





# Overview

Based on IBO's projection of a continued surge in tax revenues, we now anticipate that the city will end the current fiscal year with a surplus of \$2.5 billion—the largest budget surplus since fiscal year 2001. This surplus—roughly \$500 million more than the Mayor anticipated in the Preliminary Budget he presented in January—will be used to prepay some debt service and other fiscal year 2006 expenditures. Even with the expiration of the increases in the sales tax and the personal income tax for high income filers, which together will cost the city \$650 million in revenue in 2006, IBO projects the city will end next fiscal year with a surplus of more than \$470 million.

IBO's review of the Mayor's Preliminary Budget for 2006 and Financial Plan through 2009 finds the city on surer fiscal footing than just three years ago. There are still some issues that could cause considerable budgetary pressures, most notably contract settlements with municipal labor unions, less federal and state assistance than anticipated, and the eventual resolution of the Campaign for Fiscal Equity lawsuit. But if these issues are resolved favorably, near-term budget gaps do not appear as daunting as in the recent past.

Some key highlights of our analysis and reestimate of the 2006 Preliminary Budget and Financial Plan include:

- Spurred by the continuing economic recovery and the ongoing strength of the local real estate market, tax revenues will total just over \$29 billion in 2005—\$1.5 billion more than anticipated under the budget adopted last June.
- Due to the expiration of temporary sales and personal income tax increases adopted in 2003, city tax revenues are expected to fall in 2006 to \$28.9 billion.

- Without a large surplus from 2006 to cover the ongoing imbalance between revenues and expenditures, a budget gap of nearly \$3.5 billion emerges in 2007.
- The property tax will drive much of the tax revenue growth over the Financial Plan period, rising from \$11.5 billion in 2005 to \$15.3 billion in 2009.
- City spending will grow at a relatively modest annual rate of 2 percent under the Mayor's plan through 2009. Much of the rise comes from just a few costly items: principally Medicaid, debt service, and pensions and other fringe benefits for municipal employees.

## BUDGET SURPLUSES AND GAPS

If the budget plan is adopted as proposed, IBO projects the city will end this year with a surplus of \$2.5 billion, which will be used to prepay some 2006 expenditures. With our expectation of a significantly smaller surplus of \$474 million in 2006, a budget gap of nearly \$3.5 billion emerges in fiscal year 2007. But unlike most Financial Plan projections in which budget gaps grow over time, IBO projects the opposite here—the gap shrinks to just over \$3 billion in 2008 and falls to \$2.2 billion in 2009.

The 2006 surplus could be erased, and the 2007 gap widened, depending upon the terms of labor agreements reached with the police, teachers, fire, sanitation, and correction officers unions currently working under expired contracts as well as all the other municipal unions whose contracts begin to expire this coming June. There also is some uncertainty that the city will garner \$750 million in anticipated state federal budget relief for next year, especially given the fiscal difficulties in Albany and Washington the city's projected surplus. Nor is it certain the city will achieve all of its \$325 million pension savings expected in 2006. In addition, policy changes proposed in Albany and Washington, such as the overhaul of the federal tax code and

Total Revenue and Expenditure Projections						
<i>Dollars in millions</i>						
	2005	2006	2007	2008	2009	Average Change
<b>Revenues</b>						
Taxes	29,042	28,900	29,923	32,045	33,753	3.8%
Other Revenues	7,523	6,660	6,016	5,840	6,025	-5.4%
State / Federal Grants	15,583	14,067	14,255	14,354	14,369	-2.0%
<b>Total Revenues</b>	<b>52,148</b>	<b>49,627</b>	<b>50,194</b>	<b>52,239</b>	<b>54,147</b>	<b>0.9%</b>
<b>Expenditures</b>	<b>52,148</b>	<b>49,153</b>	<b>53,676</b>	<b>55,246</b>	<b>56,370</b>	<b>2.0%</b>
<b>IBO Surplus / (Gap) Projection</b>	<b>\$ -</b>	<b>\$ 474</b>	<b>\$ (3,482)</b>	<b>\$ (3,007)</b>	<b>\$ (2,223)</b>	

SOURCE: IBO.  
 NOTES: IBO projects a surplus of \$2.5 billion for 2005, \$485 million above the Mayor's forecast. The surplus is used to prepay some 2006 expenditures, leaving 2005 with a balanced budget. Estimates exclude intra-city revenues and expenditures.

