

Overview

An improving local economy along with a set of tax increases and spending reductions has helped move the city from the fiscal precipice it faced the past two years. Now the city's near-term fiscal outlook is markedly better: IBO projects that under the Mayor's latest budget plan the city will end the current fiscal year with a surplus of \$1.6 billion and will end 2005 with \$469 million more in revenues than expenditures, which can be used to fund new priorities or meet other needs. This picture could dim, though, if a number of measures assumed in the plan such as revenue from the Battery Park City Authority or wage increases for labor that are funded by givebacks do not materialize.

IBO's review of the Preliminary Budget for 2005 and Financial Plan through 2008 finds the city still faces pressures in the later years of the plan. Although spending for most programs and services is flat throughout the plan, total spending growth will continue to outpace revenue growth and leave the city with sizeable budget gaps in 2006 and beyond.

Some key highlights of our analysis and reestimates include:

- With the local economic recovery underway, IBO now expects tax revenue to be \$26.5 billion in 2004—\$1.0 billion more than anticipated by the Mayor when the budget was passed last June.
- The budget plan anticipates annual spending growth averaging only 0.4 percent for most city programs and services between 2004 and 2008.
- In contrast, fast-rising costs for debt service, pensions, Medicaid, and some other portions of the budget over which the city has limited control will push city spending to over \$50 billion in 2007.
- If a number of key measures in the budget plan are not achieved—from Municipal Assistance Corporation restructuring to expected federal and state aid—the 2005 surplus could become a shortfall and projected gaps of \$1.7 in 2006 and \$2.7 billion in 2007 could increase by over \$1 billion annually.

Total Revenue and Expenditure Projections						
<i>Dollars in millions</i>						
	2004	2005	2006	2007	2008	Average Change
Revenues	\$ 46,478	\$ 47,423	\$ 47,657	\$ 48,636	\$ 49,947	1.8%
<i>city-funded revenues</i>	32,551	33,242	33,476	34,319	35,501	2.2%
Expenditures	46,478	46,954	49,329	51,316	52,300	3.0%
<i>city-funded expenditures</i>	32,551	32,773	35,148	36,999	37,854	3.8%
IBO Surplus/(Gap) Projection	\$ -	\$ 469	\$ (1,672)	\$ (2,680)	\$ (2,353)	
Uncertainties						
Anticipated State and Federal Actions	-	(700)	(700)	(700)	(700)	
MAC Restructuring	(491)	(490)	(492)	(494)	(470)	
Pensions	-	(300)	(300)	(300)	(300)	
Private Bus Subsidy Reduction	-	(145)	(148)	(153)	(158)	
Battery Park City - Asset Sale	-	(150)	-	-	-	
	\$ (491)	\$ (1,785)	\$ (1,640)	\$ (1,647)	\$ (1,628)	

SOURCE: IBO.
 NOTES: IBO projects a surplus of \$1,624 million for 2004, \$234 million above the Mayor's forecast. The \$234 million is used to prepay additional 2005 expenditures, leaving 2004 with a balanced budget. City-funded revenues and expenditures exclude state and federal categorical grants. Projections are net of intra-city revenues and expenditures. Uncertainties do not include possible costs for a labor settlement and resolution of the Campaign for Fiscal Equity education lawsuit.

BUDGET GAPS

If the budget plan is adopted as proposed, IBO projects the city will end the current fiscal year with a \$1.6 billion surplus (which will be used to prepay some of next year's expenses) and a \$469 million surplus in 2005. But the pluses will turn to minuses in the ensuing years. We project a gap of nearly \$1.7 billion in 2006 and \$2.7 billion in 2007.

The surplus in 2005 could be erased and the gaps in 2006 and 2007 significantly widened if a number of measures in the Mayor's budget plan do not materialize. A partial listing of these "uncertainties" totals \$491 million in the current fiscal year, \$1.8 billion in 2005 and \$1.6 billion in 2006 and 2007 (more details on these uncertainties are provided below).

