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Fewer Funds, Shifting Priorities: The City's Capital Construction and Financing Program

SUMMARY

City spending on capital projects is a large but relatively unexamined portion of the city budget. The city's continued budgetary shortfall has led the Mayor to reduce capital spending. The four-year Capital Commitment Plan released last January totals \$24.8 billion, \$4.7 billion less than the plan presented four months earlier.

Along with this drop in the plan for capital spending over the next four years has come a shift in some priorities compared to recent years. Among these changes:

- Spending on school construction, while still one of the largest portions of the capital program, would drop to \$2.9 billion over the next four years as compared to the \$6.4 billion committed from 1999 to 2002.
- Projects to maintain and improve the city's water and sewer system would total \$7.5 billion under the January commitment plan—30 percent of all spending. Spending on these types of projects would rise by \$2.5 billion over commitments in the prior four years—a bigger increase in dollar terms than in any other area.
- Transportation capital commitments would total \$4.9 billion—20 percent of the January plan—and \$1.9 billion more than actual commitments over the previous four years.
- Spending on projects related to public safety would rise to \$2.3 billion, doubling the level of commitments over the past four years. This is largely driven by spending on court construction.

The city also released a draft 10-year capital strategy in January. This plan also reflects shrinking city resources and would total \$40.3 billion—significantly less than the \$45.8 billion spent over the past 10 years. In the draft strategy the priorities generally remain the same as over the past decade, with education, environmental protection, and transportation consuming roughly two-thirds of the program.

Despite the plans to scale back spending, debt service to pay for these capital needs would consume an increasing share of the city's budget. Debt service totaled \$3.8 billion in 2002 and is projected to rise to \$5.5 billion, or just over 19 percent of city tax revenue by 2008.

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

While the Capital Budget is often the step-child to the Expense Budget, it funds a wide array of crucial public service needs. Much of the infrastructure for delivering basic city services is funded through the Capital Budget, from building new schools, to repaving roads, replacing garbage trucks, and maintaining the city's parks. Moreover, each year, repaying the bonds issued to finance capital spending consumes a significant portion of city taxpayer dollars.

The city's capital needs are always immense and varied. The city continually faces the challenge of balancing the need for new capacity (such as new schools or new court buildings) against the need to maintain the existing capital stock (rebuilding bridges, sewer pipes, and public buildings) and to replace aging equipment such as garbage trucks and fire engines. These competing needs must be accommodated within the overall limit of what is affordable.

COMMITMENTS SCALED BACK

The city's continued budgetary shortfall has led the Mayor to scale back capital spending. The four-year Capital Commitment Plan released in January totals \$24.8 billion—\$4.7 billion, or 16 percent, less than the plan presented four months earlier. On a general city debt funds basis (excluding federal and state grants and environmental protection projects¹), the reduction was almost 24 percent, from \$20.3 billion to \$15.5 billion. Including the environmental protection projects, the January plan reduces capital commitments for 2003-2006 by 16 percent overall—17 percent on a city funds basis—compared to the plan

issued last September.

A More Sustainable Level of Commitments While these reductions seem very large, they bring the city's capital program more into line with its level during most of the 1990s. During the last two fiscal years (2001 and 2002), general city debt-funded capital commitments surged to \$4.5 billion a year (excluding water projects), compared to an average annual level of \$3.2 billion between 1996 and 2000, in inflation-adjusted terms—a 40 percent increase. Projected annual capital commitments under the current plan would come back down to roughly their earlier level.

