$136	$273
Low-Rise Safety Inspections	6	203	405
Gut Renovations Plan Review & Inspection	6	243	485
Total, Phase II	15	$582	$1,163
TOTAL, Special Enforcement Plan	**79**	**$6,524**	**$5,931**

SOURCES: IBO; Mayor's Office of Management and Budget; Department of Buildings.
NOTE: Phase II also includes six dedicated positions for the After-Hours Inspection Team. These positions are not budget additions.

for violations. The building industry and construction trades—DOB's principal "clients" as well as the subject of its oversight and enforcement responsibilities—have also pressed for reform.

In response to both the effort to improve the buildings department and a high level of construction activity, DOB's budget has more than doubled since 2002, from $41.3 million to $90.4 million in 2009. The Department of Buildings has increased its headcount commensurately, from 737 positions in 2005 to a budgeted 1,286 for 2009 (DOB's headcount as of the end of January stood at 1,122). The buildings department did not take the 5 percent cut to its 2009 budget that most other city agencies did.

Safety and Enforcement Focus. In the 2008 and 2009 budgets, DOB continues its focus on safety and enforcement. In last year's preliminary budget, the buildings department added 15 positions and $1.2 million for a scaffold inspection unit. Other recent initiatives include registration requirements for general contractors and new regulations for building demolitions with explosives.

In the 2008 Adopted Budget, DOB initiated a three-phase Special Enforcement Plan. The 2008 Adopted Budget provided $5.9 million in the current year (including one-time equipment and other outfitting costs), and $4.8 million in 2009 to fund 64 positions for Phase I. The initiative included 21 positions for Special Enforcement Teams made up of attorneys, plan examiners, investigators, inspectors and support staff whose mission is to pursue builders who consistently and openly disregard building code and zoning regulations. It also included 29 positions for Professional Certification Review and Audits by a team of inspectors, plan examiners and support staff to review and audit professionally certified jobs and applications for zoning and code compliance, looking for patterns of abuse. Lastly, the initiative added 14 positions for Excavations Inspections and Audits to identify and inspect sites to ensure proper excavations and the protection of adjacent properties.

Professional Certification Program

The Department of Buildings' Professional Certification Program has been in existence since 1995. Registered architects and engineers may submit plans for new construction and renovations or alterations that they certify meet all applicable building code and zoning laws and regulations. The plans are not reviewed by DOB plan examiners, but a certain number of professionally certified submissions are audited each year for compliance. Both the department and the City Council have been concerned the potential for abuse of professional certification. According to Commissioner Lancaster's testimony to the City Council on the preliminary budget, the failure rate on professional certification audits was more than 50 percent in 2007.

In the 2009 Preliminary Budget, DOB announced Phase II of the Special Enforcement Plan, which adds 15 positions and $582,000 in fiscal year 2008 and $1.2 million in fiscal year 2009. Phase II includes three positions for the Prequalifying Professional Certification Program, which will develop and implement qualifications which professional engineers and registered architects must meet in order to participate in the professional certification program. Phase II also includes six positions for the Low-Rise Safety Inspections initiative, which requires that buildings between 7 and 14 stories now be monitored by the Buildings Enforcement and Safety Team (BEST) for compliance with the city's building and fire safety codes. Phase II also adds six

DOB Spending and Revenues
Dollars in millions

	2005	2006	2007	2008 Budgeted	2009 Preliminary
Spending					
Inspection / Examination	$23.20	$22.70	$25.30	$35.40	$31.60
Investigation / Enforcement	4.1	4.7	6	6.4	6.4
Safety	3.8	5	6.2	5.8	5.8
Administration	21.8	26.6	34.1	39.1	35.3
Unallocated OTPS	11.3	22.5	15.6	13.9	11.3
Total DOB before fringe	**$64.30**	**$81.50**	**$87.20**	**$100.60**	**$90.40**
Fringe Benefits	14.5	17.2	21.3	30.6	30.7
TOTAL, DOB Spending	**$78.80**	**$98.70**	**$108.50**	**$131.10**	**$121.10**
Revenue					
Construction Permits	$67.70	$78.20	$84.30	$84.00	$80.00
All Other Revenue	46.7	46.2	48.7	55	38.5
Total Revenue	**$114.40**	**$124.50**	**$133.00**	**$139.00**	**$118.50**

SOURCES: IBO; Mayor's Office of Management and Budget.

positions for the Gut Renovations Plan Review and Inspections initiative, which requires that gut renovation jobs be reviewed by an engineer of record and that an engineer be part of the inspection team for gut renovations to ensure that renovations are structurally sound. Finally, Phase II dedicates six positions for the After-Hours Inspection Team to crack down on job sites that work after business hours without a permit. These six positions are not budget additions.