Medicaid cutbacks, also could have budgetary consequences for the city.

## ECONOMIC AND REVENUE ESTIMATES

IBO forecasts that the local economy will continue to grow over the next four years, although job growth will be relatively modest. A gain of 0.9 percent, or 32,400 jobs, is expected in calendar year 2005, followed by gains averaging 1.0 percent, or 37,000 jobs, annually in 2006-2009. IBO anticipates the city will reach its pre-recession employment peak of 3.8 million jobs in calendar year 2009.

Much of the job growth will be in the education, health, and social service sectors, as well as professional and business services. Tourism and leisure-related activities are also expected to generate a considerable number of new jobs, and job growth is also projected for information services. But the outlook for employment growth in the city's finance industry—the highest paying sector on average—is far weaker. IBO estimates annual growth rates of less than 1 percent for this key sector of the local economy, which is not expected to return to its pre-recession employment levels for well over a decade from now.

The outlook for city tax revenues is much more positive. Spurred by the city's continued economic recovery and the ongoing strength of the local real estate market, IBO now projects that tax revenues will total just over \$29 billion in 2005—\$1.5 billion more than anticipated under the budget adopted last June. Much of this increase stems from large jumps in collections from the real property transfer and mortgage recording taxes, both of which are expected to generate extraordinarily high revenues this year.

In 2006, IBO estimates total tax revenues will decline by more than \$140 million. The decline is caused by two factors: the expiration of the temporary personal income and sales tax increases enacted in 2003, and the expectation that rising interest rates will cause property transfer tax revenues to fall by more than one third, or \$630 million.

IBO projects that total tax revenue growth will resume in 2007 and reach \$33.8 billion by 2009. Over the 2005-2009 period annual growth will average 3.8 percent.

Much of the ongoing growth in tax revenues is led by the property tax. IBO projects property tax revenue to rise at an average annual rate of 7.4 percent, growing from \$11.5 billion in 2005 to \$15.3 billion in 2009. Business taxes also

are expected to rise steadily, though at more modest rates than the property tax, in 2005-2009. Personal income and sales tax revenues are expected to take a bumpier trajectory. IBO projects that both personal income and sales tax revenues will decline by more than \$200 million in 2006 due to expiration of the temporary tax increases and then resume steady growth in 2007 through 2009.

## EXPENDITURE ESTIMATES

IBO estimates that total city spending will grow at an average annual rate of 2.0 percent under the Mayor's latest Financial Plan, rising from \$52.1 billion in 2005 to \$56.3 billion in 2009. This modest average increase (somewhat understated because of one-time spending in 2005 for a \$1 billion federally funded insurance program) is largely fueled by just a few costly items: principally Medicaid, debt service, and pensions and other benefits for the city's workforce. Spending for most city programs and services remains flat under the budget plan through 2009.

The main reason why projected agency growth is flat is that there is no provision for future raises. Contracts with District Council 37 and other unionized civilian employees will start to expire at the end of this fiscal year. The Mayor insists raises must be paid for with "productivity enhancements" or givebacks. IBO estimates that each 1 percent raise for all unionized municipal employees costs the city \$218 million.

Much could depend on the outcome of the Public Employment Relations Board decision on police officers' wage demands. The officers as well as other uniformed services and teachers are currently working without contracts. The board is expected to soon deliver a binding police settlement decision, which may influence the outcome of negotiations with other unions. Both the firefighter and the teacher unions are in mediation. The budget plan includes only enough money to cover a settlement of police, teacher, firefighter, sanitation, and correction officer contracts based on the same terms reached in 2003 with District Council 37. IBO estimates that each 1 percent increase above those terms for uniformed employees and teachers whose contracts have expired will cost the city \$149 million.