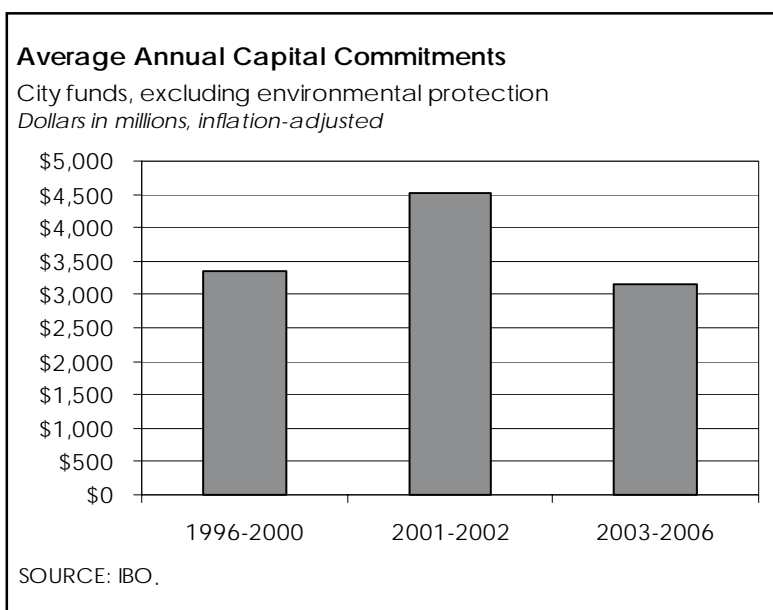
CHANGING PRIORITIES

Along with lower overall spending, the new plan also reveals changing priorities. As in the past, three areas dominate the capital plan in terms of total dollars: environmental protection, transportation, and education. Together they account for over 60 percent of projected capital commitments.

But compared to actual capital commitments in the previous four-year period (1999 through 2002), the 2003-2006 plan marks some significant shifts in priorities. The share of the capital program dedicated to school construction and renovation, which was the dominant priority in recent years, would fall dramatically—so much so, in fact, that almost every other area of the capital program would grow relative to its level in the previous four years. Water and sewer projects would comprise 30 percent of the capital program and transportation nearly 19 percent, while education would fall to 12 percent of projected commitments over the next four years.

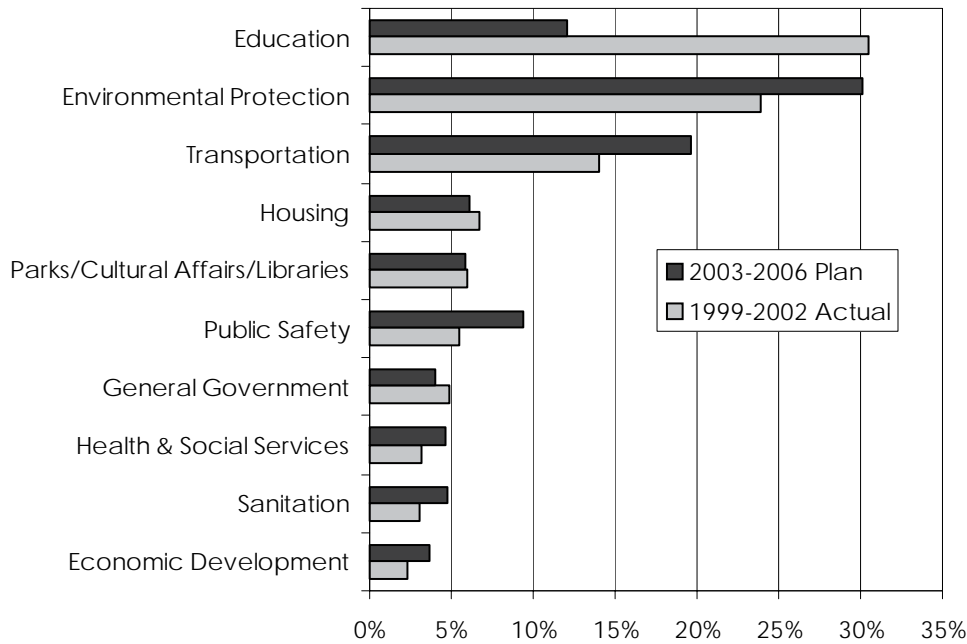
In dollar terms, transportation and water quality and supply projects also would see the largest growth in the January plan. Public safety and sanitation projects also would have a relatively large increase in dollar commitments. Conversely, education would have the largest decrease in capital commitments compared to actual spending over the previous four years.

The Education Capital Plan. The Department of Education's capital plan has been scaled back several times in the last 18 months, and is now planned at \$2.9 billion through 2006. This would constitute a very sharp 53 percent reduction from the \$6.4 billion committed between 1999 and 2002. In particular, several expansion projects—new school construction as well as leases and additions to existing facilities—have been cut from the current plan. The Mayor and the Chancellor have



Four-Year Actual and Planned Capital Commitments

Percent of total commitments



SOURCE: IBO.

proposed several reforms to reduce the city's school construction costs by about 25 percent (from \$438 to \$325 per square foot).

The Environmental Protection Plan. Funded by bonds issued by the Municipal Water Finance Authority and backed by user charges, at \$7.5 billion the environmental protection program comprises 30 percent of the four-year capital plan. In dollar terms, environmental protection shows the largest growth compared to the previous four years' actual commitments. The program is driven by a combination of federal mandates for water quality and wastewater discharge, and by the need to address the city's aging water tunnels and aqueducts, which stretch 125 miles upstate and are now over a century old.