The buildings department will implement Phase III of the Special Enforcement Plan in a later budget plan. Details of what Phase III will include are still under development.

Increases Aligning DOB Spending and Revenues. The city has faced pressure for years over inadequate funding for the buildings department. State law requires that charges for services—such as construction permit application fees—cannot exceed the cost of the service provided; construction permit and other DOB revenues, however, routinely exceeded its budget.

The rising level of funding for DOB is bringing its budget into closer alignment with the revenues it collects, even as those revenues have also grown. Total revenue from licenses, permits, and fees increased from $105.4 million in 2005 to a projected $139.0 million in fiscal year 2008. Construction permit fees have increased from $67.7 million to a projected $84.0 million in 2008. Spending—including fringe benefits for DOB employees paid from central city accounts—has risen from $78.8 million in 2005, or about 69 percent of revenues that year, to a budgeted $125.5 million this year (about 90 percent of revenues). As budgeted for 2009, spending exceeds projected revenues, although revenues are often forecast conservatively.

Labor

The January 2008 Financial Plan projects spending for personal services to increase by 4.8 percent in 2009, to $34.7 billion, and to continue to grow at the same rate, on average, through 2012, when it will reach $39.9 billion (including intra-city funds). Headcount, including the full-time equivalent of part-time personnel, is projected to decline by 3,154 positions in 2009, then rise slightly in 2010 and remain flat for the rest of the financial plan. In short, the growth in personal services spending is attributable to rising salaries, wages and benefits rather than to growth in the size of the city's labor force.

Salaries and wages are projected to grow at an average annual rate of 4.8 percent, while fringe benefits are projected to grow at a rate of 4.7 percent. This is the first time in several years that fringe benefits are not projected to grow faster than wages, due in large measure to a projected leveling off in the growth of pension contributions. A recent agreement on a new pension plan between the city and the United Federation of Teachers (UFT), while increasing costs in the short run, will help reduce costs in the future through higher contributions by new UFT members.

Health insurance expenditures continue to grow rapidly, however, and despite plans to negotiate $200 million annually in savings, a number of factors could contribute to higher increases in the future.

SALARIES AND WAGES

The projected growth of salaries and wages is principally driven by two factors. First, the Bloomberg Administration incorporated into its October Financial Plan the assumption that the 4 percent annual increases negotiated with the city's uniformed services unions (except the police officers' union) would be extended to all other city employees in the next round of bargaining, covering 2009 through 2011. District Council 37, which bargains on behalf of most of the unionized non-pedagogical civilian workforce and whose contract expired March 2nd, is expected to settle soon on a new contract.

Second, the Bloomberg Administration's budget for the Department of Education assumes substantial increases in state aid for education as a result of the Campaign for Fiscal Equity settlement (although how the funds would be used remains to be determined). Former Governor Spitzer's Executive Budget for state fiscal year 2008-2009, however, projected less state aid in 2009 than the city had anticipated in preparing the January Financial Plan.

PBA Arbitration. The one major municipal union that remains without a settled contract is the Patrolmen's Benevolent Association (PBA), representing the 23,000 rank-and-file city police officers. The PBA's previous contract was also not settled at the negotiating table, but awarded by an arbitration panel of the state Public Employees Relations Board (PERB). That contract—which covered fiscal years 2003 and 2004—was awarded in June 2005. It provided for two annual 5.0 percent increases. To help offset the cost, the PERB panel lowered starting salaries for new recruits and stretched out the time needed to reach the top pay grade by six months, to 5.5 years.

Personal Services Spending in the January Financial Plan

Dollars in millions; all funds

	2008	2009	2010	2011	2012	Avg. Annual Change
Salaries & Wages						
Salaries & Wages	$20,443	$20,804	$21,582	$22,149	$22,022	1.9%
Labor Reserve	560	1,106	2,166	2,855	3,286	55.6%
Total Salary and Wages	**$21,003**	**$21,910**	**$23,748**	**$25,004**	**$25,308**	**4.8%**
Fringe Benefits						
Pensions	$5,749	$6,237	$6,536	$6,530	$6,545	3.3%
Health Insurance	3,397	3,529	3,868	4,238	4,575	7.7%
All Other Fringe	2,963	3,013	3,176	3,325	3,457	3.9%
Total Fringe Benefits	**$12,109**	**$12,780**	**$13,580**	**$14,093**	**$14,577**	**4.7%**
Total, Personal Services	**$33,112**	**$34,690**	**$37,327**	**$39,097**	**$39,885**	**4.8%**
Planned Headcount						
Full-time (FT)	279,248	276,332	277,730	277,916	277,916	-0.1%
Full-time Equivalents (FTE)	33,323	33,085	33,054	33,071	33,071	-0.2%
Total FT + FTE	**312,571**	**309,417**	**310,784**	**310,987**	**310,987**	**-0.1%**

SOURCES: IBO; Mayor's Office of Management and Budget.

