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# **Analysis of the Mayor's Preliminary Budget for 2002**

*IBO's Reestimate  
of the Mayor's  
Preliminary Budget  
for 2002 and  
Financial Plan  
through 2005*

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# Preface

For the past five years, New York City has ended its fiscal year with a substantial surplus—and the city will end the current year in much the same fashion. But with economic growth beginning to slow, the city's fiscal outlook has become uncertain. One thing is clear: the recent history of ever-increasing surpluses has ended. Without significant surpluses to transfer from one year to the next, budget gaps that swell from \$1.1 billion in 2002 to \$4.5 billion in 2005 will be increasingly difficult to close.

This analysis of the Preliminary Budget for 2002 and Financial Plan provides a follow-up to the January 2001 *Fiscal Outlook* report, which forecast city finances under the assumption that spending policies and tax laws will remain unchanged. Those projections offer a starting point for considering the Mayor's budget proposals.

In this report IBO examines a number of key budget proposals presented in the 2002 Preliminary Budget. The first section provides an overview of broad trends in spending, revenues, and budget balance. The next sections present IBO's economic and revenue forecasts and a detailed discussion of the Mayor's proposed tax cut initiatives. The expenditure sections review the budget's spending proposals, including significant changes in current programs, major capital budget initiatives, and differences between the Administration's cost estimates and IBO's.

This report, as required by section 246 of the New York City Charter, was completed under the supervision of Preston Niblack, Frank Posillico, and George Sweeting. Doug Turetsky served as project manager and edited the volume, and Michael Hartmann did the layout. A list of IBO contributors along with their respective areas of responsibility follows at the end of the report; this collaborative effort is the product of their expertise and hard work.

Ronnie Lowenstein

Director

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# Overview

This report presents the Independent Budget Office's (IBO) reestimate and analysis of the Mayor's Preliminary Budget for 2002 and Financial Plan through 2005.

IBO's analysis—which reflects its independent assessment of revenues, repricing of the Mayor's policy proposals, and reestimate of the cost of delivering existing services—indicates that the city will end the current fiscal year with a surplus of \$2.2 billion. As in the past, the surplus will be used to prepay debt service. IBO expects this year's surplus to provide \$1.9 billion to help close the projected budget gap in 2002, with the additional \$345 million used to help close the 2003 gap.

The current year will be the fifth consecutive year with a budget surplus greater than \$1 billion. Given the current slowdown in U.S. economic growth IBO projects that this year's surplus will not be repeated next year. And without a surplus to transfer from one year to the next, it will be increasingly difficult to remedy future budget shortfalls.

If the expenditure and tax policy changes proposed in the Mayor's Preliminary Budget are enacted, IBO projects that the city would face a budget gap of \$1.1 billion in 2002. Similarly, IBO forecasts gaps of \$3.3 billion in 2002, rising to \$4.5 billion in 2004 and 2005. Weaker tax collections, poor prospects for realizing planned, one-time revenue gains, the cost

## IBO's Estimates Under the Mayor's Financial Plan

*Dollars in millions*

	2001	2002	2003	2004	2005	Average Change
<b>Revenues</b>						
Taxes	\$ 22,859	\$ 22,651	\$ 23,266	\$ 24,070	\$ 24,787	2.0%
Miscellaneous Revenues	3,360	2,953	2,852	2,571	2,608	-6.1%
State/Federal Categorical Aid	12,555	12,478	12,648	12,931	13,189	1.2%
Other	1,812	1,977	1,961	1,924	1,999	2.5%
<b>Total Revenues</b>	<b>40,586</b>	<b>40,059</b>	<b>40,727</b>	<b>41,496</b>	<b>42,583</b>	<b>1.2%</b>
<b>Expenditures</b>						
City-Funded	28,031	28,681	31,407	33,047	33,908	4.9%
State/Federal Categorical Funded	12,555	12,478	12,648	12,931	13,189	1.2%
<b>Total Expenditures</b>	<b>40,586</b>	<b>41,159</b>	<b>44,055</b>	<b>45,978</b>	<b>47,097</b>	<b>3.8%</b>
<b>IBO Surplus/(Gap) Estimate</b>	<b>\$ -</b>	<b>\$ (1,100)</b>	<b>\$ (3,328)</b>	<b>\$ (4,482)</b>	<b>\$ (4,514)</b>	

SOURCE: IBO.

NOTES: IBO projects a surplus of \$2.218 billion for 2001, \$49 million below the Administration's forecast.

Expenditures are not adjusted for prepayments. If adjusted, total spending would grow at a 3.2 percent average annual rate from 2001 through 2005.

Appendix A presents a more detailed repricing of the Mayor's financial plan.

Excludes intra-city revenues and expenditures.

of already enacted tax cuts, and higher spending growth all contribute to the widening shortfalls. IBO's gap forecasts are roughly \$1 billion greater than the Administration's forecasts for 2002 and 2003, and over \$2 billion greater in 2004 and 2005.

Past IBO reports on the Preliminary Budget have underscored the near-term strengths of the Financial Plan—usually projecting substantially larger surpluses and stronger tax revenue growth than anticipated by the Administration at that point in time. Of course, each report also struck a note of caution regarding whether record-breaking economic growth could be sustained over later years of the plan.

The circumstances and findings of this year's report are very different. The question is no longer when the economy will come down from the stratosphere, but how difficult our landing will be. The economic forecast underlying our spending and revenue projections assumes the U.S. economy will grow more slowly than in the recent past but will not slip into recession. Even with this slow growth, no-recession outlook, the projected gaps are much larger than those identified by IBO in previous years, and will pose a significant challenge to the current Mayor and City Council—and their successors—as they strive to close them.

**IBO reestimates.** IBO has reestimated the revenues and expenditures that would result from adopting the Mayor's Preliminary Budget. Differing estimates of city revenues and city-funded spending affect the size of projected budget surpluses or deficits. In contrast, differing estimates of state and federal categorical aid do not, since they are matched by changes in spending funded with categorical aid. IBO's estimates can diverge from the Administration's due to differences in underlying assumptions about the economy, differences as to the unit cost of goods or services, and disagreements over the timing and implementation of new proposals.

**Revenues.** Despite a weakening U.S. economy, New

York City's economy has continued to grow. Employment, household and business spending, real estate prices, and tax revenues in the city remain resilient. So far the only significant evidence of a local impact from slower national growth is a decline in city business income tax collections. Reflecting the strength of the local economy, IBO forecasts that tax revenues for 2001 will be 3.9 percent higher than in 2000—and \$141 million more than the Administration expects.

IBO's revenue forecast for 2002 does assume that slower economic growth will lead to some erosion in other taxes, particularly those that are sensitive to the business cycle: the personal income tax, the sales tax, and the property transfer taxes. IBO's baseline tax revenue forecast, which excludes the tax cuts proposed in the Preliminary Budget, shows sluggish growth of 0.8 percent in 2002, with the property tax providing much of the positive momentum. This forecast is \$264 million higher than the Administration's. The additional tax revenues IBO projects for 2002 are more than offset, however, by the expected failure of a number of proposed actions to generate additional funds. These include the city's plan to recoup airport rental income of \$345 million in 2002, and \$250 million in proceeds from the proposed sale of the Off-Track Betting Corp. IBO assumes that the former will not occur and that the latter is unlikely to be completed in time to contribute to 2002 revenues.

Baseline revenue growth, again excluding the proposed tax reductions, is expected to rebound in 2003 and beyond, but not fast enough to keep pace with projected growth on the spending side of the budget. IBO's slightly higher reestimates of baseline tax revenues (an average of \$65 million per year above the Administration's) are cancelled out by lower estimates of miscellaneous and other revenues (an average of \$69 million below the Administration's).

The Preliminary Budget includes seven tax reduction proposals that IBO estimates would cost the city \$400 million in tax revenue in 2002. With all



provisions fully phased in, the cost would grow to \$1.2 billion in 2005, or 4.8 percent of baseline tax revenues. IBO's repricing of the proposals is not significantly different from the Administration's estimates. Each of these proposals is discussed in the revenue section of this report. In addition to describing the proposals, the discussions review the

arguments for and against each of the tax reductions. Where feasible, IBO has quantified some of the secondary tax impacts that can result when a tax cut stimulates growth in the city's economy. However, IBO, like OMB, does not explicitly incorporate estimates of possible secondary tax impacts into its forecasts.

### Details of Pricing Differences Between IBO and the Administration

Items that Affect the Gap

Dollars in millions

	2001	2002	2003	2004	2005
<b>Gaps as Estimated by the Mayor</b>	\$ -	\$ -	\$ (2,423)	\$ (2,466)	\$ (2,307)
<b>IBO Pricing Differences:</b>					
Revenues:					
Taxes:					
Property	(14)	(4)	24	52	89
Personal Income	185	186	96	17	(56)
General Sales	(27)	31	47	28	30
Business Income	(30)	(1)	(36)	(26)	(70)
Real-Estate Related	27	51	6	(46)	(89)
	<b>141</b>	<b>263</b>	<b>137</b>	<b>25</b>	<b>(96)</b>
Tax Reduction Program	-	(11)	(16)	46	(8)
STaR Reimbursement	-	(4)	34	(20)	44
Miscellaneous Revenues:					
Airport Rent	-	(345)	(200)	(135)	(65)
Sale of OTB	-	(250)	250	-	-
<b>Total Revenues</b>	<b>141</b>	<b>(347)</b>	<b>205</b>	<b>(84)</b>	<b>(125)</b>
Expenditures:					
Public Assistance	(65)	(83)	(69)	(70)	(70)
Medicaid	(114)	(111)	(117)	(121)	(207)
Education (excluding labor adjustment)	(136)	(147)	(285)	(414)	(474)
Education Reserve (shift to BOE)	43	5	21	21	21
Interim Waste Export Contracts	15	11	11	8	4
State & Federal Actions not Expected	-	(350)	(350)	(350)	(350)
Labor Costs Exceeding Reserve	-	-	(270)	(541)	(860)
Campaign Finance Board	-	(50)	-	(30)	-
Sports Facilities	90	104	95	(289)	-
Overtime	(23)	(83)	(146)	(146)	(146)
<b>Total Expenditures</b>	<b>(190)</b>	<b>(704)</b>	<b>(1,110)</b>	<b>(1,932)</b>	<b>(2,082)</b>
Reduce Debt Service Prepayment	49	(49)	-	-	-
<b>Total Pricing Differences</b>	<b>-</b>	<b>(1,100)</b>	<b>(905)</b>	<b>(2,016)</b>	<b>(2,207)</b>
<b>IBO Surplus/(Gap) Estimate</b>	<b>\$ -</b>	<b>\$ (1,100)</b>	<b>\$ (3,328)</b>	<b>\$ (4,482)</b>	<b>\$ (4,514)</b>

SOURCE: IBO.

NOTES: Negative pricing differences (in parentheses) widen the gap estimated by the Mayor.  
Positive pricing differences narrow the gap.

**Spending.** IBO's analysis indicates that the Administration has significantly underestimated expenditure growth pressures in the Financial Plan. IBO's reestimates assume, among other things, that municipal workers will not accept zero pay raises after 2002; that overtime costs will be higher; that costs for Medicaid will grow at rates comparable to those witnessed in recent years; that the city's costs for as many as 100,000 welfare recipients will double when their Temporary Assistance for Needy Families (TANF) benefits expire and they shift to the Safety Net program; that the simultaneous implementation of a number of education initiatives will require more city resources than the Administration recognizes; and that a lengthy list of proposals to increase the federal and state shares of services funded by matching grants will once again be ignored by Washington and Albany. These reestimates add over \$700 million to city-funded spending in 2002, over \$1.1 billion in 2003, and roughly \$2 billion in 2004 and 2005.

The city's long-term capital strategy was also released with the Mayor's Preliminary Budget, and IBO examines several of its elements. The Mayor's housing initiative would allocate \$384 million in new capital funds to a mix of renovation and new construction. The Mayor's budget also proposes capital spending of \$1.2 billion on libraries and cultural affairs over the next ten years, including \$240 million for the renovation of Lincoln Center. The city plans to spend \$900 million over the next decade to expand permanent jail capacity—although the inmate population has been falling as a result of the declining crime rate. IBO's analysis also finds that planned capital projects are likely to result in higher increases in water and sewer rates than users have recently faced.

Recent and proposed capital spending have major implications for the expense budget, as they drive a nearly 25 percent increase in debt service over the next five years (adjusted for prepayments). IBO projects that paying off city debt will consume almost 20 cents of each city tax dollar by 2005.

**Closing the gaps.** IBO's revenue reestimates leave no cushion to absorb the higher estimates of health, welfare, education, and labor costs over the Financial Plan. The projected 2004 and 2005 gaps are so large that even if all proposed new tax cuts were cancelled or deferred, the gaps would still run well over \$3 billion per year. City financial plans have routinely presented large out-year gaps that are eventually closed—the city must have a balanced budget for the current year—but the gaps projected by IBO are too large to simply out-grow. Especially because the nearer-term gaps are also much larger than those of previous years, there appears little likelihood (even without new tax cuts) that 2002 or 2003 will yield surpluses large enough to remedy the subsequent budget shortfalls.

**Recession scenario.** The uncertain fiscal picture sketched above and detailed in the chapters to follow assumes that city economic growth dips in calendar year 2001 and stabilizes—at rates well below the record pace of recent years—for the remainder of the Financial Plan period. The picture would turn darker were the nation and city to be hit by an actual recession—defined as two or more consecutive quarters of negative economic growth. To gain some perspective on how tax revenues would be affected in a recession, IBO reestimated our tax forecasts using an alternative economic forecast. IBO's alternative scenario assumed a relatively short and mild recession precipitated by weakness in the U.S. manufacturing sector. Under this scenario IBO's city tax revenue projections would fall by \$76 million in the current fiscal year, \$725 million in 2002, and about \$650 million to \$675 million per year over the rest of the Financial Plan. It is also likely that higher unemployment resulting from a recession would add to the public assistance and Medicaid caseloads, requiring additional city spending.

Whether or not the slowdown turns into a recession, the city faces the unenviable choice between increasing taxes in a slowing economy or reducing spending when it is needed most.

***Revenues***

**Revenues Introduction**

IBO estimates that total city revenues for 2001 will be \$40.6 billion, 7.1 percent higher than 2000. Due to slower economic growth and the cumulative effect of tax cuts—including those proposed in the Preliminary Budget—total revenue growth is expected to be much slower from 2002 through 2005, averaging only 1.2 percent per year. In 2002, assuming that all of the Administration’s tax proposals are enacted, total city revenues are actually projected to fall by \$527 million to \$40.1 billion.

This chapter begins with an overview of the economic outlook for the U.S. and New York City. Although IBO forecasts that the national and local

economies will experience much slower growth over the next six months than has occurred in recent years, a recession is not expected. The economic forecast is then used to develop IBO’s tax revenue baseline—an estimate of tax revenues assuming that currently enacted tax law remains unchanged. To consider the potential impact on revenues of an economic downturn, IBO has modeled one possible recession scenario and reestimated its tax forecasts.

The majority of the chapter focuses on a repricing and assessment of the seven tax policy changes proposed in the Preliminary Budget. The chapter concludes with IBO’s estimates for state and federal categorical aid and a forecast for other revenues.

<b>IBO Revenue Estimates Under the Mayor's Financial Plan</b>						
<i>Dollars in millions</i>						
	2001	2002	2003	2004	2005	Average Change
<b>Tax Revenues:</b>						
Property Tax	\$ 8,078	\$ 8,586	\$ 9,044	\$ 9,503	\$ 9,962	5.4%
Personal Income tax (includes TFA)	5,810	5,536	5,765	6,044	6,333	2.2%
General Sales tax	3,572	3,614	3,764	3,895	3,960	2.6%
General Corporation Tax	1,708	1,519	1,555	1,632	1,730	0.3%
Unincorporated Business Tax	790	767	798	843	872	2.5%
Banking Corporation Tax	392	378	393	396	414	1.4%
Real-Estate Related Taxes	1,121	1,167	1,225	1,264	1,310	4.0%
Other Taxes (with Audits)	1,388	1,484	1,443	1,448	1,447	1.0%
<b>Total Taxes Before Reductions</b>	<b>22,859</b>	<b>23,051</b>	<b>23,987</b>	<b>25,025</b>	<b>26,028</b>	<b>3.3%</b>
Tax Reduction Program	-	(400)	(721)	(955)	(1,241)	n/a
<b>Total Taxes After Reductions</b>	<b>22,859</b>	<b>22,651</b>	<b>23,266</b>	<b>24,070</b>	<b>24,787</b>	<b>2.0%</b>
STaR Reimbursement	504	666	765	735	821	13.0%
Miscellaneous Revenues	3,360	2,953	2,852	2,571	2,608	-6.1%
State / Federal Categorical Aid	12,555	12,478	12,648	12,931	13,189	1.2%
All Other Revenues	1,308	1,311	1,196	1,189	1,178	-2.6%
<b>IBO Total Revenue Estimate</b>	<b>\$ 40,586</b>	<b>\$ 40,059</b>	<b>\$ 40,727</b>	<b>\$ 41,496</b>	<b>\$ 42,583</b>	<b>1.2%</b>

SOURCE: IBO.  
 NOTES: Miscellaneous revenues are net of intra-city revenues. All other revenues include unrestricted government aid, anticipated aid, other categorical grants, inter-fund revenue, and disallowances.  
 A portion of the commercial rent tax reduction proposed in the Preliminary Budget has already been enacted and is therefore reflected in IBO's baseline forecast.

# Economic Outlook

- Both the U.S. and the city's economies grew strongly in calendar year 2000, though in the latter half of the year there were signs of weakness and slower growth in the national economy.
- In comparison with the last several years, IBO expects much slower growth of the national economy but not a recession in 2001—followed by modest growth with low inflation.
- The nation's economic slowdown and an expected retreat in the profits of securities firms from their record levels of the last two years will also dampen the city's economy, slowing employment growth starting in 2001 and personal income growth starting in 2002.

**Recent developments.** U.S. economic growth for calendar year 2000 exceeded most economists' expectations, extending the longest national economic expansion since World War II. (All reference to years in the Economic Outlook section denote calendar years, not fiscal years.) The national unemployment rate—4.0 percent—reached its lowest level in 30 years and real (inflation-adjusted) gross domestic product (GDP) grew at a very robust rate of 5.1 percent. But GDP and employment growth slowed considerably in the latter half of the year, as rising energy prices, a downturn in corporate profits, and a break in what had been a strong bull market on Wall Street combined to dampen both business investment and consumer demand. Inventories of

many businesses began to rise, resulting in a slowdown of manufacturing. With consumer confidence levels beginning to fall by the year's end, many retailers suffered a weak Christmas season. Finally, with short-term interest rates gradually rising throughout the year, yields on Treasury bills began to exceed those on long-term Treasury bonds, a relationship known as “an inverted yield curve” often evident when the national economy is either slowing sharply or entering a recession.

New York City's economic expansion in 2000—the eighth year in a row that city employment increased—generally matched the nation's, and there were few signs of it slowing down by the year's end. Recent revisions of the employment data indicate that a record 100,000 new jobs were added in 2000, the fourth consecutive year with job growth of 70,000 or more. The city unemployment rate fell to 5.8 percent, its lowest level since 1989. Almost all of the new jobs were in the private sector, with employment gains in a large number of service-sector industries, especially business services. This strong employment growth plus another year of record-breaking profits for the securities industry—the profits of Securities Industry Association firms soared 29 percent in 2000 to reach \$21.0 billion—generated an estimated 5.3 percent growth in personal income in the city. Despite the city's economic strength, inflation as measured by the local price index remained a modest 3.2 percent.

Though recent city job growth has been spread

across a broad range of industries, New York's economy remains heavily dependent on Wall Street. Spending by securities firms supports many of the jobs in the city's thriving business services sector. Securities firms also account for a disproportionately large share of personal income and their employees' spending generates many jobs in restaurants, retail establishments, real estate, and other sectors.

Although tourism and real estate grew strongly in 2000, both sectors showed signs of weakness late in the year. Hotel occupancy rates reached a record 84.6 percent for the year but slipped in the fourth quarter, perhaps in response to a decline in consumer confidence and a tightening of tourist budgets. Similarly, although the decline of midtown and downtown commercial real estate vacancy rates to under 4 percent led to unprecedented asking rates for Manhattan offices, rents had stopped rising by the fourth quarter.

**National economic outlook.** Though the U.S. economy was clearly weakening by the end of 2000, IBO is not forecasting a recession. Much of the economic slowdown at the end of 2000 can be attributed to the unusually cold weather of November and December, which—given the high price of heating fuel—took an especially big bite out of household budgets. The break in the boom market also slowed spending, with investors less confident about the value of their investments. Although consumer confidence levels have fallen sharply over the last five months, consumer demand in a number of areas, such as autos and housing, has been remarkably resilient. While the rate of inflation increased in 2000, it remained a relatively low 3.4 percent in spite of rising energy costs. Finally, moderate rates of inflation make it more likely that the Federal Reserve will be able to continue to ease monetary policy, boosting the economy and making recession less likely.

But even if a recession is avoided, the weakness in consumer spending, rising energy prices, declines in corporate profits, well-publicized layoffs, and the sputtering of securities markets during the last few

months all suggest that U.S. economic growth will slow significantly in 2001. IBO expects real GDP to rise by only 2.7 percent, little more than half of the 2000 growth rate, and employment growth to dip to 0.8 percent. IBO's forecast of GDP growth is roughly on par with OMB's (2.5 percent), though OMB predicts a much greater slowdown of national employment growth, to 0.1 percent. (IBO's economic forecast is contrasted with the Administration's in Appendix D.) With the economy slowing, IBO expects inflation to fall to 2.6 percent (equal to OMB's forecast) and the unemployment rate to rise to 4.3 percent (slightly below OMB's forecast). As the Federal Reserve continues to ease monetary policy, the federal funds rate (a key interest rate controlled by the Fed) will decline to 5.6 percent, and the yield curve will revert to its more usual shape. In other words, short-term interest rates will again be lower than long-term rates.

Rebounding from slow growth in 2001, IBO forecasts modest economic growth at relatively low rates of inflation for the post-2001 period. IBO expects that U.S. economic growth will pick up after 2001, though forecasts of real GDP growth—ranging from 3.1 percent to 3.7 percent annually during the 2002 through 2005 period—are somewhat less than the actual growth of the last several years. Similarly, IBO projects employment will grow by 1.2 percent to 1.5 percent each year, generally less than the eight years of employment growth after the early 1990s recession. An expected decline in energy prices by the end of 2001 plus relatively modest economic growth will reduce inflation to less than 2.5 percent a year after 2001, though slower growth will also cause the unemployment rate to gradually rise and reach 5.0 percent by the end of the forecast period.

**Local outlook.** The nation's economic weakness has not yet had much of an effect on New York City, in part because regions with a larger share of the U.S. manufacturing base have borne the brunt of the U.S. slowdown and the Northeast has fared relatively well. Still, the slowdown will dampen local economic growth in the near future. A decline in corporate earnings will take its toll on Wall Street,

and IBO expects the securities industry's profits to sharply decline from their record levels in 1999 and 2000—to about \$10.0 billion in 2001 and 2002, and an average of \$12.5 billion from 2003 to 2005.

IBO projects slower economic growth in New York City starting in 2001. The rate of local job creation is expected to decline steadily over the forecast period, to 1.1 percent in 2001 (41,000 jobs) and 1.0 percent or less from 2002 through 2005 (an average of 34,000 jobs annually). IBO's employment forecast is nearly equal to OMB's for 2001, though somewhat lower in subsequent years. Declines in personal income growth are also expected, though income in 2001 will be boosted by the very high levels of bonuses paid by securities firms at the beginning of the year as a reward for record profits in 2000. As a result, IBO forecasts personal income growth of 5.1 percent in 2001—just slightly below our forecast for 2000—declining to an average of 4.4 percent in the remaining years of the forecast period. IBO's personal income forecast for 2001 is significantly greater than OMB's, then drops slightly lower than the Administration's for the remainder of the period.

With the cooling off of the local economy, both IBO and OMB expect inflation to moderate further after 2001, though the Administration expects prices to rise more rapidly than does IBO for all but one year

of the forecast period. In the city's housing market there already is evidence of a break from the high prices of the past year, and IBO expects a similar slowdown in markets for commercial real estate. IBO projects that Manhattan office rents will decline slightly and then level off; in contrast, OMB expects office rents to rise steadily.

**Threat of a recession.** The next section of this chapter presents IBO's baseline revenue forecast, premised on the slow-growth, no recession economic outlook presented above.

In spite of factors suggesting that the economy will avoid a recession in the near term, a recession could occur if eroding confidence and the impact of losses in the stock market lead consumers to curb spending. (A recession is formally defined as a period in which the nation's economic output declines for two or more quarters in a row.) Lower spending levels in turn discourages output and employment. A continued decline on Wall Street would also increase the likelihood of a recession by making it more difficult for businesses to finance expansion. Following the presentation of the baseline revenue forecast, IBO summarizes how a recession centered in the first three quarters of 2001 would affect tax revenues.





# Baseline Revenue Forecast

- Continued local economic growth, despite weakness in the national economy, will produce a 3.9 percent increase in baseline tax revenues in the current year, as tax collections will total \$22.9 billion in 2001.
- Due to the slowdown of the national and city economies, baseline tax revenues for New York will only increase slightly in 2002, to \$23.1 billion.
- From 2003 to 2005, tax revenues will increase 4.1 percent annually to total \$26.0 billion by 2005.
- For all but the final year of the Financial Plan, IBO's baseline tax forecast is greater than the Administration's, with the biggest difference in the two forecasts (\$264 million) occurring in 2002.

**Background.** IBO's tax revenue projections for the city budget include a forecast of baseline tax revenues plus a re-pricing of the proposals contained in the tax reduction program of the Preliminary Budget. The baseline forecast is a projection of tax revenues given the economic outlook. For the baseline forecasts IBO assumes that currently enacted tax law—including scheduled changes and expirations—remain in effect.

This section examines IBO's baseline forecasts of the largest streams of city tax revenue—the real property tax, property-related taxes, the personal income tax, the business income tax, and the general sales

taxes—which together account for 94 percent of all tax collections. Subsequent sections provide a brief examination of what baseline tax revenues would be in the event of a recession, and then a re-pricing and evaluation of the Mayor's set of proposed tax reductions.

With local economic growth continuing in spite of weaknesses in the nation's economy, city tax collections are projected to increase in the current year, albeit at a moderate 3.9 percent rate. IBO projects baseline tax revenues to total \$22.9 billion in 2001, including tax collections dedicated to the Transitional Finance Authority. With slower economic growth anticipated in the coming months, the forecast for total revenues for 2002 is \$23.1 billion, only 0.8 percent higher than the previous year. With the resumption of economic growth, total city revenues are expected to grow at an average of annual rate of 4.1 percent from 2002 to 2005 and reach \$26.0 billion by the end of the forecast period.

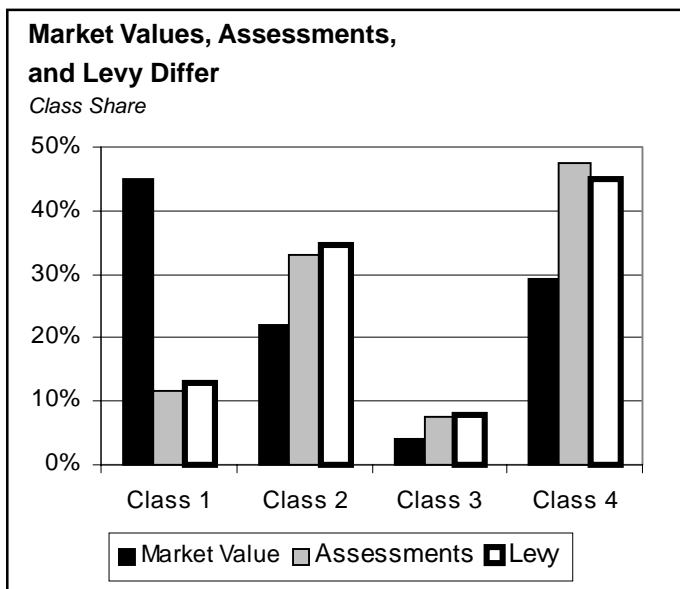
IBO's total baseline tax forecast is \$141 million greater than OMB's in the current year and \$264 million greater in 2002. In 2002, this difference amounts to 1.2 percent of total tax revenues. But from 2002 to 2005, the Administration expects tax collections to increase at a somewhat faster pace (4.7 percent), so that the gap between OMB's baseline forecast and IBO's diminishes during the out-years; by 2005, IBO's forecast is \$96 million less than OMB's.

## Real Property Tax

Strong growth in property values across the city will help boost property tax revenues in 2002 by 6.3 percent to \$8,586 million. From 2003 to 2005, growth in revenues will continue, although at the somewhat more moderate average pace of 5.1 percent annually. Much of this growth is attributable to a feature of the city's property tax system that phases in market value appreciation over five years for apartment buildings and commercial properties. The rise in market values in recent years has created a "pipeline" of assessment increases still being phased in that will help sustain revenue growth even if current market conditions slow or decline.

**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.<sup>1</sup>

Under the property tax law, every parcel is assigned to one of four classes for tax purposes: 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.



Because assessment rates (the share of market value actually subject to tax) and, to a lesser extent, tax rates vary from class to class, there are wide differences between each class's share of total market value, assessed value, and tax burden (levy). On the 2001 assessment roll, class 1 homes account for 45 percent of market value in the city, but only 12 percent of assessed value for tax purposes and 13 percent of the tax levy. In contrast, the other three classes each account for greater shares of the assessed value than of market value, and therefore bear a disproportionately large share of the property tax burden.