ECONOMIC AND REVENUE ESTIMATES

After three consecutive years of job losses, the city's economy is finally beginning to grow. IBO expects employment in New York City to rise a modest 21,200 jobs (0.6 percent) this calendar year followed by stronger growth of 59,100 jobs (1.7 percent growth) in 2005. Similarly, after two years of decline, wages and salaries will grow 4.0 percent this year, helping to fuel a 5.8 percent jump in personal income. Wall Street profits, an important marker for the city's fiscal health, reached \$15.1 billion in 2003—more than double the year before—and are expected to remain above \$15 billion both this year and next.

IBO projects that total city revenue, which includes state and federal aid, fees and fines, and other miscellaneous resources, will grow by nearly \$1 billion in 2005 and reach \$47.4 billion. Total revenue will continue to rise at an average annual rate of 1.8 percent through 2008 when it is estimated to reach \$49.9 billion.

Reflecting the improved local economy, city tax revenue will grow at a steady pace, although well below the growth rates of the late 1990s. IBO estimates that tax revenue will rise by \$370 million in 2005 and total \$26.9 billion assuming the Mayor's proposed property tax rebate and repeal of the absentee landlord surcharge are adopted. Tax revenue will grow at an annual average rate of 3.0 percent and reach \$29.8 billion in 2008.

Tax increases enacted for 2003 and 2004 account for much of the growth in tax revenue in 2004. Without the increases, tax

revenues would have increased by 5.4 percent in 2004, barely a third of the 14.2 percent increase forecast by IBO. Except for the property tax rate increase, which the Financial Plan assumes is permanent, the other increases are all temporary. The scheduled phase out of the increases will constrain tax revenue growth in 2005 through 2007. The sunset provisions reduce tax revenue growth in 2005 by nearly 60 percent.

Among the city's major tax sources, property-tax collections will increase the most in percentage and dollar terms. IBO projects property tax revenue will rise by \$553 million in 2005 and total \$11.9 billion. Property-tax collections will rise at an annual average rate of 4.8 percent and reach \$13.8 billion in 2008. Since the property tax rate increase has already been fully phased in, this increase results from continued strength in local property values.

Growth in personal income tax revenue will be more modest and will remain below the peak—reached in 2001—until 2008. IBO anticipates that personal income tax revenue will rise by \$142 million in 2005 and total \$5.5 billion. This growth occurs despite the phasing out of increases on upper-income filers. Growing at an annual average rate of 2.6 percent throughout the Financial Plan period, we expect personal income tax revenue to be just under \$6 billion in 2008.

This growth in tax revenue is partially offset by declines in sales and mortgage recording tax revenues in 2005. IBO projects sales tax revenue will fall by \$165 million in 2005 because of the phase out of the sales tax increase enacted last year; the mortgage recording tax will drop by \$78 million in 2005 because higher interest rates will reduce mortgage refinancing activity.

EXPENDITURE ESTIMATES

IBO projects that total city spending will grow by \$476 million—or 1 percent—in 2005 and reach \$46.9 billion. Over the course of the Financial Plan total spending will rise by \$5.8 billion and reach \$52.3 billion in 2008. The city-funded portion of this spending will rise steadily as well. IBO anticipates city-funded expenditures to increase from \$32.6 billion in 2004 to \$32.8 billion in 2005, a \$222 million increase. City-funded spending will continue to rise in the following years and reach an estimated \$37.9 billion in 2008.

While overall expenditures will grow at an average annual rate

of 3 percent, little of this can be attributed to increases in basic city programs and services. On an operating level city spending is flat, growing at an annual average rate of 0.4 percent, although this is partly a result of the fact that the budget includes no funding for wage increases.

enacted in 2004, including shrinking the police force, closing several fire houses, reducing spending on after-school care for children, and other cutbacks have established a new baseline spending level that the Mayor proposes to hold essentially flat for 2005 and the remainder of the Financial Plan period.