NOTES: Includes intra-city funds. Health insurance includes miscellaneous budget, Department of Education, and CUNY.

In the meantime, the Bloomberg Administration settled with all other uniformed labor unions on a pattern of two increases of 3.0 percent and 3.15 percent. In the most recent round of uniform labor contracts, the uniformed unions obtained 4.0 percent annual increases, along with other wage gains, including higher step increases, differential pay, additional paid holidays, and, notably, higher starting salaries for new recruits, among other measures. The PBA, however, has refused to settle on the pattern set by the other agreements, and the contract is once again in arbitration. Since an arbitrated contract can cover no more than two years under state law, this contract—expected to be awarded in April—will also be entirely retroactive, bringing the police officers' contract up to July 31, 2006.

Most observers expect the award will include higher starting salaries for new recruits—which the Bloomberg Administration included in its last offer to the PBA before arbitration—to help remedy the recruiting shortfalls since the lower starting salaries took effect with the January 2006 class of police recruits (see police hiring, page 44-45). But whether the arbitrator will agree with the PBA's contention that all its members—not just new recruits—are underpaid relative to their counterparts elsewhere, or with the city's contention that it cannot afford larger increases, remains to be seen. We estimate that each percentage point the PBA contract exceeds the established uniformed pattern would cost $15.2 million for 2005 and $16.4 million in 2006 and beyond (excluding additional pension contributions).

Moreover, if the terms of the arbitrated contract are more generous than those negotiated last fall with the other uniformed unions, the city risks pressure from several of the other unions that obtained contract reopener clauses to match the terms of the PBA settlement. If these other unions exercise their contract reopener clauses and the city were to agree to match a PBA settlement above the current pattern, we estimate the potential cost at between $27 million and $35 million annually for each percentage point by which the PBA contract exceeded the uniform wage pattern (again, excluding pension costs).

FRINGE BENEFITS

Two components of benefits for city employees—health insurance and pensions—make up 75 percent of the cost of fringe benefits. We evaluate risks to the city's current health insurance cost projections, followed by a review of the recently enacted "25/55" pension plan for teachers and other Department of Education employees represented by the United Federation of Teachers.

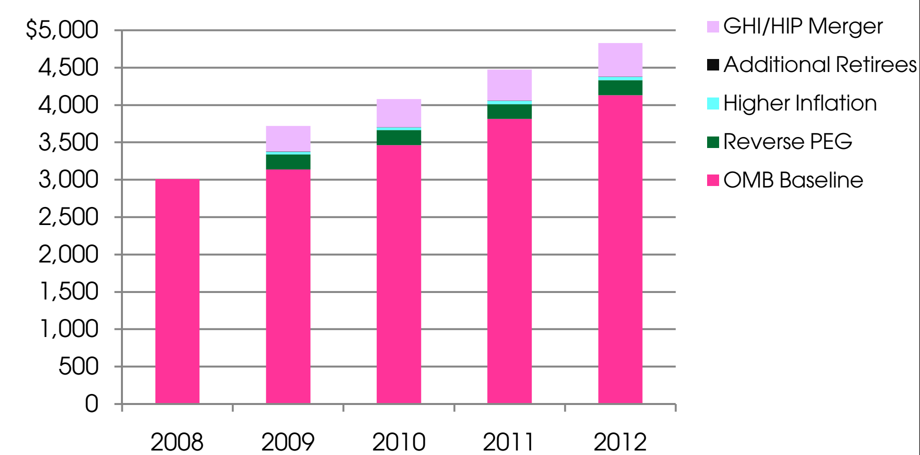
Health Insurance Costs Could Exceed Projections. The city, like other state and local governments and private employers, continues to experience growth in employee and retiree health insurance costs above the core inflation rate. Budgeted health insurance costs increased 9.4 percent for 2008, which was reflected in the January Financial Plan (excluding contributions to the Retiree Health Benefit Trust).

The Mayor's budget office currently projects approximately $3.4 billion in health care expenditures for 2008, increasing to almost $4.6 billion by 2012. These projections included cost adjustments arising from the city's hiring freeze and vacancy reduction program, the enhanced teacher's pension benefits (see below), and $200 million in unspecified savings starting in 2009.

