April 2017

City's Capital Spending and Borrowing Grows

Four-Year Capital Commitment Plan

The January 2017 Capital Commitment Plan (January plan) for fiscal years 2017 through 2020, which accompanied the Mayor's preliminary budget, includes $64.0 billion for the city's capital program. Over $57 billion of the four-year capital plan, is city-financed, with the remaining $6.8 billion expected to come from federal, state, and private grants. The plan includes $20.1 billion of capital commitments for 2017, declining to $17.9 billion in 2018, with $13.4 billion and $12.7 billion planned in 2019 and 2020, respectively.[1] (All years are fiscal years unless otherwise noted.)

The January plan is $4.2 billion (7 percent) greater than the capital commitment plan adopted last June for the 2017-2020 period. The majority of the increase in planned spending occurred in four agencies: Department of Transportation increased by $917 million (a 10 percent increase), Department Environmental Protection increased by $816 million (8 percent), Department of Parks and Recreation increased by $556 million (16 percent), and the Department of Citywide Administrative Services increased by $544 million (11 percent).

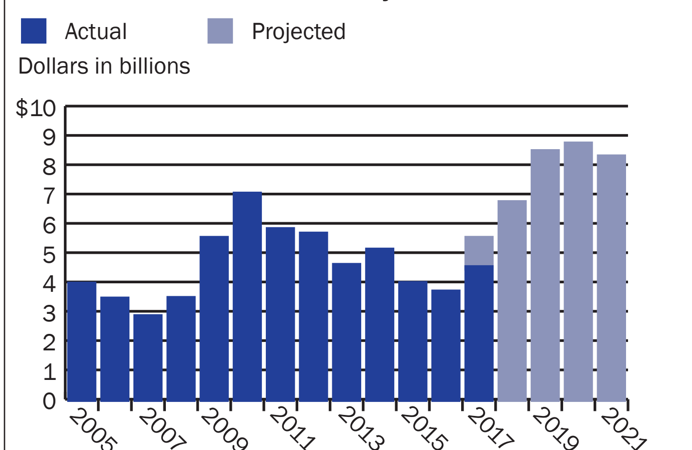
Financing the Capital Plan

Borrowing. To finance the capital commitment plan, the city will borrow money by issuing three types of debt: general obligation (GO), Transitional Finance Authority (TFA), and Municipal Water Finance Authority (often referred to as New York Water or NYW). General obligation debt is backed primarily by the city's property tax. TFA debt is backed by the city's tax on personal income. NYW debt is backed by fees and charges levied on users of the New York City water and sewer systems. The proceeds of water authority debt are pledged exclusively to capital improvements for the city's water and sewer system. All the rest of the city-funded portion of the capital program is financed by GO and TFA debt proceeds.

Annual borrowing is determined by the city's cash needs for capital projects. Cash needs are roughly correlated with city capital expenditures in a given year. Cash needs or capital expenditures have little connection to the amount of capital commitments in a given year. Capital commitments (which are dated when a contract for a capital project is registered) occur in one fiscal year but often result in actual expenditures over the course of multiple years.

City Debt Issuance Trends. The Mayor's Office of Management and Budget (OMB) projects that the city will issue $5.5 billion in new debt in 2017, a 50 percent

Bond Issues Financed From City's General Fund



SOURCE: Mayor's Office of Management and Budget
NOTES: Includes general obligation and Transitional Finance Authority new money bond issues. Excludes refunding bonds,Transitional Finance Authority Recovery Bonds, Transitional Finance Authority Building Aid Revenue Bonds, and Muncipal Water FInance Authority Bonds.
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increase over the $3.7 billion issued in 2016. New debt issuance is planned to grow in each of the subsequent years peaking in 2020 at $8.7 billion. The scheduled amount of annual debt issuance is determined by an analysis of planned commitments as well as actual commitments from previous years. The planned growth in debt issuance reflects both the historically large four year capital plan, as well as a greater reliance on GO borrowing to finance the city's education capital program as the city has largely exhausted a state-funded alternative financing mechanism.