**Outlook for assessments in 2002.** In January, the Department of Finance released the tentative 2002 assessment roll. After taxpayer challenges and other department adjustments are processed, the values will be finalized in May and used for setting 2002 tax bills. Market values grew by 11.4 percent over the prior year, with class 1 showing the largest increase at 13.7 percent, followed by class 2 at 10.8 percent and class 4 at 9.6 percent. Manhattan rental apartment buildings, midtown primary office buildings, and hotels all showed very strong market-value growth on the 2002 assessment roll.

IBO projects that total assessed value on the final 2002 tax roll will grow 6.4 percent over the 2001 roll. Although less than half the increase in market values, it is still the largest one-year increase in assessments since 1991. The required phase-in of assessment increases for classes 2 and 4 accounts for part of this difference. An additional constraint on growth is the 6 percent cap on annual assessment increases (or 20 percent over five years) for class 1 properties. While class 1 market values on the 2002 assessment roll grew by 13.7 percent, class 1 assessed value will show growth of only 3.4 percent. While the city eventually captures the phased-in assessment increases, the value lost to the caps in class 1 is essentially lost to the city forever.

**Assessment outlook for 2003 to 2005.** Market values are expected to grow at a slower pace over the last few years of the Financial Plan. IBO projects that class 1

market value growth will average 5.8 percent annually, class 2 will average 2.6 percent, and class 4 will average 3.9 percent. Due to the caps and the implementation of the state's school tax relief (STaR) program, class 1 assessment growth will be well behind market-value appreciation in the class, averaging 2.6 percent in the final three years of the forecast period.<sup>2</sup> The pipeline of previous growth will keep assessments in class 2 and 4 growing fairly briskly—and faster than market values—averaging 4.6 percent and 5.9 percent, respectively. Overall, assessment growth for all classes of property will average 5.0 percent.

**Revenue outlook.** The amount of net property tax revenue in a fiscal year is determined not only by the assessments and tax rates, but also by the delinquency rate, abatements granted, refunds for disputed assessments, and collections from prior years. IBO projects that net property tax revenue for 2001 will total \$8,078 million, 3.7 percent higher than in 2000. For 2002, revenue will grow by 6.3 percent to \$8,586 million. For 2003 to 2005, growth will average 5.1 percent, with revenue totaling \$9,962 million by the last year of the plan period.

## Property-Related Taxes

**Commercial rent tax.** Between 1994 and 1999, a series of tax policy changes have significantly altered the incidence of the commercial rent tax (CRT) and reduced the revenues from over \$700 million in 1994 to \$333 million in 1999. In 2000, growth resumed as revenues rose to \$344 million. In January of this year, another policy change was enacted by the City Council against the backdrop of the Preliminary Budget's proposal to eliminate the tax entirely (see the section on proposed tax reductions in this chapter for details).

As of December 1, 2000, the tax is now only assessed on commercial tenants with annual rents over \$150,000 (with liability phased in for rents between \$150,000 and \$190,000) in Manhattan below 96th Street. Liability is computed using an effective rate of 3.9 percent of the rent. The most

recent change, which raised the liability threshold from \$100,000 to \$150,000, removed over 3,300 tenant-taxpayers with relatively modest rents, leaving roughly 10,000 still subject to the tax.

Because rents paid by tenants who are still subject to the tax have risen rapidly in recent years, commercial rent tax collections have remained relatively stable over the last few years despite the recent tax cuts. For 2001, with the new higher threshold in effect for half of the year—at a cost of \$8 million—revenues will still grow by 3.8 percent from their 2000 level to \$357 million. In 2002, IBO expects rents to grow more slowly, with a corresponding slowdown in CRT revenue growth; CRT revenues will increase by 2.6 percent, reaching \$366 million. The commercial rental market will then gain renewed strength, resulting in a growth in revenues from 2003 to 2005. Revenues are projected to reach \$419 million in the last year of the forecast period (average growth of 4.5 percent).

**Transfer and mortgage recording taxes.** The real property transfer tax (RPTT) and mortgage recording tax (MRT) are two closely related revenue sources, levied at opposite ends of residential and commercial real estate transactions. The RPTT is directly levied on the sale price and typically paid by the seller. The MRT is levied on the mortgage used to finance the purchase (usually the sale price less the down payment) and paid by the buyer. While mortgage refinancings are subject to the MRT, they are exempt from the RPTT, as no transfer of property is involved. On the other hand, sales of coop apartments are subject to the RPTT but are exempt from the MRT because coop financing loans are not technically mortgages.

Over the last 15 years, revenues from these two real estate transfer taxes have shown a common trend. Both declined following the 1987 stock market reversal and the early 1990s economic recession, and both have seen spectacular increases in the current expansion. In 1999, both the RPTT and the MRT soared to record collections. The RPTT rose to \$424 million, 48 percent above the 1998 level. The MRT

shot up to \$408 million, 78 percent more than in the previous year. In 2000, the MRT was essentially unchanged (\$403 million) and the RPTT continued to grow, albeit at a slower pace, to \$483 million.

The rise in sales prices for residential and commercial properties has already begun to slow, and IBO's outlook for calendar year 2001 assumes that prices—and therefore growth in the city's two real estate transfer taxes—will return to more typical growth rates. In contrast, the Federal Reserve's cuts in interest rates are expected to result in lower mortgage rates, thereby boosting sales and partly offsetting the slowdown. Taking both of these factors into account, IBO projects that receipts from the two taxes will return to more modest growth rates in 2002.

The RPTT will grow by 4.8 percent to \$441 million and the MRT will rise by 5.0 percent, reaching \$360 million. From 2003 on, IBO expects growth for both of these revenue sources to pick up. RPTT growth will average 6.8 percent per year, with revenues totaling \$538 million by 2005. The MRT will grow at a somewhat slower pace, averaging 5.8 percent per year, and reach \$426 million by 2005.

## Personal Income Tax

**Background and recent changes.** The personal income tax (PIT) is levied on the incomes of city residents. Resident PIT liability is made up of two components: a base and surcharge. The base rate is progressive, with income in higher tax brackets taxed at higher rates. In January 2001 the surcharge rate was reduced to 7 percent of base rate liability on all but the highest income bracket. Taxpayers in the highest bracket (for example, joint filers with taxable incomes over \$90,000) pay 14 percent of any liability above the top range.<sup>3</sup>

A number of recent tax cuts and credits—such as elimination of the commuter tax, reduction of the current surcharge, expiration of 12.5 percent “criminal justice” surcharge, and the STaR program's PIT credit and cut in base rates—have together

reduced collections by one-fifth of what they would have been in the absence of the cuts. In spite of this substantial loss of revenue, PIT revenue grew 8.1 percent annually from 1997 to 2000, buoyed by a prolonged local economic expansion that continually surpassed expectations.

**Revenues in the current year.** For 2001, IBO expects the PIT to account for \$5,810 million in 2001, roughly one-quarter of all city tax revenues, and 7.6 percent greater than 2000 collections. (These and other collections figures reported in this section include PIT revenue dedicated to the Transitional Finance Authority.) IBO's 2001 PIT forecast exceeds OMB's by \$185 million—3.3 percent of the total.

Record city employment growth and strong increases in personal income during calendar year 2000 have fueled collections so far in this fiscal year, particularly withholding deducted from employee paychecks. Profits of securities firms also reached a record in 2000, resulting in a surge of year-end bonuses paid at the beginning of 2001. Monthly withholding collections surpassed the \$500 million mark for the first time in January 2001—13.9 percent greater than last January's withholdings. Quarterly estimated payments made by the self-employed and those realizing capital gains have also increased substantially, reflecting the general rise of stock market prices over the past several years.

**The forecast for 2002 and beyond.** IBO expects PIT revenue to fall to \$5,536 million in 2002, a 4.7 percent reduction from its level in the current year. Already enacted tax cuts will lower 2002 collections relative to 2001, particularly the PIT surcharge reduction and the STaR PIT cuts because each of their full impacts are not felt until 2002. Even in the absence of tax cuts, PIT growth would still be just 0.7 percent because of the economic outlook. The anticipated slowdown in local employment and income growth in calendar year 2001 plus an expected reduction in Wall Street bonuses will constrain withholding collections, while the projected leveling off in capital gains realizations will weaken estimated payments.

Because New Yorkers' tax liabilities in calendar year 2001 will generally be less than in the previous year, IBO expects a large increase in PIT refunds that will depress collections in 2002. IBO's 2002 personal income tax forecast is \$186 million greater than OMB's, reflecting a relatively higher projection of personal income growth and securities industry profits.

IBO expects PIT growth to resume in the out-years of the Financial Plan, but at a significantly slower pace. PIT revenues will increase 4.1 percent in 2003 and 4.8 percent in the last two years of the plan. By 2005, IBO forecasts revenue from the tax to equal \$6,333 million. OMB, however, expects PIT collections to increase at a higher rate than IBO—by an annual average rate of 6.1 percent from 2002 to 2005. The faster revenue growth being predicted by OMB follows from an expectation of faster income and employment growth than in IBO's economic outlook. As a result, the difference between the IBO and OMB personal income tax forecasts narrows after 2002—to \$96 million in 2003 and only \$17 million in 2004. By 2005, OMB's forecast exceeds IBO's by \$56 million.

## Business Income Taxes

**General corporation tax.** One of the few localities in the United States to levy a tax on corporate income, New York City collected \$1,779 million in general corporation taxes (GCT) in 2000.<sup>4</sup> About three-quarters of GCT revenues come from a tax of 8.85 percent imposed on the portion of net income that corporations allocate to New York City. The rest comes from three alternative bases for calculating city corporate tax liability: (1) capital allocated to the city; (2) net income plus compensation paid to major shareholders; and (3) a minimum tax of \$300. The alternative bases apply when they yield a higher liability than the net income base.

GCT collections in 2000 were up 25 percent over 1999, and were the highest in the city's history. IBO forecasts declines in GCT collections in 2001 and 2002, and does not expect collections to surpass last

year's peak at any time over the Financial Plan period. While collections (net of refunds) in the current fiscal year were 12 percent higher than last year through February, this was all due to a fast start in September and October; since then, net collections have been 2 percent behind last year's pace. IBO expects net collections to fall 16 percent over the rest of the year, resulting in an overall decline of 4 percent (to \$1,707 million) for the whole year. IBO projects a further 11 percent drop (to \$1,519 million) in 2002.

The main reason for the accelerating decline in collections in the next year and a half is a steep fall-off in securities industry profits. From an all-time peak of \$21.0 billion in calendar 2000, IBO expects that they will fall to \$10.0 billion in 2001 and 2002.

Another factor contributing to the decline in collections is the growing impact of previously enacted tax policy changes. The total cost of tax programs enacted since 1994 is expected to rise from 15 percent of baseline collections in 2000 (\$233 million) to over 20 percent of baseline collections in 2001 (\$289 million) and almost 25 percent of baseline collections (\$299 million) in 2002. Two tax policy changes are responsible for most of the added cost: New York State's 1994 recognition of limited liability companies, which has resulted in an increasing number of businesses opting to pay the city's unincorporated business tax rather than the GCT; and the removal of compensation paid to corporate officers from the income plus compensation base of the GCT (enacted in 1997).

In 2003 through 2005, growth in security industry profits is expected to rebound and the incremental cost of previously enacted tax reductions will diminish. As a result, collections are projected to grow 2.3 percent, 5 percent, and 6 percent over the last three years of the Financial Plan, reaching \$1,730 million in 2005.

**Unincorporated business tax.** New York City levies a 4.0 percent unincorporated business tax (UBT) on the income of sole proprietorships, partnerships, and,

since 1994, limited liability companies. Until recently, sole proprietorships constituted more than three-quarters of UBT payers, while over 80 percent of UBT revenue has come from partnerships. An increase in UBT credits from \$800 to \$1,800 in 1998, however, has completely eliminated UBT liabilities for many smaller businesses (predominantly sole proprietorships). At the same time, the share of total UBT revenues accounted for by limited liability companies has been growing. Most UBT revenue comes from partnerships in the legal services and financial sectors.

UBT revenues more than doubled between 1994 (\$379 million) and 2000 (\$805 million), with economic factors accounting for nearly all of the increase. IBO forecasts much slower revenue growth over the 2001 through 2005 plan period, with declines of 1.9 percent (to \$790 million) in the current year and 2.8 percent (to \$767 million) in 2002, followed by modest increases over the following three years. By 2005, IBO expects UBT revenues to stand at \$872 million, just 8.4 percent above the 2000 level.<sup>5</sup>

As is the case with GCT, UBT net collections are slowing as the current fiscal year progresses; UBT revenues have been flat since October and are expected to run almost 8 percent behind last year for the rest of the fiscal year. The drop in securities industry profits from their calendar year 2000 peak is a major factor in the fall-off. For the UBT, however, the effects of the tax program are softening rather than amplifying the revenue decline. In particular, without the growth in limited liability corporations subject to unincorporated business taxes, UBT revenues would decline by 8.2 percent rather than 4.7 percent between 2000 and 2002. Growth from 2003 to 2005 would also be slightly slower.

**Banking corporation tax.** New York City imposes a separate tax on banking corporations doing business in the city. Like the GCT, the banking corporation tax (BCT) requires three alternative calculations, including a 9 percent tax on net income allocated to the city. BCT revenues have always shown a pattern

of sharp year-to-year jumps and declines. This pattern has continued in recent years, with a 50 percent plunge in 1994 followed by a 45 percent increase in 1995, and a 46 percent increase in 1998 followed by drops of 25 percent and 11 percent in 1999 and 2000. This volatility stems from overpayments and underpayments based on losses or gains experienced in some years but not recognized until a year or two later. Other contributing factors are the underlying volatility of bank profits in this rapidly restructuring industry, and the relatively small number of payers accounting for the majority of BCT liabilities.

IBO expects this pattern to continue over the next two years, albeit muted by the current slowdown affecting all the business taxes. For the current year, BCT gross collections (not audited) are 48 percent higher than 2000 revenues through February, but are forecast to be only about 6 percent above last year for the remainder of 2001. Combined with a sharp spike in refunds of prior years' overpayments—\$115 million over the past three months (December through February)—this will yield \$392 million in total BCT revenues by year's end, up 13 percent for the year. This relatively modest increase (following two years of decreases) will be followed in 2002 by a projected 3.7 percent decline to \$378 million.

For the rest of the Financial Plan period IBO projects slow growth in BCT revenues from \$393 million in 2003 to \$414 million in 2005.<sup>6</sup> While this projection flattens likely out-year collections volatility, such forecast cannot be made confidently so far in advance.

## General Sales Tax

Consumers in New York City pay 8.25 percent tax on the sales of most goods and services. This tax is composed of a 4.0 percent city tax, a 4.0 percent state tax, and a 0.25 percent public transportation surcharge to the Metropolitan Transit Authority. The sales tax base exempts most food products, medical services and supplies, mortgage and rental payments, interstate and international telephone

services, and, beginning in March 2000, all clothing priced under \$110. City sales tax revenues are largely a function of household spending of city residents, with expenditures by businesses, commuters, and tourists also playing an important role. Household spending, in turn, is primarily determined by disposable income and the level of consumer confidence.

In 2000, sales tax revenues jumped 10 percent, and would have been up 13 percent over 1999 if the exemption for clothing priced under \$110 had not gone into effect last March, costing the city an estimated \$95 million. IBO forecasts a much smaller sales tax revenue increase of 1.8 percent in the current year, when a full year of clothing sales tax exemptions is projected to cost the city \$258 million. Absent the reduction in the clothing sales tax, growth in sales tax revenues would have been a more robust 6.3 percent. IBO expects sales tax revenues to total \$3,572 million for the year.

IBO projects even slower sales tax revenue growth in 2002—an increase of only 1.2 percent, to \$3,614 million. This slow revenue growth—well below the projected rate of inflation—is mostly attributable to the slowdown in the city's economy. (The clothing tax cut was fully implemented during 2001 and therefore is not a factor in slower sales tax growth rates for 2002 and later years.)

Utility deregulation is another factor contributing to slower growth. The growth in net sales tax revenues will be 0.5 percent below what it would have been in 2002 if utility deregulation by the state was not reducing the volume of utility receipts subject to taxation. These deregulation-related revenue losses

will have an increasingly significant effect over the course of the Financial Plan period, as they climb from \$45 million in 2002 to \$260 million by 2005. Absent these losses, sales tax revenues would average 4.9 percent annual growth over the last three years of the plan; with deregulation, IBO forecasts average growth of only 3.1 percent in the 2003 through 2005 period. Sales tax revenues are projected to rise to a little under \$4.0 billion by 2005.

#### Notes

<sup>1</sup> When IBO refers to market values and assessments, the reference is including only taxable property. The assessed value for tax purposes reflects the required phase-in of assessment changes for apartment, commercial, and industrial buildings.

<sup>2</sup> STaR is a state-wide program using state aid to reduce local taxes for schools. In the city, it reduces property tax liability for qualifying owner-occupants of houses and apartments, lowers personal income tax rates, and provides a refundable personal income tax credit. Elsewhere in the state, STaR applies only to property taxes that are the predominant local financing source for school districts. The state reimburses the school districts and the city for the revenue foregone through the tax cut.

<sup>3</sup> From 1991, when the surcharge was established, through the end of 2000, its rate simply equaled 14 percent of non-surcharge liability. 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.

<sup>4</sup> The city also collects a significant amount of audit revenues from the GCT—\$230 million in 2000. Audit receipts are segregated from their individual taxes and shown as a separate tax revenue source in city budget documents.

<sup>5</sup> These projections are exclusive of audit revenues, which are expected to be around \$31 million per year over the next five years.

<sup>6</sup> Annual BCT audit revenues of \$63 million to \$76 million are expected in 2001 through 2005.





# An Alternative Forecast

- If a national recession occurs this year, New York City tax collections would be reduced by \$76 million in 2001 and by \$653 million to \$725 million a year in 2002 and beyond.
- In the near term, business and personal income taxes would be most adversely affected by a recession. While business tax collections would largely rebound after 2002 to levels nearing what they would have been in the absence of a recession, the decline in personal income tax (PIT) revenue would persist throughout the Financial Plan period.

**Recession scenario.** While IBO's baseline revenue forecast is currently premised on a slow-growth economic outlook, there is considerable risk that a U.S. recession could develop in the near term. Because of this risk, IBO has modeled a recessionary economic outlook to estimate an alternate revenue forecast, and is presented here in brief. IBO's alternate economic scenario is a mild recession that originates in the manufacturing sector and in which real GDP falls during the first three quarters of this year.

Though New York and the Northeast have a disproportionately small share of the nation's manufacturing base and thus would fare better than most other regions under such a recession, the city would still endure a significant loss of jobs. In calendar year 2001, there would be 36,000 fewer jobs in the city than under IBO's slow-growth, no-recession baseline

forecast, eliminating almost all of the employment growth IBO expects for the year. The impact on employment swells to 56,500 fewer jobs in the following year. Under the mild recession scenario the city would lose 22,500 jobs in calendar year 2002, compared with an expected gain of 34,000 under the slow-growth scenario. Retail trade, securities, business services, health, and other service-sector employment would bear much of the impact. The projected job loss for 2002 is roughly double the decline in New York City employment in 1982, when a major manufacturing recession occurred. But it is a far smaller decline than the one during the recession of the early 1990s. Driven in large part by financial market troubles, the 1990s recession particularly affected the Northeast and the city, and led to a loss of over 326,000 jobs during a three-year period.

The mild recession IBO has modeled would also sharply reduce the profits of the securities industry to \$5.9 billion in calendar year 2001—about 41 percent less than what it would be under IBO's slow-growth economic scenario. But the expectation is that the Federal Reserve's actions to ease monetary policy in the face of a recession would cause the securities industry to rebound in the following year, with annual profits nearing \$11.8 billion.

**Impact on tax revenues.** In comparison to the no-recession baseline forecast, a recession would reduce city tax collections in the current fiscal year only slightly—by \$76 million or 0.3 percent of total tax revenues. In 2002, this impact mushrooms to

\$725 million, or 3.1 percent of collections in the absence of the recession. With the exception of the real property tax, all major taxes would be affected in 2002. Roughly four-fifths of the revenue declines would be due to lower business and personal income tax collections; the decline in business income taxes is nearly twice as steep as the fall in the PIT. Total business income tax collections would be 11.6 percent, or \$309 million, lower than under IBO's baseline, slow-growth forecast. Personal income tax receipts would be 5.1 percent, or \$280 million, lower. The recession's impact on sales tax revenue in 2002 would also be substantial—an \$88 million, or 2.4 percent, loss of revenue compared with the slow-growth scenario.

For each year from 2003 to 2005, IBO projects that total city tax revenues would be between \$653 million and \$675 million less under the recession scenario than under the slow-growth baseline.

After 2002, the recession's affect on business income, personal income and sales taxes differ in their persistence. If a recession were to occur in calendar year 2001, PIT revenue would resume growth after 2002 at rates roughly comparable to those under the slow-growth scenario. But tax collections would grow from a lower base, meaning

the loss of revenue persists over time. For the out-years of the Financial Plan, PIT collections are between \$261 million and \$325 million a year less than they would have been in the absence of a recession. The sales tax follows a similar pattern, with revenue remaining \$81 million to \$100 million lower per year.

In contrast, after a sharp fall-off in 2002, business income tax revenues rebound and approach levels that would have been collected in the absence of the recession as the economy recovers. Projected business income tax revenue growth from 2002 to 2005 actually exceeds estimates under the baseline forecast; by 2005, total revenues from the three business income taxes would be just \$58 million, or 1.9 percent, lower under the recession scenario than under the baseline forecast.

The real property tax exhibits yet a third pattern of revenue affects. The impact on the real property tax, which is negligible in 2001, gradually increases over time, to reach \$170 million, or 1.7 percent of collections, in 2005. The delayed response of this tax to the recession reflects provisions of the real property tax law, which limit changes in the assessed value of commercial property and apartment buildings over time.

# Tax Reduction Program

## Coop/Condo Abatement

**The proposal.** The tax program calls for extending the existing coop/condo property tax abatement—scheduled to expire after this fiscal year—through 2005. Designed to reduce the disparity in tax burdens between owners of cooperative and condominium apartments and owners of one-, two-, and three-family homes, the abatement will cost the city \$176 million in 2001. IBO estimates that under the Preliminary Budget proposal, the cost would grow to \$190 million in 2002 and \$227 million by 2005. Viewed from a different perspective, the cost in 2005 would equal 2.2 percent of what property tax revenues would be that year without the abatement.

**History of the abatement.** The city's property tax system has four tax classes, with different assessment procedures and tax rates for each class. Most coop and condo apartment buildings are assigned to tax class 2 for property tax purposes, while one-, two-, and three-family homes are designated as tax class 1. The city's average effective tax rate (property tax as a share of market value) for class 1 homes is 0.68. In contrast, average effective tax rates for most coops and condos are 1.18 and 1.44, respectively, both significantly higher than the class 1 rate.<sup>1</sup>

Advocates for coop and condo owners have long contended that the city should treat all homeowners equally, regardless of whether they live in apartment buildings or houses. In 1996, legislation was enacted to create a temporary three-year abatement to narrow the gap in effective rates by reducing the tax

on qualifying apartments by 17.5 percent.<sup>2</sup> Two years ago, the program was extended through 2001.

The abatement was instituted as a stopgap to provide some relief while the city developed a long-term solution to eliminate the difference in tax burdens faced by apartment owners and class 1 homeowners. Both the original legislation establishing the abatement and the legislation extending the abatement for two years included a requirement that the city deliver recommendations for permanently resolving the problem to the state legislature. Both deadlines have been missed.

Last year, the Department of Finance completed a report that was to serve as the basis for developing a long-term solution to replace the current abatement. The report has not been released. Rather than submitting a plan to the legislature, the city instead sent a letter asserting that given the large deficits in the out-years of the Financial Plan, the fiscal cost of a long-term solution was prohibitive. The Preliminary Budget proposes to simply extend the abatement for three more years.

**Evaluation.** Because the current abatement suffers from a number of shortcomings, extending it in its current form may be undesirable from the perspective of sound tax policy. First, the abatement does a poor job of targeting benefits to the buildings with the greatest need. Effective tax rates on coops and condos—and hence the gap between class 1 tax burdens and the burdens on apartment owners—

vary greatly across the city. These differences stem from distortions in the assessment process that cannot be equalized by an abatement that reduces tax bills by the same percentage for all owners. The areas of the city receiving the largest reductions in the class 1 gap (the difference between the effective rate for coops and condos and the class 1 effective rate) are those with the smallest gaps to begin with, and the least need for relief. The smallest class 1 gaps are found in the prime coop neighborhoods flanking Central Park.

Second, the current abatement is inefficient. IBO found that in 1999, \$29 million (19 percent) of the benefits were going to apartment owners who either already had tax burdens below the class 1 level before the abatement, or who needed only a portion of their abatement to reach the class 1 level.

Even without a long-term solution, the abatement could be modified to address some of these equity and efficiency concerns. One way is to reduce or eliminate the abatement for some apartments based

on criteria such as value or location. The Preliminary Budget proposes to simply extend the abatement in its current form.

Finally, extending the abatement for three more years postpones the promised reform that would give many apartment owners the full benefits of class 1 treatment. The Department of Finance's unreleased report was expected to contain one or more options for achieving this goal.

**An alternative solution.** IBO's earlier report analyzed one solution that would have coops and condos assessed and taxed using sales-based market values subject to the same protections enjoyed by class 1 property owners. Such a reform would eliminate the differences in effective rates among apartment owners, and all coops and condos with tax burdens above the class 1 level would have their taxes brought down to that level.<sup>3</sup> The largest reduction in tax burdens in percentage terms would be concentrated in the areas of the city—largely outside Manhattan—that now have the largest class 1 gaps.

<b>IBO's and Mayor's Estimates of the Tax Reduction Program</b>					
<i>Dollars in millions</i>					
	2001	2002	2003	2004	2005
<b>IBO's Estimate of the Tax Reduction Program</b>					
Extension of Coop/Condo Abatement	\$ -	\$ (190)	\$ (203)	\$ (215)	\$ (227)
CRT Elimination	-	(38)	(147)	(259)	(438)
Earned Income Tax Credit (EITC)	-	(54)	(55)	(56)	(57)
S-Corp Credit	-	(22)	(51)	(53)	(56)
Hotel Tax, Repeal \$2 Fee	-	(21)	(42)	(42)	(43)
Business Taxes, 10% Reduction	-	(23)	(119)	(221)	(307)
Sales Tax Exemption: Clothing, Over \$110	-	(53)	(105)	(109)	(114)
<b>Total Cost of Tax Program - IBO's Estimate</b>	<b>-</b>	<b>(400)</b>	<b>(721)</b>	<b>(955)</b>	<b>(1,241)</b>
<b>Mayor's Estimate of the Tax Reduction Program</b>					
Extension of Coop/Condo Abatement	-	(185)	(194)	(204)	(214)
CRT Elimination	-	(39)	(156)	(336)	(460)
Earned Income Tax Credit (EITC)	-	(48)	(48)	(48)	(48)
S-Corp Credit	-	(22)	(51)	(53)	(56)
Hotel Tax, Repeal \$2 Fee	-	(19)	(39)	(39)	(40)
Business Taxes, 10% Reduction	-	(23)	(121)	(223)	(314)
Sales Tax Exemption: Clothing, Over \$110	-	(53)	(96)	(98)	(101)
<b>Total Cost of Tax Program - Mayor's Estimate</b>	<b>-</b>	<b>(389)</b>	<b>(705)</b>	<b>(1,001)</b>	<b>(1,233)</b>
<b>Difference</b>	<b>\$ -</b>	<b>\$ (11)</b>	<b>\$ (16)</b>	<b>\$ 46</b>	<b>\$ (8)</b>
SOURCE: IBO					
NOTES: A portion of the commercial rent tax reduction proposed in the preliminary budget has already been enacted and is therefore reflected in both IBO's and the Mayor's baseline forecast. Numbers may not add to totals because of rounding.					

The cost of a long-term solution using sales-based values to tax coops and condos has declined over the past few years. In a December 1998 study, IBO estimated that it would cost \$270 million—based on market values at that time—to completely eliminate the class 1 gap. The appreciation in coop and condo apartments since that time, which results in lower effective tax rates, has narrowed the gap. Thus, the cost of a comprehensive solution would be smaller today than it was three years ago.

## Commercial Rent Tax Elimination

**The proposal.** The Preliminary Budget calls for gradually eliminating the commercial rent tax (CRT) by 2005. The city recently reduced the number of firms required to pay the tax. Under this year's budget proposal the effective tax rate would decline, from 3.9 percent to 3.5 percent in 2002, to 2.5 percent in 2003. The more substantial reductions would occur in 2004, when the rate would drop to 1.5 percent, and in 2005 when the tax would be eliminated. (The CRT liability year runs from June 1 to May 31, so the changes listed would actually take effect on June 1, 2001, June 1, 2002, June 1, 2003, and June 1, 2004, respectively.) If fully enacted, these would be the last in a series of reductions in one of the city's unique taxes, one that has often drawn attention from those concerned with the city's tax burden relative to other locations.