IBO believes that OMB's baseline health insurance forecast could underestimate actual health insurance costs for several reasons, including higher-than-projected health care inflation, the number of covered city employees and retirees, and the potential impact of the merger and for-profit conversion of the city's primary health insurance providers, GHI and HIP. In addition, the $200 million annual savings will require negotiation with the municipal labor unions, which may or may not yield the expected savings. We estimate that, taking all these factors into account, by 2012 the cost of employee health insurance could be higher by as much as 16 percent to 18 percent compared to OMB's baseline estimate.

Health Insurance Inflation. The first factor is the assumed

Multiple Risks to Health Insurance Projections
Dollars in million



SOURCES: IBO; Mayor's Officeof Managment and Budget.

health insurance inflation rate. While OMB assumes an 8 percent health insurance inflation rate in its projection, IBO believes that, based on the recent past experience of New York City health insurance premium prices, the health insurance inflation rate should be closer to 9 percent. The increase in the city's primary health insurance premium costs has averaged 9.4 percent annually since 2001. A 9 percent figure also better reflects specific factors that are driving up New York City health insurance costs in particular, such as Timothy's Law (mandating mental health coverage parity) and high and rising medical malpractice insurance premiums. This would add $33 million to costs in 2009, rising to $43 million by 2012.

Many observers believe that the rate of growth of health insurance is likely to moderate in coming years because the current rate of growth is fiscally unsustainable both nationally and locally. An aging population, technology, the possibility of Democratic majorities in both Congress and the White House seeking to extend coverage more broadly, and at the state level, the need to address the crisis in medical malpractice costs, will all exert pressure to reduce the rate of cost growth. But this is not likely to happen overnight, and any reforms will take time to translate into lower premium growth.

How Many Retirees? A second factor concerns the expected number of retirees. Even with New York City's plans for a hiring freeze and other attrition-based personnel adjustments, we expect an increase in retiree primary health insurance expenses with the passage of the 25/55 UFT enhanced retirement benefit legislation, signed by the Governor February 27th. While part of this increase in retiree health insurance costs is expected to be offset by the lower salaries of their replacements and by attrition, the adoption of the 25/55 legislation will increase future health insurance costs.

The city has budgeted additional health insurance expenditures for the increase in retirements expected as a result of the UFT 25/55 pension legislation. In the January Financial Plan, the Department of Education budgeted $7.4 million in 2009, $13.6 million in 2010, $19.3 million in 2011, and $24.9 million in 2012, to account for an increase in early retirements. These estimates were made based on projections by the Office of the City Actuary. The actuary's office has assumed that the probabilities of accelerated retirements for eligible plan members are 40 percent in the first year of eligibility, 30 percent in the second year, and 20 percent thereafter.

These increased probabilities of retirement, however, are less than the probabilities of retirement previously used under the 1995 Chapter 96 25/55 early retirement plans (60 percent in the first year, 40 percent in the second year, and 20 percent thereafter). If the actual number of accelerated retirements is closer to the probabilities used in 1995, costs would be higher by approximately $3.7 million in 2009, $4.7 million in 2010, and $5.1 million thereafter.

Other possible causes of higher retirement rates (not included in our projections), could include pressure by other unions to obtain pension parity with the UFT's 25/55 enhanced retirement plan, which could result in other incumbents having the ability to retire without penalty as early as age 55, and the possibility of early retirement options and incentives if the city enters a prolonged period of rough economic times.

GHI-HIP Merger and For-Profit Conversion. Finally, the merger of the city's two primary health insurance providers, GHI and HIP, and the merged company's planned for-profit conversion will carry fiscal risks for the city. IBO estimates that, under a scenario in which the new company raised health insurance premiums by roughly 10 percent, the city would incur more than $300 million in additional costs in 2009 (if the entire increase were to take effect at the beginning of the year), rising to over $400 million by 2012.

Risks and Offsets. While the factors considered here could raise costs substantially, there are some offsetting factors as well. As discussed above, some observers believe that recent health cost growth is not likely to be sustained in the future. In addition, while the Bloomberg Administration's $200 million "health benefits restructuring" savings is as yet merely a goal, it is entirely possible that the city will reach an eventual agreement with the Municipal Labor Council on health insurance benefits, although the ultimate savings are impossible to predict.

The effect of the GHI-HIP merger is also difficult to assess. As of this writing, the state Insurance Department continues to review the conversion proposal. The Governor's Executive Budget for 2008-2009 assumes that the proceeds from conversion would be captured entirely by the state. The Bloomberg Administration has argued strenuously that the proceeds from conversion to for-profit status should be shared with the city, which could help offset any increase in premiums.