The Transportation Plan. Transportation capital commitments—including \$749 million for the MTA— would total \$4.9 billion—20 percent of the total four-year capital plan and \$1.9 billion more than actual commitments over the previous four years. The Department of Transportation's capital program of \$4.1 billion is roughly 25 percent funded by federal and state grants. Spending on roads and bridge repairs dominate the transportation capital program. Beyond these reductions, the city has also proposed reducing its contribution to the Metropolitan Transportation Authority's capital program by about 30 percent annually, from \$105 million to \$74 million.

The Housing Plan. The fourth largest component of the capital program in recent years has been housing, which accounted for

\$1.4 billion in capital commitments between 1999 and 2002, or almost 7 percent of the total. Planned commitments for 2003 through 2006 are rising slightly to \$1.5 billion. The housing capital program continues to be dominated by the rehabilitation and disposition of the stock of city-owned *in rem* housing seized for tax arrears during the 1970s and 1980s. After 2006, however, these costs decline significantly, and the Mayor has proposed holding housing capital commitments roughly constant and shifting funds used for *in rem* disposition to new housing construction and rehabilitation.

The Public Safety Plan. In the current four-year plan the general category of public safety would rise

significantly in importance, doubling the level of commitments from the previous four years to \$2.3 billion. This is driven largely by the \$1.2 billion in capital spending on courts. Although the courts are a state institution, the city is responsible for the capital program. The Brooklyn courthouse complex at 330 Jay Street is the largest single project, at \$628 million, and is slated for completion in 2004.

The Sanitation Plan. Sanitation capital spending also would grow substantially, rising from \$964 million to \$1.2 billion—a 21 percent increase. This increase reflects the higher estimated costs of marine transfer station retrofits to implement the city's proposed long-term waste disposal plan.

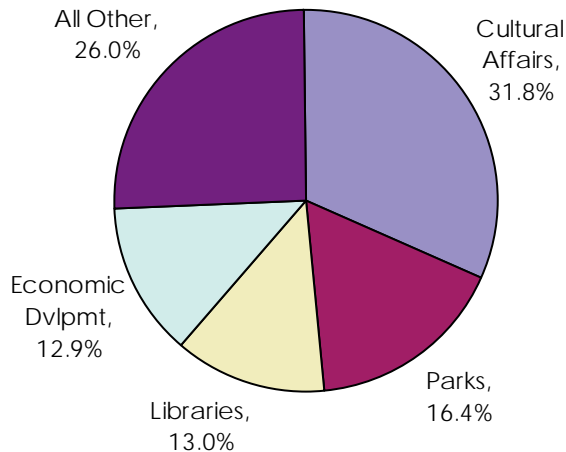
COUNCIL AND BOROUGH PRESIDENT PRIORITIES

The City Charter provides local Community Boards and the Borough Presidents with the opportunity to express their priorities during the preparation of the Capital Budget. To help meet these local needs, the Borough Presidents each year share an allocation of capital funds equal to 5 percent of what are determined to be discretionary capital appropriations. The allocation to each borough is based on a formula equally weighting land area and population. In addition, the City Council adds projects to the Executive Capital Budget that reflect local needs and broader Council priorities.

In the current 2003-2006 commitment plan, Borough President

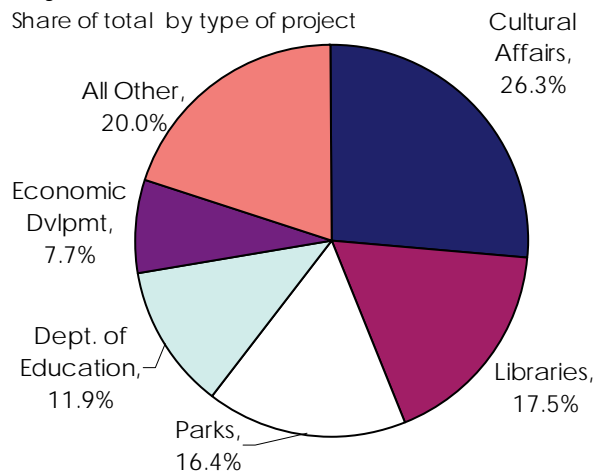
Borough President Allocations

Share of total by type of project



City Council Allocations

Share of total by type of project



SOURCE: IBO.

NOTE: Includes \$67 million in school construction projects jointly funded with Mayor.

capital projects total 1.3 percent of the total, or \$316.4 million.² The bulk of the allocations are for cultural organizations, parks, libraries, and local economic development projects. The Council's capital priorities are similar.³ Together, the Borough Presidents and the City Council provide the bulk of capital funding for several program areas in the capital budget, including 85 percent of funds for library construction and reconstruction, 56 percent of funds for cultural organizations, 48 percent of funding for community and senior colleges in the CUNY system, and 39 percent of funds for senior centers.