IBO estimates that the cost to the city of the Preliminary Budget proposal, including foregone audit revenue, would be \$38 million in 2002, growing to \$147 million in 2003, \$259 million in 2004, and \$438 million in 2005.<sup>4</sup> These costs differ somewhat from the Administration's projections (adjusted for the enactment of the higher exemption), particularly for 2004. Some of the variance is due to differences in the baseline revenue forecasts.

**Who pays the CRT?** The CRT is paid by commercial tenants based on the amount of rent they pay to their landlords. Only tenants with annual rents of more than \$150,000 and whose businesses are

located in a limited part of the city pay the tax. Tax liability is determined by a single flat rate applied to the base rent.

Although the CRT tax burden has been reduced several times since its peak in 1977, in recent years the city has made much more dramatic changes, significantly decreasing both the number of firms subject to the tax and the liability of the remaining taxpayers. Since September 1995, only leases in buildings south of 96th Street in Manhattan are subject to the tax. Beginning in June 1997 only tenants with base rents above \$100,000 have any tax liability. In January 2001, the City Council enacted an increase in the liability threshold to \$150,000, retroactive to December 2000. A sliding-scale credit, which phases out as taxable rent increases, helps to moderate what would otherwise be a steep rise in the marginal tax paid on rents just over the liability threshold.

These enacted changes have greatly reduced the number of CRT taxpayers—approximately 10,000 remain—while increasing the share of large firms among those still paying the tax. Nevertheless, tenants with relatively modest rents still account for the majority of remaining taxpayers. IBO estimates that 67 percent of the remaining taxpayers have annual rents of \$500,000 or less. The average rent for this group of taxpayers is just under \$250,000.

For tenants still subject to the tax, the most important change has been a reduction in the effective tax rate, which has fallen from 6.0 percent in September 1995 to 3.9 percent currently.

The rate reductions beginning in 2002 would cut the CRT owed by a firm paying \$250,000 a year in rent from \$9,750 in 2001 to \$8,750 in 2002, \$6,250 in 2003, \$3,750 in 2004, and then to zero in 2005. Although reducing the effective rate benefits all taxpayers still subject to the tax, the dollar value is concentrated at the higher end, with over 60 percent of the additional benefit flowing to taxpayers with annual rents of \$1 million or more.

**Evaluation.** New York's tax on commercial occupancies is subject to a number of criticisms. Simply because it is unique, the CRT stands out when tenants, and potential tenants, evaluate how the city's tax structure affects them. The existence of such a unique tax sends a signal that the city's tax policies are not "business friendly."

Perhaps the greatest defect of the CRT is that it pyramids one tax upon another. Commercial rents, which are the basis of the tax, already include a portion of the owner's property tax. Indeed, commercial leases in the city usually include a tax escalation clause passing all property tax increases directly on to tenants. Thus, a portion of a tenant's CRT burden is a tax on the landlord's property tax.

While the arguments against the CRT have become well known, some of the criticisms are overstated. Moreover, there has been little discussion of the CRT's positive role in the city's tax structure.

The economic development argument against the CRT focuses on the additional burden placed upon businesses in Manhattan that they would not face in competing localities. This would be true if the ultimate bearer of the CRT is always the tenant—but this is not always the case.

In a soft market, when the supply of space exceeds demand, the landlord's need to secure tenants results in the shift of much, if not all, of the true cost of the CRT to the landlord who must sacrifice some potential rent to attract and keep tenants. Although this shifting is a constraint on earnings in the real property sector of the city's economy, the tax itself has little effect on the city's ability to attract and hold businesses that need to rent space in Manhattan when the market has sufficient space available.

When market conditions favor landlords and tenants are competing for a limited supply of commercial space—as has generally been the case in Manhattan in recent years—tenants bear more of the burden of the CRT and little is shifted to landlords. But such market conditions occur precisely when the city is

succeeding in retaining and attracting businesses, making the economic development rationale for eliminating the tax less persuasive.

The CRT is appropriately viewed as a companion to the city's real property tax. Indeed, it was created in 1963 when the city was approaching a constitutional limit on the size of the property tax levy.<sup>5</sup> Prohibited from raising the necessary revenue through the property tax, the city turned to a tax that allowed it to capture the growth in the value of commercial properties by taxing the rents that underlie the buildings' market values.<sup>6</sup>

Although the constitutional operating limit is no longer a significant factor in the city's overall tax structure, the CRT continues to function as a compliment to the property tax. Assessment increases for commercial buildings, excluding increases attributable to physical improvements and new construction, are phased in over five years. This results in the city not immediately receiving the revenue benefits of rising market values. Given that most assessment increases subject to the phase-in requirement are attributable to growing rental incomes, the CRT allows the city to capture these increases earlier in the business cycle.

### **Earned Income Tax Credit**

**The proposal.** The Mayor's tax reduction program includes a proposal to create an earned income tax credit (EITC) against the city's personal income tax (PIT) for low-income working New Yorkers, starting in the 2001 tax year. Like the existing federal and state credits, the city EITC would be refundable, meaning that a filer whose allowable credit is greater than his or her pre-credit income tax liability would receive a check for the difference. The proposed city credit would equal 5 percent of the current allowable federal EITC.

Based on a large sample of city tax returns and a forecast of income growth, IBO estimates that under the Mayor's proposal 596,000 households would receive \$54 million in EITC benefits for tax year

2001—an average credit of \$90 per household. Virtually all of the cost to the city of the tax year 2001 credit would occur in fiscal year 2002. After 2002, the estimated average value of EITC benefits, the number of recipients, and the total cost to the city would increase slowly to \$58 million by 2005. IBO's projections of the annual cost of creating the proposed EITC are \$6 million to \$9 million greater than the Administration's.

In each of the years of the Financial Plan period, IBO estimates that refunds made would account for \$43 million of the total amount of EITCs given—\$3 million more than OMB's estimates. The Administration proposes to use some of the TANF (Temporary Assistance to Needy Families) surplus to pay for the refundable portion of the EITC and offset a large share of the cost of providing the credit. Under U.S. Department of Health and Human Services' 1999 guidelines, states may either use the federal TANF block grant to cover the cost of EITC refunds made by state and local governments or count EITC refunds as part of maintenance-of-effort spending. While the proposal in the tax reduction program is to obtain TANF funds, the city's access to these funds, like the creation of the credit itself, would require state approval.

**The structure of EITCs.** Under the structure of the federal EITC—the basis for both the proposed city EITC and the existing state EITC—the amount of the credit for the lowest-income households increases as income from work rises. For the 2000 tax year, a household with two or more children received a federal EITC of 40 cents for every dollar earned up to \$9,720—the annual income level at which the credit reached its maximum value of \$3,888. The federal EITC remained at this maximum level for incomes up to \$12,290 and then declined at a rate of roughly 21 cents for each additional dollar earned until it phased out entirely for income above \$31,152. (Filers with one or no children received a smaller maximum credit that phased out at a lower level of income.) Each year the EITC income thresholds and credit amounts are adjusted for inflation by the federal government, so the value of

the federal credit (and by extension the state and proposed city credit) does not erode over time.

**Evaluation.** In addition to giving general tax relief to low-income workers, EITCs are structured to provide incentives for increased labor force participation because the amount of the credit increases as income from work rises. These incentives complement the goal of moving public assistance recipients into the paid labor force in the wake of federal welfare reform.

The creation of a city EITC would eliminate income tax liability for many city residents, including many whose incomes are too low to incur federal or state income tax liability but still owe city taxes. For the 2001 tax year, IBO estimates that under current law 113,000 filers—almost four-fifths of whom are single parents—will owe city but not state income tax. Establishing an EITC equal to 5 percent of the federal credit would reduce this number by nearly half, to 66,500 filers.

Using a portion of New York State's TANF surplus to pay for most of the refunded tax credits would substantially reduce the cost to the city of providing an EITC. But it is far from certain whether state officials will make any of the TANF surplus available to the city for this purpose, especially given the state's ability to use the surplus to pay for its own EITC refunds. Even if funds are available, the use of the TANF surplus to fund EITC refunds might limit the city's ability to implement and finance other welfare reform policies, such as expanded work programs or subsidized child care. Finally, because the size of the TANF block grant to New York State is likely to be reduced significantly after 2002, when re-authorization of the grants occurs, it is far from certain that these surpluses will exist in the future.

### **Subchapter S Corporation/PIT Credit**

**The proposal.** The Mayor's tax reduction program renews a proposal to allow resident shareholders of subchapter S corporations a credit against PIT liability for their share of corporation taxes paid to

the city. The credit would also make the the PIT treatment of resident S corp shareholders more comparable to that of resident owners of unincorporated businesses.

The Financial Plan calls for an S corp credit that would cost the city an estimated \$22 million in 2002, \$51 million in 2003 (the first year in which the full effect of the credit would be felt), \$53 million in 2004, and \$56 million in 2005. These costs are roughly equal to the estimated annual loss of PIT revenue due to the similar, existing credit for owners of unincorporated businesses.

**S corps under current law.** S corps are a special type of small business eligible for certain tax benefits at the federal and state levels. In order to organize as an S corp, a firm must meet several qualifications, the most important of which are that it have no more than 75 shareholders and that its shares not be publicly traded.

Under federal law, the earnings of an S corp are exempt from corporate income tax, though the earnings distributed to individual shareholders as dividends are subject to the federal personal income tax. Under state law, S corps can elect "New York S corporation" status and receive various tax benefits. The most basic benefit is that although S corps are subject to the state's corporate franchise tax, they pay at a much lower rate—0.825 percent of net income rather than the regular 8.0 percent rate for the current year.

Under city law, however, S corps are treated like all other corporations and subject to either the city's general corporation tax (GCT) or banking corporation tax (BCT) with no preferential treatment.

The current proposal would not alter the corporate taxation of S corps on the city level, but it would benefit city residents who are shareholders in S corps subject to the GCT or BCT. Specifically, starting in the current year these taxpayers would be permitted a credit against PIT liability for a portion of GCT and BCT payments attributable to the

taxpayer's stake in the S corp. The proposal is patterned after the existing unincorporated business tax (UBT)-PIT credit and would be structured similarly, with the percent of business tax liability that could be claimed as a PIT credit decreasing as the taxpayer's income rises. By matching information reported on S corps' federal tax returns with information obtained from local GCT, BCT, and PIT returns, the Department of Finance had estimated last year that 49,000 resident taxpayers would qualify for an S corp-related PIT credit.

**Evaluation.** The proposal to give city residents a PIT credit for their share of S corp-related GCT and BCT payments serves goals related to both personal and business income taxation.

The proposal would reduce double taxation of business income for city residents, who alone among owners of local S corps are subject to the city's PIT in addition to corporate income taxes. The new proposed credit, like the already existing one for UBT payers, targets benefits specifically to city residents while retaining the city's ability to tax business income generated in the city by S corp shareholders who do not reside here.

The credit would also make the treatment of resident shareholders in local S corps similar to that of city residents who are business partners and proprietors paying the UBT. Finally, the proposed credit would benefit owners of small, New York City-based businesses because S corps—like most unincorporated firms—are relatively small entities.

## **Hotel Occupancy Tax Cut**

**The proposal.** The tax reduction package renews a proposal to cut the city's hotel room occupancy tax by eliminating the flat, \$2 per day fee paid on most rooms. The tax on hotel room rentals, which is levied in addition to city and state general sales taxes, currently equals 5.0 percent of the room rent plus a flat fee of \$2.00 per day for rooms renting for \$40 or more per day (or smaller amounts for rooms renting for less than \$40).



Because virtually all hotel rooms rent for at least \$40 a day, revenue from the flat component of the tax basically equals \$2 multiplied by the number of hotel room rentals (that is, the number of rooms rented times the number of days). Using recent and projected data on hotel occupancy rates, IBO estimates that eliminating the \$2 per room flat fee this December would reduce hotel occupancy tax revenues by \$21 million in 2001, when revenue would be lost for only half of the fiscal year, and roughly \$42 million annually thereafter. These estimates are about \$3 million a year higher than the Administration's and, like the Administration's, do not include any possible secondary impacts that would increase tax revenues.

**Background on the hotel tax.** The hotel occupancy tax is generally borne by non-residents, so it does not add to the tax burden facing city residents and businesses. With the exception of four years, the current hotel occupancy tax rate has been in effect since 1986. In 1990, a series of tax increases by both the city and state sharply increased the overall tax rate on hotel rooms costing \$100 a night from 15.25 percent to 21.25 percent—the highest rate in the country. Pressure to reduce these taxes led the state to eliminate its 5 percent hotel occupancy tax in September 1994, with the city following suit by cutting the variable component of its hotel tax rate from 6.0 percent to 5.0 percent in December of the same year.

The current proposal is to eliminate the flat per day component of the tax starting in December 1, 2001. With the average hotel room rate now equal to \$237 per day, this part of the tax is equivalent to a tax rate of less than 1 percent of hotel room charges, far less than the 5 percent rate that constitutes the variable component of the tax.

**Evaluation.** It is unclear if enacting the current proposal would lead to substantial secondary economic activity. To the extent that a cut in the hotel occupancy tax would increase the number of overnight visitors to New York, the direct loss of revenue would be offset in part by secondary

revenue impacts. These impacts would include a boost in hotel and sales tax revenue resulting from a rise in the number of hotel stays; more sales tax revenues due to the increase in non-hotel spending in stores, restaurants, and other city businesses that would accompany the increase in overnight stays; and additional sales tax and business and personal income tax revenue resulting generally from the induced increase in city economic activity.

In a 1997 fiscal brief, IBO developed an econometric model to examine the near concurrent 1994 state and city hotel tax cuts. IBO found that above and beyond the very significant influences of factors such as domestic and foreign economic growth and the city's crime rate, the large tax cuts of 1994 had a role in boosting hotel stays and tourism in the city and thus generated substantial secondary revenue impacts, although not nearly enough to offset the lower direct cost of the tax cut. The size of the tax cut now being proposed, however, is much smaller than the combined state and city cuts of 1994 and it is unclear if the current proposal would induce much of an increase in tourism in the city. As a result, IBO expects that revenue impacts under the current proposal to reduce the hotel occupancy tax would be more modest—relative to the proposal's cost—than was the case for the 1994 tax cut.

Another factor to consider in evaluating the proposal is who pays the hotel occupancy tax. Almost all of the tax is exported—that is, the tax is directly borne by individuals who reside outside New York or by businesses located elsewhere. With the increase in tourism in recent years, the tax has been a growing source of revenue without contributing to the tax burden on city residents and businesses.

## **Business Tax Reductions**

The Preliminary Budget revives a proposal to reduce the city's business income tax rates by 10 percent over three years. Assuming that the city's rate reductions would be phased in three equal steps, and that the changes would occur for taxpayer liability years beginning in 2001, 2002, and 2003, the

first fiscal year with all business income tax collections based on rates reduced by a full 10 percent would be 2005. The cost of the business tax cuts would total around \$23 million in 2002 and rise by about \$100 million per year in 2003 and 2004 and then by another \$85 million or so in 2005. IBO expects the total cost of these cuts to reach \$307 million in 2005 when they are fully phased in, with approximately \$175 million of the reduction coming from the general corporation tax (GCT), \$90 million from the unincorporated business tax (UBT), and \$42 million from the banking corporation tax (BCT).

This proposal is spurred in part by recent state business tax reductions. Through changes enacted in the 1999 and 2000 budgets, the state corporate income tax rate along with the insurance and bank tax rates are being reduced in three half-percentage point steps from 9.0 percent to 7.5 percent. These tax cuts will leave the state rates well below the city's GCT rate of 8.85 percent and BCT rate of 9.0 percent, both of which are imposed in addition to the state taxes. The proposed 10 percent city cut would bring the city's GCT rate down to 7.97 percent and BCT rate down to 8.1 percent, both within roughly a half percentage point of the state's eventual rate. It would also lower the city's UBT rate from 4.0 percent to 3.6 percent. (There is no state business tax counterpart to this city tax.)

These costs would be offset to some extent by increases in levels of business activity and taxable income in the city due to the reduction in business tax rates. A more favorable business climate also might allow the city to rely less heavily on the targeted tax abatements and exemptions it now uses to spur economic development. But the extent to which reduced business tax rates improve the city's business climate would depend, in part, on whether and how the lost revenues affect city service levels.<sup>7</sup>

### **Clothing Sales Tax Cut**

The 2002 Preliminary Budget also revives a proposal to extend the clothing sales tax exemption, currently limited to items priced under \$110, to all articles of

clothing beginning on December 1, 2001. IBO estimates that this would cost the city about \$53 million in 2002 and \$105 million to \$114 million per year over the 2003-2005 period.

The proposal requires state legislation to become effective. While New York City consumers do not pay city *or* state sales taxes on clothing below \$110, it seems unlikely that the state would join the city in eliminating taxes on clothing priced \$110 or more. Were Albany to approve only the proposed new city clothing tax cut, consumers would still be responsible for paying the 4.0 percent state sales tax and 0.25 percent transportation surcharge.

Without the additional stimulus provided by a state clothing tax cut, IBO estimates that the city exemption for items priced \$110 or more would boost clothing sales in the five boroughs by no more than about \$1.65 for every dollar of city sales tax revenues lost, much less than the up to \$3.15 in estimated new sales for every dollar of city sales tax revenues lost on items priced under \$110. The relatively smaller economic impact would in turn yield relatively smaller secondary city tax revenue increases. IBO has estimated that while secondary city tax increases may eventually offset up to 16 percent of the city's under-\$110 clothing tax revenue loss, without an accompanying state tax cut the maximum secondary city revenue offset for a \$110-and-over city clothing tax cut would not exceed 9 percent.

#### **Notes:**

<sup>1</sup> This 1998 measure of the effective tax rates for coops and condos is based on true market value rather than the official city market value, which is artificially lowered under section 581 of the real property tax law. See IBO, *The Coop/Condo Abatement and Residential Property Tax Reform in New York City*, December 1998. With the appreciation in coop and condo units since 1998, effective rates based on true market value would be lower if measured today.

<sup>2</sup> In buildings with average apartment assessed values of \$15,000 or less, the reduction is 25 percent. Apartments that have not been sold by the sponsor or developer are excluded, as are apartments in buildings enjoying J-51 or 421-a benefits.

<sup>3</sup> Those with burdens already below the class 1 level could be held harmless from the reform.

<sup>4</sup> In order to be consistent with the Preliminary Budget's presentation of CRT elimination, these estimated costs include reductions in audit revenues attributable to the proposal. Note that all other tax program costs are estimated without accounting for their impact on audit revenues.

<sup>5</sup> The New York State Constitution limits the amount of the city's operating budget funded from the property tax to 2.5 percent of the full value of the property tax base. In 1963, the property tax accounted for a much greater share of tax revenues than in more recent years. At that time the city did not have a personal income tax, and the gross receipts tax accounted for a smaller

share of revenue than do the business income taxes that have replaced it.

<sup>6</sup> The market value of commercial properties reflects the discounted value of current and future rents earned from the property.

<sup>7</sup> This is also true when evaluating the impact of the state's business tax cuts on the city's business climate. Insofar as the state cuts lead to reduced state services and/or reduced state aid to the city, the overall benefit to city businesses could be diminished.



# Other Revenues and Categorical Grants

## Other Revenue

IBO's estimate of revenue from sources other than taxes totals \$4.3 billion in 2002, \$595 million lower than projected in the Preliminary Budget. The differences between IBO and Administration forecasts vary for the out-years of the plan, with IBO \$50 million above the Administration in 2003, \$135 million below in 2004, and \$65 million below in 2005.

Other revenues include funds from unrestricted intergovernmental aid, private grants, inter-fund capital transfers, anticipated state aid for the closure of Fresh Kills landfill, and miscellaneous revenues from recurring and nonrecurring sources. Some items of particular note follow.

**Airport rent.** IBO estimates that airport rental income will be \$20 million in 2002 and each year thereafter. These annual estimates are substantially lower than those presented in the Preliminary Budget, and amount to \$345 million less in 2001, \$200 million in 2003, \$135 million in 2004, and \$65 million in 2005. Airport rent consists of two components: prior-year rental income and anticipated current-year rent receipts. The collection of airport back-rent has been under arbitration for some time and there is little evidence to suggest that this issue will be resolved in the city's favor. Accordingly, IBO's revenue forecast entirely excludes contested rental income from past years.

**Nonrecurring miscellaneous revenues.** The Preliminary Budget includes \$530 million in nonrecurring

revenue for 2002. This is made up from \$250 million in revenue from the proposed sale of the Off-Track Betting Corporation (OTB), \$75 million in anticipated state funding for Fresh Kills landfill closure, and \$205 million in a number of initiatives, including the sale of various city properties.

The city anticipates receiving \$250 million from the sale of OTB in 2002. After soliciting proposals for the sale of the franchise and operations of the OTB, the city has narrowed its selection to four potential buyers. In the upcoming months the city anticipates selecting one candidate from among qualified bidders. Due to complexities surrounding the sale, including the necessary approval by the state legislature, IBO believes it is unlikely that the sale will be completed in 2002, and has shifted the receipt of revenue from the sale to 2003.

The city anticipates receiving \$75 million from the state to supplement costs associated with the closure of the Fresh Kills landfill. When New York State enacted the 1996 Clean Water/Clean Air Bond Act, \$75 million was earmarked for the closure of Fresh Kills. It was intended that this money be used to supplement closing costs in order for the landfill to stop receiving refuse by December 31, 2001, as mandated by state law. To date, \$45 million has been appropriated by the state, but not yet committed to specific projects. The Governor has proposed adding the remaining \$30 million in this year's state budget. Therefore, IBO's forecast—like the Administration's—includes the full \$75 million in

state funding expected for this initiative in 2002. (See Department of Sanitation in chapter 3 for details.)

The city anticipates receiving \$205 million through a number of initiatives to generate revenue in 2002. These initiatives include: \$50 million from the sale of mortgages and \$56 million from the sale of land and buildings by the Department of Housing Preservation and Development; receipt of \$26.5 million in federal grants for projects previously funded by the Economic Development Corporation; and \$41 million from the sale of three properties by the United Nations Development Corporation. IBO anticipates that these transactions will take place on schedule.

### **Categorical Grants**

Categorical grants received from the state or federal government to fund specific expenditures such as education, health, child care and housing account for approximately 30 percent of all funds spent by the city each year. IBO projects that state and federal categorical grants will total \$8.1 billion and \$4.4 billion, respectively, in 2002. For some types of categorical aid, such as education and welfare, IBO has developed forecasts based on changes in programs and caseloads. IBO's forecast of categorical aid in other parts of the budget is based on a methodology that takes the grant level in the current year, adjusts for historical trends, and applies growth factors on an agency-by-agency basis.

IBO's forecast of state categorical grants is \$86 million higher than the estimate provided in the Preliminary Budget for 2002, and continues to exceed the city's projections by \$270 million in 2003, growing to more than twice that amount in 2005. The major reason for the difference is IBO's significantly higher forecast of state aid for education; IBO's forecast exceeds the Administration's by \$289 million in 2002, growing to \$771 million in 2005. This increase is offset in part by IBO's decision to exclude \$250 million annually in state aid anticipated by the Administration, such as funding for Medicaid fraud prevention initiatives and various tort reform efforts.

IBO's forecast of federal categorical grants is \$485 million higher than the 2002 Preliminary Budget estimate, and remains higher through 2005. IBO's estimates of education, health, child care, and housing aid—which together account for close to 70 percent of all federal grants—are significantly greater than the Preliminary Budget's. This higher projection is offset in part by IBO's lower estimate of federal social services grant levels, attributable to lower family assistance caseload projections, starting in 2002 when the five-year limit on federal assistance will begin to take effect (see the public assistance section of the chapter on expenditures for more details). IBO's forecast also excludes \$100 million in anticipated federal aid that is unlikely to occur, such as having the federal government assume a greater share of Medicaid costs for children.

***Expenditures***

## Expenditures Introduction

IBO's expenditure estimates exceed those proposed in each year of the Financial Plan. In 2002, IBO projects expenditures under the proposed plan to be \$41.2 billion, or \$704 million more in city-funded spending than the Administration's forecast. The difference in spending grows annually, reaching \$2.1 billion in 2005 when IBO anticipates total spending to be \$47.1 billion. Generally, these differences occur due to varying economic, technical and legislative assumptions.

By far the largest differences between IBO's forecast and the Administration's are in the areas of labor costs and education. The Preliminary Budget includes two years of funding for merit pay increases. Assuming collective bargaining agreements are made at the rate of inflation, IBO projects spending that exceeds the Financial Plan by \$541 million in 2004 and \$860 million in 2005. IBO

also anticipates that spending on education will grow from \$142 million more than in the Administration's plan in 2002, to \$453 million more in 2005. Other large differences can be seen in Medicaid spending, which IBO expects to exceed the Administration's projection by \$207 million in 2005, and overtime expenses that are estimated to be \$146 million higher than in the Financial Plan for 2003 through 2005.

In addition to presenting IBO's expenditure estimates, this chapter discusses the budgetary implications of a number of new programs, including major capital budget initiatives. The section is organized around a number of broad programmatic areas: health and human services, education, infrastructure, public safety and community services. It concludes with a presentation of several miscellaneous spending issues, including labor costs, overtime, stadium financing and debt service.

### IBO's Expenditure Estimates Under the Mayor's Financial Plan

Dollars in millions

	2001	2002	2003	2004	2005	Average Change
<b>Health/Social Services</b>						
Social Services	\$ 5,693	\$ 5,611	\$ 5,640	\$ 5,849	\$ 6,041	1.5%
Admin. for Children Services	2,335	2,297	2,332	2,345	2,349	0.1%
Health	1,980	1,973	1,991	2,009	2,028	0.6%
Homeless	484	487	502	504	505	1.1%
All Other	523	428	424	424	425	-5.1%
<b>Subtotal</b>	<b>11,015</b>	<b>10,796</b>	<b>10,889</b>	<b>11,131</b>	<b>11,348</b>	<b>0.7%</b>
<b>Education</b>						
Board of Education	11,606	12,175	12,656	13,103	13,507	3.9%
CUNY	395	389	393	397	401	0.4%
<b>Subtotal</b>	<b>12,001</b>	<b>12,564</b>	<b>13,049</b>	<b>13,500</b>	<b>13,908</b>	<b>3.8%</b>
<b>Uniformed Services</b>						
Police	3,404	3,422	3,563	3,706	3,806	2.8%
Fire	1,107	1,140	1,171	1,207	1,239	2.9%
Correction	861	911	963	985	1,006	4.0%
Sanitation	941	1,011	1,053	1,072	1,096	3.9%
<b>Subtotal</b>	<b>6,313</b>	<b>6,484</b>	<b>6,750</b>	<b>6,970</b>	<b>7,147</b>	<b>3.2%</b>
<b>Debt Service</b>	3,069	2,311	4,093	4,672	4,853	12.1%
<b>All Other</b>	8,188	9,004	9,274	9,705	9,841	4.7%
<b>IBO Total Expenditure Estimate</b>	<b>\$ 40,586</b>	<b>\$ 41,159</b>	<b>\$ 44,055</b>	<b>\$ 45,978</b>	<b>\$ 47,097</b>	<b>3.8%</b>

SOURCE: IBO.

NOTES: Expenditures are not adjusted for prepayments. If adjusted for prepayments, spending would grow at a 3.2 percent average annual rate from 2001 through 2005, and debt service would grow at an average annual rate of 5.6 percent.  
Excludes intra-city expenditures



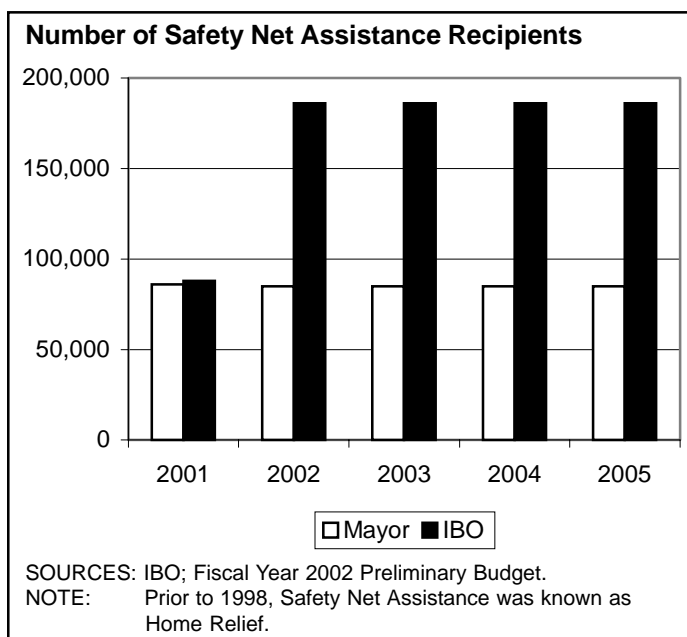
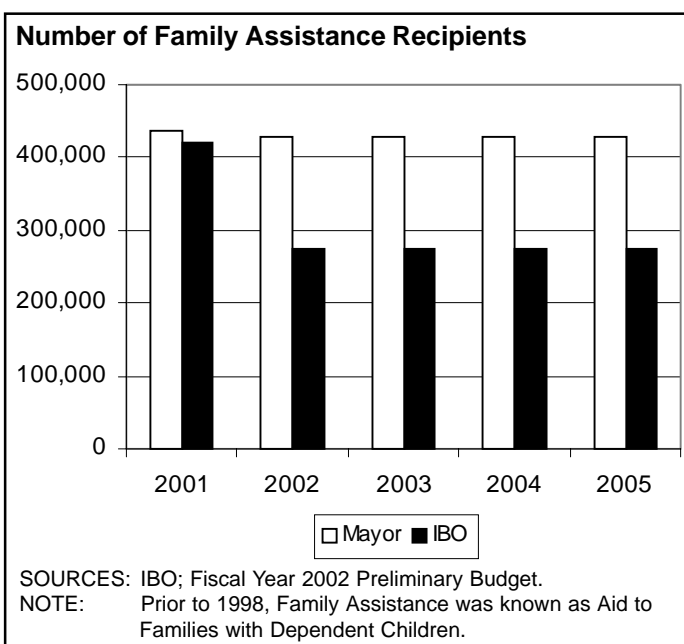
# Health and Human Services

## Public Assistance

**Budget overview.** Continuing a six-year trend of falling caseloads, the Preliminary Budget projects that the number of persons receiving Family Assistance (FA) will decrease from 450,000 in December 2000 to 437,000 in June 2001, to 429,000 in June 2002, and then stay constant during the remaining years of the Financial Plan. The number of Safety Net Assistance (SNA) recipients is projected to decrease very slowly from 88,000 in December 2000 to 86,000 by June 2001, to 85,000 by June 2002, and remain at that level through 2005.