Pensions. Contributions made by the city to pension funds on behalf of covered employees have grown substantially over the last several years, from $1.75 billion in 2003, to $5.7 billion this year, and a projected $6.5 billion in 2012. The increases have been driven by a combination of enhanced benefits, including the automatic cost-of-living adjustment enacted by the Legislature in 2000, the amortization of stock market losses, and adjustments to the actuarial assumptions used in calculating the

Fiscal Effect of New TRS/BERS "55/25" Pension Plan
City funds; in millions

	2009	2010	2011	2012
City Pension Contributions	$100.6	$93.7	$74.1	$57.6
DOE: Health Ins. & Welfare Fund	8.9	16.2	22.7	29.0
DOE: Salaries (incl. FICA)	(52.0)	(84.8)	(110.2)	(130.2)
TOTAL	**$57.5**	**$25.1**	**($13.4)**	**($43.6)**

SOURCES: IBO; Mayor's Office of Management and Budget.
NOTES: Positive amounts represent costs; negative amounts (in parentheses) represent savings.

city's pension liabilities.

The current city projection is that the steep increases in pension contributions will moderate over the next few years. But an extended financial market downturn will significantly and adversely affec pension contributions if the rate of return on pension fund investments is below the assumed rate of return of 8 percent annually. Each percentage point below the expected 8 percent costs the city roughly $10 million in the second year following, rising to about $60 million by the time the effect is fully recognized in the seventh year.

Teacher's Retirement Plan. As part of the settlement of the last UFT contract, labor and management agreed to discuss revisions to the retirement plan benefits for members of the Teachers Retirement System (TRS) and certain Board of Education Retirement System (BERS) members represented by the UFT. The city and the UFT have now agreed to an improved pension plan, the so-called 25/55 plan, described in more detail below.

Under the agreement *current* members will be eligible to opt in to the new "25/55" plan for six months, or remain in their current plan. Prior to the change, plan members who retired before age 62 with less than 30 years of service saw a reduction in their full pension benefit. The new plan will allow them to retire at age 55 with 25 years of service with no reduction in benefits. Current members who opt in will be required to pay an additional member contribution of 1.85 percent of earnings until retirement.

For new members, the plan parameters will be slightly less generous, allowing for full retirement benefits at age 55 with 27 years of service. New members will also pay the additional contribution rate, for a total of 4.85 percent a year for the first 10 years of service, then 1.85 percent annually until they reach 27 years of service. Participation in the plan will be mandatory for new hires.

The fiscal impact of the new plan has two dimensions: First, higher costs for the enhanced pension benefits and retiree health insurance; second, savings in education department salary costs as older teachers retire earlier and are replaced by new, lower-paid teachers. The city projects that the salary savings will outweigh the higher pension and health insurance costs within three years.

Additional city pension contributions are projected to be $100.6 million in 2009, declining slightly in 2010 and then more sharply after that, with a projected cost of $57.6 million in 2012. Employer pension costs represent the difference between the actuarially calculated present value of benefits, less the actuarial present value of future member contributions. While initially this results in a net cost to the city, the cost will fall over time as existing members retire and new employees replacing them are required to make the additional 1.85 percent member contribution for 27 years. The City Actuary, in his fiscal note accompanying the legislation, concluded that, over time, "employer costs will reduce and eventually the [new additional member contributions] will be able to fully support the Program ..."

A large portion of the initial increase in pension costs—close to 70 percent—is the result of current members being able to retire earlier without having made retroactive additional member contributions to fund the enhanced benefit.

In addition to the pension costs, earlier retirements will mean additional retiree health insurance costs, as eligible members retire and are replaced with new employees. Additional contributions to supplemental employee welfare benefit funds will also be required. The combined increase in health insurance and welfare benefit funds will cost the city $8.9 million in 2009, rising to $29.0 million in 2012.

Capital Program, Financing, and Debt Service

CAPITAL COMMITMENT PLAN

The January Capital Commitment Plan accompanying the preliminary budget, covering the period 2008-2011, projects $52.5 billion in spending on the city's capital programs, including $42.5 billion in city funds and $10 billion in non-city funds. After adjusting for the expected levels of annual commitments, the planned city funds commitments in the four-year plan total $38.3 billion.

Capital spending is dominated by three areas—education, environmental protection, and transportation—that comprise $30.5 billion in total funds, representing 58 percent of the entire capital plan.