Pricing Differences Between IBO and the Administration

Items that Affect the Gap

Dollars in millions

	2004	2005	2006	2007	2008
Revenues					
Taxes					
Property	\$ 5	\$ 83	\$ 387	\$ 420	\$ 358
Personal Income	122	172	160	132	136
General Sales	27	(113)	(181)	(236)	(275)
General Corporation	73	114	37	(57)	(149)
Unincorporated Business	19	7	(5)	(19)	(31)
Banking Corporation	71	57	59	(4)	(94)
Real Property Transfer	8	74	63	35	23
Mortgage Recording	(46)	(11)	(19)	-	22
Commercial Rent	5	5	6	8	15
	284	388	507	279	5
STaR Reimbursement	(23)	(18)	1	16	13
Total Revenues	\$ 261	\$ 370	\$ 508	\$ 295	\$ 18
Expenditures					
Public Assistance	\$ 21	\$ 41	\$ 64	\$ 67	\$ 67
Medicaid	(23)	(66)	(69)	(72)	(74)
Police Overtime	(25)	(115)	(100)	(100)	(100)
Board of Elections	-	-	(20)	-	(20)
Campaign Finance	-	8	(34)	8	(1)
Department of Buildings	-	(3)	(3)	(3)	(3)
Total Expenditures	\$ (27)	\$ (135)	\$ (162)	\$ (100)	\$ (131)

SOURCE: IBO.

NOTE: Negative pricing differences (in parentheses) widen the gaps, while positive pricing differences narrow the gaps.

Based on the Mayor's Financial Plan, we project that such program areas as education and sanitation will see a modest rise in spending, averaging a little over 1 percent annually. Spending on other services—from fire to correction to children's services—will fall while police expenditures will remain essentially unchanged over the course of the Financial Plan.

The Mayor's 2005 agency program to eliminate the gap imposes few significant new cuts to agency services beyond those already enacted last year. The \$2.1 billion in savings

Driving the increase in overall expenditures is a number of factors over which the city has little or no direct control. Interest and principal payments on city-backed bonds, including those issued by the Transitional Finance Authority will rise from \$3.5 billion in 2005 to \$5.1 billion in 2008, an increase of \$1.6 billion. The rise in debt service stems mostly from the city's annual capital spending plan continuing to be larger than it was in the late 1990s.

Expenditures on pensions and fringe benefits—fueled primarily by the rising cost of health insurance—for city

employees are also projected to rise steeply. The city's contribution to the five pension funds are expected to rise by \$610 million in 2005 and total \$3 billion. By 2008, the city's pension spending—driven largely by the need to cover prior-years pension losses as well as a state mandated cost-of-living increase—will increase an additional \$1.2 billion and equal \$4.2 billion. Spending on health insurance and other fringe benefits for the municipal workforce (excluding the education department) will grow by \$197 million in 2005 and total \$3.1 billion. These costs will grow an additional \$662 million by 2008 and total \$3.8 billion.

Medicaid also continues to drive up city spending. IBO projects that city Medicaid expenditures—driven largely by growing drug and long-term care costs—will be \$4.6 billion in 2005 and grow by \$619 million through 2008 and total \$5.2 billion. Much of the city's Medicaid spending is carried within the budget of the Human Resources Administration. When the Medicaid portion of the agency's budget is included, Human Resources Administration spending is projected to rise at an annual average rate of 3.1 percent through 2008. If Medicaid is subtracted from the Human Resources Administration budget, the agency's spending *falls* at an average annual rate of nearly 2 percent.

UNCERTAINTIES

If a number of proposals included in the Preliminary Budget are not resolved or aid expectations unmet, the city's 2005 surplus could be quickly erased. Likewise, these uncertainties could swell the city's out-year budget gaps.

State and Federal Aid. The Mayor's budget plan assumes \$700 million in state and federal assistance, with \$400 million coming from the state. The Governor's budget contains by his estimate \$418 million in gap-closing aid for the city. But the single largest portion of it, which would provide the city an estimated \$162 million in revenue, is a continuation of the sales tax on clothing purchases for under \$110—something the Mayor has said he will not support. State legislative support for the Governor's Medicaid cost-containment proposals, which he estimates would save the city \$141 million, is far from guaranteed. If these two proposals are rejected, the city is a long way from realizing the amount of anticipated state aid.