SETTING LONG-TERM PRIORITIES

In addition to the four-year commitment plan, the city also develops a longer term 10-year strategy that is issued every two years and that balances capital development among needs for expansion, maintenance, and replacement. As described in the draft released in January, the overall context of the city's capital program is one of a "mature" city with a stable total population and limited opportunities for new development. Much like the four-year plan, the draft 10-year strategy projects a significant reduction in capital spending.

Limited Resources and Stable Priorities. The *Draft Ten-Year Capital Strategy 2004-2013* totals \$40.3 billion, which represents a considerable reduction from the \$54.4 billion foreseen in the 2002-2011 plan. Even more strikingly, it would be a much lower level of investment than was undertaken in the last decade.

In inflation-adjusted terms, the 10-year strategy projects capital spending of \$34.6 billion, compared to \$55.2 billion from 1993 through 2002. The final version of the strategy, to be released later this month in conjunction with the Executive Budget, will

likely include roughly a doubling of the environmental protection program, but even adjusting for this increase, the inflation-adjusted total would be \$41.3 billion—25 percent less than during the preceding decade.

In the draft 10-year strategy the priorities for the next decade generally continue those of the last decade, with education, environmental protection, and transportation consuming roughly two-thirds or more of the total capital program. The share devoted

Council and Borough President Funds as Percent of Total Funding, 2003-2006

Category	Borough Presidents	City Council	Combined	Category as Percent of Total Capital Plan
Libraries	19.4%	65.4%	84.8%	0.9%
Cultural Organizations	18.4%	37.9%	56.3%	2.2%
CUNY	13.0%	34.5%	47.6%	0.4%
Senior Centers	5.5%	33.1%	38.6%	0.1%
Parks	7.7%	19.1%	26.8%	2.7%
Housing Authority	2.9%	22.9%	25.8%	0.3%
Health Facilities	1.9%	12.3%	14.2%	0.6%
City-owned Buildings	5.5%	6.6%	12.1%	0.1%
Economic Development	4.5%	6.8%	11.3%	3.6%
All Other	0.3%	0.8%	1.0%	89.0%
Total	1.3%	3.2%	4.5%	100%

SOURCES: IBO; January 2003 *Capital Commitment Plan*.

to school construction and renovations would rise compared to the 2003-2006 plan as capital spending on education is projected to rise in future years. Environmental protection, in part because it is financed by revenue bonds backed by user charges rather than by general obligation debt backed by city tax dollars, is set to expand its share of the total when the final version of the strategy is released. Since financing costs do not have to compete with other uses of Expense Budget funds, the environmental protection program is insulated from the cutbacks that affect the draft 10-year strategy as a whole.

One-third of the total will go to program expansion projects, including new school construction, housing programs, new court facilities, and water supply projects, among others. Since much of the expected expansion of the environmental protection program will likely fall into this category, the share of total capital funds going to expansion projects is likely to increase relative to the other categories when the final strategy is released.

The remaining 25 percent—\$9.9 billion—would go to "programmatic replacement." This category is dominated by \$3.6 billion in spending on projects to meet water quality mandates, including replacement of water pollution control plant components. The rest goes to numerous routine replacement needs such as new buses, garbage trucks and fire engines, water and sewer main replacements, and rebuilding of courts, precinct houses, and other facilities.

Several large projects will result in increased spending in certain areas, compared to the previous decade:

- Construction of the Croton filtration plant (\$1.0 billion) and completion of city water tunnel no. 3 (\$650 million) drive higher spending in the environmental protection capital program;
- Street reconstruction and resurfacing would cost \$2.3 billion over the decade—a 13 percent increase, in real terms, over the last decade;
- Retrofits of existing marine transfer stations and other infrastructure to implement the Mayor's proposed barge-based long-term waste disposal program (\$540 million);
- Completion of the Brooklyn courthouse project at 330 Jay Street (\$628 million) would substantially raise the level of capital spending to implement the courts capital program;

Several factors will likely shape the final strategy, including the progress of negotiations between the city and the Metropolitan Transportation Authority regarding the disposition of the city-owned East River bridges, franchise bus routes, and the city's capital contribution to the authority.

FINANCING

The capital program is heavily financed by city general obligation (G.O.) debt. Ninety-two percent of the plan—\$20.4 billion—is city-funded. With TFA about to reach its \$11.5 billion authorization, the city will increasingly turn once again to G.O. debt, which is slightly more expensive to the city.

