IBO

New York City Independent Budget Office

Fiscal Brief

May 2007

Analysis of the Mayor's Executive Budget for 2008

Also available...

Detailed Tables on IBO's Revenue and Expenditure Estimates

... at www.ibo.nyc.ny.us

SUMMARY

WITH TAX REVENUES CONTINUING TO EXCEED EXPECTATIONS, New York City's fiscal picture looks brighter today than even just a few months ago. The most pressing fiscal question faced by the Mayor and City Council in the near-term is how to best use a surplus now estimated at $4.4 billion.

Projecting a local economic slowdown that will curb tax revenue growth, the Mayor has stressed fiscal prudence. The Executive Budget for 2008 and Financial Plan through 2011 heeds that caution with a proposal to use $1.2 billion this year for early debt retirement, saving more than $600 million in 2009 and 2010, years in which budget gaps are expected to emerge. But the Mayor also proposes $1.3 billion in tax reductions, growing to $1.9 billion in 2011 by IBO's estimate, as well as $715 million in city-funded new spending in 2008.

IBO has reviewed the 2008 Executive Budget and Financial Plan and undertaken are own estimates of revenues and expenditures. Among our findings:

- Tax revenues are now forecast to rise 9.8 percent in the current year. If the Mayor's tax reductions are fully enacted, IBO expects the combination of tax cuts and slower economic growth will cause tax revenues to decline 3.6 percent in 2008 and then rise at an average rate of 2.3 percent from 2008-2011.
- As the local real estate market begins to cool, the property transfer taxes that have been providing a major revenue boost are expected to decline in 2008, with the mortgage recording tax falling by 18.4 percent and the real property transfer tax by 17.3 percent.
- Business income taxes, which have also been a major contributor to the current surplus, are projected to decline 4.5 percent in 2008 as Wall Street profits are expected to drop from last year's near record level.
- Executive Budget proposals for new city-funded spending exceed proposals for savings by $242 million in 2008, with the largest increases for schools, the public hospitals, and plaNYC.
- Since last June, the city has added funds to the labor reserve to cover wage and benefit settlements in excess of the original assumption of increases of about 1.25 percent annually—$315 million for 2007, rising to $628 million for 2008 and to $1.6 billion by 2011.

IBO finds budget shortfalls similar to those estimated by the Bloomberg Administration. While these gaps are indicative of an underlying mismatch between recurring city revenues and expenses, they are not large given the size of the city's budget. IBO's budget gap projection of $1.7 billion in 2009, $144 million more than the Mayor's estimate, is particularly manageable. If, for example, there were no tax cuts and a relatively small portion of the current surplus was not shifted to 2010, the 2009 gap would be eliminated.

New York City
Independent Budget Office
Ronnie Lowenstein, Director
110 William St., 14th floor
New York, NY 10038
Tel. (212) 442-0632
Fax (212) 442-0350
e-mail: ibo@ibo.nyc.ny.us
http://www.ibo.nyc.ny.us

INTRODUCTION

With tax revenues continuing to exceed expectations, New York City's near-term fiscal picture looks even brighter than it did just a few months ago. The Mayor's Executive Budget for 2008 and four-year Financial Plan through 2011 now projects a surplus of $4.4 billion for the current fiscal year—$500 million more than the Bloomberg Administration estimated in January. The most pressing near-term fiscal question faced by the Mayor and City Council is how to best use this surplus.

Much as in past budget presentations, the Mayor has urged fiscal prudence. Heeding this caution, he has proposed using $1.2 billion this year for early debt retirement, saving more than $600 million in debt service in both 2009 and 2010 in order to reduce projected budget shortfalls in those years. This action also serves to take $1.2 billion "off the table" so it cannot be used for recurring expenditures or tax reductions that could be difficult to sustain. The Executive Budget also includes a proposal—first introduced in January—to add $500 million in 2008 to the trust fund that can only be drawn down to pay health care costs for retired city workers. These actions mirror last year's Executive Budget, when a variety of proposals took nearly $2 billion off the table.

But the Mayor also departs from some of his prior caution in the 2008 Executive Budget. The budget includes more than $1.3 billion in tax reductions, most first proposed in January. It also includes proposals for new 2008 spending, such as $198.8 million for plaNYC initiatives in 2008 and $156 million to aid the fiscally ailing public hospitals system.