Education projects constitute the largest share of total funds at 23 percent of the capital budget. Of the approximately $12 billion in total funds for education capital projects, which include construction, expansion, and rehabilitation, more than half ($6.6 billion) is state funding. For most other project areas, except transportation and housing, city funds provide more than 90 percent of funding for the capital program.

Environmental protection projects—principally for mandated investments in the city's water and sewer system—constitute the second largest share, with $11.5 billion projected, or 22 percent of the total. The third largest component of the capital plan, 13 percent or $7.0 billion, is projected for transportation projects. The remaining $21 billion, or 26 percent of all funds, is divided among general services, which includes the capital programs for sanitation, public buildings and real estate, and citywide computer equipment; housing and economic development; parks, cultural affairs, and libraries; public safety, which includes capital programs for corrections, police, fire, and juvenile justice; and health and social services.

The projected capital commitments in the current four-year capital plan represent a 60 percent increase over actual commitments in the four years 2004 through 2007 on an all funds basis, and a 48 percent increase on a city funds basis. A combination of rising materials costs, high demand for large capital construction projects in the region, and an expanding number of projects included in the capital budget are contributing to this increase.

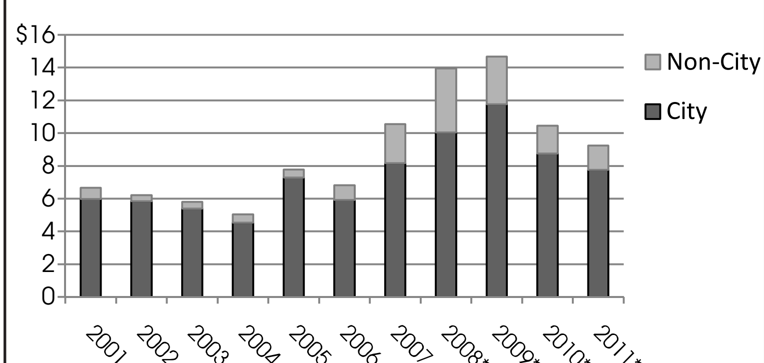
Rising Construction Costs Take a Toll on the Capital Budget. There have been many recent examples of project bids coming in considerably higher than budgeted. For example:

- The cost of the Department of Environmental Protection's (DEP) Catskill/Delaware ultraviolet water treatment facility has risen 35 percent from the previous plan, to nearly $1.5 billion.
- The Department of Sanitation's projected costs to complete several large projects, including construction of Marine Transfer Stations, the West Side garage in Manhattan, and the South Brooklyn Marine Terminal recycling facility, have gone up anywhere from 15 percent to 60 percent over previous estimates. As a result, construction of a new garage to serve District 1 in Staten Island has been deferred, despite having been characterized by the department as "antiquated" and too small to serve the district.
- Replacing the Willis Avenue Bridge over the Harlem River came in nearly 50 percent over the originally estimated cost, at $612 million.
- Costs for construction of new school buildings and additions have risen on average 45 percent since the Department of Education five-year capital plan for was originally released in June 2004 (see the school capital spending on page 29 of this report and the recent IBO fiscal brief, *Higher Costs, Delays in Amended School Construction Plan*, for additional detail).

The rising costs have a cascading effect on the capital plan, pushing projects into later years in order to accommodate higher than expected costs of projects in the current year. Some projects ultimately will not be done, or will be more expensive because the assets will suffer further deterioration and require more extensive repair and/or upgrading.

There are a number of factors behind the rise in construction costs. Construction costs began rising nationally early in 2004 as

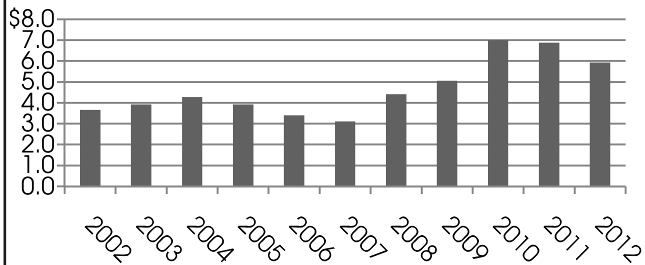
Capital Commitments
Dollars in billions



SOURCES: IBO; Mayor's Office of Management and Budget.
NOTE: Includes Environmental Protection projects funded by Municipal Water Fianance Authority bonds.
*Figures for 2008 through 2011 are City projections.