In previous years, the city assigned state building aid revenue to the TFA, which is authorized to issue Building Aid Revenue Bonds (BARBs) to finance a portion of the city's school construction needs. Because the TFA is nearing the limit of $9.2 billion in BARBs that can be outstanding, the city will use GO bonds for some projects that would have been financed using BARBs if the limit on outstanding BARB debt had not come into play. From 2013 through 2016, the city issued an average of $775 million in BARBs annually. Over the next four years, however, the city projects it will only issue an average of $248 million a year in BARBs in order to stay under the $9.2 billion cap. The shift is effectively revenue neutral as school building aid from the state will still be used to pay the debt service on GO bonds used for school construction projects. Swapping BARBs for GO debt, however, means that a greater share of education spending qualifies as city obligations, and therefore counts against the city's debt limit.

Cost of Debt Service. Debt service—the cost of repaying principal and/or interest on outstanding bonds—is a function of the amount of outstanding debt and the terms that were obtained when the debt was issued. Debt service in the city budget reflects GO and TFA borrowing, as well as several smaller obligations. Debt service for NYW borrowing is not an item in the city budget as it is paid directly by the water authority—a self-financing public benefit corporation.

The January plan includes $6.5 billion for debt service costs adjusted for prepayments and defeasances—the use of current surplus funds to prepay future interest and principal on existing debt—in 2017. After adjusting, this is a 7.6 percent increase over the debt service the city paid in 2016. The $6.5 billion in debt service forecast for 2017 in the January plan is 1.3 percent ($85 million) less than forecast in the November 2016 Financial Plan and a total of 3.5 percent ($235 million) less than forecast in the adopted budget released last June.

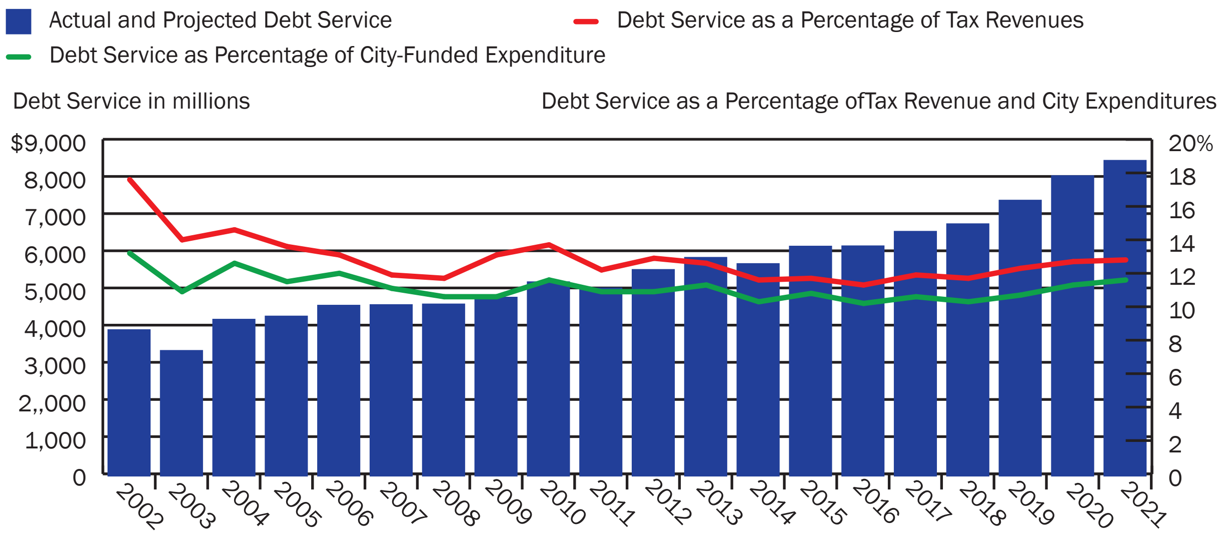
The majority of the reduction in the city's debt service costs since adoption results from the city's assumption of lower interest rates on the city's outstanding variable rate debt obligations in 2017. When the budget was adopted last June the city's interest rate assumptions were 4.25 percent for tax-exempt debt and 6.0 percent for taxable debt. In November, OMB lowered its assumption for 2017 rates to 3.31 percent for tax exempt debt and 4.63 for taxable debt, generating initial savings of $75 million. In the January plan, the interest rate assumptions were further reduced to 2.46 percent for tax-exempt debt and 3.34 percent for taxable debt, generating additional savings of $66 million for 2017. IBO estimates that the average interest rates for 2017 will be even lower than assumed by OMB (1.2 percent for tax-exempt and 2.1 percent for taxable debt), which would reduce debt service expenditures by an additional $83 million in the current year.