Despite the city's extraordinary current surplus, under the Mayor's plan budget gaps are expected to emerge in future years. IBO's review of the Mayor's spending plans along with our own revenue projections finds shortfalls similar to those estimated by the Bloomberg Administration.

While these gaps are indicative of an underlying mismatch between recurring city revenues and expenses, they are not especially large given the size of the city's budget. IBO's budget gap projection of $1.7 billion in 2009, $144 million more than the Mayor's estimate, is particularly manageable. If, for example, there were no tax cuts and the relatively small share of this year's surplus expected to be shifted to 2010 was instead used earlier, the 2009 gap would be eliminated.

In 2010, IBO anticipates a shortfall of just under $3 billion and a gap of $3.9 billion in 2011, roughly $270 million and $380 million less than the Mayor's estimates in each of those years. Both IBO and the Bloomberg Administration believe the city is facing a period of slower local economic growth; the variations in the gap estimates are largely a result of differences in the extent and duration of the slowdown.

TAXES AND THE ECONOMY

Overview. Thanks to another strong quarter in the local real estate market and larger than expected Wall Street profits, the near-term outlook for tax revenues is now even brighter than IBO anticipated in our Preliminary Budget review. IBO's projection for 2007 tax revenues is now $37.0 billion, which is $1.4 billion above our March estimate and $4.6 billion (14.3 percent) above the Bloomberg Administration's forecast when the 2007 budget was adopted last June. IBO's 2007 updated tax revenue forecast is virtually identical, just $52 million—roughly one-tenth of 1 percent—lower than that of the Bloomberg Administration's latest estimate in the Executive Budget.

But the economic and revenue outlook shifts abruptly beginning in 2008. After growing by an anticipated 9.8 percent in the current year, baseline tax revenues—which excludes the impact

Total Revenue and Expenditure Projections

Dollars in millions

	2007	2008	2009	2010	2011	Average Change
Revenues	$59,885	$59,513	$60,169	$63,028	$65,529	2.3%
City-funded Revenues						
Taxes	*37,016*	*37,034*	*38,186*	*40,320*	*42,435*	3.5%
Tax Reduction Program	-	*(1,353)*	*(1,637)*	*(1,780)*	*(1,903)*	n/a
Other Revenues	*6,751*	*7,530*	*6,636*	*6,655*	*6,728*	-0.1%
Expenditures	59,885	59,513	61,866	66,017	69,440	3.8%
City-funded Expenditures	*43,767*	*43,211*	*44,882*	*48,184*	*51,171*	4.0%
IBO Surplus / (Gap) Projection	**$-**	**$-**	**$(1,697)**	**$(2,989)**	**$(3,911)**	n/a

SOURCE: IBO.
NOTES: IBO projects a surplus of $4.27 billion for 2007, $119 million below the Bloomberg Administration's forecast. The surplus is used to prepay some 2008 expenditures, leaving 2007 with a balanced budget. IBO projects a surplus of $2.10 billion for 2008, $257 million below the Bloomberg Administration's forecast. The surplus is used to prepay some 2009 expenditures, leaving 2008 with a balanced budget. Estimates for all years exclude intra-city revenues and expenditures.

of proposed tax reductions—are expected to grow less than 0.1 percent in 2008. Moderate growth will resume after 2008, averaging 4.6 percent annually through 2011. The Mayor's forecast is similar, with a very small decline projected from 2007 to 2008, followed by annual growth of 4.2 percent from 2008 through 2011.

Tax Program. If the Mayor's tax proposals are fully enacted, there would be a decline in revenues for 2008 of 3.6 percent, instead of remaining essentially unchanged from their 2007 level, and the revenue growth over the course of the Financial Plan would be slower (2.3 percent from 2008 through 2011, rather than 3.5 percent). By 2011, tax revenues would be $1.9 billion lower than currently anticipated by IBO without the proposed tax cuts.

The Mayor's Executive Budget adds several new tax proposals to those outlined in his Preliminary Budget in January. The Preliminary Budget included proposals for a 5 percent property tax rate reduction (cost of $767 million in 2008), extension of the $400 homeowner property tax rebate ($256 million in 2008), a new personal income tax child care credit ($42 million in 2008), elimination of the city sales tax on all clothing items ($113 million in 2008), and a package of business cuts (combined 2008 cost $142 million). The largest of the new Executive Budget tax proposals is a $0.50 per pack increase in the cigarette tax, which is expected to raise an additional $20 million in tax revenue even as the higher cost further discourages smoking. There are also a number of small tax exemptions and abatements under the Mayor's plaNYC initiative that are intended to create incentives for using energy-conserving building designs and the purchase of hybrid vehicles.