City Bond Issues

Dollars in billions



SOURCES: IBO; Mayor's Office of Management and Budget.
NOTES: *Includes general obligation and Transitional Finance Authority and new money issues. Excludes TFA Recovery Bonds and Building Aid Revenue Bonds; excludes Municipal Water Finance Authority Bonds.

a worldwide spurt of construction pushed demand for materials and labor—especially specialized construction labor, such as construction management—to new highs. Nationally, costs of inputs to construction rose by over 6.5 percent annually from 2003 to 2007, and the cost of heavy construction projects grew by more than 8 percent on an annual average basis.

In the New York City region, costs have risen even more sharply as construction activity has grown, fueled in no small measure by growth in public-sector projects. There have been a large number of high-profile projects, including Metropolitan Transportation Authority (MTA) expansion projects such as East Side Access and the Second Avenue subway, DEP's Croton Filtration Plant, and others. Public and private rebuilding projects in lower Manhattan have also accounted for a great deal of recent construction activity. The public-sector projects come on top of a growing level of private construction of housing and office buildings. Housing starts in the city have exceeded 30,000 per year since 2005; office building construction has been in excess of 2.5 million gross square feet every year since 2004.

Low interest rates on tax-exempt bonds issued by the city, the Municipal Water Finance Authority, MTA, and others, have helped spur the demand for public-sector construction.

Together these factors have led to a situation in which the public sector is now competing not just with the private sector, but also to some extent with itself. With all the demand for construction, and because the city is often viewed as a difficult client, especially on large and complex projects, firms bidding on city projects may not feel that they need city contracts, and therefore place a premium on their bids.

Cost Containment Measures. The city and state have proposed measures to help reduce public-sector construction costs, although it remains unclear if they will all succeed in the Legislature. The Governor's Article VII legislation accompanying the Executive budget included a proposed reform to the so-called Wicks Law, which requires multiple prime contracting for city construction projects (a general construction contract as well as separate contracts for plumbing, electrical, and HVAC—heating, ventilation, and air conditioning). The proposal would exempt projects in New York City up to $3 million, and would permit project labor agreements in place of multiple prime contracts on projects that would otherwise be subject to Wicks. The Bloomberg Administration estimates that this would save about $2.2 million in 2009.

Another bill, introduced in the Legislature last year and expected to be reintroduced this year, would statutorily eliminate the "no damages for delay" clause that is currently a standard feature of city construction contracts. Damages for delays are paid to contractors when, through no fault of their own, they incur costs due to delays in completing projects. Currently, although contractors are liable for monetary penalties for delays they incur, the city is not liable for monetary penalties for delays that are within its control as a client. The result, according to many observers, is two-fold: first, bidders incorporate a risk premium into their bids on city contracts; and second, since there are fewer bidders who can bear the financial risk, there is less competition for city contracts. Although monetary damages for delays undoubtedly are in effect paid now at least to some extent, through the mechanism of change orders to contracts, explicitly allowing contractors to seek compensation for delays caused by the city as project owner would in theory create a financial incentive for the city to avoid delays, as well as expand the number of bidders. This would be further facilitated, according to supporters, by eliminating the requirement of multiple prime contractors and making a single project manager responsible for subcontractor delays.

While these reforms would undoubtedly save the city money, the rising cost of public-sector construction projects is more fundamentally due to the current imbalance between supply and demand in the local, national, and global construction markets. As the economy cools, a retraction in private- sector construction activity may ease the cost pressure on the city capital program.

PAYING FOR THE CAPITAL PROGRAM

Borrowing. To finance the city's expansive capital program, the city borrows money by issuing three types of debt: general obligation (GO), Transitional Finance Authority (TFA), and Municipal Water Finance Authority. To finance its current capital commitment plan, the city expects to issue approximately $21.8

NYC General Obligation Debt

	Current	Previous
Moody's	Aa3	A1
Standard & Poor's	AA	AA-
Fitch	AA-	A+

billion in general obligation bonds between 2008 and 2011. Annual bond issuance will reach $7 billion in 2010 and nearly that amount in 2011—a record level.

The TFA, which is authorized to issue $13.5 billion of obligations for general city capital purposes, has exhausted its issuing capacity. The Bloomberg Administration has sought, and the former Governor included in legislation accompanying the 2008-2009 Executive Budget, permission to issue TFA debt in place of GO bonds, with the combined total subject to the current state constitutional limit on debt outstanding. The Bloomberg Administration estimates that TFA bonds, which tend to sell with lower yields than GO debt, would save the city $14 million in debt service in 2009; the savings would grow as more TFA debt was issued in place of GO bonds.