MAC Restructuring. The Financial Plan also assumes a savings of roughly \$490 million annually in 2004 through 2007 from the state taking over the payments of the city's debt service on Municipal Assistance Corporation bonds. The takeover plan,

which was passed by the state Legislature but opposed by the Governor, is now tied up in court. The Governor has proposed his own takeover plan, but IBO does not expect the plan to generate enough revenue to finance the takeover.

Pension Costs. Based on a biennial review by an independent auditor, the city may need to increase its contribution to the pension funds by \$300 million a year. The "experience study," which draws on data from 1988 through 2001, concluded that because of likely salary increases, higher than anticipated overtime, and other factors the city should increase its pension contribution. The city actuary will make the final determination and has not yet decided if he agrees with the recommendations in the study.

Private Bus Takeover. The city has been negotiating with the Metropolitan Transportation Authority to take over the seven private bus franchises operating here and relieve the city of its \$145 million annual subsidy of these lines. The negotiations have stalled—the city had previously sought a deal by last December—and given the transportation authority's own budget problems it is unlikely to take over the bus service without some continued city contribution.

Battery Park City Revenue. The Preliminary Budget also includes revenue of \$150 million in 2005 from the Battery Park City Authority from the sale of an "asset." Given that no asset has yet been identified, completion of a sale and receipt of the funds by the city in 2005 is very tentative.

Labor Settlements. Two other uncertainties, although harder to quantify in dollar terms, also could affect the city's fiscal balance. Despite nearly all of the city's contracts with its unions having expired, the budget plan includes no funds for wage increases. The Mayor has said that there will be no retroactive pay raises and no raises that are not self-funded by the workforce through changes that provide savings from labor. This may prove a hard bargaining line to hold. Each 1 percent increase in wages for city workers costs \$208 million in the first year and more than double that the next.

Education Lawsuit. Additionally, the state's highest court has ordered the Legislature to develop a new education financing system to resolve the lawsuit brought by the Campaign for Fiscal Equity. Since the suit seeks to ensure that the city has adequate resources for its schools, many have assumed the settlement would solely involve more state aid. In fact, a new financing arrangement could require the city to spend more than the \$5 billion it already allocates for public schools.

CONCLUSION

New York City's fiscal health has improved markedly and we will end the current fiscal year with a substantial surplus, which will be followed by a smaller surplus in 2005. This relatively strong near-term outlook is tempered, though, by a number of uncertainties in the Mayor's budget plan. These

uncertainties, ranging from the possible failure to meet the anticipated level of state and federal gap closing aid to the need to cover the cost of settlements with the city's unions, could add significant pressures to the city's fiscal balance. Moreover, keeping spending level for most city programs and services, with or without some additional cost from a labor settlement, could also prove difficult.

IBO Expenditure Projections*Dollars in millions*

	2004	2005	2006	2007	2008	Average Change
Health & Social Services						
Social Services:						
Medicaid	\$ 3,419	\$ 3,858	\$ 4,049	\$ 4,250	\$ 4,458	6.9%
All Other Social Services	2,868	2,693	2,648	2,653	2,653	-1.9%
HHC:						
Medicaid - HHC	747	764	783	783	783	1.2%
All Other HHC	96	94	93	93	93	-0.8%
Health	1,474	1,490	1,516	1,545	1,546	1.2%
Children Services	2,256	2,157	2,156	2,158	2,158	-1.1%
Homeless	653	648	647	650	651	-0.1%
Other Related Services	460	399	399	399	399	-3.5%
<i>Subtotal</i>	11,973	12,103	12,291	12,531	12,741	1.6%
Education						
DOE	12,741	12,819	13,090	13,315	13,469	1.4%
CUNY	467	460	457	455	455	-0.6%
<i>Subtotal</i>	13,208	13,279	13,547	13,770	13,924	1.3%
Uniformed Services						
Police	3,476	3,452	3,474	3,475	3,477	0.0%
Fire	1,198	1,150	1,153	1,147	1,142	-1.2%
Correction	844	824	829	827	827	-0.5%
Sanitation	1,001	1,036	1,052	1,052	1,052	1.3%
<i>Subtotal</i>	6,519	6,462	6,508	6,501	6,498	-0.1%
All Other Agencies	4,448	4,426	4,515	4,468	4,523	0.4%
Fringe Benefits (excluding DOE)	2,950	3,147	3,348	3,553	3,809	6.6%
Debt Service	4,323	3,515	4,006	4,907	5,101	4.2%
Pensions	2,419	3,029	3,822	4,199	4,215	14.9%
Judgments and Claims	643	676	713	752	794	5.4%
General Reserve	100	100	300	300	300	n/a
Pay-As-You-Go Capital	200	200	200	200	200	n/a
Expenditure Adjustments	(305)	17	79	135	195	n/a
Total Expenditures	<u>\$ 46,478</u>	<u>\$ 46,954</u>	<u>\$ 49,329</u>	<u>\$ 51,316</u>	<u>\$ 52,300</u>	<u>3.0%</u>