While the Mayor's budget plan does not include large increases in agency spending, it also does not include many substantial—or controversial—spending cuts. Although the plan does include cuts to libraries, cultural programs, some

**Pricing Differences Between IBO and the Bloomberg Administration**

Items that Affect the Gap

*Dollars in millions*

	2005	2006	2007	2008	2009
<b>Gaps as Estimated by the Mayor</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ (3,718)</b>	<b>\$ (3,565)</b>	<b>\$ (3,179)</b>
<b>IBO Pricing Differences</b>					
Revenues					
Taxes					
Property	5	58	257	399	671
Personal Income	156	(48)	102	218	118
General Sales	153	105	90	114	108
General Corporation	2	(6)	(54)	(111)	(129)
Unincorporated Business	20	2	5	7	12
Banking Corporation	73	36	(18)	-	(32)
Real Property Transfer	(16)	23	(45)	68	138
Mortgage Recording	131	93	(34)	37	71
Hotel Occupancy	4	11	17	25	30
Commercial Rent	(5)	(7)	(4)	3	9
Cigarette	2	(2)	(3)	(3)	(2)
	525	265	313	757	994
STaR Reimbursement	(3)	(67)	72	(51)	81
<b>Total Revenues</b>	<b>522</b>	<b>198</b>	<b>385</b>	<b>706</b>	<b>1,075</b>
Expenditures					
Public Assistance	23	54	65	65	65
Medicaid	54	21	19	28	57
Department of Education	(39)	(126)	(126)	(126)	(126)
Overtime					
Police	(63)	(89)	(94)	(94)	(94)
Fire	(12)	(22)	(17)	(17)	(17)
Department of Buildings	-	(4)	(4)	(4)	(4)
Board of Elections	-	(9)	-	-	-
Campaign Finance Board	-	(34)	8	-	-
<b>Total Expenditures</b>	<b>(37)</b>	<b>(209)</b>	<b>(149)</b>	<b>(148)</b>	<b>(119)</b>
<b>Total IBO Pricing Differences</b>	<b>485</b>	<b>(11)</b>	<b>236</b>	<b>558</b>	<b>956</b>
Prepayment Adjustment	(485)	485	-	-	-
<b>IBO Surplus / (Gap) Projection</b>	<b>\$ -</b>	<b>\$ 474</b>	<b>\$ (3,482)</b>	<b>\$ (3,007)</b>	<b>\$ (2,223)</b>

SOURCE: IBO.

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

The gap-closing measures that are proposed for 2005 and 2006 rely heavily on revenue initiatives, many of them nonrecurring, such as property sales or settlements of past tax liabilities. A number of agencies expect to increase summons issuance and hence fine revenues, and/or to do a better job at collecting fines. Altogether, agencies anticipate an additional \$128 million in revenues this year, \$51 million next year, and approximately \$25 million in ongoing revenues.

Where spending is expected to grow substantially is in a few discrete portions of the budget that are largely outside the city's near-term control. These are the largely the costs that continue to drive the city's spending upwards at a rate that exceeds revenue growth.

But even here it appears that some rapidly rising costs will begin to stabilize—albeit at higher levels. For example, pension contributions for city workers are expected to rise from \$3.1 billion in 2005 to \$4.5 billion in 2008, when the city will have finished making up for the funds' investment losses during the last recession.

senior services, and after-school programs, overall the budget for 2006 appears focused on preserving certain key service areas, and minimizing the service cuts in other areas to the extent possible. Police, fire, and sanitation department uniformed staffing, for example, will essentially remain stable at roughly current levels. The single largest agency PEG (program to eliminate the gap) measure is in the police department, and consists largely of substituting federal homeland security funds for city funds and a reestimate of average salary costs.

Pension contributions are expected to decline slightly, to just under \$4.5 billion, in 2009.

Likewise, the growth in Medicaid spending also may be easing. IBO estimates Medicaid spending will climb from nearly \$4.9 billion in 2005 to \$6.1 billion in 2009. While still a steep rise, it would have been even higher if not for the state takeover of Family Health Plus costs now being phased in. With the Governor's proposals of benefit cuts and a swap of a portion of local sales tax for a state takeover of some Medicaid costs, the climb in the city's Medicaid burden may

ease even more. But under at least some of the Governor's proposals there could be ramifications for other portions of the city budget. Lower Medicaid reimbursements could put further strain on the already shaky budget of the city's public hospitals and could seriously affect the entire health services industry, which is one of New York City's primary employers.