Based on these expected caseload reductions, the Administration projects federal, state, and city expenditures for public assistance grants to decrease from \$1.3 billion in 2001 to \$1.2 billion in 2002 through 2005. The city's share of welfare spending is forecast to decrease from \$401 million in 2001 to about \$350 million in 2002 and thereafter.

IBO projects somewhat higher city expenditures because of the effects of federal public assistance eligibility limits, which will push 100,000 people into the state-and-city funded Safety Net Assistance Program; local spending requirements; and the Mayor's proposal for a city Earned Income Tax Credit. Based on these factors, IBO projects city public assistance-related spending will exceed the Administration's forecast by \$65 million this year, \$82 million in 2002 and \$70 million in 2003 through 2005.



**The effect of federal time limits.** Under the 1996 federal welfare act, there is a five-year limit on recipients' eligibility for federally supported public assistance. By the end of this calendar year, the first cohort of FA recipients will reach their five-year limit, shifting tens of thousands of public assistance recipients into New York's SNA program. The Administration's projections in the Preliminary Budget do not account for this shift. IBO estimates that the number of Safety Net Assistance recipients will grow from 88,000 in June 2001 to 186,000 in June 2002 and the following three years.

For the Family Assistance caseload, IBO projects a faster decline in the near term than the Preliminary Budget. This rapid decrease will be driven in part by the conversion of the 11 remaining welfare centers to job centers over the next few months, as a result of the recent lifting of a court injunction that had blocked these conversions for the last two years. The new job centers are being created to implement the Mayor's policy of front-end diversion, employing new job search requirements and other mechanisms designed to greatly reduce the number of individuals who end up on the welfare rolls. In addition, state officials have announced a new intensified campaign to move long-term recipients off of the welfare rolls before they reach their five-year limit on assistance, including additional efforts to increase job placements, child support payments from absent fathers, and federal disability benefits.

IBO projects that these new state and local initiatives will contribute to the decline in FA recipients to 419,000 by June 2001. By December 2001, when the first cohort of recipients reaches its last month of eligibility under the five-year limit, IBO anticipates the FA caseload will drop to 389,000, or 40,000 less than estimated in the Preliminary Budget.

IBO's forecast begins to diverge more significantly from the Preliminary Budget in January 2002 because of the impact of the five-year limit on federal assistance. Based on analysis of recent state projections, IBO estimates that by December 2001, despite an intensified campaign to move long-term

recipients off of the welfare roll, about 149,000 individuals statewide will have been on FA for five years—the federal limit set in the 1996 welfare law. Although federal law allows the state to exempt up to 20 percent of the caseload from having their FA benefits terminated and shifted to SNA, the state expects to exempt only about 5 percent. IBO projects that city residents account for approximately 100,000 of these non-exempted five-year beneficiaries who will be required to switch from FA to SNA beginning in January 2002. As a result, IBO expects the FA caseload for 2002 and the remaining years of the Financial Plan to dip well below the Mayor's projections, which do not account for this provision of federal welfare law. Conversely, the number of SNA recipients will be significantly higher than the Administration's estimates.

Taken by itself, the shift from FA to SNA will have significant budget implications for New York City, due to the difference in the way that the two programs are funded. For SNA the state and city are responsible for the entire cost of the program, with a city share of 50 percent. For FA the federal government covers half of the costs, with a city share of 25 percent. For this reason any shift of recipients from FA to SNA will require additional city expenditures. The net incremental cost to the city of shifting 100,000 persons from FA to SNA beginning in January 2002 would amount to \$29 million in 2002, and rise to \$57 million in 2003.

**Spending falls below federal requirements.** Putting an actual price tag on this shift between public assistance programs, however, is complicated by the federal maintenance of effort (MOE) requirement. Under the 1996 federal welfare law, New York's state and local governments together must spend at least 75 percent of what they spent on needy families in federal fiscal year 1995, an annual MOE of about \$1.7 billion. As the FA caseload and grant expenditures have steadily decreased, the state and the city have chosen not to spend all of the resulting savings on other low-income programs.

## The Uncertain Future of the "TANF Surplus"

Aside from the risks and challenges of federal time limits and spending requirements, there are other potential factors largely outside of the city's control that could add to its welfare costs. The most important of these is the re-authorization of the federal welfare system, which must be completed by September 2002. Under the 1996 law, Temporary Assistance for Needy Families (TANF) funds are distributed to each state as a block grant based on the state's welfare spending in federal fiscal years 1992 through 1995. Because caseload levels in New York State have declined significantly relative to those base years, New York—and many other states—has been receiving more TANF dollars than are required to maintain the programs that were incorporated into the block grant. The excess amount is often referred to as the "TANF surplus."

Over the last few years the city has made increasing use of these surplus funds allocated by the state to support ongoing child welfare programs such as foster care and preventive services, as well as expansions of its welfare to work initiatives including employment programs, child care, and transitional services. IBO estimates that in state fiscal year 2000/2001 the city will receive about \$470 million in TANF surplus funds for these purposes.

When TANF was originally authorized, few people anticipated the magnitude of the caseload reductions that have occurred. There was no intent to create large TANF surpluses in the states. Since TANF funds compete with other federal spending needs, it is likely that some in Congress will push for significant reductions in the block grants to states. Depending

on the size of any reduction, a decrease in New York State's grant could result in the reduction or elimination of the flow of TANF surplus funds to the city. Given the city's growing dependence on these funds, a significant reduction could have a major fiscal impact, and force city officials to make difficult choices between increased city funding for social programs and program cuts.

A second potential risk to the city's welfare budget is the possibility of an economic recession. All of the reductions in the FA and SNA caseloads in recent years have occurred during a period of economic prosperity. Historically, economic downturns have been associated with growing public assistance caseloads, as increases in unemployment push more people onto the rolls and make it harder for others to leave. In the recession of the early 1990s, the net loss of about 350,000 jobs in the city was associated with a rise in the public assistance rolls of about 300,000 persons. While welfare reform policies have raised the barriers to receiving assistance, it is likely that a similarly severe downturn in the local economy would significantly increase caseloads and grant costs.

The current slowdown in the national economy, which was first felt in the manufacturing sector, appears to be following a different course from the recession of the early 1990s. Even if growth at the national level were to turn negative for two or more consecutive quarters (the official definition of a recession), city job losses on the scale seen a decade ago are not anticipated. If the impact on the city's job market is modest, any increase in the welfare caseload is also likely to be modest.

For the state fiscal year 2000/01, state officials have projected a statewide MOE spending shortfall of \$225 million. In order to bring spending up to the MOE level, they are increasing the state's share of spending on Family Assistance, and assessing a "surcharge" on local governments. The local government surcharges will be withheld from their

federal reimbursement for grant expenditures, forcing the localities to bear more than their usual 25 percent of the FA cost. The city's surcharge for the current state fiscal year is expected to be about \$78 million. The MOE shortfall and the resulting surcharges for state fiscal year 2001/02 are expected to be somewhat higher.

**IBO Reestimate of the Mayor's Budgetary Proposals for Public Assistance***Dollars in millions*

	2001	2002	2003	2004	2005
<b>CITY FUNDS</b>					
Mayor's Projections	\$401	\$351	\$355	\$355	\$355
IBO Adjustments:					
Cash Grants	\$0	\$8	\$28	\$29	\$29
Additional Funds to Cover MOE Shortfall	\$65	\$34	\$1	\$1	\$1
Assumption of No Use of TANF Funds for EITC	<u>\$0</u>	<u>\$40</u>	<u>\$40</u>	<u>\$40</u>	<u>\$40</u>
<b>Total Adjustments to Mayor's Projections</b>	<b>\$65</b>	<b>\$82</b>	<b>\$69</b>	<b>\$70</b>	<b>\$70</b>
<b>IBO Projections</b>	<b>\$466</b>	<b>\$433</b>	<b>\$424</b>	<b>\$425</b>	<b>\$425</b>
<b>TOTAL FUNDS</b>					
Mayor's Projections	\$1,295	\$1,243	\$1,244	\$1,246	\$1,246
IBO Adjustments:					
Cash Grants	(\$9)	(\$84)	(\$117)	(\$117)	(\$117)
Additional Funds to Cover MOE Shortfall	\$65	\$34	\$1	\$1	\$1
Assumption of No Use of TANF Funds for EITC	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
<b>Total Adjustments to Mayor's Projections</b>	<b>\$56</b>	<b>(\$50)</b>	<b>(\$116)</b>	<b>(\$116)</b>	<b>(\$116)</b>
<b>IBO Projections</b>	<b>\$1,351</b>	<b>\$1,193</b>	<b>\$1,128</b>	<b>\$1,130</b>	<b>\$1,130</b>

SOURCES: IBO; Fiscal Year 2002 Preliminary Budget

The Preliminary Budget includes some city funds to cover the MOE shortfall, but not nearly enough to fully fund the expected surcharge. IBO estimates that the additional city funds needed to cover the surcharge will amount to \$66 million in 2001, \$62 million in 2002, and \$59 million in later years, before accounting for the incremental costs of shifting recipients from FA to SNA. Under federal rules, each additional dollar spent in shifting families from FA to SNA reduces the MOE shortfall by an equal amount. The city will still be responsible for satisfying its share of the MOE, whether it accomplishes this by paying a surcharge or through higher grant costs from shifting recipients from one program to another. As a result, at least under the current circumstances, the additional costs of shifting recipients to the SNA program are not expected to change the city's overall liability.

**The impact on recipients.** While shifting recipients from FA to SNA may have little impact on the city budget in the near term, it does have an impact on recipients. Once they are shifted to SNA, most of

their benefits will be distributed in the form of vouchers, and eventually through debit cards, rather than as cash. (Although SNA recipients generally receive cash benefits during their first two years on the program before being shifted to a voucher arrangement, the state plans to treat those recipients shifting over from FA as having exhausted their cash benefit period.) Vouchers and debit cards cannot be as widely used as cash, which may help reduce problems with benefits being used inappropriately. On the other hand, they may limit the possibilities for recipients to stretch benefits by shopping at tag sales and other informal markets.

**Earned Income Tax Credit.** An additional element in IBO's expenditure projections is the Mayor's Earned Income Tax Credit (EITC) proposal. The Preliminary Budget calls for establishment of a city EITC, with the refundable portion funded using federal TANF dollars. Using TANF funds for this purpose requires the state to allocate some of its TANF surplus, an action that may not occur, in part because the state uses TANF surplus funds to help pay the refundable

portion of its own state-level EITC. To account for the proposed use of TANF funds for the refundable portion of the credit, the Preliminary Budget removes \$40 million in city funds from the Human Resources Administration (HRA) budget and replaces them with an equal amount of TANF funds. (These freed-up city funds are then available to offset the personal income tax revenues lost to the EITC.) If the use of TANF funds for a city EITC is rejected by the state legislature, there would be a \$40 million shortfall in the welfare budget in 2002 and later years. IBO's expenditure estimates assume that TANF funds will not be made available and therefore \$40 million in city funding will be restored to HRA's budget each year.

As an alternative to using TANF funds to pay for the refundable portion, the city could implement an EITC using only city funds. If it did so, the city could then count the cost of the refundable portion against its MOE, a procedure that is allowed under current federal rules.

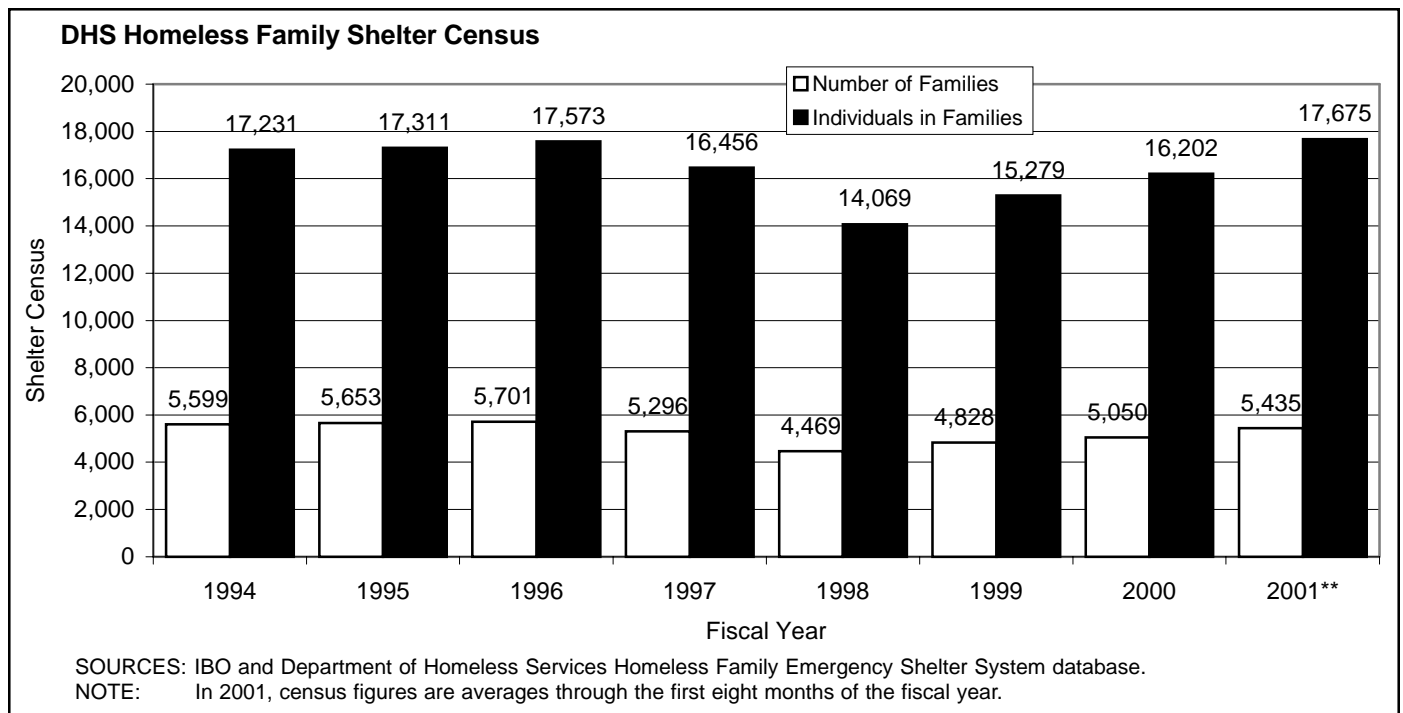
**Department of Homeless Services**

**Budget overview.** IBO estimates that spending by the Department of Homeless Services (DHS) for the current year will be \$482.5 million, an increase of

\$31.7 million over the Adopted Budget. The majority of the additional funding, \$19.1 million, will provide new shelter units for the increasing number of families in the system, raising family shelter spending at DHS to \$175.6 million for 2001. Under the Preliminary Budget, \$21.5 million in additional family shelter spending would also be provided for 2002, bringing total DHS spending to \$483.9 million. For the 2003 to 2005 period, \$34.1 million in family shelter spending would be added each year, with total DHS funding roughly constant at \$497 million annually.

The additional funds will add 600 hotel units and 400 Tier II units. The privately run hotels house families waiting for eligibility determination in order to enter the system. The Tier II shelters provide transitional housing for eligible families waiting for permanent housing.

As of the end of January 2001, the shelter system contained over 5,500 family units in 100 facilities. Four hundred of the additional 600 hotel units identified in the Preliminary Budget have already been added to the system, while 11 of the 400 Tier II units have been added. By 2003, when all of the units have been added, the system will contain over 6,000 family units.



**Rising homeless population.** The Administration has increased funding in response to the growing number of families in need of shelter. Since DHS was established in 1993, the peak census year for the shelter system was 1996 with an average of 5,701 families for the year. Due in part to mandated eligibility investigations, the census dipped to 4,469 families by 1998. Since then, the census has climbed each year. Through the first eight months of 2001, the census has averaged 5,435 families.

One reason the number of families in the system has increased is the lack of affordable housing options available to low-income families. The production of housing for homeless families has declined in the last five years, according to the Mayor's Management Report. This is a key reason families are forced to stay in the system for longer periods. The average length-of-stay at all family emergency shelter facilities has risen from 257 days in 1999 to 285 days in 2000. Through the first eight months of 2001, the average length-of-stay has grown to 305 days.

## Department of Employment

**Budget overview.** The Department of Employment (DOE) uses funding primarily from the federal Workforce Investment Act (WIA). The city is expected to receive approximately \$126 million annually in WIA funding targeted to three distinct populations: adults, dislocated workers, and youth.

DOE projects spending \$140 million in 2001. In 2002, however, spending will decline to \$100 million. The decrease is due to the transfer of WIA-funded adult programs from DOE to the Human Resources Administration. DOE will retain responsibility for WIA's dislocated worker and youth programs, which are expected to receive \$86 million in federal funds in 2002.

**Youth employment programs.** WIA legislation requires that funds be used to provide year-round programs for youth, ages 14 to 21, rather than stand-alone summer youth employment programs as under previous law. These year-round services will include

work-readiness training, leadership development, tutoring, and career exploration workshops. The city recently selected organizations to provide these services and expects year-round program services for 11,000 youth to begin by April 2001.

Based on the Preliminary Mayor's Management Report, the city provided 39,610 jobs for youth in summer 2000, comparable to the average of 39,962 jobs provided over the five preceding summers. A total of \$44.5 million was spent to provide the summer positions, including \$12.6 million in WIA funding, \$22 million in Temporary Assistance for Needy Families (TANF) funds, and \$9.9 million in city funds. Without the infusion of TANF funding from the state, however, the city would have provided significantly fewer jobs than in the past.

For summer 2001, the Governor has proposed allocating \$25 million in TANF funding for youth employment programs. Based on federal funding formulas, the city would receive approximately \$15 million of these funds. Additional funding may be added, however, when the state budget is ultimately enacted.

Beyond the uncertainty over funding levels, another issue is whether the TANF-funded portion of this year's program will be summer-only or for the entire year. Last summer was considered transitional, and the year-round component of the program was not fully implemented. It is not yet known what guidelines will be attached to the state funds provided for this upcoming summer. If the funds are distributed with WIA-compatible regulations, the city would have to provide follow-up services for the participants. Because this would raise the cost of each position, such a requirement could result in fewer jobs than provided last year even with the same amount of funds. Unless a new stand-alone summer youth employment program is developed without the use of WIA funds, community-based organizations that are contracted to run the program, as well as the young people who participate, will need to adjust quickly to maximize the benefits of the services provided under the new legislation.

## Health and Hospitals Corporation

**Budget overview.** After five consecutive years of surpluses generated through cost cutting and higher productivity, the Health and Hospitals Corporation (HHC), is now facing a period of decreasing revenues and rising expenses. As a result, the agency expects to end 2001 with a projected budget deficit of \$313 million<sup>1</sup> for its network that includes 11 acute care hospitals, six diagnostic and treatment centers, four long-term care facilities, 46 child health clinics, and a health maintenance organization called MetroHealth Plus.

Though HHC finished 2000 with a surplus of \$9 million, this was achieved only through last-minute budget maneuvers that are not likely to recur—a payment of \$108 million from the city for various HHC services and \$93 million from one-time pension savings. From 2000 to 2001, HHC is expecting revenues to decrease by 5.0 percent while expenses rise by 2.9 percent. HHC expects its deficit to grow further in 2002 to \$356 million. Despite these projections, the city is not obligated to provide assistance unless HHC's cash position—as opposed to its financial condition according to generally accepted accounting principles—turns negative.

**Decreasing revenues.** The projected decline in revenues from 2000 to 2001 is attributable to several factors. HHC expects reductions in inter-governmental transfers due to changes proposed by the Governor in Medicaid reimbursement. Losses are also projected as a result of reductions in Medicare reimbursements mandated by the federal Balanced Budget Act of 1997. Losses stemming from the continued increase in the share of Medicaid beneficiaries in managed care will cause relatively modest reductions in HHC's revenues this year. Managed care is expected to have a greater effect in future years, however, as competition increases for Medicaid patients and reimbursement per patient declines (see Medicaid discussion for additional information).

**Increasing expenses.** Compounding its revenue shortfall, HHC is also contending with significant unreimbursed costs and anticipated increases in basic operating expenses. The largest factor is the cost of treating the uninsured. In 2000, HHC cared for 560,476 uninsured patients, an increase of 13 percent over the prior year. While HHC was reimbursed \$480 million for treating the uninsured by the state's Bad Debt and Charity Care pools, the pool reimbursements fell short, forcing HHC to provide an additional \$300 million in unreimbursed care.

The cost of caring for the uninsured is exacerbated by Medicaid ambulatory care reimbursement rates that have not increased in over 10 years. The effects of the stagnant rates are reflected in HHC's analysis of its ambulatory care clinics, which shows that in 1999 HHC lost \$58 per visit in its hospital-based clinics and lost \$104 per visit at its diagnostic and treatment centers.

In addition to the significant unreimbursed costs, HHC faces the burden of making debt service payments to modernize its infrastructure. Prior to 1993, the city covered the cost of servicing HHC's debt. Since then, HHC has made debt service payments ranging from \$150 million to \$200 million a year. HHC also expects significant increases in costs associated with collective bargaining negotiations and prescription drug purchases.

**Deficit reduction plans.** HHC has taken several steps to combat the pending deficits. Besides implementing a hiring freeze, HHC will try to reduce its workforce by 4,000 employees over the next four years through attrition and early retirement incentives. For 2001, HHC estimates that it will save \$9 million through early retirement actions. To spur further savings, HHC is conducting a survey of all of its ambulatory care clinics and plans a consolidation of services; HHC has also placed a moratorium on building new ambulatory care centers or expanding existing ones.

In addition, HHC has begun privatizing its non-core services by outsourcing its laundry and security. HHC expects to save \$3 million annually through

privatizing its laundry services and \$61.6 million over five years through privatizing security services. The plan to privatize hospital security is now facing considerable opposition. A recent City Council bill aimed at preventing the change was vetoed by the Mayor, and the Council is considering an override. Additionally, the union representing the current 837 hospital peace officers has filed a lawsuit to block the privatization.

In order to increase revenues, HHC implemented a new corporate-wide policy in February 2001 that charges a \$10 administrative handling fee per outpatient prescription for uninsured patients. This fee is projected to yield up to \$5 million a year. (In 2000, HHC spent more than \$23 million on prescription drugs for the uninsured outpatient population.)

HHC also has increased efforts to reduce the impact of treating the uninsured by attempting to enroll eligible hospital patients in Medicaid. In 2000, HHC enrolled 45,063 of its 68,580 uninsured hospitalized patients who were eligible for Medicaid. HHC estimates that it gains between \$7,000 to \$9,000 per patient through the conversion process.

## Medicaid

**Expense overview.** New York City contributes almost 20 percent of the local cost of Medicaid, a federal health insurance program for the poor. The federal government pays for 50 percent of Medicaid, and the state covers the remainder.

The Preliminary Budget projects that the city's Medicaid expenditures will be \$2.9 billion in 2002, a 7.2 percent increase over the Administration's projection for 2001. The average annual increase from 2002 to 2005 is projected to be 5.0 percent. Most of the increases are attributable to higher costs for skilled nursing facilities, inpatient hospitalization, and pharmaceuticals, rather than the impact of major policy changes.

IBO's forecast for Medicaid spending by the city in 2002 is also \$2.9 billion, although IBO projects

slightly higher growth averaging 5.8 percent through 2005. By 2005, IBO estimates that total spending on Medicaid will be \$3.5 billion, \$150 million higher than the Administration's estimate. The difference in the forecasts is driven by IBO's estimate that inpatient hospital expenses and pharmaceutical costs will grow even faster than the Administration assumes.

**Mandatory managed care.** The number of the city's non-elderly Medicaid recipients enrolled in managed care is a very important factor in projecting the city's Medicaid budget. In the past, the Administration has estimated that a shift into managed care will yield annual savings of 10 percent, because managed care can provide services more efficiently. The rate at which the Medicaid population transitions into managed care could have a significant effect on overall Medicaid spending.

Currently, managed care enrollment and its impact on Medicaid spending remain very unpredictable. There are 1.8 million Medicaid recipients in the city, approximately 1.5 million of whom are required to enroll in a managed care plan as part of a mandatory enrollment process. Although mandatory enrollment is scheduled to phase in over several years, so far enrollment has barely increased. At the start of mandatory enrollment in the fall of 1999, 375,000 Medicaid recipients were voluntarily enrolled in managed care plans; as of December 2000, enrollment was just over 395,000. At this current rate of growth, under 20,000 a year, managed care will not likely have any significant impact on Medicaid expenditures by 2005.

**HealthStat.** In the fall of 2000 the city began an outreach effort—called HealthStat—to expand enrollment of uninsured children into Medicaid and Child Health Plus, a publicly subsidized insurance program for lower income working families. The number of uninsured in the city has been growing, in part because of a fall-off in Medicaid enrollment that started in 1995 when Medicaid covered 900,000 city children. As of June 2000, the number of children enrolled in Medicaid had fallen to 800,000.



Even if the enrollment program is successful and the number of children covered grows substantially, it may have limited effect on overall Medicaid spending. Although children are currently about 45 percent of total enrollment, they represent approximately 20 percent of the city's Medicaid expense. For every 10 percent increase in the number of children enrolled, IBO projects that the city's overall Medicaid expense will rise by only 2 percent. In contrast, if HealthStat were expanded to include aggressive outreach to adult populations, the effect on cost would be significantly higher. The Administration has indicated that it might seek to enroll more adults in Medicaid if the outreach program with children is successful, although there is no provision for such an initiative in the Preliminary Budget.

**Family Health Plus.** In early 2000, the State of New York enacted Family Health Plus, an expansion of

Medicaid eligibility for uninsured adults as part of the Health Care Reform Act 2000. Because responsibility for funding Medicaid is shared by the city, state, and federal governments, the expanded program will increase spending by all three levels of government. Although the New York State Department of Health expected to begin enrollment in this year, the program is still awaiting approval from the federal government. IBO's estimate of Medicaid expenditures assumes that approval will be granted and enrollment will begin this fall, costing the city about \$18 million in 2002. Assuming that enrollment will reach 150,000 over the next four years, IBO projects that Family Health Plus will cost the city \$100 million in 2005.

**Notes:**

<sup>1</sup> Like the rest of the city's budget, these figures are reported on a 'modified accrual basis' in accordance with generally accepted accounting principles for governments. On a cash basis, however, HHC expects to end the year with a surplus of \$324 million.



# Education

## Board of Education

- Board of Education (BOE) spending is projected to reach \$12.2 billion in 2002 and grow at an average annual rate of 3.9 percent through 2005, considerably slower than the 9.4 percent average annual growth over the past four years.
- The proposed budget would increase resources for summer programs, weekend classes, classroom libraries, and school safety. The city would provide no new funds for these initiatives; instead the city would return to BOE a portion of the funds that it transferred last June to an education reserve in the miscellaneous budget.
- The Governor's executive budget does not address the recent court order overturning the state education finance system.

This section begins with an overview of BOE's budget, highlighting several factors contributing to spending growth. The discussion continues with an examination of proposals to expand summer school, add weekend classes, create classroom libraries, and hire more school safety agents. The next segment discusses the fiscal impact of new policies pertaining to bilingual instruction and special education. The focus then turns to the state budget and its impact on education aid for the city, including a brief discussion of the recent court ruling overturning the state's system of education finance.

**Budget overview.** IBO estimates that under the Mayor's Preliminary Budget proposals, BOE spending will be

\$12.2 billion in 2002, an increase of \$669 million over the projected 2001 level. Spending will grow at an average annual rate of 3.9 percent during the Financial Plan period, reaching \$13.5 billion in 2005.

In comparison, the Administration projects BOE spending of \$11.4 billion in 2002 and \$11.8 billion in 2005. Most of the difference between the IBO forecast and the financial plan is due to our higher forecasts of state and federal education aid. The Administration's intergovernmental aid forecasts are conservative. For example, the Administration projection of federal aid in 2005 is less than BOE actually received in 2000, and \$447 million below the IBO projection.

A second difference is IBO's inclusion, at the agency level, of five years of anticipated salary increases. In contrast, the Administration has not budgeted for salary increases beyond 2003. The Administration's collective bargaining reserve for BOE equals \$125 million for 2001, \$284 million for 2002, and levels off at \$327 million a year for 2003, 2004, and 2005. A third difference is that IBO assumes that the Administration will eventually return to BOE all of the funds that were transferred from the board to an education reserve in the city's miscellaneous budget. The balance of the difference, \$142 million in 2002 growing to \$453 million in 2005, is primarily attributable to differences in assumptions about the cost of implementing policy initiatives.