TFA Building Aid Revenue Bonds. Although the ability to borrow through the Transitional Finance Authority for general city capital purposes is currently depleted, the state authorized a special issue of bonds through the TFA for school construction, of up to $9.4 billion. Unlike regular TFA debt, which is backed by city personal income tax revenues, the TFA Building Aid Revenue Bonds (or BARBs) are backed by state building aid, which reimburses the city for roughly 60 cents on each dollar spent. The city currently projects issuing $4.8 billion to fund the 2005-2009 educational capital plan. Because the city has assigned all of its rights to state building aid to the TFA to pay for debt service on the bonds, TFA BARBs debt service is not included in the city's budget. All residual building aid beyond what is needed for BARBs debt service is turned over to the city for the general fund. (For additional information, see the section "School Construction" on pp.29)

Credit Market Turmoil. During the summer of 2007, all three rating agencies upgraded New York City's GO credit ratings, citing steady economic growth and robust revenue.

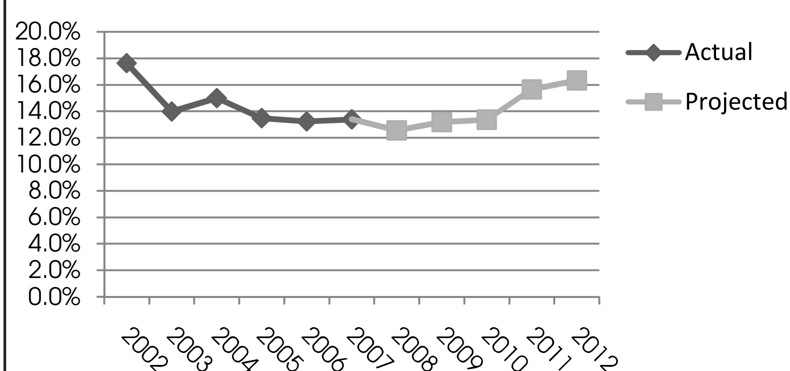
Despite New York City's enhanced credit ratings, current turmoil in the municipal market may result in higher borrowing costs for the city, although it is too early to assess the long-term effect. In particular, the volatility in the municipal insurance industry (prompted largely by the bond insurers' subprime mortgage exposure) and in the auction-rate bond market may cause a rise in the city's debt issuance costs. Although none of the bonds insured thus far in 2008 have been insured by monoline insurers that face possible rating downgrades, a portion of two of the city's five bond issues in 2007 were insured by companies involved in the subprime crisis, Ambac and FGIC.

The current turmoil in the auction-rate bond market may also adversely affect New York City's debt issuance costs. The city currently has roughly $2 billion of GO debt outstanding in auction-rate mode, including two bond subseries with a total par value of $475 million issued this fiscal year.

Auction-rate mode bonds are variable-rate bonds that are put up for sale on a periodic basis (weekly or monthly); the rate on the bonds is determined by supply and demand at the time of the auction. Auctions on some of the city's auction rate securities failed last month due to the widespread market dislocations resulting from uncertainty about the availability of insurance for this debt and the constrictions in the capital market more generally. When an auction fails, bondholders are left holding the securities and interest rates are reset at a level, typically higher, as outlined in the official statements issued at the initial bond sale. To counter this trend, New York City plans this month to convert more than half of its $2 billion of GO debt in auction-rate mode to fixed-rate bonds and variable-rate bonds through a $1.3 billion refunding. It is expected that the city will refund maturities of auction-rate securities generally inside of 10 years with the fixed-rate portion.

Debt Service. Debt service is the scheduled repayment of the borrowed funds plus interest. By 2012, debt service payments will total $6.7 billion—approaching 16.3 percent of city tax revenues. This represents a one-third increase in debt service from 2007, in which approximately $5 billion was spent (adjusted for prepayments).

Debt Service as Percentage Of Tax Revenues



SOURCES: IBO; Mayor's Office of Management and Budget.
NOTE: Adjusted for prepayment of debt service.
Projection based on IBO tax revenue forecast.

In the last several years the city has refunded nearly $20 billion in outstanding GO or TFA bonds in order to lower its interest costs. This, combined with the 2003 property tax increase (and other temporary increases in the personal income and sales taxes), have lowered the burden of debt service on the budget, with debt service projected to be below 13 percent of tax revenues for the first time since 1990. By 2012, however, debt service is projected to rise to more than 16 percent of tax revenues. Although the city tends to project its debt service conservatively—assuming higher nominal interest rates than current yields—the fact remains that the high level of borrowing planned for the next several years will inevitably lead to a continued rapid growth in debt service—an average annual rate of 6.6 percent per year from the current year for the next decade, which is likely to be well above the growth rate of tax revenues, assuming no tax policy changes. The city will have to continue to strike a balance between the need for investment and the ability to afford other city services.

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