The final item is also part of plaNYC and would dedicate a portion of city personal income tax (PIT) revenue to the proposed Sustainable Mobility and Regional Transportation (SMART) Financing Authority. (The other contributions would be from the state and the net revenues from the proposed congestion pricing fees for weekday access to Manhattan below 86th Street.) The arrangement contemplates that a portion of the PIT revenue not used by the Transitional Finance Authority (TFA) would be diverted to the SMART Financing Authority for debt service before it is available to the city's general fund. Although many details remain to be worked out, including a commitment from the state to match the city contribution, the Financial Plan assumes that SMART would reduce general fund tax revenues by $50 million in 2008 and $220 million in 2009. In following years the city's contributions would grow in conjunction with PIT revenue.

Tax Revenue Projections. IBO expects business income taxes, which consist of the general corporation tax (GCT), the unincorporated business tax (UBT), and the banking corporation tax (BCT) to show the strongest year-over-year growth in 2007, up by 36.6 percent ($1.4 billion) from the 2006 level. Indeed, even though the fiscal year still has several months to go, revenues from the GCT and the BCT have already exceeded previous highs.[1] One reason is the very large profits earned by Wall Street firms in calendar year 2006—$21 billion, just below the 2001 all-time high— particularly in the fourth quarter of 2006, when proprietary trading and investment earnings helped boost quarterly profits over $7 billion. Additionally, the high profitably of corporations nationally contributed to year-over-year growth in GCT revenue of 35 percent in 2007.

For 2008, IBO expects business income tax revenues to decline by 4.5 percent, although the GCT is forecast to show essentially no change from this year to next. A projected decline in Wall Street profits for calendar year 2007 to $16.2 billion, along with a fall-off in growth and profits in the broader U.S. economy, account for most of the decline in projected business income tax revenues in 2008. Little change in revenue from these tax sources is expected after 2008.

The other tax source with double digit growth this year is the real property transfer tax (RPTT), which is now expected to total $1.6 billion in 2007, up 27.3 percent from 2006. Although the city's residential market has not yet shown the price declines and inventory build up underway in some other major markets, this year's growth in the RPTT is largely due to a relatively small number of high-priced transactions, including such deals as the sale of Stuyvesant Town/Peter Cooper Village ($5.4 billion), 1261 Sixth Avenue ($1.5 billion), and the New York buildings acquired by The Blackstone Group last fall. Through the first half of fiscal year 2007, the handful of transactions with sales prices greater than $100 million accounted for less than 0.2 percent of the commercial transactions, but over 42 percent of the total collections. With residential transactions largely flat and smaller commercial transactions declining in number, it is the very large deals that account for much of this year's growth in RPTT revenue.

The mortgage recording tax (MRT), which is also triggered by real estate sales, had been growing in tandem with the RPTT. But the pattern has been broken this year, with MRT revenues expected to show growth of 8.9 percent—less than a third of the corresponding growth in the RPTT—as higher interest rates have cooled the market for mortgage refinancing and growing concern over problems in the sub-prime mortgage market has led to greater scrutiny by the banks—and hence less mortgage activity.

The outlook for the MRT and the RPTT for 2008 is for declines of 18.4 percent and 17.3 percent, respectively. The decline in revenue reflects expectations that the number of transactions will decline sharply, with a more modest decline in the growth rate of property values. Modest annual combined growth of about 4.5 percent is expected in 2009 through 2011.

The tax revenue source with the strongest expected growth after 2007 is the property tax, with annual growth averaging 8.0 percent. The tentative assessment roll that will be used for 2008 tax bills showed unusually strong increases in valuations, particularly for apartment buildings and commercial properties. Some of these increases were due to an administrative change by the Department of Finance and may prove temporary once property owners file a required form. IBO expects that these adjustments will be smaller than we had previously anticipated with revenue now projected to total $14.2 billion in 2008. Driven by expectations of continued growth in the value of New York City property, as well as a pipeline of previous assessment increases still being phased-in, property tax revenue is expected to continue growing through 2011 and reach $17.7 billion.