IBO uses an econometric model to forecast education spending. The model incorporates the historical relationship between actual expenditures and enrollment and staff levels with the greatest weight given to the most recent years.

**Recent growth in spending.** Over the last four years, BOE spending has grown at an average annual rate of 9.4 percent.

Average Annual Change in BOE Spending		
	Nominal	Real
1990-1997	3.4%	-0.2%
1997-2001	9.4%	5.6%
2001-2005	3.9%	0.6%

SOURCE: IBO.  
 NOTES: Data for 2001-2005 are IBO projections. Real growth adjusted for inflation based on New York state and local government output.

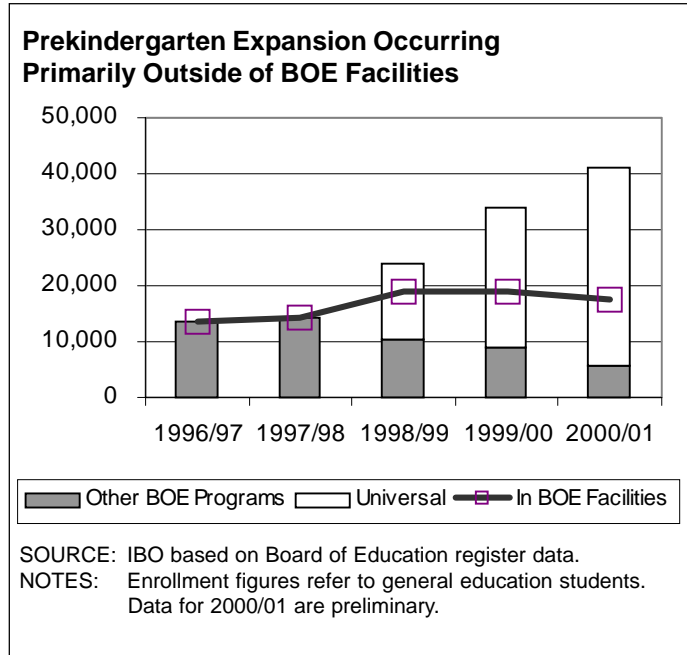
This period of expansion follows several years during which BOE spending grew at roughly the rate of inflation. An important factor driving

the recent spending increases has been state and local pressures to improve student performance to meet higher promotion and graduation standards. The board has been reducing class sizes, expanding summer and evening sessions, and devoting more resources to instruction, especially early childhood and arts programs. As a result, pedagogical staff has increased from 80,900 to 94,800 during the past four school years. IBO projects that under the Preliminary Budget, pedagogical headcount would stabilize in 2002 and remain essentially level through 2005.

Preliminary data from the current school year confirm that K-12 enrollment has stopped growing in recent years. Although total enrollment has increased by 24,000 students since 1998, virtually all of this growth is attributable to prekindergarten expansion. In contrast, enrollment was growing by nearly 20,000 pupils per year during the early- to mid-1990s. BOE projects stable K-12 enrollment through 2005, with a steady rise in high school enrollment offset by a decline in the early grades.

**Prekindergarten expansion.** Three years into a four-year state initiative to make preschool available to all four-year olds, the board's general education pre-k

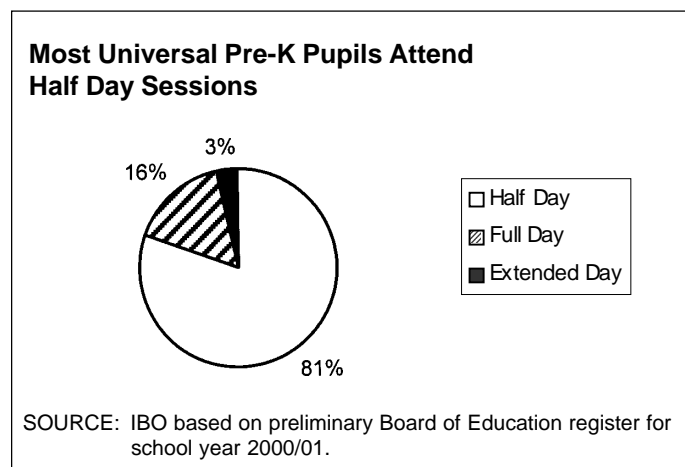
enrollment has grown by nearly 26,800 pupils to 41,100. Around 35,300 pupils are enrolled in the state-funded universal prekindergarten program, while 5,800 pupils are in programs—such as Super Start—that predate the universal state program.



The board faces serious challenges expanding prekindergarten while simultaneously trying to ease overcrowding and reduce class sizes in grades K-3. Many areas of the city lack the classroom space in schools or community-based facilities needed to serve all eligible four-year olds.

Another challenge is that universal pre-k is primarily a half-day program and demand for short sessions has been below expectations, leaving seats unfilled in some neighborhoods. The schedules of working parents usually make full-day preschool or child care programs more attractive than half-day sessions. Some providers have used other funds in conjunction with universal pre-k dollars to create full-school-day sessions, and in a few instances longer sessions that extend beyond the regular school day. Nevertheless, roughly fourth-fifths of universal prekindergarten pupils attend school for half a day. Fifty percent of universal pre-k students attend morning sessions and 30 percent attend afternoon sessions.

BOE needed to enroll 44,000 pupils in universal pre-k this year to qualify for the maximum state grant of \$147 million. Because BOE has fallen short by 8,700 students, state funding for the current year has been reduced by \$29 million. The state allowed approximately \$19 million of that amount to be placed in reserve for use during the next school year, but due to missed deadlines for identifying the shortfall, the remaining \$10 million of state aid will be forfeited. IBO projections assume that prekindergarten expansion will continue but that full implementation of the universal pre-k initiative will take longer than was anticipated in the original legislation. IBO expects pre-k enrollment to increase by another 30,000 students by 2005 with most of the expansion occurring in community-based sites. The number of prekindergarten classes housed in BOE facilities has already leveled off.



**Charter schools.** One factor reducing the number of students entering BOE schools is the opening of publicly funded charter schools. In 1998, the state enacted a law permitting the creation of 100 new charter schools statewide, plus an unlimited number of conversions of existing public schools to charter schools. During the current school year, 14 charter schools are operating in New York City (eight new schools and six conversions) with six more (five new and one conversion) already approved to open next fall. IBO projects that charter school enrollment will reach 25,000 pupils by 2005.

By law, BOE must provide charter schools in the city with a base operating payment equal to the school system's average operating expenditure per pupil as calculated by the state. Average operating expenditures exclude items for which charter schools receive separate funding, such as state and federal categorical grants, food service, and transportation. Some of these supplemental funding streams flow through BOE, while others flow directly to the charter schools. IBO projects that total BOE payments to charter schools (base plus categorical payments for special education and textbooks) will equal \$83 million in 2002 rising to \$236 million in 2005.

In preparing the financial plan, the Administration assumes that the level of funding for charter schools has no impact on the overall BOE budget because nearly all students attending New York City charter schools would have otherwise attended BOE public schools. In contrast, based on the experience of other states with charter schools, IBO assumes that 25 percent of the students in new city charter schools (excluding conversions) would not otherwise attend public schools. If charter schools were not an available option, these students would either attend parochial and private schools, be schooled at home, or drop out. Their enrollment in charter schools increases the number of students who are the fiscal responsibility of the board. IBO projects that by 2005, BOE will spend \$31 million on 3,400 additional students attending charter schools who would not otherwise be enrolled in BOE schools.

When estimating costs, IBO assumes that charter schools will have the same special education student profile as BOE schools. This assumption will likely need to be modified when more information becomes available about the characteristics of charter school students.

**Pay-as-you-go capital.** The board faces daunting capital needs, with three-fifths of its students attending overcrowded schools and many school buildings outdated and in poor condition. School construction

and repair is generally funded through the city capital budget using debt financing, but during 2000 BOE began funding some capital projects from its operating budget. Consistent with the city's capital commitment plan, IBO projections include \$85 million in pay-as-you-go capital spending for education in 2001, \$75 million in 2002, and \$80 million annually in 2003 through 2005.

**Education reserve in miscellaneous budget.** As has been the case in recent years, the Preliminary Budget for 2002 includes new initiatives to increase instructional time and enhance school safety. This year's highlights include Saturday classes for English Language Learners and students preparing for Regents science exams, summer classes for 50,000 additional students, hiring 800 school safety agents, purchasing 300 library books for each elementary and middle school classroom, and adding teachers to work with students serving in-school suspensions.

Unlike previous years, however, no new city funds would be provided for these initiatives. Instead, the Administration would return to BOE a portion of the

The city would also free up \$20 million per year to pay for the initiatives by rescinding a scheduled increase in spending on physical education and athletics.

The Administration transferred \$88 million per year to the miscellaneous account in an effort to compel the board to reduce central administration and redirect resources to instruction. Since then the Chancellor has detailed administrative cost reductions of \$9 million in 2001 and \$13 million in 2002. The city has already returned \$44 million of the 2001 miscellaneous reserve to BOE to fund new initiatives and under the Preliminary Budget would return \$83 million in 2002, and \$67 million in 2003, 2004, and 2005. IBO spending projections assume that the administrative savings identified by the Chancellor will be realized and that all funds remaining in reserve—\$43 million in 2001, \$5 million in 2002 and \$21 million per year beginning in 2003—will eventually be transferred back to BOE.

**Details of local initiatives.** Implementation of several of the local initiatives highlighted in the Preliminary

<b>Existing Funds Used for New Initiatives</b>					
(Millions of dollars)					
	2001	2002	2003	2004	2005
<b>Sources of Funding</b>					
Funds Returned from Miscellaneous to BOE (1/01)	\$44	-	-	-	-
Proposed Return from Miscellaneous to BOE	-	83	67	67	67
Rescind Increase in for Fit-for-Life	-	20	20	20	20
<b>Total Funding</b>	<b>\$44</b>	<b>\$103</b>	<b>\$87</b>	<b>\$87</b>	<b>\$87</b>
<b>Proposed Spending</b>					
Classroom Libraries	\$15	\$17	-	-	-
Project Science	6	25	25	25	25
Hiring of School Safety Officers	3	10	10	10	10
Summer School Expansion	2	23	23	23	23
In-School Suspension Centers	5	19	19	19	19
Project English	2	9	9	9	9
Other Current Year Needs	11	-	-	-	-
<b>Total Spending</b>	<b>\$44</b>	<b>\$103</b>	<b>\$87</b>	<b>\$87</b>	<b>\$87</b>

SOURCES: IBO, OMB, Board of Education.  
 NOTES: Numbers may not add due to rounding.

\$88 million per year that was transferred last June to an education reserve in the miscellaneous budget.

Budget has already begun. By next year, all K-8 classrooms in BOE, charter, and nonpublic schools

are expected to have collections of 300 new books. Later this spring, BOE plans to initiate Project Science, a Saturday program providing three hours of supplemental science instruction for students in grades eight through 12. Over 45,000 pupils will attend classes averaging 15 students in preparation for meeting increasingly challenging state graduation requirements. Students will have to pass a Regents science exam to graduate, beginning with the cohort that entered ninth grade in September 1999. The minimum passing score in science will increase from 55 percent to 65 percent beginning with the cohort entering ninth grade in September 2001.

BOE transferred responsibility for school safety functions to the Police Department in December 1999, although the funding remains within the BOE budget. The Preliminary Budget would allocate \$10 million for 293 new school safety positions. The plan anticipates increasing the school safety force by a total of 800 including filling 507 vacancies. Another preliminary budget proposal would mitigate disruptive behavior by creating in-school suspension centers. Principals and superintendents suspended over 45,000 students during the 1999/00 school year, according to the board. Rather than sending all these disruptive students home, some would be assigned temporarily to an in-school suspension classroom. The budget would allocate \$19 million to hire teachers to staff the suspension classes, 50 percent of the total cost. The city expects the board to fund half the cost through state aid increases.

The Preliminary Budget would increase annual funding for summer school by \$23 million. Funding for summer session instruction would increase from \$151 million to \$174 million while funding for support services would remain unchanged at \$20 million. The enhanced summer program, part of the board's continuing effort to end social promotion, provides another opportunity to earn promotion to the next grade.

Although the increased funding reportedly provides the resources to serve a total of 370,000 students this summer, some uncertainty remains about the

anticipated enrollment. Under state law, summer attendance is not compulsory, even for students assigned to attend. Moreover, some students voluntarily attend summer classes for enrichment. In summer 1998, when there was no policy of assigning students to summer school, 215,000 students attended. Enrollment increased to 228,000 in summer 1999, when the board began assigning students to attend. A larger number of students were assigned to attend summer school in 2000. Funding was provided for 321,000 pupils and 319,000 pre-registered. Enrollment, however, fell to 292,000 with surplus funds reallocated to support school-year programs.

**New policy for English Language Learners.** In February, the board approved the development of a new instructional policy for the roughly 15 percent of city public school students that are English Language Learners (ELLs). Among other changes, the policy sets a goal of having all students in the ELLs program develop English proficiency within three years of entering. Under the new graduation requirements, the state requires all students, including ELLs, to pass Regents exams in English, math, global history and geography, U.S. history and government, and science. The budget would allocate \$9 million for Project English, a new program to provide three hours of intensive English instruction on Saturdays for the 38,600 students in the system who have been in the ELLs program for at least three years.

The Chancellor has estimated that implementing the new instructional policy will cost \$75 million per year. The Chancellor is expected to seek the remaining \$66 million in his forthcoming annual budget request.

**New continuum for special education.** In recent years, BOE has faced continuing pressure from the federal and state governments to limit special education referrals and place students in the least restrictive environments. In June 2000, the board adopted a new Continuum of Special Education Services to more effectively align services to students' individual

learning and behavioral needs. The most important aspect of the Continuum is its emphasis on educating children in the least restrictive environment. This means that fewer students will be referred to special education and also that a greater proportion of those students referred to special education will receive services in a general education setting.

For the current school year, the board has revised its budget procedures to maximize district flexibility in implementing the new plan. More than 40 formerly separate budget allocations have been combined into a single Special Needs/Academic Intervention Services (SN/AIS) allocation. The new SN/AIS allocation provides districts with funding based on multiple measures of student need. The number of youngsters served in self-contained special education classes under the old system is only one of seven factors determining the SN/AIS allocation that a district receives. The number of students receiving special education services in the current year does not affect the SN/AIS allocation.

While the new continuum should result in fewer students being registered in special education, it will not necessarily produce cost savings. The policy has been designed to reclassify and redirect services rather than reduce services. In other words, while spending on special education should decrease, spending on general education may very well increase by a commensurate amount. The new policy may, however, cause BOE to lose revenue because the current state formulas for excess cost aid and high excess cost aid are driven by the percentage of the time a student spends in a special education classroom. One of the board's top legislative priorities is obtaining increases in forms of aid that are placement neutral, such as Educationally Related Support Services Aid.

## State Budget for Schools

**Overview.** One of the major uncertainties facing the city and the BOE in assembling their budgets for the upcoming year is the amount of state aid that will be

available. School aid is one of the most contentious issues each year in the budget negotiations between the Governor and the legislature, so the final level is usually not known until late spring.

In light of the court decision earlier this year overturning the state education finance system, school aid negotiations are likely to be even more difficult than usual this year. (See sidebar "Campaign for Fiscal Equity and Local Effort.") Although the decision ordered the legislature to overhaul the state's school aid formulas by this fall, no change is expected for the 2001/02 school year because the state is appealing the decision. Given the uncertainties as to the ultimate outcome and when a new system would be implemented, IBO projections make no provision for changes that may result from the court order.

The annual school aid allocation process begins with submission of the Governor's Executive Budget in January. As in prior years, the Governor's budget for state fiscal year 2001/2002 contained a number of significant spending modifications, resulting in a modest 2.8 percent net increase (\$382 million) in education aid statewide.<sup>1</sup> By comparison, if no changes were made to current laws spending next year would grow by \$1.5 billion, according to State Education Department (SED) estimates.

Based on past experience, the State Senate and Assembly are likely to restore some of the reductions in current law allocations proposed by the Governor and add some of their own initiatives during the coming negotiations. The adopted state budget, therefore, will likely increase education aid more than the Governor's proposal.

The Governor's budget proposals do not explicitly address the findings of the CFE decision. Instead his proposals focus on streamlining the allocation of school aid to allow districts greater flexibility in how they use state aid, scaling back the universal pre-k and early grade class size initiatives, and restructuring the building aid program.



## Campaign for Fiscal Equity and Local Effort

On January 10<sup>th</sup>, Justice Leland DeGrasse ruled in favor of the Campaign for Fiscal Equity (CFE) in its lawsuit against New York State. He found that the BOE was not able to deliver a “sound basic education” as required by the State Constitution, laying much of the blame on inadequate and overcrowded school buildings, poor teacher quality, and deficient instructional materials and textbooks. The Judge attributed many of these problems to a lack of financial resources, specifically faulting a process of allocating state aid that does not sufficiently recognize the city’s concentration of high-need students and competing demands for the city’s fiscal resources. He ordered the legislature to come up with a new funding arrangement by September 15<sup>th</sup> of this year. Governor Pataki has decided to appeal, so a final outcome will likely be delayed for at least a year and perhaps considerably longer.

In the aftermath of the decision, some officials have shifted discussion about deficiencies in state education aid to alleged shortcomings in city funding for education. Statements by the Governor and state legislators have cited recent increases in the share of total state aid going to the city. They also claim that the city’s contribution to BOE (local effort) is low compared with other districts with similar taxable resources (fiscal capacity) and has fallen as state aid to the city has been growing.

Measuring spending by funding source is not straightforward. Results can differ widely depending on which costs are included and when revenues are recognized, because intergovernmental aid payments are often delayed. For example, some calculations

focus on BOE’s operating budget, while others include additional costs for debt service and pension contributions.

Measuring and comparing local effort is even more problematic because it requires the selection of an appropriate fiscal capacity (the aggregate economic resources available to support locally funded expenditures) to serve as the denominator in the calculation: Local effort equals locally funded expenditures divided by fiscal capacity. While not ideal, assessed value for property tax purposes is commonly used to measure school district fiscal capacity because it is available for all districts across the state.

IBO analysis of BOE spending over the past decade finds that after a period of decline in the early 1990s, spending has increased markedly since 1997. The increase is due to additional funding from the city, state and federal governments, with city financing growing faster than state and federal financing. The city-funded share of the BOE operating budget grew from 40.0 percent in 1997 to 43.7 percent in 2000, while the state-funded share fell from 48.4 percent to 45.2 percent.

Additionally, state reports on local effort by the city seem inconsistent with IBO findings on total taxpayer burdens. IBO analyses measure local effort for all municipal services, not just education. Nevertheless, the high tax effort measured in IBO’s studies suggests that the city’s contribution to BOE relative to the city’s fiscal capacity may be higher than measured by New York State.

*Please see the following IBO publications for more background:*

“City Spending on Schools Rising,” Inside the Budget, January 30, 2001

“Taxing Metropolis,” Fiscal Brief, February 23, 2000

“Comparing Homeowner Tax Burdens Across New York State,” Fiscal Brief, February 11, 2000

**Flex Aid.** The Governor’s budget presentation stressed flaws in the current school aid formulas, citing their needless opacity and complexity, and the

limited flexibility they give school districts in determining how to spend state aid.

The state currently uses more than 50 different formulas to allocate grants to school districts. The centerpiece of the Governor's education program is a proposal to simplify and reduce the number of formulas. The Executive Budget would consolidate 11 existing formulas—including operating aid, several special education formulas, and minor maintenance aid—into a single formula with the goal of better reflecting regional cost differences and each district's enrollment of high needs students. Districts would have greater flexibility in spending the money granted.

Flex Aid would supplement current year funding under the 11 formulas by \$250 million, although keeping the existing formulas would result in a \$387 million increase for 2001/02. The single new Flex Aid formula would be used to distribute a total of \$9.8 billion—nearly 70 percent of all school aid—in 2001/02. The shift to Flex Aid in 2001/02 would result in New York City receiving \$102 million more in grants than it received from the 11 superceded formulas during the current year, according to state Division of Budget estimates.

**Universal prekindergarten and early grade class size.** In 1997, the state enacted legislation creating several initiatives aimed at improving early grade education. The major components—universal prekindergarten and early grade class size reduction—were to be phased-in over several years. The legislation included specified year-by-year funding levels for each initiative, although the actual grants are subject to annual appropriations. The Governor's budget proposes to forego next year's scheduled increases in funding for these two programs, holding appropriations at the 2000/01 level.

Universal pre-k makes preschool classes available to all four-year olds in the state. Under the terms of the 1997 legislation, 2001/02 was to have marked the fourth and final expansion of the program. Total appropriations for the statewide program were to grow from \$225 million in the current year to \$500 million for 2001/02. The Governor now proposes to forego the increase and maintain funding at this

year's level. He notes that actual spending in the current year will be less than the appropriation, and that many districts are finding demand below expectations and having difficulty locating classroom space to use all of the available grant. The city has experienced both problems and has been forced to forfeit some of this year's grant. For the city, next year's funding would be \$147 million rather than \$184 million. The city also would have available \$19 million in universal pre-k funds placed in reserve during the current year.

The class size reduction initiative makes resources available to districts to lower class sizes in grades K-3 to an average of 20 students. (Districts also receive federal funds to reduce early grade class sizes.) The state initiative started in 1998/99 and is scheduled to be fully phased in for the 2001/02 school year. The Governor proposes to hold funding for next year at \$140 million rather than the \$225 million anticipated in the original legislation. The 2001/02 state grant to New York City for the program would be held at \$89 million rather than increase to \$127 million.

**Building aid.** The Governor has proposed a significant overhaul of building aid formulas, which reimburse school districts for a portion of their capital expenditures. If his changes were enacted, building aid would grow by \$176 million next year, far less than the \$487 million increase that would result under present law. The proposal would create a fixed pool of aid to be allocated using a new priority rating operated by the State Education Department. This would replace an open-ended entitlement for projects meeting defined criteria. New York City would be guaranteed a minimum of 40 percent of the pool.

**City share of state aid.** The Governor emphasizes that the city's share of education aid has increased in recent years. This point is only accurate when excluding a major type of school district assistance distributed by the state: STaR aid. The STaR program reduces school district taxes for homeowners. Districts are reimbursed by the state for the foregone revenue using general funds raised through the state

personal income tax. STaR aid is most appropriately viewed as education aid, although it has not been consistently categorized as school aid in state and city budget documents.

As previous IBO analysis has shown, New York City receives a disproportionately low share of the statewide benefits.<sup>2</sup> STaR aid will increase by \$536 million in 2001/02, more than the proposed increase in all other types of education aid combined, according to the state Division of Budget. When STaR aid is properly included in the calculation of school aid shares, the portion flowing to the city remains well below the city's share of pupils.

### **City University of New York Community Colleges**

**Budget overview.** The City University of New York (CUNY) is the largest municipal university system in the nation. CUNY receives roughly three-fifths of its \$1.4 billion operating budget from the city and state and about two-fifths from tuition and fees.

The city and state have different areas of financial responsibility within the CUNY system. The state funds the four-year degree programs at 11 colleges, plus the graduate, law and medical schools. Both the city and state fund the six community colleges and the associate degree programs located in four of the senior colleges. The city alone funds elementary and secondary schools sponsored by Hunter College. Additionally, the state and federal governments subsidize tuition for low- to moderate-income students through grants, loans, and tax credits.

Under the Mayor's Preliminary Budget proposals, city spending on CUNY would be nearly flat through 2005. The budget proposes that CUNY reallocate funds from current resources to hire more full-time faculty and expand the College Now program with public high schools.

IBO estimates that the Preliminary Budget would result in spending of \$389 million for CUNY in 2002, a \$6 million decrease from the estimated 2001 level.<sup>3</sup>

This would provide approximately \$347 million for community colleges, exclusive of pension contributions. In addition, the budget would maintain current city contributions of \$32 million for associate degree programs at senior colleges and \$10 million for elementary and secondary schools sponsored by Hunter College.

Beginning in 2003, spending would rise by \$4 million per year, reaching \$401 million in 2005. Spending is projected to grow slowly—well below the rate of inflation—in part because of the city's decision not to fund collective bargaining costs for the community colleges. Although the city budget does not provide funds for increased labor costs, the university must still pay salary and wage increases negotiated with its unionized employees. If CUNY fails to secure funding from other sources for these mandatory costs, the university will have to close the gap by reducing other operating costs and/or increasing tuition.

Since 1991, annual state budget legislation has contained maintenance of effort (MOE) provisions compelling the city to provide the community colleges with at least the same subsidy as the previous year. Under the state provisions, CUNY community college tuition may only exceed one-third of operating costs if the city maintains effort. The Preliminary Budget proposal would provide the minimum level of city funding needed to comply with the state MOE requirement.<sup>4</sup>

**CUNY budget request.** The CUNY budget request, approved by the Board of Trustees on November 20, 2000, outlines priorities for the upcoming year. The trustees seek to increase the operating budget of the community colleges by \$32 million with roughly half of the new funding coming from the city and half from the state. Tuition revenue would not change, with the \$2,500 annual full-time tuition for New York State residents remaining the same for the seventh straight year.

The request includes funds to hire more full-time faculty, expand College Now, and \$5.3 million

needed to meet obligations of current labor contracts. Other requested increases include funds for digital library materials, instructional equipment, academic advising and tutoring, utilities, facility maintenance, and business incubator projects.

**City response.** Two community college initiatives, highlighted in CUNY's annual budget request, are included in the city's budget proposal. The initiatives would allocate \$5.5 million to hire more full-time faculty and \$5.0 million to expand College Now, a collaborative program to raise the academic performance of BOE high school students. With these additional funds CUNY would hire 100 full-time professors and expand the College Now program by 50 percent, raising enrollment from 25,000 high school pupils to 37,500.

But the Preliminary Budget also includes a \$10.5 million *decrease* labeled as an "MOE adjustment." The adjustment would prevent the city's contribution to CUNY in 2002 through 2005 from increasing beyond its current level. As a result, any spending increases for full-time faculty or College Now would have to be offset by reductions in other operating costs and/or increases in state aid or tuition. Without identifying alternative funding sources, it is unclear

whether CUNY will be able to meet the faculty or College Now goals.

The biggest proposed reduction in CUNY funding in the Preliminary Budget is the elimination of \$6.5 million in merit scholarships for graduates of New York City high schools entering senior colleges. The budget would preserve \$500,000 in scholarships for students entering community colleges. In each of the past two years, the Preliminary Budget proposed cutting merit scholarships, but each time funding was restored in the Adopted Budget.

**Notes:**

<sup>1</sup> In addition, the executive budget proposes no new appropriations for RESCUE, which would decrease capital funding for school construction and modernization by \$50 million.

<sup>2</sup> "School Tax Relief (STaR) in New York City," IBO Conference Paper, December 21, 1999.

<sup>3</sup> IBO expenditure projections exclude \$35 million for the senior colleges that each year are placed in the budget but by design are not spent; the \$35 million item merely functions as an accounting placeholder for expected state funding. IBO projections also exclude intracity sales.

<sup>4</sup> For more explanation of state requirements for funding community colleges see IBO's May 1999 report, "Analysis of the Mayor's Executive Budget for 2000," p. 17.

# Infrastructure

## Department of Housing Preservation and Development

**Expense budget.** The Mayor's Preliminary Budget for fiscal year 2002 provides \$321.8 million for the Department of Housing Preservation and Development (not including funds transferred among city agencies). City funds will comprise \$63.6 million of HPD's budget, with the rest coming from state and federal funds. HPD's projected budget for next year is less than its current modified budget of \$426.5 million, including \$68.2 million in city funds. IBO estimates that HPD's actual spending in 2002 will be at least \$411 million (net of agency transfers).

Part of the reason for the \$105 million difference between this year's housing budget and the Mayor's 2002 projected budget stems from the way the city recognizes federal support. Federal funds make up 80 percent of the HPD expense budget. HPD's budget will include at least \$175.4 million in federal community development block grant (CDBG) funds in 2002. CDBG funds are used for code enforcement, for classes in building management and maintenance for building owners, and for maintenance of city-owned (*in rem*) buildings. HPD also administers approximately 14,000 federal Section 8 vouchers, which accounts for about \$140 million of the agency's budget. Much of these Section 8 funds will not be recognized in the city budget until later modifications. IBO's estimate assumes that the city will receive an amount of federal aid consistent with previous years.

Management of HPD's extensive capital program is projected to cost \$15.7 million per year.

The Mayor's budget proposal eliminates \$4.2 million in City Council initiatives for legal services, community consultants and neighborhood preservation programs, and housing court information services. These items are regularly deleted in the Mayor's Preliminary Budget and added back by the Council in the Adopted Budget.

**Capital budget.** The highlight of this year's housing budget is the Mayor's \$1.2 billion capital construction initiative, which would be the largest investment in housing by New York City in nearly a decade. The four-year plan proposes the creation or renovation of 10,100 apartments.

Specifically, the Mayor's housing proposal would finance the renovation of roughly 7,000 existing units (including 1,100 vacant apartments), the construction of 3,100 new units, and the development of 875,000 square feet of commercial and retail space. Altogether, the plan would add 4,200 new or currently vacant units to the city's housing inventory, and renovate and return to private ownership another 5,900 occupied units. While these occupied units are likely to be home to many low-income households, the new apartments to be created under the plan are targeted to moderate- and middle-income families. The Mayor has made implementation of the entire initiative contingent upon the City Council passing rules that will ease regulations and lower the cost of construction in the city.