SOURCE: IBO.

NOTES: Debt service expenditures, if adjusted for prepayments, would grow at an annual average rate of 7.6 percent. A one-time increase in the Federal Medical Assistance Matching Percentage (FMAP) saved the city \$230 million in Medicaid expenditures in 2004. When adjusted for this measure, Social Services Medicaid expenditures would grow at an annual average rate of 5.1 percent. Debt service includes Transitional Finance Authority (TFA) debt service expenditures. Expenditure adjustments include energy, lease, non-labor inflation estimate, and prior year adjustments. Estimates exclude intra-city sales.

IBO Revenue Projections*Dollars in millions*

	2004	2005	2006	2007	2008	Average Change
Tax Revenues						
Property	\$ 11,384	\$ 11,937	\$ 12,712	\$ 13,266	\$ 13,757	4.8%
Personal Income	5,390	5,532	5,575	5,599	5,975	2.6%
General Sales	3,939	3,774	3,795	3,938	4,121	1.1%
General Corporation	1,527	1,681	1,720	1,729	1,732	3.2%
Unincorporated Business	899	933	961	987	1,013	3.0%
Banking Corporation	312	348	417	399	333	1.6%
Real Property Transfer	487	518	531	538	558	3.5%
Mortgage Recording	526	448	459	511	560	1.6%
Utility	294	278	278	284	284	-0.9%
Hotel Occupancy	209	230	247	261	273	6.9%
Commercial Rent	425	435	447	464	485	3.4%
PILOT's	238	177	173	150	150	-10.9%
Other Taxes and Tax Audits	919	879	879	874	872	-1.3%
Total Taxes Before Proposals	26,549	27,170	28,194	29,000	30,113	3.2%
<i>Tax Proposals</i>						
<i>Property Tax Rebate</i>	-	(250)	(259)	(263)	(267)	n/a
<i>Absentee Landlord Surcharge Repeal</i>	(44)	(45)	(47)	(48)	(49)	n/a
Total Taxes After Proposals	26,505	26,875	27,888	28,689	29,797	3.0%
Other Revenues						
StaR Reimbursement	654	697	723	786	819	5.8%
Miscellaneous Revenues	3,185	3,969	3,147	3,115	3,156	-0.2%
All Other	2,207	1,701	1,718	1,729	1,729	-5.9%
Total Other Revenues	6,046	6,367	5,588	5,630	5,704	-1.4%
State Categorical Aid	8,422	8,726	8,785	8,931	9,073	1.9%
Federal Categorical Aid	5,505	5,455	5,396	5,386	5,373	-0.6%
Total Revenues	<u>\$ 46,478</u>	<u>\$ 47,423</u>	<u>\$ 47,657</u>	<u>\$ 48,636</u>	<u>\$ 49,947</u>	<u>1.8%</u>

SOURCE: IBO.

NOTES: Personal Income Tax includes Transitional Finance Authority (TFA) dedicated personal income tax. All other non-tax revenues include unrestricted intergovernmental aid, other categorical grants, inter-fund revenues, and disallowances. Miscellaneous revenues are net of intra-city revenues.