The other two major city tax sources, the PIT and the general sales tax, are expected to see somewhat less dramatic changes in revenue. IBO expects the PIT to show an increase of 5.4 percent over 2006 levels to reach $7.7 billion this year. With capital gains realizations expected to be lower and employment growth slowing, PIT revenue is projected to show a small decline in 2008 before resuming growth averaging about 4.5 percent annually in 2009 through 2011. IBO anticipates the sales tax to bring in $4.5 billion in 2007 and $4.7 billion in 2008, with growth over the entire forecast period averaging 3.8 percent annually.

Is This Year Different? A reader may have a sense of deja vu when considering this forecast. One year ago IBO projected a very similar pattern of revenue growth. After noting a very large increase in current year revenue (8.9 percent) we were forecasting a 2.4 percent slowdown of tax revenue for the forthcoming year, followed by modest growth averaging 4.4 percent annually for the balance of the Financial Plan period. In fact, 2006 finished even stronger than IBO anticipated with growth of 10.2 percent, and far from declining in 2007, tax revenues are now expected to grow by 9.8 percent this year.

While it is possible that another tax revenue "surprise" could occur in 2008, there are several reasons why it is unlikely. First, the outlook for 2008 looks weak compared to the double-digit gains (adjusted for tax policy changes) in each of the last four years, but a continuation of such growth for a fifth year would be unprecedented for the period since 1980. IBO's tax revenue forecast for 2008 is still 50 percent higher, (measured using common rate and base) than the previous peak set in 2001. Second, the gains of 2007 depended in part on a number of factors that are not likely to be repeated on a regular basis. These include the unprecedented spike in Wall Street profits late in calendar year 2006 and a handful of very large property transactions.

Third, the economic forecast, particularly for 2007 and 2008, is for slower growth for both the U.S. and the local economies, and is generally more pessimistic than the economic forecasts IBO used last spring. Recent reports of much lower growth in gross domestic product (GDP, 1.3 percent in the first quarter of calendar year 2007), weak employment growth in April (88,000 new jobs for the U.S.) and slumping retail sales in April, confirm that growth has already slowed.

Finally, the downside risks relative to upside potential seem greater this year than last. The housing adjustment that has largely run its course elsewhere in the country may now be reaching the New York market. If not for strong high-end commercial property sales—which includes apartment buildings—RPTT collections would have grown much less in 2007. Price adjustments in either the residential or commercial sectors larger than IBO is anticipating would result in even larger declines in transfer tax revenues for 2008. For the national economy, the potential fallout from the problems with the sub-prime market and the build-up of unsold properties may reduce U.S. GDP growth to an even slower pace than currently forecast by IBO.

EXPENDITURES

IBO projects that city spending (from all city, state, and federal sources) will grow at a faster pace than revenues (from all sources) under the Mayor's plan through 2011. IBO estimates that spending will be $59.5 billion in 2008, not including expenditures prepaid with the 2007 surplus, and grow by nearly $10 billion to $69.4 billion in 2011.

The Executive Budget proposes spending reductions across a wide range of agencies. Most of the savings were achieved through recognition that agencies did not need some budgeted funds for reasons such as attrition leading to lower average salaries, substitutions of federal or state aid for city funds; and reduced demand or caseloads. On balance, however, new agency spending needs and initiatives more than offset the savings program beginning in 2008, resulting in a net increase of $242 million in 2008 and similar amounts in future years.

Spending Reductions. The Mayor proposed spending reductions totaling $224 million in city funds in 2007, rising to $410 million next year. Major items in the Program to Eliminate the Gap (PEG) include the elimination of Department of Education regional offices and other efficiencies, saving $75 million beginning in 2008. In the police department, higher-than-expected attrition and difficulty in filling recruit classes is expected to save $55 million this year and $99 million next year. Lower overtime and salary needs for firefighters and sanitation workers will save $46 million this year and $26 million in 2008. There are also unspecified procurement efficiencies that are expected to save $54 million beginning in 2008.

In addition, the Mayor proposes $11 million in annual funding cuts for the libraries beginning 2008 and $6 million in annual cuts for cultural programs. Library funding had increased in the year 2007 budget and the City Council has proposed additional funding to extend six-day service to all libraries. The Mayor proposed an increase in cultural affairs spending in the 2008 Preliminary Budget. In both cases the reductions are a relatively small share of the prior increases.