To date, \$688 million in public funds for the \$1.2 billion initiative have been identified. The administration expects private sector sources of funding will make up the balance. These would likely include commercial bank loans and private equity raised through the federal and state low-income housing tax credits (LIHTC). The federal LIHTC—allocated to states on the basis of population—was recently raised to \$1.75 per capita.

Public funding for the plan is proposed to come from two sources. City capital funds will provide \$336.0 million. At this time, no federal funds are planned for this initiative, but the administration is negotiating with two entities—the Battery Park City Authority and the New York City Housing Development Corporation (HDC)—to provide another \$150 million as part of the city’s capital plan.

Additionally, \$202 million is to be provided in the form of tax-exempt loans from HDC. These funds are part of the city’s share of the so-called private activity volume cap, under which state and local governments and quasi-public authorities such as HDC may issue tax-exempt debt on behalf of private-sector entities for purposes such as housing and commercial development.

**The construction programs.** The housing plan includes three programmatic elements.

The first would renovate and sell 5,900 occupied units through HPD’s third-party transfer program. Under this program, buildings that are often rundown and are in tax arrears are transferred by HPD to new ownership (tenants’ right of occupancy is protected, although rents may be restructured). The funds for this portion of the initiative—\$278.3 million—will be channeled through the city’s Participation Loan Program (PLP).

PLP loans, which have an interest rate of 1 percent, are blended with commercial bank and other private lending sources to provide below market interest rate loans for the moderate- to gut-rehabilitation of buildings with more than 20 apartments. For extensive rehabilitation work, one dollar of city PLP funds typically leverages 75 to 80 cents of private money, according to HPD.

Two other components of the Mayor’s initiative would add units to the affordable housing stock. The Vacant Buildings 2000 program would allot \$77.7 million—\$30.5 million in city funds and \$47.2 million in non-city funds—for loans and grants to privatize 133 vacant, city-owned (*in rem*) buildings containing 1,100 apartments. Under an expansion of the ANCHOR Program, the Mayor’s initiative would build 3,100 new units as well as help create 875,000 square feet of commercial space. The plan proposes allocating \$331.9 million in new city and non-city funds over four years for ANCHOR. Most of the remainder of the overall \$1.2 billion—about \$300 million—would come from private sources and be put toward the development of the ANCHOR commercial and retail component. The success of this portion of the initiative will depend to a great extent on the ability of the city to persuade private-sector partners to participate.

Most of the units to be renovated under the plan will be affordable to moderate- and middle-income

<b>Program</b>	<b>Total</b>	<b>City Funds</b>	<b>Non-City Funds</b>	<b>HDC Private Activity Bonds</b>	<b>Units</b>
Third-Party Transfer (PLP)	\$278.3	\$233.3	\$45.0	\$0.0	5,900 (rehab)
Vacant in-rem	77.7	30.5	11.2	36.0	1,100 (rehab)
ANCHOR	331.9	72.2	93.8	166.0	3,100 (new)
<b>TOTAL</b>	<b>\$688.0</b>	<b>\$336.0</b>	<b>\$150.0</b>	<b>\$202.0</b>	<b>10,100</b>
SOURCES: IBO; OMB; NYC Department of Housing Preservation and Development.					
NOTE: Individual items may not add to totals due to rounding.					

households—incomes up to \$45,000 and \$67,000 for a family of four, respectively. In the case of the Vacant Buildings 2000 program, initial rents will be

set at market rates, and the apartments will then be covered under rent-stabilization guidelines. The HDC private activity bonds—to be used mostly for new construction under the ANCHOR initiative—typically finance construction of multi-family cooperative or rental buildings affordable to households with incomes up to a maximum of \$140,000 for a family of four.

**Other capital programs.** Although the Mayor's housing initiative includes \$336.0 million in city capital funds, the overall increase in the city-funded HPD capital

million in city funds and \$310.8 in federal HOME funds. Total funding for privatization of occupied *in-rem* housing will increase by \$15.6 million, with an \$83.4 million reduction in city funds offset by a \$99.0 million increase in federal HOME funds.

The plan increases funding for two of HPD's existing small vacant building privatization programs by \$10.5 million—StoreWorks (\$14.4 million total for 2001 to 2005) and HomeWorks (\$10.1 million total)—while eliminating \$97.1 million in previously programmed funds for CityHome. This latter

program had shown declining capital spending in recent years (and none in 2000) as the inventory of small buildings has diminished. The StoreWorks and HomeWorks programs will fund the return to private ownership of roughly 425 housing units.

Funding for the city's Small Homes Private Loan program, which provides low-interest loans for the moderate-to-gut rehabilitation of buildings of 20 units or less, has been reduced by \$45.4 million over the 2002-2005 period. Total city funding is now \$23.9 million, supplemented by \$13.6 million in federal aid, bringing funding more into line with actual commitments in recent years.

plan for 2002 to 2005 is \$102.7 million. The Mayor's plan entails reallocation of \$233.3 million of existing city capital funds from other programs to the new initiative, which would be partially offset by an anticipated increase of \$131.0 million in federal funds. Overall, for programs that are not part of the new initiative there is a \$102.3 million decrease in city funds, when reallocations, reductions, and replacements with federal funds are taken into account.

The city's *in-rem* privatization programs—the Neighborhood Entrepreneurs Program (NEP), Neighborhood Redevelopment Program (NRP), and Tenant Interim Lease (TIL)—are set to receive \$817.1 million from 2002 through 2005, including \$506.3

**Reallocations of Funds in the HPD Capital Plan for 2002-2005**

Dollars in millions

	City Funds	Non-City Funds	Total Change
Mayor's Plan	\$336.0	\$150.0	\$486.0
Other HPD Capital:			
Building Blocks	(83.4)	99.0	15.6
All Other HPD	(149.9)	32.0	(117.9)
<b>Subtotal, Other HPD</b>	<b>(\$233.3)</b>	<b>\$131.0</b>	<b>(\$102.3)</b>
<b>Total HPD Capital</b>	<b>\$102.7</b>	<b>\$281.0</b>	<b>\$383.7</b>

SOURCES: IBO; September 2000 and January 2001 Capital Commitment Plans  
NOTE: Figures in parentheses are negative amounts.

**Biggest Increases for Housing Preservation and Neighborhood Development Over Long Term**

Total Funding, All Sources, Fiscal Years 2002-2009

Dollars in Millions

Program Area	September	January	Change	% Change
In-Rem Disposition and Maintenance	\$924.7	\$896.1	(\$28.6)	-3.1%
Housing Preservation	340.7	557.0	216.3	63.5%
Neighborhood Development	90.8	256.8	166.0	182.9%
Supportive Housing	101.8	130.0	28.2	27.7%
Homeownership	116.6	118.4	1.8	1.6%
All Other HPD	32.1	32.1	0.0	0.0%
<b>Total</b>	<b>\$1,606.7</b>	<b>\$1,990.4</b>	<b>\$383.7</b>	<b>23.9%</b>

SOURCES: IBO; September 2000 and January 2001 Capital Commitment Plans  
NOTE: Figures in parentheses are negative amounts.

Other reallocations result in a net decrease in city funds for various other HPD capital programs of \$7.3 million over the four-year period.

The reallocation of funding within HPD's capital plan signals a larger shift in long-term priorities. The biggest dollar increase is in the area of housing preservation, which directly results from the increase in PLP funds as part of the Mayor's initiative. The largest *percentage* increase is in the area of neighborhood development—essentially the ANCHOR program.

This shift in emphasis carries forward into the years beyond 2005. The city's Ten-Year Capital Strategy, issued at the same time as the Mayor's budget in January, lays out HPD's long-term priorities. As in the previous strategy, HPD plans to have entirely divested the *in-rem* inventory by the end of fiscal year 2007. Capital dollars used to maintain this inventory—well over \$200 million annually in combined city and federal funds—would then be shifted to the development of mixed-income, owner-occupied housing, with average commitments totaling over \$300 million annually. Compared to the September commitment plan, however, support for homeownership programs after 2007 is lower by \$58 million each year. This cut, along with a reduction of \$9.5 million annually in the Small Homes Loan program, funds an increase of \$68 million each year in the Participation Loan Program, as part of a longer term focus on preventing abandonment and neglect.

HPD's lead-paint abatement program is funded at \$21.7 million in 2001, including \$7.5 million for lead treatment in city-owned buildings, \$12.7 million for lead-paint removal in private buildings, and \$1.5 million for the housing department's Primary Prevention Program, which provides forgivable loans to building owners for lead-paint abatement. Total funding for lead-paint abatement drops to \$7.5 million in 2002 and 2003. No funds are currently included in the capital plan after 2003.

## Department of Buildings

The Mayor's preliminary budget funds the Department of Buildings at \$45.9 million (entirely city funds) in 2002, \$41.5 million in 2003, and \$41.4 million in 2004 and 2005. The current modified budget for 2001 stands at \$50.9 million, an amount inflated this year by one-time purchases of cars and other equipment.

The buildings department proposes to add 29 new full-time positions and 23 per-diem staff to pursue two major initiatives. The first addresses the agency's code enforcement and inspection programs, and the second is an effort to improve records management and customer service. Related one-time non-personnel expenses will be incurred in this fiscal year, with smaller ongoing amounts in future years.

About 30 percent of building permit applications are filed through the agency's professional certification program, which allows engineers or architects to certify the compliance of building plans with relevant zoning and code requirements without review by DOB. Currently about 20 percent of the self-certified filings are audited annually. The budget would add 12 new audit staff to enforce self-certification requirements.

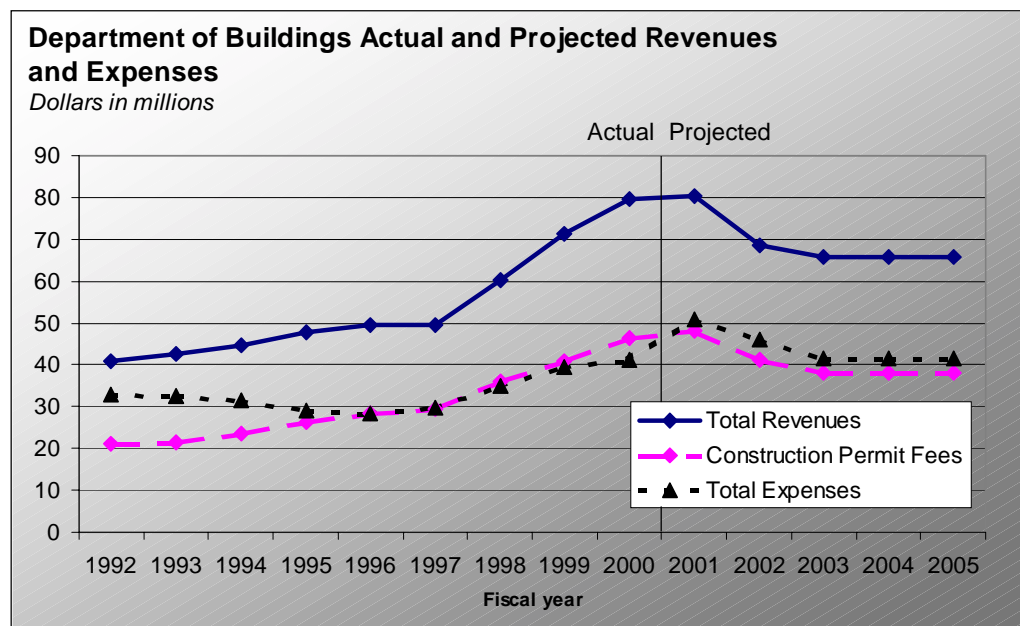
In addition, DOB proposes to add three full-time and three per-diem staff to enforce compliance with the newly revised electrical code. Finally, the budget includes funds for five administrative personnel to support the inspection staff, as well as for non-personnel items including uniforms, new vehicles, replacement of outdated radios, and extension of a cellular telephone contract, all to improve the effectiveness and efficiency of the inspection and enforcement staff. The total cost in 2002 and beyond for the heightened enforcement effort is \$1.2 million.

DOB is also making a push to improve its records management and customer service, for which it has received much criticism in the past. The budget would add four full-time and 20 per diem employees to reorganize and improve public access to records,



and fund the purchase of additional equipment and storage space. The buildings department has also included funding for five computer personnel to improve the agency's on-line filing and processing.

estimate, 60 percent of the increase in construction permit fee revenues in recent years can be attributed to rising construction costs alone.



The Preliminary Budget forecasts total DOB revenues falling from \$80.3 million this year—the highest ever—to \$65.7 million by 2003. This fall-off is driven by a downturn in projected construction permit fees, which will decline from a forecast \$48.2 million this year to \$38.0 million in 2003 and subsequent years. Despite this drop, the agency's projected revenues will continue to exceed spending by \$24 million annually.

Funding for these initiatives will total \$1.3 million in 2002 and \$1.1 million in subsequent years.

Much of the cost for both the increased enforcement and the records management/customer service initiatives will fall on the other-than-personal-services (OTPS) side of the budget in the current fiscal year. OTPS is projected to decline from \$15.3 million this year to \$5.4 million in 2003 and beyond. The buildings department's OTPS spending in fiscal year 2000 was \$9.9 million. The high level this year includes purchase of 100 new vehicles for inspectors, photocopiers and microfiche and microfilm readers, office space renovation, and replacement of outdated radios.

**Rising revenues from construction permits.** In recent years, DOB's revenues—particularly from construction permits—have risen sharply. This increase has resulted in part from higher construction activity, but also from rising construction costs. Because permit fees for alteration work are determined by the cost of the work, rising costs have driven up fee revenues. By IBO's

## New York City Transit

**Budget overview.** New York City Transit is an affiliate of the Metropolitan Transportation Authority (MTA), a New York State public benefit corporation responsible for providing public transportation services in New York City and surrounding counties. NYC Transit carries over 1.2 billion subway and 600 million bus passengers per year, and has an annual operating budget of roughly \$4 billion.

The city provides both operating and capital subsidies to NYC Transit. The operating subsidies totaled \$233 million in calendar year 2000, and a similar level is expected in calendar year 2001. The two largest components of the subsidy are a fixed \$158 million annual contribution to match state operating aid, and \$45 million to reimburse NYC Transit for the cost of pupil transportation—a \$14 million annual cut by the city since 1995.

The agency pays debt service on its bonds out of the operating budget. Due to an aggressive financing

program and rising indebtedness, debt service payments are projected to rise sharply in coming years, from roughly \$323 million, or 8 percent of the operating budget, in 2001 to \$606 million, or 13 percent by 2004. Despite these pressures, MTA officials have stated publicly that they do not intend to seek a fare increase in 2001. Strong fare and tax revenues, combined with major efforts to contain costs, have enabled NYC Transit to maintain a base fare of \$1.50 since 1995 and to provide significant discounts to riders through MetroCard.

Capital expenditures are an important part of NYC Transit's total spending. After years of neglect, the agency began a major capital rebuilding program in the 1980s. This capital spending has been channeled through a series of multi-year plans, the most recent of which was for the period 1995-1999. From 1982 through 1999 NYC Transit spent \$19.2 billion on repairing, maintaining, and upgrading its infrastructure, with \$1.8 billion of this expenditure occurring in 1999. In 2000 the MTA and the state approved a capital plan for 2000-2004 that called for NYC Transit to spend an average of \$2.4 billion per year—\$12 billion in total. While the proposed plan continues efforts to bring NYC Transit's existing infrastructure to a state of good repair, it also contained \$1.8 billion for subway system expansion, including \$1.0 billion for initial design and engineering work for a Second Avenue subway.

**Financing the capital plan.** The MTA's current capital plan (calendar years 2000-2004) relies more heavily on debt financing than did the previous (1995-1999) plan. The capital programs of NYC Transit and the commuter railroads are financed using a combination of direct governmental subsidies, bonds backed by fares, toll revenues, and transfers from the operating budget. Forty-two percent of the funding for the 1995-1999 plan came from bonds issued by the MTA. In contrast, 38 percent of the funding for the 2000-2004 plan comes from "new" MTA debt and 18 percent comes from refinancing existing debt. Another 9

percent of funds were contingent on the enactment of the state's Transportation Bond Act, which was defeated in a November 2000 referendum. The shares of federal funding are similar in both the 1995-1999 and 2000-2004 capital plans: 30 percent and 29 percent, respectively. There is no "pay-as-you-go" capital spending in the new plan, which would reduce debt service. In the 1995-1999 plan 6 percent of spending was on a "pay-as-you-go" basis.

Because voters rejected the bond act last November, the MTA currently faces a \$1.6 billion funding gap in its capital program. The MTA is currently negotiating with the state legislature to obtain replacement funding.

New York City provides an annual contribution to NYC Transit's capital budget. In recent years the amount of this contribution has been \$105 million, with an additional \$1 million for the Staten Island Railroad. The city is contributing an additional amount to NYC Transit's capital program pursuant to

Source of funds	1995-1999	2000-2004
Federal aid	30%	29%
City aid	9	3
State direct aid	1	0
MTA bonds	42	38
MTA debt restructuring	0	18
State bond act	0	9
Transfers from operating budget	6	0
All other sources	12	3
<b>TOTAL</b>	<b>100%</b>	<b>100%</b>

SOURCES: IBO; MTA.

an agreement through which the MTA gives its proceeds from the sale of the New York Coliseum (\$345 million) to the city, and the city gives back an equivalent amount of bond proceeds.

**Major elements of the capital strategy.** The city's Ten-Year Capital Strategy earmarks the \$345 million from sale of the Coliseum plus an additional \$65 million

per year to transit improvement projects. The remainder of the city's annual appropriation is earmarked for trackwork (\$35 million) and miscellaneous NYC Transit projects (\$5 million).

The city has stated that the funds destined for transit improvement projects will be used either for an extension of the number 7 subway line to the far west side of Manhattan, or for construction of a rail link between midtown Manhattan and LaGuardia Airport. In reality, the MTA has the final say as to how the funds will be spent. Of the two proposed projects, there are indications that the authority may favor the 7 line extension, in part due to community opposition in Queens to the LaGuardia project.

## Department of Transportation

**Budget overview.** The Department of Transportation (DOT) is the agency responsible for maintaining New York City's 5,700 miles of streets and arterial highways and 848 bridges and tunnels. The agency also maintains and collects revenue from parking meters, manages municipal parking facilities, maintains streetlights and traffic signals, operates the Staten Island Ferry, funds bus service for pre-kindergarten children in special education, and oversees and subsidizes the operation of ferries and private franchise buses.

IBO projects an operating budget for the Department of Transportation of \$480 million in fiscal year 2002, slightly higher than projected expenditures of \$468 million for 2001. IBO's estimate of 2002 spending is higher than OMB's projection (\$403 million), due to OMB's practice of not recognizing some state and federal aid until it is received. IBO projects that DOT's operating budget will grow at roughly the expected rate of inflation in the out-years, to \$496 million in 2003, \$506 million in 2004, and \$515 million in 2005.

About four-fifths of DOT's operating budget comes from city funds, 15 percent from New York State, and the balance from federal sources. Around 40 percent of the department's budget is spent on traffic

operations, 20 percent each on transit and highway operations, and 10 percent each on the Bureau of Bridges and general administrative costs. Overall, roughly 48 percent of the department's operating budget is for personnel expenses, and 52 percent for non-personnel expenses. Management of the department's extensive capital program is projected to cost \$86.2 million annually.

**New initiatives.** As in past years, DOT will substitute state Consolidated Highway Improvement Program funding for several projects involving highway, bridge, and parking meter maintenance and repair, saving more than \$6 million in city funds. The department also plans to integrate its Communications Center in Manhattan into the Traffic Management Center in Long Island City. This consolidation is projected to save roughly \$325,000 per year in operating costs. Since the Traffic Management Center is federally funded, the proposed merger also makes the activities of the Communications Center eligible for federal funding.

DOT expects significant increases in revenue from two of its programs beginning in 2002. The department will increase the number of red light cameras from 30 to 50, at a cost of \$668,000. The projected increase in revenue from fines is \$4.3 million. DOT also expects revenues from its bus shelter concession to increase by almost \$4 million in 2002, and \$2.4 million in 2003. The agency contracts with a private firm to construct, maintain, and lease advertising space on shelters.

**Franchise bus contracts.** DOT contracts with seven private companies to provide local bus service in Queens and Brooklyn, and express bus service between the other boroughs and Manhattan. These private buses carry approximately 335,000 passengers on an average weekday. The city pays the companies a subsidy, funded through the miscellaneous budget, that covers the difference between the companies' expenses and revenues. This subsidy amounted to \$148 million in 2000. DOT also incurs annual expenses of roughly \$6 million to administer the franchise program.

The private bus program faces two major challenges in coming months. The labor agreements between the private companies and their drivers have expired, and a new contract is being negotiated. The

to issue new franchises.

The existing operating agreements between DOT and the private bus companies expire at the end of 2002, but in theory could be terminated sooner if the agency is authorized to issue new franchises. The TWU is asking for a three-year contract, which would put the private companies in the position of being bound by a labor agreement that extends beyond the life of the current operating agreements.

	2001	2002	2003	2004	2005	Total
Waterway bridges	\$302.1	\$121.1	\$201.9	\$413.8	\$208.9	\$1,247.8
Highway bridges	188.7	677.8	599.4	414.2	342.1	2,222.2
Roads and highways	288.7	355.6	315.1	311.8	357.7	1,628.9
All other	240.0	322.6	111.4	81.6	93.7	849.3
<b>Total</b>	<b>\$1,019.5</b>	<b>\$1,477.1</b>	<b>\$1,227.8</b>	<b>\$1,221.4</b>	<b>\$1,002.4</b>	<b>\$5,948.2</b>

SOURCES: IBO; January 2001 Capital Commitment Plan; Ten-Year Capital Strategy.

Transit Workers Union (TWU), which represents the drivers, is pushing for wage parity with NYC Transit drivers. Wage parity would require an increase of more than 20 percent in driver wages over three years, thereby increasing the subsidy required for bus operations.

At the same time that the private bus companies are negotiating new contracts with their drivers, the city is moving ahead with plans to issue new franchises. Responding to concerns over the quality of service, the Office of the Mayor has sent a draft resolution to the Speaker of the City Council. The draft resolution authorizes DOT to grant new bus franchises to either existing or to new providers, and details the form that the franchise agreements should take. If the Council and the Mayor subsequently approve a final resolution, DOT will be allowed (but not obligated)

**The capital budget.** Capital spending is an important component of the DOT budget. In 2000 the department's capital expenditures were \$585 million (roughly 20 percent greater than operating expenses). Between 1983 and 2000 the department spent \$6.9 billion on capital projects. Over two-thirds of this spending was for highways (\$3.0 billion) and waterway bridges (\$1.6 billion). Highway capital spending is allocated primarily to street reconstruction and street resurfacing. Bridge spending is primarily for reconstruction and painting of existing bridges, plus a small amount for facilities and equipment. In a few instances bridge reconstruction actually involves construction of a new bridge and demolition of the older structure, such as the replacement of the Willis Avenue Bridge during the next decade.

	1983-2000 Actual	2001	2002	2003	2004	2005	Total
Brooklyn Bridge	\$112.5	\$5.5	\$47.1	\$8.5	\$0.0	\$137.9	\$311.5
Manhattan Bridge	308.0	205.3	1.4	3.8	143.1	0.0	661.5
Williamsburg Bridge	754.1	37.0	2.0	103.7	0.0	0.0	896.8
Queensboro Bridge	286.5	19.1	59.8	28.1	2.1	0.0	395.5
<b>Total, East River Bridges</b>	<b>\$1,461.1</b>	<b>\$266.9</b>	<b>\$110.3</b>	<b>\$144.1</b>	<b>\$145.1</b>	<b>\$137.9</b>	<b>\$2,265.4</b>

SOURCES: IBO; OMB, Monthly Transaction Analysis, Report 2, June (various years); January 2001 Capital Commitment Plan.

IBO projects future capital spending using planned commitments. Planned capital commitments represent the value of contracts a department expects to sign in a particular year. Planned commitments can be very different from actual capital expenditures in any given year, but generally closely reflect actual spending over the long term.

Planned capital commitments for DOT total \$5.9 billion over the period 2001 to 2005, of which 86 percent (\$5.1 billion) are city funds. Fifty-eight percent of total planned commitments (\$3.5 billion) are for waterway and highway bridges, including \$867.4 million for the four major East River crossings. The second-largest spending category is for highway maintenance and repair, with \$1.6 billion, or 27 percent of planned commitments.

DOT has devoted substantial capital resources during the past two decades to bringing the four major East River bridges to a state of good repair. The Williamsburg Bridge received the largest share of funding through 2000, but in 2001-2005 the Manhattan Bridge will receive the largest amount of money. Over three-quarters of the waterway bridges program between 1983 and 2005 will have gone to these four spans.

## Department of Environmental Protection

**Expense budget.** Under the Mayor's Preliminary Budget proposals, IBO estimates that the Department of Environmental Protection (DEP) will spend \$664 million in 2002, a 2.7 percent decrease from 2001. The decline can be mainly attributed to lower projected costs of materials and supplies associated with the water supply and wastewater collection and treatment functions. Between 2002 and 2005, IBO estimates spending for environmental protection will grow at an average annual rate of 1.5 percent, reaching \$694 million in 2005. The operation and maintenance of the water and sewer system accounts for four-fifths of DEP's expense budget, and is financed through user charges levied on the system's customers.

**Capital budget.** For 2001-2004, DEP's capital budget totals \$7.9 billion. Nearly 50 percent of the capital plan is devoted to water pollution control projects (\$3.8 billion). Water supply and distribution projects (including trunk and main replacements and water quality preservation) make up the next largest category of capital spending (\$3.2 billion, or roughly 40 percent). The remaining 10 percent of the capital budget is allocated to citywide sewer replacements and upgrades and general equipment needs. Nearly a quarter of DEP's total capital budget is dedicated to projects required because of consent decrees.

Several major projects are slated for completion by 2004, including a filtration plant for the Croton watershed, a large portion of city water Tunnel #3, and substantial upgrades of the city's wastewater treatment plants to meet federal standards.

New York City is a party to a federal court consent decree with the U.S. Environmental Protection Agency and New York State requiring the design and construction of a full-scale water treatment facility to filter the Croton water system, which provides roughly 10 percent of the water used daily by system customers. The city's 10-year capital improvement program provides \$921 million for this project, with \$639 million slated for commitment in 2002, when construction was expected to begin. The New York State Court of Appeals ruled recently that the site selected by DEP needs state legislative approval before construction can begin. State approval appears unlikely. The city's options include an appeal, alternative siting, or legislative relief. In light of the ruling it is very unlikely that construction will begin on the Croton facility in 2002, requiring a shift in the planned commitment date for capital funds to later years. Any delay in constructing the facility, however, could result in penalties of \$5,000 to as much as \$25,000 a day being assessed against the city under the consent decree.

One of the largest capital projects ever undertaken by DEP is the construction of water Tunnel #3. Construction of the tunnel began in 1970 and is expected to be completed in 2020 at a total

estimated cost of \$6 billion. The project is being undertaken to improve distribution, to allow the two existing tunnels to be emptied and inspected, and to provide redundancy for these two aging city tunnels.

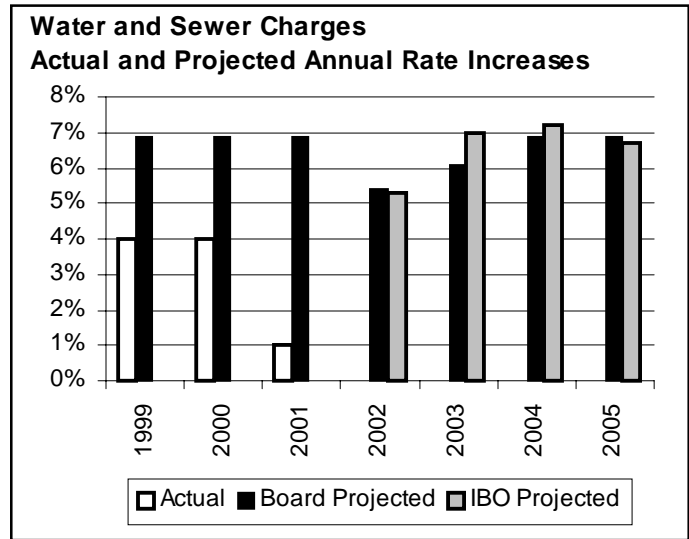
Work on the tunnel is being completed in stages: stage one became operational in 1998 and stage two is expected to be completed in 2008. Over the 2001-2004 period, approximately \$900 million will be committed for Tunnel #3 construction costs. Construction of a third water tunnel is necessary, but it is not mandated. Thus, funding commitments for Tunnel #3 can be spread out over a long period of time to minimize rate increases for system users.

The largest water pollution control project currently in progress by DEP is the upgrade of three wastewater treatment plants and the construction of an intercepting sewer at the Newtown Creek plant, as required by the federal Clean Water Act. A total of \$694 million is committed for these projects over the 2001-2004 period.

**Funding the capital plan.** Ninety-nine percent of DEP's capital budget is funded through the proceeds of bond sales (and other forms of indebtedness) by the Municipal Water Finance Authority (MWFA). Currently, the MWFA has \$9.4 billion in outstanding debt and is projecting an annual issuance of \$1.45 billion in new debt for 2001-2005. All the debt issued by the MWFA is in the form of bonds backed by user payments collected from in-city and upstate system customers. The New York City Water Board sets water and sewer rates each year at the level necessary to cover debt service and operating costs.