Capital Strategy for Next Decade Emphasizes Similar Priorities to Last Decade's Spending

	Actual 1993-2002	Strategy 2004-2013	Adjusted Strategy
Education	25.6%	24.5%	20.2%
Transportation	19.7%	22.1%	18.3%
Environmental Protection	22.6%	19.8%	33.8%
Housing	7.0%	9.4%	7.7%
Public Safety	6.3%	8.7%	7.2%
Sanitation	3.2%	5.6%	4.7%
General Government	4.8%	3.3%	2.8%
Parks/Cultural Affairs/Libraries	5.2%	2.8%	2.3%
Health & Social Services	3.2%	2.2%	1.8%
Economic Development	2.6%	1.6%	1.3%
<i>Memo: Total (billions)</i>			
<i>Nominal dollars</i>	\$45.8	\$40.3	\$48.8
<i>Inflation-adjusted</i>	\$55.2	\$34.6	\$41.3

SOURCES: IBO; *Draft Ten-Year Capital Strategy 2004-2013*.

NOTE: Adjusted strategy based on a \$16.5 billion environmental protection program.

The 10-year strategy tends to understate the share of total capital spending in some areas because it does not include either the Borough Presidents' allocations or City Council additions, which together add considerably to the area of parks, cultural affairs, and libraries, and to a lesser degree to economic development, housing, and other areas, as previously discussed.

Balancing Needs. The current draft strategy places slightly more emphasis on program expansion, and slightly less on "state of good repair," than did the 2002-2011 strategy—all in the context of a considerably reduced total.

The draft 2004-2013 strategy assumes that 42 percent of the total will be used to keep city infrastructure and facilities in a state of good repair. Major projects include reconstruction of the East River and other bridges, reconstruction and rehab of school buildings, highway and street resurfacing and reconstruction, and reconstruction and renovation of other city buildings and facilities.

The reduction in the capital plan, however, means that the city now foresees issuing \$3.3 billion less in G.O. debt over the period from 2003 through 2007. Relative to the November forecast, the city anticipates debt service savings of \$480 million, in present value terms, over the four-year plan period, and almost \$2.3 billion over the life of the 10-year capital strategy.

Affordability. The amount of outstanding city debt counted towards the city's constitutional debt limit is projected to rise from \$32.7 billion in 2003 to \$41.1 billion in 2006—which is, according to IBO projections, \$3.3 billion below the city's debt limit in 2003 and \$3.8 million below the city's debt limit in 2006.

The city's \$55 billion in outstanding debt represents nearly 17 percent of personal income in the city—up from 14 percent a decade ago. This growth is almost exclusively the result of the growth in debt of the Municipal Water Finance Authority. Excluding this debt to finance the city's water supply and waste water treatment program, debt as a percentage of personal income was essentially flat over the last ten years. If the city issues debt at the same rate it has over the past 10 years the debt burden will grow.

Although debt service as a percentage of tax revenue has declined recently because of refunding and increased tax collection, it is still projected to rise to just over 19 percent of city tax revenue by 2008—even with January's scaled-back plan. After 2008, when the roughly \$500 million per year cost of servicing MAC debt ends, the debt service burden drops again to about 18 percent of city tax revenues. In order to maintain debt service at about this level in the future, the city's tax

revenues will have to grow at least at the roughly 3.2 percent average annual rate of growth of debt service over the next ten years.

CONCLUSION

The capital program is a very large but relatively unexamined portion of the city budget. During the past two fiscal years, capital spending reached \$6.4 billion annually. Even with the significant reductions in the January commitment plan, general city debt-funded spending would total \$15.5 billion over the next four years. The cost of financing capital spending is projected to consume 19 percent of city tax revenue by 2008.

But attention to the capital plan is warranted not just because of its cost—many critical policy decisions involving the provision of current services as well as the city's future growth are determined by how capital funds are spent. Balancing the city's capital needs with what it can afford involves a series of tradeoffs. Because of their importance, there should be more discussion of how these tradeoffs are resolved as well as consideration of new options for capital financing.

ENDNOTES

¹ Environmental protection projects are funded by debt issued by the Municipal Water Finance Authority and backed by revenue from charges to system users, rather than by tax revenue.

² Sixty percent of Borough President and Council funds are scheduled in the current fiscal year (2003). For 2003, Borough President funds constitute 3 percent of the total capital plan, and an estimated 12 percent of discretionary capital funding.

³ The Council and the Mayor jointly funded \$125.2 million in school construction projects. We have assigned half of that amount to the Council's capital funds.