A number of agency initiatives to raise revenues complement these spending reductions. Several agencies have implemented fee increases, or intend to collect more in fine revenues for various types of code violations. Parking fines, on the other hand, are projected to fall by $15 million annually. Altogether, increases in fees, license, franchise, and concession revenues, fines, and other actions are expected to raise an additional $33 million in 2007 and $63 million in 2008.

In addition to the PEG program, there are other sources of city-fund savings. For example, lower-than-expected caseloads in the Department of Health and Mental Hygiene's early intervention programs will save $40 million this year and $55 million in 2008.[2] And because the overhaul of the city's emergency communication network is not yet complete, the $31 million budget for the system's maintenance will not be needed this year.

plaNYC Initiatives
City funds, in millions

	2008	2009	2010	2011
SMART Fund	$50.0	$220.0	$270.0	$282.0
Tax Credits	3.0	4.0	5.2	6.3
Agency Spending	145.7	117.0	111.8	122.9
TOTAL	**$198.8**	**$340.9**	**$387.1**	**$411.2**

SOURCES: IBO; Mayor's Office of Management and Budget.
NOTE: SMART Fund includes IBO repricing.

Spending Increases. The Executive Budget proposes a total of $715 million in new city-funded spending in 2008, declining to $583 million in 2009, $578 million in 2010, and $582 million in 2011. The largest components of the increases are new spending in the Department of Education, additional support for the public hospitals, and agency spending on the Mayor's long-term sustainability initiatives, variously known as plaNYC or NYC 2030.

plaNYC. Proposed spending for plaNYC includes an annual contribution to the regional SMART fund and tax credits for certain types of energy-reducing investment (discussed above), as well as agency spending for parks and open spaces, brownfields remediation, and transportation and traffic mitigation. The largest single investment will be city spending of approximately $80 million annually to improve the energy efficiency of city buildings, in the expectation of achieving a 30 percent reduction in energy consumption within 10 years. The Executive Budget does not include funding to implement a congestion pricing system.

Agency Spending Reductions and New Spending in the Executive Budget Financial Plan
City funds, in millions

	2007	2008	2009	2010	2011
Agency Savings *(PEGs)*					
Spending Reductions	($224)	($410)	($297)	($252)	($251)
Revenue Initiatives	(33)	(63)	(49)	(52)	(51)
	($257)	**($473)**	**($346)**	**($304)**	**($302)**
New Agency Spending *(New Needs and PEG Restorations)*					
Dept. of Education	$41	$222	$227	$227	$228
plaNYC	0	146	117	112	123
All Other	29	343	235	235	216
	$70	**$715**	**$583**	**$578**	**$582**
Net Increase/(Decrease)	**($187)**	**$242**	**$237**	**$274**	**$280**

SOURCES: IBO; Mayor's Office of Management and Budget.
NOTE: New agency spending excludes other types of adjustments.

Education. IBO projects that the total budget for the Department of Education (including the labor reserve) in 2008 will be $16.9 billion, $1.0 billion higher than the current projection for 2007, a 6.4 percent increase. City funds will account for $7.1 billion of total 2008 spending. Although the final resolution of the Campaign for Fiscal Equity litigation will bring additional state and city funding to the schools, much of the increase from 2007 to 2008 is baseline growth, driven by collective bargaining and rising costs for items such as transportation, fringe benefits, and payments to nonpublic schools, including special education contract schools. Spending will continue to grow from 2008 through 2011 at an average rate of 6.1 percent annually, reaching $20.1 billion ($8.4 billion in city funds).

The Executive Budget includes both increases and decreases to the current 2008 spending plans, resulting in a net increase of $198 million since the Preliminary Budget. There are $75 million in so-called "efficiency savings" that are counted as the education department's contribution to the citywide PEG. The savings include $25 million from eliminating what had been a middle administrative tier between headquarters at Tweed Courthouse and the individual schools. Other efficiency savings are expected to come in the food and transportation areas as well as a reduction in spending for certain nonpublic school special education placements. The efficiency savings are exactly offset by $75 million in new spending to increase instructional services in schools.

Another $291 million in new 2008 spending ($163 million city funded) is also included, mostly attributable to higher costs and/or caseloads for various mandated programs such as special education related services ($46 million), special education pre-kindergarten ($28 million), tuition for foster care students attending schools outside the city ($26 million), and the state-funded expansion of universal pre-kindergarten ($62 million). The new spending also includes adjustments for higher costs in school food, and school safety. There is also new spending to reflect higher operating costs and additional services for pupil transportation ($47 million).