The board instituted a 1 percent increase in water rates for fiscal year 2001. Currently, the board is predicting an average annual increase of 6.5 percent for 2002 through 2005. Although in recent years the board's projections for water and sewer rate increases have been higher than have proven necessary, IBO estimates that, at least for 2002-2005, the currently projected rate increases may not be overstated if DEP's capital plan is to be fully funded.

DEP's long-term capital plan (after 2005) shows dramatic decreases in several areas of spending. Stages 3 and 4 of the third water tunnel are not yet scheduled for any funding commitments. In addition, the full estimated cost of the Croton filtration plant has not yet been committed—as of 2002, \$804 million out of an estimated cost of \$921 million will have been committed, with no further commitments included in the plan after 2005. Finally, DEP is projecting that no new vehicles or equipment used for field operations and plant maintenance will be required after 2005. Given the possibility of both



delays in the Croton project and further as yet unplanned needs, DEP's total long-term capital plan is probably understated.

There is also the possibility that, beginning in 2008, DEP will have to begin construction of a filtration plant for the Catskill/Delaware water supply system, which supplies 90 percent of the city's drinking water. DEP's current estimated cost for this plant, if required, is \$2.74 billion, although other estimates range from \$4 to \$8 billion. If DEP is required to build such a plant, even the lower cost estimates will dramatically increase DEP's total capital budget requirements, and raise water rates for the system's customers (see IBO's report, *The Impact of Catskill/Delaware Filtration on Residential Water and Sewer Charges in New York City*, November 2000).

# Public Safety

## New York City Police Department

**Budget overview.** The Mayor's Preliminary Budget proposes spending \$3.1 billion for the Police Department (NYPD) in fiscal year 2002—8 percent of total city spending—a slight decrease from forecast spending in the current fiscal year. Budgeted growth in NYPD spending through 2005 in the Mayor's Financial Plan is nearly flat.

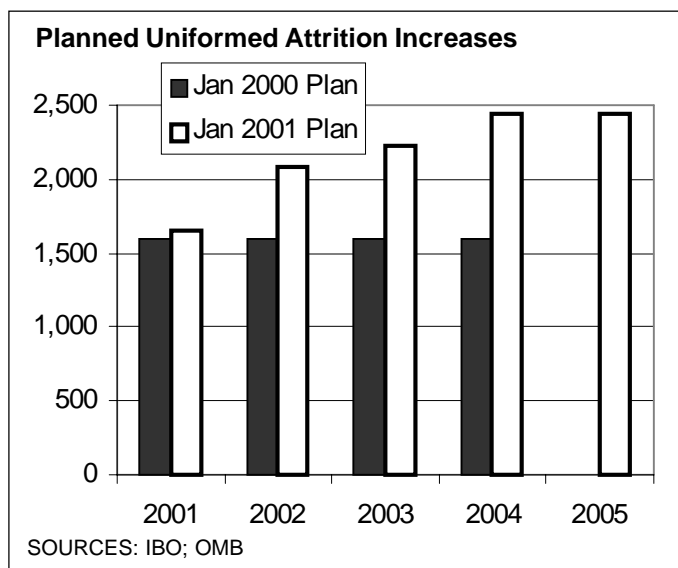
The Preliminary Budget provides for overtime spending of \$187 million in 2002, including an additional \$20 million for planned and unplanned events and \$50 million for the Mayor's quality-of-life initiative focusing on low-level offenses. IBO projects total 2002 overtime spending of \$270 million—\$83 million more than included in the Mayor's budget proposal. IBO also expects continued total overtime spending at about the \$270 million level through 2005, although this will depend in part on continuation of current patterns of deployment.

The 2002 budget would also provide \$22 million in additional spending—including \$13 million in overtime—associated with the agency's anti-narcotics initiatives and \$15 million for police cars and other vehicles.

**Uniformed staffing.** The Preliminary Budget provides for peak uniformed staffing of 40,710 in 2002, a level expected to be attained this coming July 1 with the admission of 848 recruits into the Police Academy. This peak level is 730 officers fewer than the 41,440

previously planned. The peak level reflects just a single day. Not only is the planned peak dropping, but so too is the average planned staffing level during the course of the year.

One of the reasons for this is that the department now anticipates a higher level of attrition from the force than previously expected. Over the course of 2002, attrition from the police force is now forecast to be 2,086 officers, as opposed to the previously



projected 1,589. Total uniformed headcount is now expected to decline to 38,624 by the close of 2002. Over the course of the 2001 through 2005 Financial Plan period, end-of-year police staffing is scheduled to decline from 39,862 this year to 38,274 by 2004—almost 1,600 fewer officers than previously planned.

Annual attrition will climb to 2,436 by 2004, an increase of 53 percent over the previous projection.

This decline in uniformed staffing is not fully reflected in the NYPD budget. The Preliminary Budget assumes that increased attrition from the force will yield savings of \$15 million in 2002. In subsequent years, however, the financial plan does not reflect further savings despite the declining average force level. IBO estimates that savings could be \$19 million in 2003 and \$26 million in both 2004 and 2005.

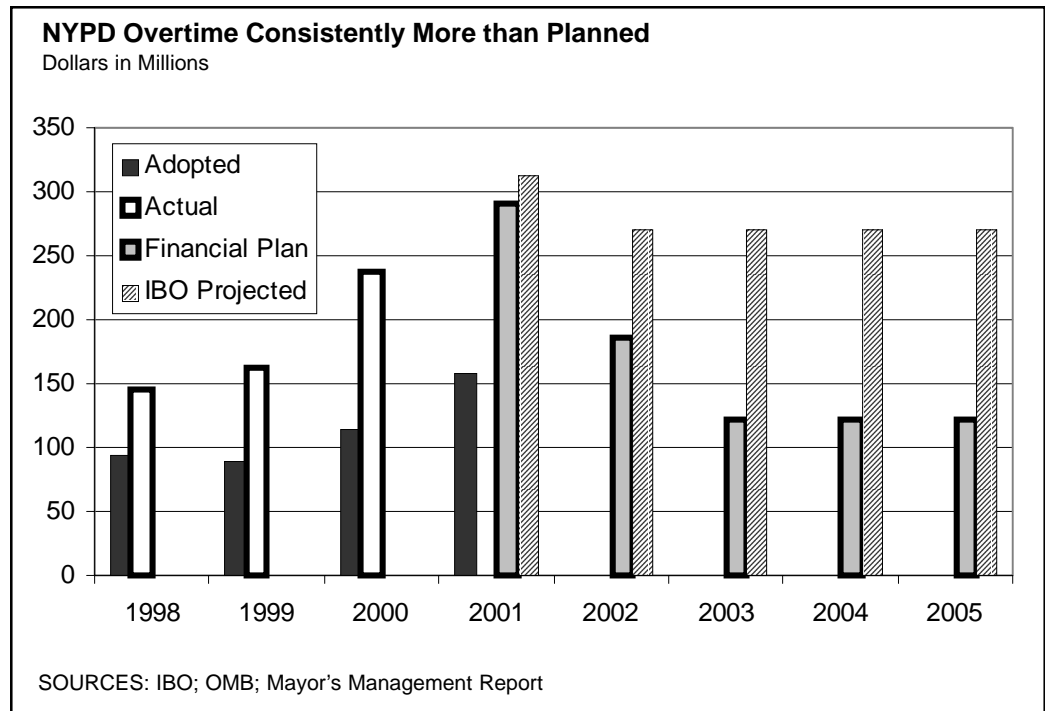
The higher than expected rate of attrition also means that the department will have to hire more officers than it had previously planned—over 2,000 new recruits per year after 2002—in order to reach the peak level. If the department's recent difficulties in hiring continue, reaching even this lower peak level could prove difficult.

**Crime Bill funds.** A reduction in planned uniformed staffing in the next few years would also entail a decrease in federal Crime Bill grant funds. The latest award of \$92.3 million, announced by the Mayor in April 2000, was to have helped fund 1,230 new police officers over the 2001-2004 period. The city is now planning to fill only 500 new positions, which would secure a total of \$44 million in Crime Bill funds. Since Crime Bill funding ultimately covers less than half the total cost of each new position, the planned reduction in uniformed staffing will save about \$55 million in city funds. The additional \$48.3 million in Crime Bill funding will remain available in the event that the NYPD hires more than 500 new officers.

**Civilianization.** Civilian police staffing within the NYPD is also scheduled to decline—from actual staffing of just under 9,000 in November 2000 to 8,100 by the end of 2002, and to 7,944 in 2003 through 2005. The projected decline of almost 1,100 civilian employees in the agency reflects uncertainty surrounding the continued availability of federal grant funds to support civilianization, as well as a planned cut of 500 city-funded positions.

In the short term, putting civilians in jobs currently held by uniformed personnel costs the city money. The city cannot reduce its uniformed headcount without forgoing federal Crime Bill funds, so any positions in which uniformed personnel are to be replaced with a civilian requires the hiring of a new civilian. Given that the recently awarded Crime Bill grant is based only on uniformed police staffing in the agency, any attempt by the city to use these funds to hire additional civilians would first require securing a waiver from the U.S. Department of Justice.

**Overtime.** NYPD overtime expenditures in 2000 totaled \$237 million, 46 percent more than in 1999 and 63 percent higher than in 1998. Overtime spending in 2000 by the agency was more than





double the amount originally included in the adopted budget. In the first four months of the current fiscal year, NYPD spent \$129 million on overtime—82 percent of its original overtime budget for the entire year. IBO projects that NYPD overtime expenditures will ultimately reach \$313 million in the current year, \$23 million more than currently budgeted.

The Mayor's Preliminary Budget increases planned overtime spending to \$187 million in 2002 and to \$121 million annually in 2003 through 2005. The budget adds \$50 million in overtime in 2002 to continue the Mayor's quality-of-life initiative. In addition, baseline overtime spending for planned events would increase \$20 million for each year through 2005.

Despite the increase in NYPD's planned 2002 overtime expenditures, IBO estimates that the agency will expend \$270 million on overtime next year, or \$83 million more than the amount provided for in the Preliminary Budget. For 2003 through 2005, IBO projects continued annual NYPD overtime expenditures of about \$270 million, almost \$150 million more than provided for in the current Financial Plan.

The recent jump in overtime spending has occurred in parallel with a steadily increasing force size. Even with a substantially larger total force, however, some amount of overtime spending is unavoidable. For particular events, such as parades, regularly scheduled tours of duty will not provide sufficient coverage, and overtime costs are incurred as a result of these occasional peak needs. Moreover, some of these costs can be anticipated in advance, while others cannot, resulting in so-called "unplanned events" overtime spending. Other regular causes of overtime spending include processing arrests, investigations (stakeouts, extraditions, and wiretaps), court appearances, and operational overtime (when tours of duty are extended because of incidents or special events).

Other overtime spending, on the other hand, results

from policy decisions and is thus more discretionary. The department's quality-of-life initiative, which targets low-level offenses of various sorts, cost \$17.5 million in overtime in the first quarter of 2001. The Preliminary Budget includes an additional \$50 million to continue the initiative in 2002

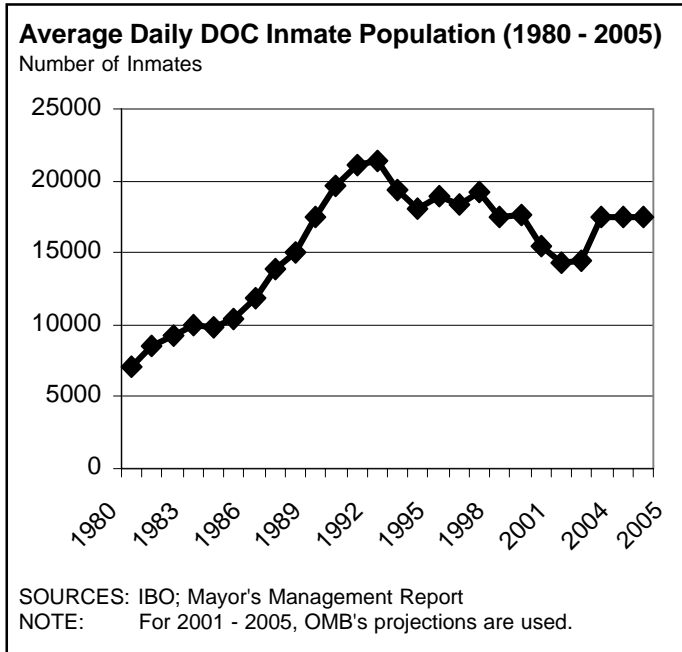
Both rising force size and growing overtime costs have occurred against a backdrop of slight declines in total arrest activity. It is difficult to conclude from declining total arrest activity that the city could safely reduce either overtime spending or the total police force, since it may be that the larger police force, or the quality-of-life initiative, or both, have had a deterrent effect. On the other hand, crime may be declining at least in part for reasons unrelated to police force size or tactics, in which case a reduction in the police force or changes in tactics could be undertaken without running the risk of a rising crime rate.

## Department of Correction

**Expense budget.** Spending for the Department of Correction (DOC) is forecast to be \$837 million for the current fiscal year—\$28 million less than the amount budgeted at the beginning of the year. The drop in planned expenditures this year is primarily attributable to a decline in the inmate population, which in turn has allowed the agency to accrue savings from unfilled uniformed and civilian positions. The Preliminary Budget for 2002 proposes spending of \$863 million for DOC—up \$26 million from forecast spending this year. The agency's proposed budget would increase again to \$892 million in 2003 and then remain at that level through 2005.

The single most important determinant of DOC spending is the number of inmates in custody. After more than tripling from 7,042 in 1980 to an all-time high of 21,449 in 1992, the average number of inmates in the city jail system has declined in recent years, dropping to an average of 14,458 during the first four months of 2001. Proposed expenditures for DOC in the Mayor's Financial Plan are predicated on

the assumption that the average inmate population will once again rise, to about 17,500 from 2003 through 2005.



Based on the projected rise in the inmate population, the Preliminary Budget calls for DOC end-of-year uniformed staffing to increase by 213 in the coming year, to 10,926. Uniformed staffing would then increase to 11,182 in 2003 and remain at that level through 2005.

Civilian staffing within DOC is set to decline very slightly, from a budgeted level of 1,831 at the close of 2001 to 1,823 by the end of 2005.

The Preliminary Budget provides for DOC overtime spending of \$52 million in 2002, up \$3 million from this year's budgeted amount. Beyond next year, the agency's overtime budget jumps to \$70 million for 2003 through 2005 in anticipation of a growing number of inmates.

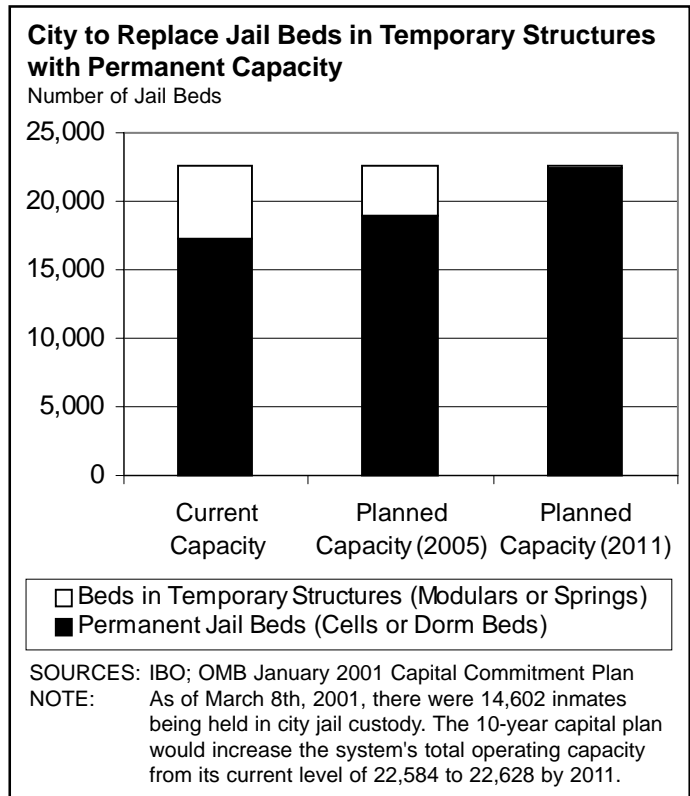
**Capital budget.** The DOC capital plan also reflects the anticipated increase in inmate population. The agency is taking advantage of the current low inmate population to prepare for an eventual resurgence in the number of inmates by starting to replace temporary structures with permanent

capacity, at a cost of \$292 million over the next four years.

DOC operates 16 jails, including 10 facilities on Rikers Island and six borough facilities. It also manages court detention facilities in each borough, and prison wards in four city hospitals. Cumulatively, the department's jails have a maximum operating capacity of over 22,500 beds—about 8,000 of which are currently empty.

The January capital plan for 2002 through 2011 calls for replacing 5,100 beds currently situated in temporary structures (referred to as “modulars” and “sprungs”) with permanent capacity. The jail space to be replaced was erected during the 1980s as a short-term expedient necessary to house the then rapidly growing inmate population. The 5,100 temporary beds are all to be replaced with permanent capacity in the form of cell or dormitory additions to existing facilities, with another 44 beds added in the process.

Half of the \$588 million in planned DOC capital commitments over the next four years—or \$292



million—would go for the construction of 1,700 new beds, one-third of the total beds in modulars and sprung to be replaced with permanent space over the next ten years.

Another \$229 million in planned commitments over the next four years would fund various building system and infrastructure improvements,

such as reconstruction of roofs, ceilings, showers, and dayrooms; and the upgrade of plumbing, heating, electrical and mechanical systems. The remaining \$70 million would provide improvements to support spaces as well as the upgrade or replacement of vehicles, computers, security equipment, and communication systems.



# Community Services

## Department of Parks and Recreation

**Budget overview.** The Administration is again proposing to reduce funding for the Department of Parks and Recreation (DPR). The Mayor's budget would provide \$172.3 million for DPR in 2002 and similar amounts in 2003 and beyond, a reduction of 6.8 percent from the \$184.4 million forecast for the current fiscal year.

Funding for programs adopted at the initiative of the City Council would be reduced by \$3.6 million a year from 2002 through 2005. A water safety program, certain tree services, and Operation REACH (a recreation program) would be eliminated. The budget would also cut 51 seasonal playground associates and 51 seasonal skilled-maintenance and operations employees (one of these positions in each council district). As is often the case, the Mayor's proposal to cut programs in the Preliminary Budget that will likely be restored by the City Council.

The Administration proposes to reduce full-time positions and substitute seasonal workers, a continuation of long-term trends. Under the proposed budget, full-time staff would fall by 42 positions to 2,034 (1,662 city funded) by the end of 2002, for a savings of \$619,000 yearly beginning in 2003. This attrition of full-time positions would be offset by hiring 150 seasonal city park workers, at a cost of \$1.9 million annually. These workers would work half a year, filling low skill and low-paying positions and earning \$12,000.

After the release of the Preliminary Budget, the Mayor announced a plan to increase DPR maintenance workers due to a decline in park conditions reported in the Preliminary Mayor's Management Report. He has since proposed hiring up to 1,000 former Work Experience Program participants who are nearing their five-year time limit for federal welfare eligibility. The hires would be on a six-month, seasonal basis and salaries would be paid through the Human Resources Administration using federal grant funds.

**Park event fees.** The budget would also provide \$1 million annually to the department as an incentive to deposit event fees into the city's general fund, rather than steering them to private organizations such as the City Parks Foundation and Central Park Conservancy, as has been recent practice. The parks department would turn over to the city fees it collects for use of park facilities, and in turn the city will allot funds back to DPR based on average fee collections in recent years.

## Public Libraries and Department of Cultural Affairs

**Expense budget.** As in previous years, the Mayor's Preliminary Budget proposes cuts in operating funds for the city's four library systems and for the Department of Cultural Affairs (DCA). In previous years, proposed cuts have been restored by the City Council in the Adopted Budget.

DCA's budget would cut basic funding and City Council initiatives for cultural groups by a total of 23 percent. For organizations not housed in city-owned buildings—"program groups"—the cut

**Capital budget.** In his budget presentation, the Mayor highlighted plans for a \$1.2 billion capital program for cultural institutions and libraries during the 11-year period covering fiscal years 2001 through 2011.

This would represent a substantial increase over average capital spending levels during the last decade. Capital commitments for the four library systems combined totaled \$197.9 million from 1991 through 2000, adjusted for inflation. The Mayor's proposal would provide a total

	Forecast		Proposed		
	2001	2002	2003	2004	2005
DCA	\$131.8	\$102.0	\$101.8	\$101.8	\$101.8
<i>Public Libraries:</i>					
NYPL	93.9	81.8	81.8	81.8	81.8
NYPL-Research	15.8	15.6	15.6	15.6	15.6
Brooklyn	69.1	60.4	60.4	60.4	60.4
Queens Borough	65.9	57.4	57.4	57.4	57.4

SOURCES: IBO; Fiscal Year 2002 Preliminary Budget.  
NOTE: Figures are net of inter-agency transfers.

amounts to \$8.8 million, or one-third of this year's funding. For cultural groups housed in city-owned buildings—Cultural Institutions Group (CIGs)—the reduction is 5 percent, or \$5.3 million.

of \$253.3 million over the period 2001 to 2011 (again adjusted for inflation). Annualized, this represents a 16 percent increase in real terms.

The library budget is to be cut by 13 percent, totaling over \$29 million. Part of this reduction takes the form of incentives to increase private funding. Partial funding would be restored to the libraries to match private grants. The Administration has previously included this proposal in the Preliminary Budget, and the Council has rejected it and restored funding to prior levels.

Cultural programs and institutions would receive an even heftier boost, with planned commitments of \$901.5 million from 2001 to 2011, compared with \$579 million in the previous 10 years (in inflation-adjusted terms)—an annualized 42 percent inflation-adjusted increase.

	Planned Commitments, 2001-2011
Cultural Institutions Groups (CIGs)	\$461.7
<i>Non-CIGs</i>	
Lincoln Center Master Plan	240.0
Museum of Modern Art	65.0
Guggenheim Museum Downtown	32.8
All Other Non-CIGs	114.7
Other DCA	28.0
<b>Total, Cultural Affairs</b>	<b>\$962.1</b>

SOURCES: IBO; January 2001 Capital Commitment Plan.

A considerable portion of the capital funding is directed to cultural programs that are not housed in city-owned buildings. Lincoln Center would be the most generously funded, with a planned total of \$275.1 million to be committed over 11 years. The city is providing \$24 million dollars annually for 10 years for the Lincoln Center Master Plan. In 2001, funding is to be provided through city general obligation debt. In subsequent years, funds will be provided through another entity—possibly the New York State Trust for Cultural Resources—with the city responsible for debt repayment. The balance includes \$28 million allocated by the City Council and the Manhattan Borough President for Jazz at Lincoln Center, plaza reconstruction, and other renovations, and \$7.1 million for façade reconstruction and other work at the New York State

Theater.<sup>1</sup> In addition, capital funds for the Lincoln Center Library for the Performing Arts will be provided through the New York Research Library.

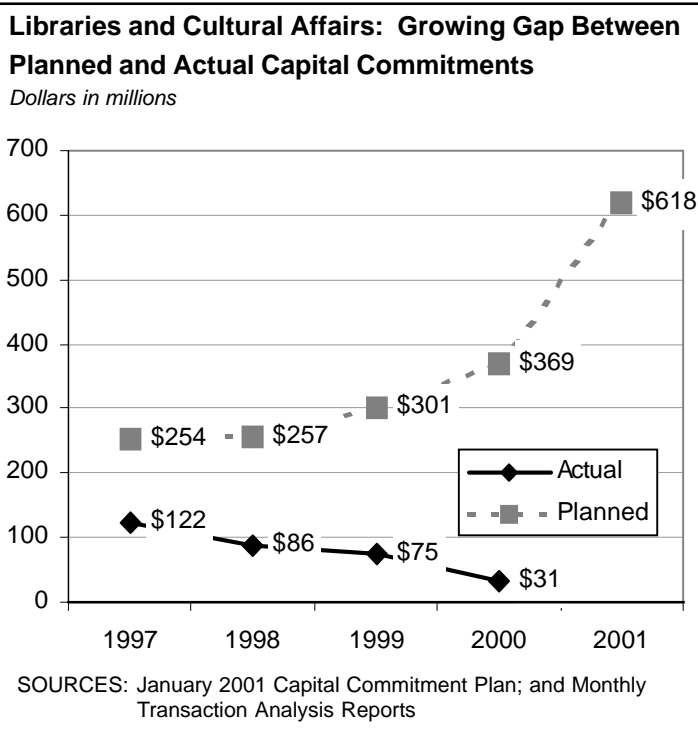
Other major program groups receiving capital funds include the Museum of Modern Art, with \$65 million (approved but not committed last year) to aid its planned \$650 million renovation, and the proposed Guggenheim museum at the South Street Seaport, which is to receive \$32.8 million for construction as well as land valued at \$32.4 million.

Among members of the Cultural Institutions Group, leading recipients of city capital funds include New York City's zoos, with \$54.2 million, the botanical gardens, with \$49.9 million, and the Brooklyn Museum of Art, with \$46.7 million.

Planned capital commitments for the four library systems total \$263.1 million over the next 11 years. Major projects include:

- The Humanities and Social Sciences Library on 42<sup>nd</sup> Street (New York Research Library), with a total of \$33.9 million;
- The Bronx Borough Center (New York Public Library) with \$27.0 million;
- The Mid-Manhattan Library (New York Public Library), with \$25.0 million;
- The Library for the Performing Arts at Lincoln Center (New York Research Library) with \$18.6 million.

The other 98 libraries—mostly smaller branches—receive a capital commitment of \$93.3 million over the same period. This is an average of less than \$1 million per branch.



**Trends in library and cultural capital spending.** The planned increases in capital funding for cultural institutions and libraries, significant as they are, represent only the portion allocated by the Administration. Traditionally, Borough Presidents and the City Council have used a major share of their capital allocations to complement funding for particular projects and institutions. The City Council provided the majority of the capital funding in 2000 for both libraries and DCA.

In recent years, however, the funding contained in the capital plan for the public libraries and DCA has proven to be substantially greater than the amount that is ultimately committed. Moreover, the divergence between plan and execution has been growing. The 2000 capital commitment plan for culturals and libraries was the largest ever, totaling \$369.2 million—but only \$30.9 million was actually committed.

**Planned Capital Commitments, Public Libraries, 2001-2011**  
Dollars in millions

	2001	2002-2011	Total
NYPL Research Libraries	\$42.2	\$13.4	\$55.6
New York Public Library	74.7	47.5	122.2
Queens Borough Public Library	12.6	23.2	35.8
Brooklyn Public Library	24.8	24.4	49.2
<b>Total, Public Libraries</b>	<b>\$154.3</b>	<b>\$108.5</b>	<b>\$262.8</b>

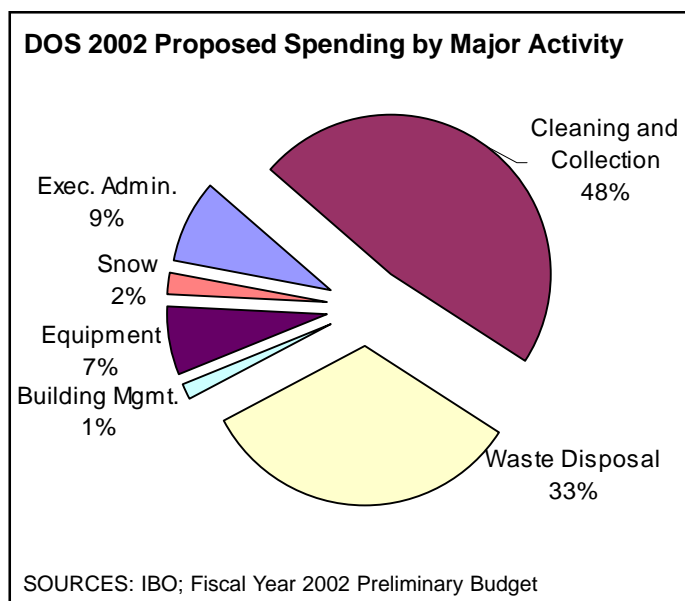
SOURCES: IBO; January 2001 Capital Commitment Plan.

The 2001 capital plan is nearly double that—\$618.3 million. Increasingly, projects contained in the current year's capital plan are not being completed, or even begun, and must be deferred into future years. Completing the ambitious \$1.2 billion capital plan for libraries and cultural institutions would require a significantly higher rate of actual commitments.

### Department of Sanitation

**Expense budget.** IBO projects that the Department of Sanitation's (DOS) budget will grow from \$941 million in 2001 to almost \$1.1 billion by 2005, an increase of 17 percent. The increase is largely due to the imminent closure of the Fresh Kills landfill and the resulting increase in collection, relay, and disposal costs associated with the interim export program. IBO projects that the cost of the interim waste export contracts will rise at an average of 9.0 percent annually from 2001 through 2005, compared with an average annual increase of 2.7 percent for other departmental spending.

Most of Sanitation's 2002 projected expenditure of \$1.0 billion is allocated to activities related to waste collection and street cleaning (48 percent) and to waste disposal, which includes costs associated with waste export, recycling, and landfill closure (33 percent).