Other fast-rising costs include debt service, expected to grow from \$5.0 billion in 2005 to \$5.8 billion in 2009, and fringe benefits such as health insurance for city workers (excluding education department employees), which are projected to grow from \$3.0 billion in 2005 to \$3.9 billion in 2009

While pension, Medicaid, debt service, and fringe benefits expenditures are largely driving the city's current spending growth, another factor (besides future labor settlements) could add substantially to local costs: resolution of the Campaign for Fiscal Equity lawsuit. Given the Governor's decision to appeal the most recent court ruling, it is unlikely the city will face additional spending related to the lawsuit in 2006. But the case could ultimately lead to a large increase in city-funded spending on schools. The court-appointed panel in the suit determined that spending should increase over four years so that it will be \$5.6 billion higher (adjusted for inflation) than in the current year. The city's portion of that new spending could be well over \$1 billion annually when fully phased in.

## CONCLUSION

Just three years ago, as the city reeled from the combined effects of a recession and September 11, fiscal commentators and editorial writers warned of an impending fiscal crisis and harkened back to the city's near bankruptcy in the 1970s. That picture has changed considerably, in part because of the budgetary decisions of the Mayor and City Council. IBO expects the city to end this fiscal year with a large surplus, and we expect 2006 to close with a relatively small surplus as well.

But the city continues to wrestle with an underlying imbalance resulting from a small number of fast-growing expenditures: pensions, Medicaid, debt service, and fringe benefits for city workers. While the rate of growth of some of these expenditures may be moderating, revenue growth cannot keep pace and budget gaps emerge in 2007 through 2009.

These gaps could widen—or emerge as early as 2006—because of two potentially substantial costs on the horizon: settlements with the city's labor unions and resolution of the Campaign for Fiscal Equity lawsuit. It is unlikely that the lawsuit will be resolved before fiscal year 2007. But with uniformed service workers and teachers currently working with expired contracts and pacts with the rest of the city's unions beginning to expire in June, large new costs could arise as soon as this year. Moreover, continuing to keep city spending level for most programs and services—regardless of labor settlements—may prove to be difficult.

**IBO Expenditure Projections***Dollars in millions*

	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>Average Change</b>
<b>Health &amp; Social Services</b>						
Social Services						
Medicaid	\$ 4,113	\$ 4,291	\$ 4,552	\$ 4,927	\$ 5,334	6.7%
All Other Social Services	2,953	2,809	2,789	2,789	2,789	-1.4%
HHC:						
Medicaid - HHC	754	774	786	783	776	0.7%
All Other HHC	238	27	171	161	157	-9.9%
Health	1,475	1,465	1,481	1,498	1,513	0.6%
Children Services	2,226	2,089	2,090	2,089	2,089	-1.6%
Homeless	703	696	704	715	715	0.4%
Other Related Services	477	403	399	399	399	-4.4%
<i>Subtotal</i>	<i>12,939</i>	<i>12,554</i>	<i>12,972</i>	<i>13,361</i>	<i>13,772</i>	<i>1.6%</i>
<b>Education</b>						
DOE (excluding labor reserve)	13,591	13,706	13,985	14,070	14,149	1.0%
CUNY	513	479	476	476	476	-1.9%
<i>Subtotal</i>	<i>14,104</i>	<i>14,185</i>	<i>14,461</i>	<i>14,546</i>	<i>14,625</i>	<i>0.9%</i>
<b>Uniformed Services</b>						
Police	3,558	3,499	3,569	3,583	3,585	0.2%
Fire	1,233	1,215	1,225	1,224	1,223	-0.2%
Correction	818	793	786	786	786	-1.0%
Sanitation	1,035	1,039	1,081	1,080	1,081	1.1%
<i>Subtotal</i>	<i>6,644</i>	<i>6,546</i>	<i>6,661</i>	<i>6,673</i>	<i>6,675</i>	<i>0.1%</i>
<b>All Other Agencies</b>	<b>5,115</b>	<b>4,982</b>	<b>5,097</b>	<b>5,124</b>	<b>5,139</b>	<b>0.1%</b>
<b>Total before Other Expenditures</b>	<b>38,802</b>	<b>38,267</b>	<b>39,191</b>	<b>39,704</b>	<b>40,211</b>	<b>0.9%</b>
<b>Other Expenditures</b>						
Fringe Benefits (excluding DOE)	3,023	3,233	3,428	3,666	3,913	6.7%
Debt Service	5,002	2,241	5,155	5,501	5,841	4.0%
Pensions	3,107	3,758	4,158	4,545	4,473	9.5%
FEMA Insurance Program	1,000	-	-	-	-	n/a
Judgments and Claims	612	641	676	718	769	5.9%
General Reserve	100	300	300	300	300	n/a
Labor Reserve:						
Education	204	189	189	189	189	n/a
All Other Agencies	285	257	257	257	257	n/a
Pay-As-You-Go Capital	200	200	200	200	200	n/a
Expenditure Adjustments	(187)	67	122	166	217	n/a
<b>Total Expenditures</b>	<b>\$ 52,148</b>	<b>\$ 49,153</b>	<b>\$ 53,676</b>	<b>\$ 55,246</b>	<b>\$ 56,370</b>	<b>2.0%</b>