The Executive Budget recognizes changes in expected state aid resulting from the new state budget. General operating support for schools, now known as "Foundation Aid," is expected to be $132 million lower for 2008 than the Mayor had expected in his Preliminary Budget in January. This was offset by increases in other types of state education aid—including the new universal pre-kindergarten funds—so that total state aid for 2008 is $62 million higher than had been anticipated in January. Overall, state aid is now expected to be $693 million higher in 2008 than in 2007.

IBO estimates that an additional $55 million in city funds will be needed in 2008 to help cover the recent teachers' contract because the Bloomberg Administration over-estimated the availability of categorical funds for this purpose. The amount of city funds needed grows to over $100 million in 2009 and beyond.

Health and Hospitals Corporation. The Executive Budget provides new recurring resources for the Health and Hospitals Corporation (HHC), leveraging city dollars to draw down additional federal Medicaid reimbursements for HHC. The additional reimbursements are authorized under federal rules that allow states to make extra payments to hospitals serving a disproportionate share of low income/high needs patients. Under current rules, these payments are matched with federal Medicaid dollars.[3] The budget plan assumes that the city will make $381 million in these types of payments for HHC, each year from 2008 through 2011.[4] Because the federal government will match these payments with Medicaid funds, HHC will receive a total of $762 million in additional resources each year. These transactions baseline a similar arrangement that was part of the 2007 budget.

These additional resources, combined with a substantial current cash reserve of over $1 billion, will stabilize HHC's long-term financial condition and avoid the need for substantial cuts that had previously been projected. With the improved fiscal outlook for HHC, the city is cutting back some of its other forms of support for HHC. The corporation will once again take on responsibility for its annual debt service costs, which have been covered by the city in recent years. HHC will make debt service payments of $154 million in 2008 and $123 million annually in 2009 through 2011. Beginning in 2009, the city will also reduce its direct HHC subsidy. The reduction will be $42 million in 2009, $44 million in 2010, and $54 million in 2011; in the past the subsidy has been the city's chief means of providing fiscal assistance to the corporation. Taking these two changes into account, plus the shift of some labor costs to HHC, and a technical adjustment due to a change in the timing of payments to the state, the city's net increase in its spending for HHC is $189 million in 2007, $156 million 2008, $120 million in 2009, and over $200 million annually in 2010 and 2011.

Changes in the Labor Reserve Since the June 2006 Financial Plan

All funds, in millions

	2007	2008	2009	2010	2011
Balance as of 2007 Adopted Budget	**$535.0**	**$939.7**	**$1,280.5**	**$1,642.9**	**$1,642.9**
Disbursements for Settlements	(538.0)	(853.0)	(1240.9)	(1332.9)	(1368.2)
Additions for Unsettled Contracts	315.2	628.3	992.3	1,231.9	1,640.1
Balance as of 2008 Executive Budget	**$312.3**	**$715.0**	**$1,031.8**	**$1,542.0**	**$1,914.8**

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

Labor Costs. The Mayor's Financial Plan assumes that the recent settlement with the United Firefighters Association, representing 9,100 rank-and-file uniformed fire department employees, will be extended to other uniformed bargaining units, including fire officers, correction officers, and sanitation workers. The firefighters won two annual raises of 4 percent. Since this exceeds the amounts that the city had been assuming for settlements, funds were added to the labor reserve to make up the difference: $19 million this year, $59 million in 2008, rising to $187 million by 2011. The additions to the labor reserve for future non-uniformed settlements maintain the assumption of annual increases at the 1.25 percent level.

Altogether, since the 2007 budget was adopted last June, the city has added funds to the labor reserve at each Financial Plan update to cover wage and benefit settlements in excess of the original assumption of increases of about 1.25 percent annually—a total of $315 million for 2007, rising to $628 million for 2008 and to $1.6 billion by 2011.

While a number of unions that had been without contracts have recently settled—notably the school principals union and members of Teamsters Local 237, in addition to the firefighters—several important contracts remain unsettled, most notably the Patrolmen's Benevolent Association (PBA), representing the city's 23,000 police officers. The PBA and the city will go to arbitration for the second time, this time to reach a settlement that will extend for two years from the termination of their previous contract (July 30, 2004). Thus, even once the PBA contract is settled, another negotiation must begin again.