The Preliminary Budget also funds a number of amendments to the Solid Waste Management Plan Draft Modification (SWMP Mod) approved by the Council in November 2000:

- \$6.3 million for a three-year pilot program for waste prevention and recycling coordinators;
- \$5.2 million for the winter/spring 2001 recycling advertising campaign and outreach to assist in increasing the recycling diversion rate;
- \$1.9 million in total from 2001 through 2005 to enhance enforcement of regulations at waste transfer stations and for private carters by adding enforcement personnel and a third tour of duty;
- \$750,000 for a three-year comprehensive study of the commercial waste stream;
- \$350,000 in 2001 for facilitating the training of city procurement personnel on waste prevention procurement practices;

**Interim waste export program.** The interim export program is a stopgap measure until the city implements the proposed long-term export plan outlined in the SWMP Mod. Under the interim export program, trash is collected and hauled by city sanitation trucks to incinerators located in New Jersey and Long Island and waste transfer stations located in the city and New Jersey. Once at the transfer stations, the waste is reloaded onto trailer trucks for export by private vendors to out-of-state incinerators or landfills (see "Closing Fresh Kills Means Mounting Costs to Dispose of New York City's Garbage," *Inside the Budget*, No. 77, February 5, 2001).

By April 2001 the Fresh Kills landfill will be closed and 100 percent of the refuse managed by DOS—11,400 tons per day—will be exported at an average cost per ton of \$63.30. This is roughly 50 percent more than it currently costs to dispose of refuse at Fresh Kills.



The growth in refuse disposal costs is the predominant reason for DOS's rising budget. The cost of the interim export contracts has grown from \$29.2 million in 1998 to \$104.6 million in 2000. IBO projects that the cost of the interim export contracts will reach \$171.4 million in 2001—rising from 5 percent of the total DOS budget in 1998 to 18 percent in 2001. In 2002, the first year that all of the city's waste will be exported, IBO expects that export costs will grow to \$227.8 million, 23 percent of DOS's budget. If the amount of waste exported remains at 2001 levels, export costs will reach \$241.8 million in 2005.

**Long-term export plan.** DOS anticipates that the proposed long-term plan could be phased in beginning as early as 2003 and completely implemented as early as 2005. Complications with the proposed waste transfer station in Linden, New Jersey could delay the plan's full implementation.

The long-term plan would rely on six waste transfer stations, two of which would be city-owned, for containerizing refuse for export by rail or barge to disposal sites outside the five boroughs. For the four privately owned facilities, the city would enter into 20-year contracts with private vendors (see "City Proposes Garbage Export Plan," *Inside the Budget* No. 65, July 17, 2000).

The payment schedule for the private sites would contain a fixed-cost component related to any capital costs incurred by the vendor to develop and equip a facility and a variable-cost component payable on a per-ton basis.

The long-term export plan's impact on the total cost of waste disposal remains uncertain. While the long-term plan would reduce collection and relay costs—primarily because it would not require city sanitation trucks to drive to out-of-town transfer and disposal sites—DOS projects that export costs will increase under the plan. By DOS's current estimates, the combined costs of refuse collection and export (including the costs associated with operating the marine transport system) under the long-term plan

will be slightly more than under the interim program. While the exact cost of the long-term plan will not be known until it is fully in place, the city will almost certainly continue to face an annual bill of over \$1 billion for sanitation-related expenses.

**Fresh Kills closure.** Since the landfill's "useful life" will be coming to an end this year, the Comptroller determined that starting in 2000 all landfill closure costs must be borne entirely in the department's expense budget. The fiscal year 2001 budget includes \$21.5 million for landfill closure construction and \$13.7 million for post-closure operation and maintenance (O&M). In addition, there is \$7.1 million for infrastructure operation expenses at the landfill such as the construction and maintenance of roads and utilities, and \$4.2 million for regulatory compliance. For 2002, \$7.5 million is set aside for landfill closure construction, \$13.7 million for post-closure O&M, \$22.5 million for

<b>Landfill Closure Expenses</b>			
<i>Dollars in Millions</i>			
Fiscal Year	2000	2001	2002
Closure construction	\$10.3	\$21.5	\$7.5
Post-closure O&M	4.2	7.5	13.7
Operations	0.9	7.1	22.5
Regulatory compliance	8.4	4.2	5.2
<b>TOTAL</b>	<b>\$23.8</b>	<b>\$40.3</b>	<b>\$49.0</b>

SOURCES: IBO; Financial Management System; Fiscal Year 2002 Departmental Estimates.  
 NOTE: Regulatory compliance includes costs associated with the Edgemere landfill.

infrastructure costs, and \$5.2 million for regulatory compliance. DOS is expecting closure costs to more than double from 2000 to 2002.

**State aid for closing Fresh Kills.** When New York State enacted the 1996 Clean Water/Clean Air Bond Act, \$75 million was authorized for the closure of Fresh Kills. To date, \$45 million has been appropriated by the state. The Governor has proposed adding the remaining \$30 million to this year's state budget.

In order for the city to receive any of this money from the state, it must match the award two for

one—\$150 million worth of closure projects. DOS recently submitted its application to the New York State Department of Environmental Conservation (DEC), including a total of \$451 million of ongoing Fresh Kills closure projects. Among the proposed projects are a drainage system for \$140 million, construction of the leachate mitigation system for \$126 million, and final cover for \$120 million. DOS is working with DEC to determine which of the projects included in the application qualify for the matching funds. The city expects to receive the full \$75 million award from the state next fiscal year.

**Capital budget.** The current five-year commitment plan for DOS from 2001-2005 totals \$1.3 billion, of which 58.5 percent (\$746.0 million) is allocated for garages and other facilities and 34 percent (\$433.0 million) for vehicle acquisition and maintenance. The remaining 7.6 percent (\$96.3 million) is for waste management-related projects, including \$59.6 million for the two new waste transfer stations in Staten Island and Brooklyn; \$10.3 million for marine transport system improvements; \$1.4 million for composting; \$24 million for landfill and incinerator closure; and \$19.7 million for an enclosed unloading facility required by a consent order for continued

### **Fresh Kills' Billion Dollar Closing Costs**

In December 1996, Mayor Giuliani and Governor Pataki announced that the Fresh Kills landfill in Staten Island—the last remaining disposal site within the city—would close by the end of calendar year 2001. Beyond the costs associated with exporting the city's refuse, there are costs directly attributable to the closure itself. According to an analysis prepared by DOS in accordance with the Government Accounting Standards Board (GASB) directive no. 34, the total cost of closing the landfill will in fact top \$1 billion. There are two major components of this cost: the actual closure of the landfill, and ongoing environmental monitoring required by state and federal law.

Fresh Kills is composed of four landfill sections, only one of which is still active and receiving refuse. Two other sections have already been covered and one, although inactive, has not yet been covered. In its GASB cost estimates, the city projects that construction costs for closing the landfill—including covering each section and putting environmental control systems into place—will total \$443.7 million (in 2001 dollars), of which \$246.7 million has already been spent. These costs include systems throughout the site for gas emissions control, drainage, and leachate control and treatment. Of the \$197.0 million of construction expenses still

remaining, 85 percent will be spent on the final cover for the last two sections, 7 percent on landfill gas emissions control, 7 percent on leachate control and treatment, and one percent on site work and drainage.

Once the site is completely closed, the city must continue to monitor the facility for conformity with environmental regulations. The city estimates that these ongoing operations and maintenance costs will total \$625.8 million over 30 years. These costs include \$335.3 million (53.6 percent) for care of the final cover; \$145.9 million (23.3 percent) for leachate control and treatment; \$74.0 million (11.8 percent) for groundwater monitoring; \$51.4 million (8.2 percent) for landfill gas emission monitoring and control; \$12.8 million (2.1 percent) for surface water and sediment monitoring; and \$6.3 million (1.0 percent) for facility monitoring. Some of these post-closure costs have already been incurred for the two inactive, covered sections of the landfill.

An additional \$146.4 million in operating costs for landfill gas control are being assumed by the city's landfill gas concessionaire, and therefore will not be an expense to city.

operation of the Fresh Kills landfill. Since Fresh Kills will be permanently closed this year, this facility will not need to be built.

Longer term, DOS's capital plan for 2002-2011 totals \$2.8 billion. The plan's out years (2006-2011) include \$712 million for garages and other facilities, \$654 million for vehicle acquisition and maintenance, \$260 million for landfill closure activities and improvements to the marine transport system, and \$20 million for a new composting facility. Although the capital plan also includes \$153.9 million for purchasing landfill capacity,

these funds will not be needed if the city's proposed long-term waste export plan is implemented. DOS believes that these funds could potentially be used for end-use projects at Fresh Kills once closure construction activities are completed.

**Note:**

<sup>1</sup> The New York State Theater—including the New York City Ballet and the New York City Opera—is a member of the Cultural Institutions Group (CIG). Other tenants of Lincoln Center, including the Metropolitan Opera, New York Philharmonic, and the Lincoln Center Theaters, are not members of the CIG.



# Other Expenditures

## Collective Bargaining Agreements

Labor contracts for most city employees have expired and the city and its unions are currently negotiating new contracts. The city's Financial Plan only incorporates labor costs associated with a two-year agreement with the unions. If the agreement were to cover the entire plan period and provide increases equal to the rate of inflation, city-funded costs would increase by \$860 million in 2005.

Unlike past contracts that provided the same percentage base salary increase to all employees of a specific union, the city has proposed a merit pay plan. Under the merit pay plan, employees would receive salary increases based on performance evaluations. The best workers would be rewarded with the largest wage increases and those workers who do an adequate job would receive a moderate wage increase. Those workers whose performance is inadequate would not receive a wage increase but would be given the opportunity to improve their performance.

In anticipation of a two-year settlement with average wages increasing at the rate of inflation, the city's Financial Plan includes \$325 million in 2001; \$750 million in 2002; and \$800 million in 2003, 2004 and 2005. Instead of including all of the anticipated collective bargaining expenditures in the labor reserve, funds for the projected Board of Education (BOE) wage settlement have been placed in a discrete collective bargaining unit of appropriation within BOE's budget. The funds transferred to this unit of appropriation are \$115 million in 2001;

\$274 million in 2002; and \$326 million in 2003, 2004, and 2005.

The labor productivity savings proposal included in last year's Financial Plan has been eliminated from the 2002 Preliminary Budget. The city had not provided any details regarding these anticipated savings other than to suggest they could come from employee contributions to health insurance or savings in fringe benefit costs. These savings, which would have offset part of the cost of a labor settlement, totaled \$250 million in 2001, \$265 million in 2002, \$280 million in 2003, and \$300 million in 2004 and 2005. As part of an agreement with city unions on the disposition of surpluses in the Health Insurance Stabilization Fund, the Administration has agreed to eliminate these labor productivity savings from the current Financial Plan.

The city's projection of costs associated with new labor contracts is based on a two-year agreement with the unions. Since the city's Financial Plan covers the period through 2005, IBO has projected the impact of a wage settlement that covers the full plan period. A wage settlement based on the projected rate of inflation and beginning after the proposed two-year agreement ends would increase city-funded costs by an additional \$270 million in 2003, \$541 million in 2004, and \$860 million in 2005. Five years of wage increases at the rate of inflation would cost the city \$1.7 billion annually by the final year of the plan—nearly twice as much as already budgeted.

Since it is difficult to predict the outcome of collective bargaining, it should be noted that if the agreements exceed the rate of inflation by one percentage point, contract settlements would roughly cost an additional \$110 million per year. Over the Financial Plan period, annual city spending would be \$550 million higher by 2005. Conversely, for every percentage point that agreements fall short of the rate of inflation, annual city spending would be \$550 million lower by 2005.

## Overtime Spending

Overtime costs are affected by many factors including collective bargaining agreements, management initiatives, planned events, and emergencies. IBO projects that spending will total \$635 million in 2001. This spending would be \$155 million—or 32 percent—greater than the funding included in the Adopted Budget, and also would exceed actual overtime expenditures of \$618 million in 2000.

Most of the increased overtime cost in 2001 is due to additional spending in the Police Department (NYPD). IBO projects that uniformed overtime will total \$300 million in 2001. This spending would be \$155 million—or 107 percent greater—than the funding included in the Adopted Budget for NYPD's uniformed overtime. This increase is due in large part to the expansion of the department's patrol strength—primarily through the use of overtime—for anti-drug and quality-of-life initiatives.

IBO projects that this trend in police uniformed overtime costs will continue and police uniformed overtime will be \$300 million in 2001 and \$260 million annually in 2002 through 2005. Therefore, IBO's projections are \$23 million greater in 2001 than projected in the Preliminary Budget, \$83 million greater in 2002, and \$146 million greater in each year 2003 through 2005. (For additional discussion of police overtime, see the analysis of NYPD's budget in the Public Safety section of this chapter.)

## Stadium Financing

The Administration has proposed spending \$573 million from 2001 through 2003 on a pay-as-you-go basis to fund the construction of major league sports facilities. Projects being discussed include a new stadium in Manhattan, a new Queens stadium for the Mets, and a new or rehabilitated Yankee stadium in the Bronx.

Despite the size of the city's appropriations for major league stadium construction, a great deal of uncertainty surrounds such basic issues as what projects would be funded, how much they would cost and what share of total costs would be borne by the taxpayers. Since there is no firm consensus on the plans for major league stadium construction, it is unlikely that the \$90 million that has been appropriated in the 2001 budget for stadium facility construction will actually be spent in 2001. Therefore, IBO's projections reflect a shift in expenditures of \$90 million to 2002, \$194 million to 2003, and \$289 million to 2004.

In addition to the major league stadiums, the Administration has provided funding for the construction of two minor league stadiums and a sports complex. A minor league baseball stadium along with related community and infrastructure improvements is currently under construction on Staten Island. Projected construction costs for this project total \$71 million and are made up of \$50.7 million in capital funding, \$7.6 million in expense funding, and \$12.7 million in Economic Development Corporation revenues. Also under construction, on the site of the former Steeplechase Park in Brooklyn, is a minor league baseball stadium with a projected capital cost of \$39.5 million. Construction of a \$37 million amateur sports complex, to be located in the Coney Island section of Brooklyn, has also been proposed.

## Debt Service

One of the largest items in the city's expense budget is the payment of principal and interest on debt

backed by city revenues. The level of debt service spending in the Financial Plan is driven by prior borrowing, as well as by the amount of new debt that will be issued to fund the city's capital commitment plan over the next four years.

- Debt service payments have risen sharply in recent years and are expected to continue growing. Adjusted for prepayments, debt service spending will rise 5.6 percent annually on average, from \$3.9 billion in 2001 to \$4.9 billion in 2005.
- Debt service as a percent of tax revenues is also rising, from 18.5 percent in 2002 to 19.6 percent in 2005. This is a significant increase from 1990, when debt service consumed 11.6 percent of tax revenue.
- The Preliminary Budget promises a new debt management policy to be issued later in the year.

**Types of city debt.** Five types of debt have a direct claim on the broad taxing powers of the city: General Obligation (GO) bonds, short-term notes, bonds issued by the Municipal Assistance Corporation (MAC) and the Transitional Finance Authority (TFA), and capital lease obligations. GO debt and short-term notes are backed by the full faith and credit of the city, and MAC debt is supported by the sales tax. Capital lease obligations are supported by annual city appropriations.

Unlike these other obligations, TFA debt service is not paid from the city's general fund. IBO includes it in its analysis of city debt and city debt service expenditures because TFA bonds are backed by a dedicated portion of the city's personal income tax revenues.

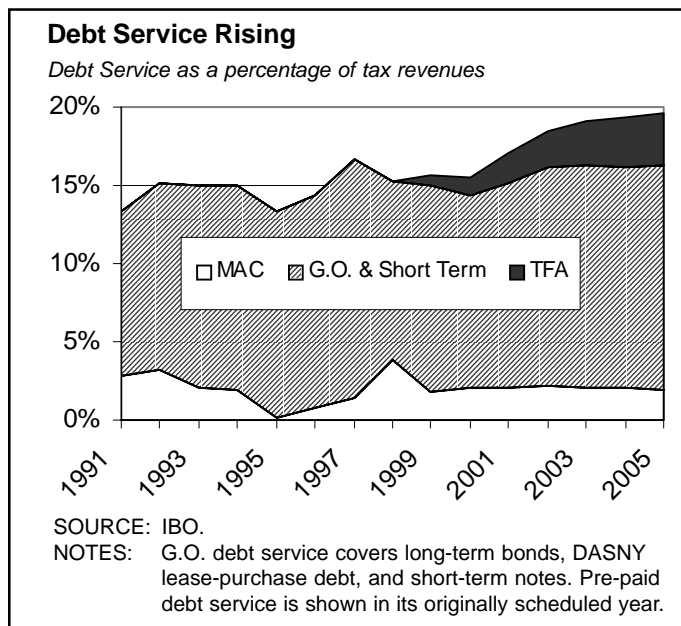
The city also finances a portion of its capital program with bonds issued by the Tobacco Settlement Asset Securitization Corporation (TSASC). Bonds issued by TSASC have no claim on city tax revenues; instead the debt is serviced by payments received from tobacco companies under the terms of the national legal settlement. IBO excludes TSASC

obligations when analyzing debt service.

**Adjusting for prepayments.** Debt service trends have been obscured in recent years by the use of surpluses to prepay debt service due in the next fiscal year. Prepayments move debt service burdens between fiscal years, increasing the total costs of debt service in the initial year and lowering them in the subsequent year. IBO's analysis of debt service shifts prepaid debt service to the year the costs were originally scheduled to occur.

For example, IBO assumes that the expected 2001 surplus will be used to prepay \$2.2 billion in debt service scheduled to be paid in 2002. Without the prepayment adjustment, 2001 debt service would appear \$2.2 billion higher and 2002 debt service would appear \$2.2 billion lower. After adjusting for prepayments, IBO estimates that transfers and payments for debt service will rise from \$3.9 billion in 2001 to \$4.2 billion in 2002 and \$4.9 billion in 2005.

**Debt service and revenues.** Transfers and payments for debt service have been absorbing an increasing share of city tax revenues since 1991.



The rising ratio of debt service to tax revenues from 13.3 percent in 1991 to a projected 17.1 percent in

2001 and 19.6 percent in 2005 is attributable to several factors. New borrowing for capital spending rose from an average of \$1.1 billion per year in the 1980s to \$2.8 billion in the 1990s, an increase of about 75 percent after adjusting for inflation. Borrowing will remain brisk over the Financial Plan period, averaging just over \$3.2 billion per year (\$3.6 billion per year if TSASC debt were included). For the years 2002 through 2005, an additional factor is the slowdown in tax revenue growth due to the slowing economy and the cumulative effect of tax cuts.

**Debt limits and affordability.** The amount of city debt outstanding is subject to several constraints or limits. Under the New York State Constitution, GO debt outstanding is limited to 10 percent of the five-year average of the full value of real property in the city, as determined by the state. The growth in property values in recent years, in conjunction with improvements in how full value is estimated by the state, has raised the forecasted level of the debt limit. With more room under the limit, concerns that the limit would interfere with the city's capital program have lessened.

A second limit is the borrowing authority of the TFA. When it was established in 1997, the amount of TFA debt outstanding was capped by the legislature at \$7.5 billion. In 2000, with the city having hit the GO

debt limit and the initial \$7.5 billion of TFA debt already issued, the legislature raised the cap to \$11.5 billion.

In his Preliminary Budget presentation, the Mayor highlighted the need to address how the city's debt limit is defined to fully recognize the city's fiscal capacity, while still providing a reasonable constraint on the share of the city's budget dedicated to debt service. The budget suggested a number of alternatives that are currently under consideration by the Administration. A final proposal is expected in conjunction with the Executive Budget in April.

Defining the level of debt service that can be reasonably borne by a municipality requires balancing a number of competing priorities. The city faces growing infrastructure needs that—barring new state and federal capital assistance—will have to be financed through the city's own capital program. Given the broad taxing powers of the city, the current constitutional limit with its definition linked solely to the property tax is probably lower than is necessary to provide assurance that bond holders can be repaid while leaving sufficient resources to meet other core municipal functions. On the other hand, there is growing concern that with debt service approaching 20 percent of tax revenues, the city may be flirting with a reasonable bound on the amount of debt that is affordable.



# ***Appendices***



# Appendix A

<b>IBO's Repricing of the Mayor's Financial Plan</b>						
<i>Dollars in millions</i>						
	2001	2002	2003	2004	2005	Average Change
<b>Revenues</b>						
Taxes						
Property	\$ 8,078	\$ 8,586	\$ 9,044	\$ 9,503	\$ 9,962	5.4%
Personal Income (includes TFA)	5,810	5,536	5,765	6,044	6,333	2.2%
General Sales	3,572	3,614	3,764	3,895	3,960	2.6%
Business Income	2,890	2,664	2,746	2,871	3,016	1.1%
Real-Estate Related	1,121	1,167	1,225	1,264	1,310	4.0%
Other Taxes (with Audits)	1,388	1,484	1,443	1,448	1,447	1.0%
<b>Total Taxes</b>	<b>22,859</b>	<b>23,051</b>	<b>23,987</b>	<b>25,025</b>	<b>26,028</b>	<b>3.3%</b>
Tax Reduction Program	-	(400)	(721)	(955)	(1,241)	n/a
STaR Reimbursement	504	666	765	735	821	13.0%
Miscellaneous Revenues (net of intra-city revenue)	3,360	2,953	2,852	2,571	2,608	-6.1%
All Other Revenues						
Unrestricted Intergovernmental Aid	616	564	564	564	564	-2.2%
Other Categorical Grants	414	389	354	347	336	-5.1%
Anticipated State and Federal Actions	-	75	-	-	-	n/a
Inter-Fund Revenues	293	298	293	293	293	0.0%
Disallowances	(15)	(15)	(15)	(15)	(15)	0.0%
<b>Total Other Revenue</b>	<b>1,308</b>	<b>1,311</b>	<b>1,196</b>	<b>1,189</b>	<b>1,178</b>	<b>-2.6%</b>
Total City Funds	28,031	27,581	28,079	28,565	29,394	1.2%
Categorical Grants:						
State	7,766	8,065	8,301	8,529	8,733	3.0%
Federal	4,789	4,413	4,347	4,402	4,456	-1.8%
<b>Total Revenues</b>	<b>40,586</b>	<b>40,059</b>	<b>40,727</b>	<b>41,496</b>	<b>42,583</b>	<b>1.2%</b>
<b>Expenditures</b>						
City Funded (includes TFA) (net of intra-city sales)	28,031	28,681	31,407	33,047	33,908	4.9%
Categorical Grants:						
State	7,766	8,065	8,301	8,529	8,733	3.0%
Federal	4,789	4,413	4,347	4,402	4,456	-1.8%
<b>Total Expenditures</b>	<b>40,586</b>	<b>41,159</b>	<b>44,055</b>	<b>45,978</b>	<b>47,097</b>	<b>3.8%</b>
<b>Surplus / (Gap)</b>	<b>\$ -</b>	<b>\$ (1,100)</b>	<b>\$ (3,328)</b>	<b>\$ (4,482)</b>	<b>\$ (4,514)</b>	

SOURCE: IBO.

# Appendix B

## IBO's Reestimate of the Mayor's Revenue Proposals

*Dollars in millions*

	2001	2002	2003	2004	2005
<b>Total Revenues as Estimated by the Mayor</b>	<b>\$ 39,672</b>	<b>\$ 39,318</b>	<b>\$ 39,143</b>	<b>\$ 39,862</b>	<b>\$ 40,767</b>
<b>IBO Reestimates</b>					
Tax Revenues					
Property Tax	(14)	(4)	24	52	89
Personal Income Tax	185	186	96	17	(56)
General Sales Tax	(27)	31	47	28	30
General Corporation Tax	(15)	1	22	43	35
Unincorporated Business Tax	(19)	(21)	(35)	(36)	(59)
Banking Corporation Tax	4	19	(23)	(33)	(46)
Real-estate Related Tax Reduction Program	27	51	6	(46)	(89)
	-	(11)	(16)	46	(8)
STaR Reimbursement	-	(4)	34	(20)	44
Miscellaneous Revenues					
Airport Rent	-	(345)	(200)	(135)	(65)
Sale of OTB	-	(250)	250	-	-
State/Federal Categorical Aid	339	571	739	943	1,118
Inclusion in the Budget					
Dedicated Personal Income Tax (TFA)	434	517	640	775	823
<b>IBO Total Revenue Estimate</b>	<b>\$ 40,586</b>	<b>\$ 40,059</b>	<b>\$ 40,727</b>	<b>\$ 41,496</b>	<b>\$ 42,583</b>

SOURCE: IBO.

NOTE: Miscellaneous revenues are net of intra-city revenues.

# Appendix C

## IBO's Reestimate of the Mayor's Expenditure Proposals

*Dollars in millions*

	2001	2002	2003	2004	2005
<b>Total Expenditures as Estimated by the Mayor</b>	<b>\$ 39,672</b>	<b>\$ 39,318</b>	<b>\$ 41,566</b>	<b>\$ 42,328</b>	<b>\$ 43,074</b>
<b>IBO Reestimates</b>					
Public Assistance	65	83	69	70	70
Medicaid	114	111	117	121	207
Education (excluding labor adjustment)	136	147	285	414	474
Education Reserve (shift to BOE)	(43)	(5)	(21)	(21)	(21)
Interim Waste Export Contracts	(15)	(11)	(11)	(8)	(4)
State & Federal Actions not Expected	-	350	350	350	350
Labor Costs Exceeding Reserve	-	-	270	541	860
Public Campaign Financing	-	50	-	30	-
Sports Facilities	(90)	(104)	(95)	289	-
Overtime	23	83	146	146	146
Reduce Debt Service Prepayment	(49)	49	-	-	-
State / Federal Categorical Funding	339	571	739	943	1,118
Inclusion in the Budget: TFA Debt Service	434	517	640	775	823
<b>IBO Total Expenditure Estimate</b>	<b>\$ 40,586</b>	<b>\$ 41,159</b>	<b>\$ 44,055</b>	<b>\$ 45,978</b>	<b>\$ 47,097</b>

SOURCE: IBO.

NOTE: Excludes intra-city expenditures.

# Appendix D

<b>Economic Forecast: IBO and OMB</b>						
		<b>Calendar Year</b>				
	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
<b>National Economy</b>						
Real GDP Growth						
IBO	5.1	2.7	3.7	3.4	3.1	3.1
OMB	5.3	2.5	3.7	4.1	3.6	3.4
Non-farm Employment Growth						
IBO	2.0	0.8	1.3	1.5	1.2	1.3
OMB	2.1	0.1	1.0	1.8	1.6	1.3
Inflation Rate (CPI-U)						
IBO	3.4	2.6	2.4	2.4	2.3	2.3
OMB	3.4	2.6	2.5	2.6	2.5	2.7
Personal Income Growth						
IBO	6.4	5.6	5.7	5.6	5.1	4.8
OMB	6.4	4.7	5.6	6.3	6.0	5.8
Unemployment Rate						
IBO	4.0	4.3	4.7	4.9	5.0	5.0
OMB	4.0	4.4	4.6	4.2	4.0	4.0
10-Year Treasury Bond Rate						
IBO	6.0	5.4	6.0	6.3	6.2	5.9
OMB	6.0	4.0	4.9	5.2	5.7	5.8
Federal Funds Rate						
IBO	6.2	5.6	5.7	5.8	5.5	5.3
OMB	6.2	5.4	5.0	5.3	5.9	6.0
<b>NYC Economy</b>						
Non-farm New Jobs (thousands)						
IBO	99.8	41.3	33.9	38.7	32.3	32.2
OMB	79.9	41.7	33.1	51.2	48.2	44.1
Employment Growth						
IBO	2.1	1.1	0.9	1.0	0.8	0.8
OMB	2.3	1.1	0.9	1.4	1.3	1.1
Inflation Rate (CPI-U-NY)						
IBO	3.2	3.3	2.8	2.6	2.3	2.3
OMB	3.1	2.9	2.7	2.6	2.6	2.9
Personal Income (\$ billions)						
IBO	\$ 290	\$ 304	\$ 317	\$ 331	\$ 346	\$ 362
OMB	\$ 300	\$ 309	\$ 319	\$ 338	\$ 356	\$ 372
Personal Income Growth						
IBO	5.3	5.1	4.3	4.4	4.5	4.5
OMB	7.6	3.2	3.3	5.9	5.3	4.5
Manhattan Office Rents (\$/sq. ft.)						
IBO	\$ 58.61	\$ 59.08	\$ 57.08	\$ 56.87	\$ 56.80	\$ 56.78
OMB	\$ 58.15	\$ 63.76	\$ 65.75	\$ 68.43	\$ 72.07	\$ 74.00

SOURCES: IBO; OMB.  
NOTE: All rates reflect year-over-year percentage changes except for unemployment, 10-year Treasury Bond, and Federal Funds. The local price index for urban consumers (CPI-U-NY) covers the New York / Northern New Jersey region.

# Appendix E

## **Contributors to this report include:**

David Belkin	Business income taxes, sales taxes, debt
Joshua Chang	Homeless services, youth employment programs, HHC
Richard Greene	Overtime spending, stadiums
Keith Goldfeld	Medicaid
Michael Jacobs	Economic outlook, personal income tax, hotel occupancy tax
Sherry Login	Sanitation
Paul Lopatto	Public assistance
Lisa Sturman Melamed	Board of Education
Preston Niblack	Housing and buildings
Bernard O'Brien	Police, correction
Merrill Pond	Environmental protection, debt
Frank Posillico	Collective bargaining, categorical grants, other revenues
George V. Sweeting	Real property tax, property-related taxes
Alan Treffeisen	Transportation
Robert Weiner	Board of Education, CUNY
Elizabeth Zeldin	Parks, cultural affairs, libraries, sales tax









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