In addition to reducing its interest rate assumptions, since adoption the city has also revised its expectations of short-term borrowing for 2017 through 2021, eliminating the entire $75 million a year of planned expenditures for short-term debt service. The city has not issued short-term notes since 2004. The budget for short-term borrowing costs in 2017 was removed in the November financial plan but remained in the subsequent years of the plan period. Short-term borrowing costs for 2018 through 2021 were eliminated in the January financial plan.

While some debt service savings were recognized in the January financial plan for 2018 and subsequent years, OMB still projects that annual debt service costs (adjusted for prepayments) will rise over the next few years, from $6.5 billion in 2017 to nearly $8.4 billion in 2021. While variable interest rate assumptions for 2017 have been lowered, they still remain at 4.25 percent for tax-exempt debt and 6.0 percent for taxable debt in 2018 through 2021. It is likely, however, that the city will realize additional savings from reduced debt service costs in the future if interest rates remain relatively low, even in light of recent interest rate increases by the Federal Reserve. IBO estimates that interest rates will still be lower than anticipated by OMB, which will reduce 2018 debt service by about $113 million. In recent financial plans the city has taken advantage of the current low interest rate environment to refinance outstanding debt at lower rates. IBO assumes that the city will continue to refinance debt, resulting in additional savings.

Federal Factors. The current discussions regarding modifications to the federal tax code are causing

Debt Service and Debt Service as Shares of Tax Revenues and Expenditures



SOURCE: Mayor's Office of Management and Budget
NOTES: Figures for fiscal years 2017 through 2021 are projected. Debt service is adjusted for prepayments. Projections based on IBO tax revenue and expenditure forecasts.

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uncertainty in the municipal bond market as some of the potential changes would likely affect the desirability and cost of tax-exempt bonds. Tax-exempt bonds account for 83 percent of the city's outstanding debt. One of the principal appeals of investing in these bonds is that the interest earned on the investment is exempt from federal taxes. Although a proposal has not been released, the Trump Administration has promised to lower individual and corporate tax rates.

A reduction in federal tax rates would diminish the relative advantage of investing in tax-exempt bonds in comparison with taxable bonds or other similar assets by reducing investors' potential tax savings. In order to keep tax-exempt bonds desirable for investors, the city would likely have to increase the interest rates it pays to more closely align with the rates the city pays on its taxable bonds. Another possible tax changes under consideration would cap or even eliminate the issuance of tax-exempt bonds, either of which would raise the city's borrowing costs.

Debt Burden. Debt service as a percent of IBO's forecasts of tax revenue is projected to total 11.9 percent in 2017, up from 11.3 percent in 2016. Debt service as a share of city-funded expenditures is forecast to total 10.6 percent, slightly higher than 10.2 percent last year. These ratios are both projected to grow through 2021, to 12.8 percent and 11.6 percent, respectively. Given the considerable interest rate increases that underlie the city's estimates of future debt service, it is quite possible that actual debt service will be lower than projected and that future ratios will be more in line with levels seen in recent years.

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Endnote

[1]Plan figures exclude interfund agreements—funding that flows from the city's capital budget into the expense budget—and contingency amounts.