Pensions and Fringe Benefits. Pension costs are once again projected to increase in the Mayor's April Financial Plan as a result of reestimates by the city Actuary. These increases come on top of $200 million per year added in the January Financial Plan to address changes recommended by an outside review of actuarial assumptions and methods. The new increases include reestimates of retirement costs for police and fire personnel and of survivor benefits, and various technical changes. Together, these changes have added over $400 million a year to pension costs since last June's estimate, beginning in 2009. Additional increases in the out-years of the plan largely are due to transfers from the city's labor reserve in recognition of contract settlements.

In contrast, fringe benefit costs were revised downward in the April Financial Plan, largely due to reestimates of the costs of retiree health benefits (unrelated to funding of the Retiree Health Benefit Trust Fund), and of health and other fringe benefits for current city employees.

Other Agency Needs and Initiatives. Offsetting some of the savings expected from lower-than-anticipated police staffing levels, the Bloomberg Administration is proposing to increase police department spending by $38 million in 2008 (declining by about $4 million annually thereafter.) The additional funds would be used for technology upgrades, higher vehicle maintenance costs, more traffic enforcement agents and various other needs. Another $40 million per year is proposed for the Administration for Children's Services for increased contract foster care caseload. Operating costs of the water and sewer system are expected to require the Department of Environmental Protection to increase spending by $46 million in 2008, $43 million in 2009, and $28 million and $27 million in 2010 and 2011, respectively; these costs would be covered by a proposed 11.5 percent water and sewer rate increase. The Department of Information Technology and Telecommunications proposes to increase spending by $36 million next year and about $23 million per year thereafter, principally for the enhancement of the 311 call system and for various citywide technology projects.

The Mayor's budget plan also provides spending increases of $9 million in 2008 and $11 million beginning in 2009 for adult literacy and summer youth employment programs; $5 million in 2008 and $10 million thereafter for health department-funded supportive housing programs; $6 million per year for 151 new parks maintenance and other workers; and $17 million in new funding for the District Attorneys.

Pension and Fringe Benefit Costs

Alll funds, in millions

	2007	2008	2009	2010	2011
June 2007 Plan	**$8,266**	**$9,228**	**$9,712**	**$9,836**	**n.a.**
Pension Contributions	(30)	114	530	737	
Health Insurance	(82)	(21)	(25)	(27)	
Social Security	8	56	72	83	
Supplemental Welfare Funds	72	38	37	37	
Total Changes	(32)	187	615	829	
2008 Executive Plan	**$8,234**	**$9,415**	**$10,328**	**$10,665**	**$10,983**

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

CAPITAL SPENDING AND DEBT SERVICE

Capital Program. The Executive Budget was accompanied by the final version of the city's biennial 10-year capital strategy document, which proposes $83.7 billion in capital spending over the next decade—up $6.3 billion from the

Ten-Year Capital Strategy, 2008-2017 *All funds, in millions*			
Agency	**Preliminary Plan**	**Executive Plan**	**Change**
Dept. of Education	$28,417	$28,463	$46
Environmental Protection	19,512	19,485	(27)
Department of Transportation	8,961	11,106	2,145
Housing	4,428	4,422	(5)
Sanitation	2,785	2,913	128
Parks & Recreation	1,558	2,653	1,095
Technology	1,789	2,292	503
Police	824	1,901	1,077
Public Buildings & Real Estate	1,209	1,340	130
Economic Development	1,113	1,220	108
Courts	1,116	1,220	103
Hospitals	694	973	279
Cultural Affairs	396	535	140
Borough President Allocation	0	387	387
All Other	4,480	4,754	275
TOTAL	**$77,282**	**$83,665**	**$6,383**

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

draft plan released in January.

In strictly dollar terms, the largest increases come in the capital programs of the Department of Transportation (DOT), the parks department, and the police department. The latter increase is largely for construction of a new consolidated police academy and training facility in Queens. The increase in the parks department capital plan is for plaNYC initiatives such as planting street trees, completing eight large destination parks, and opening school playgrounds to public use.

Over half ($1.2 billion) of the DOT increase is for reconstruction of bridges rated in "fair" condition, including $309 million attributed to plaNYC initiatives. Another $365 million is to expand street and highway reconstruction and repaving, which includes $131 million for the Mayor's Town Square Initiative to create public spaces in key neighborhoods. Another $123 million in DOT plaNYC projects is to develop and implement congestion mitigation plans in growth areas; $52 million is set aside for creating and extending an integrated "intelligent" traffic management system.