SOURCE: IBO.

NOTES: Debt service expenditures, if adjusted for prepayments, would grow at an annual average rate of 8.2 percent. Debt service includes Transitional Finance Authority (TFA) debt service expenditures. Expenditure adjustments include energy, lease, non-labor inflation estimates, and prior year adjustments. Estimates exclude intra-city expenditures.

**IBO Revenue Projections***Dollars in millions*

	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>Average Change</b>
<b>Tax Revenues</b>						
Property	\$ 11,541	\$ 12,403	\$ 13,323	\$ 14,405	\$ 15,342	7.4%
Personal Income	5,966	5,752	5,839	6,277	6,557	2.4%
General Sales	4,358	4,151	4,301	4,498	4,699	1.9%
General Corporation	1,756	1,811	1,862	1,912	2,007	3.4%
Unincorporated Business	979	998	1,045	1,096	1,151	4.1%
Banking Corporation	514	474	415	432	408	-5.6%
Real Property Transfer	869	578	526	669	761	-3.3%
Mortgage Recording	949	610	499	603	664	-8.5%
Utility	309	311	310	309	309	0.0%
Hotel Occupancy	255	275	294	316	336	7.1%
Commercial Rent	440	450	465	485	504	3.5%
Cigarette	128	119	115	112	110	-3.7%
Other Taxes and Tax Audits	978	968	929	931	905	-1.9%
<b>Total Taxes</b>	<b>29,042</b>	<b>28,900</b>	<b>29,923</b>	<b>32,045</b>	<b>33,753</b>	<b>3.8%</b>
<b>Other Revenues</b>						
STaR Reimbursement	781	667	835	723	876	2.9%
Miscellaneous Revenues	4,931	3,374	3,138	3,175	3,201	-10.2%
Unrestricted Intergovernmental Aid	562	562	562	562	562	0.0%
Other Categorical Aid	907	975	957	963	969	1.7%
Inter-fund Revenues	357	347	339	332	332	-1.8%
Anticipated State / Federal Actions	-	750	200	100	100	n/a
Disallowances	(15)	(15)	(15)	(15)	(15)	0.0%
<b>Total City Funded Revenue</b>	<b>36,565</b>	<b>35,560</b>	<b>35,939</b>	<b>37,885</b>	<b>39,778</b>	<b>2.1%</b>
State Grants	8,959	9,041	9,236	9,328	9,341	1.0%
Federal Grants	5,624	5,026	5,019	5,026	5,028	-2.8%
Federal - FEMA Insurance Program	1,000	-	-	-	-	n/a
<b>Total Revenues</b>	<b>\$ 52,148</b>	<b>\$ 49,627</b>	<b>\$ 50,194</b>	<b>\$ 52,239</b>	<b>\$ 54,147</b>	<b>0.9%</b>

SOURCE: IBO.

NOTES: Personal Income Tax includes Transitional Finance Authority (TFA) dedicated personal income tax revenue.  
 Estimates exclude intra-city revenues.