Debt Service. The Mayor's budget proposes paying off $1.2 billion in city debt this year—both general obligation and Transitional Finance Authority—which would otherwise have fallen due in 2009 and 2010. This use of surplus funds from the current year will reap savings of $639 million in 2009 and $656 million in 2010—in effect transferring resources from the current year into future years.

Other sources of savings in debt service include $83 million in lower than anticipated interest payments on bonds issued for the Hudson Yards project in 2008, and lower than anticipated debt service costs due to lower interest rates and the timing of issuance.

BUDGET SURPLUS AND OUT-YEAR GAPS

Much as in prior years, the Mayor proposes to use a large portion of the current surplus to prepay some expenses for the upcoming year in order to bring the 2008 budget into balance. But this year's surplus is larger than needed to close the 2008 budget gap and the Mayor has proposed using the remainder to reduce the gaps in the following two years as well. It is unclear why the Mayor chose to apply some of the surplus to 2010 even though 2009 still has a budget shortfall under his plan. This approach could be viewed as consistent with his calls for fiscal prudence and a way to begin to reduce the 2010 shortfall or it could be seen as a way to show a somewhat larger 2009 gap.

In presenting the 2008 Executive Budget the Mayor stressed that despite the city's current fiscal strength out-year gaps remain. The boon in tax revenues that has benefited the city this year, as well as the past few years, has effectively masked the underlying mismatch between recurring revenues and recurring expenses. As the Mayor has said, without the benefit of another year of better-than-expected tax collections, the underlying mismatch will soon cause budget gaps to emerge.

Still, the projected budget shortfalls are not nearly as large as just a few years ago. These gaps—estimated by IBO to be $1.7 billion in 2009, $3.0 billion in 2010, and $3.9 billion in 2011—are relatively small in terms of dollars or share of city-generated

Debt Service Savings in the Financial Plan *All funds, in millions*					
	2007	**2008**	**2009**	**2010**	**2011**
Early Retirement					
TFA	$543	($25)	($294)	($270)	$0
G.O.	703	(39)	(345)	(386)	0
Total, Early Retirement	$1,246	($64)	($639)	($656)	$0
All Other Changes, Net	(143)	(63)	(51)	(22)	13
TOTAL	**$1,103**	**($127)**	**($690)**	**($678)**	**$13**

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

NOTE: Transitional Finance Authority savings are reflected in the city retaining additional personal income tax revenue.

taxes and other revenues compared to just a few years ago.

The gaps would be even smaller if not for the Mayor's tax reduction proposals. The foregone revenue from the tax cuts is equivalent to about two-thirds of the projected shortfall for 2009. When he introduced most of the tax reduction plans last January, the Mayor said the largest portion, the property tax rate reduction, should only be continued after 2008 if the city can afford it. Despite his warnings of shortfalls in the out-years, the Mayor has assumed the property tax reduction will continue and included it throughout the Financial Plan at a cost in lost revenue of $767 million in 2008 growing to $957 million in 2011 according to IBO's estimates. If there were no tax cuts and if $350 million of the current surplus were not pushed into 2010, there would be virtually no projected budget gap in 2009.

ENDNOTES

[1] For the business income taxes the collections year for fiscal year accounting purposes runs from September through August. Our forecast for fiscal year 2007 revenues is based on only seven months of actual receipts (September 2006-March 2007); after only seven months, collections are already larger than for any previous full fiscal year.

[2] Another $1.3 million for 2007 and $3.7 million for 2008 in savings from early intervention caseloads were applied toward the department's PEG target.

[3] The Bush Administration has adopted a regulation that would significantly restrict states' ability to use one of these types of payments known as upper payment limit (UPL) reimbursements. Congress is considering legislation that would block implementation of the regulation for at least one year. The provision was included in the supplemental war funding bill that was passed and then vetoed by the President earlier this month.

[4] Technically the payments will between the state and HHC with the state submitting a bill to the federal government for reimbursement. The city contribution will be handled by adjusting the city's payments to the state as the state bills the city for its local share of Medicaid. The state has previously used such payments to HHC to yield federal Medicaid reimbursements with much of the new money being redirected to other state needs through an inter-governmental transfer from HHC back to the state. In this case, the state is not expected to draw off any of the newly generated federal reimbursement flowing to HHC.