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**ANALYSIS OF THE**  
**MAYOR'S PRELIMINARY**  
**BUDGET FOR 2011**

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*IBO's Reestimate  
of the Mayor's  
Preliminary  
Budget for 2011  
and Financial Plan  
through 2014*



New York City

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# Preface

As required under the New York City Charter, this report provides IBO's review of the Mayor's Preliminary Budget for 2011 and Financial Plan through 2014. The report presents our own economic and revenue forecasts and examines some of the Mayor's key budget proposals.

Since IBO presented its most recent economic forecast and tax revenue estimates at the City Council on March 4, the federal Department of Labor has revised its employment numbers for the past two years. We have revised our job loss estimates based on the new data.

As we have for the past nine years, IBO also has produced a companion volume to this report, *Budget Options for New York City*. Released in February, this year's edition includes more than 60 ways to reduce spending or increase revenue. For each measure presented, IBO discusses its pros and cons and provides an impartial estimate of the potential savings or revenue.

A note on format: unless otherwise indicated, all years refer to the city's fiscal year, which runs from July 1 to June 30.

The names and areas of responsibility of IBO's team of budget analysts and economists who contributed to this report are included at the [end of this volume](#). The report is produced under the direction of Supervising Analysts Ana Champeny, Michael Jacobs, and Paul Lopatto, and Assistant Deputy Director Ana Ventura with guidance from Deputy Directors Frank Posillico and George Sweeting. Tara Swanson coordinated production and distribution and Eddie Vega and Doug Turetsky provided editorial assistance.

Ronnie Lowenstein

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## OVERVIEW

Given the severity of the recession that gripped the U.S. for much of the past two years, New York City's fiscal picture looks better today than many analysts, including IBO's, assumed it would 12 months ago. Nonetheless, the recession exacted a significant toll on the city—in terms of lost jobs and tax revenue and related hardships for families and neighborhoods. While New York City's fiscal picture could change rapidly, particularly if the national recovery falters or the state's budget difficulties result in actions that significantly reduce aid to the city, the recession's toll has been far steeper in many other parts of the country.

Based on IBO's latest revenue and expenditure projections under the Mayor's January budget plan, we estimate the city will end this fiscal year with a surplus of just under \$3.0 billion. This surplus is the result of higher-than-expected tax revenues, the use of \$600 million in reserves and accounting adjustments related to prior years, and proposed actions by agencies that would reduce spending or increase revenue by \$484 million. With the expectation that the 2010 surplus will be used to prepay some of next year's expenditures and that the Mayor's plan for reducing city-funded spending by \$1.1 billion and extending taxes to coop mortgages and aviation fuel are approved, we estimate 2011 will end with a small surplus that could be used to prepay upcoming 2012 expenditures.

For 2010 and 2011, surpluses from prior years mask the underlying shortfalls in the city's budget. On an operating basis, city-funded expenditures would exceed city-funded revenues for a shortfall of \$2.7 billion and \$2.8 billion in 2010 and 2011 respectively.

With little surplus available for 2012 and beyond the picture changes and shortfalls emerge. We project a budget gap

of \$2.6 billion for 2012 (5.7 percent of city-funded revenues), \$540 million less than the Bloomberg Administration's estimate in January.

The city's relative near-term fiscal health in the wake of the worst nationwide economic crisis since the 1930s is the product of a variety of factors such as the federal bailout of Wall Street and monetary stimulus that has boosted financial firms' profits by keeping interest costs low, changes in the composition of employment in the city, and actions taken by the Mayor and City Council to control spending and raise revenues. But the city's ability to maintain its current position rests on two shaky pillars: the national economy and the even creakier New York State budget.

***A Recovering Economy, Rising Tax Revenue.*** Based on our current U.S. forecast, employment is expected to rise slowly this calendar year, helped by temporary hiring for the census. Nonetheless, IBO expects that average employment will be 0.7 percent below the 2009 level and that the monthly unemployment rate will reach 10.5 percent by the fourth quarter of this year. A rise in unemployment is typical in the early stages of expansion as the number of people encouraged to search for jobs exceeds the number of jobs being created.

Stronger, self-sustaining growth is forecast for 2011 and beyond, as the financial markets finally stabilize and healthy lending resumes, hiring accelerates, incomes rise, consumers gain confidence and spend more, and employers respond by stepping up hiring and increasing investment. But a critical factor in this forecast is the condition of the housing industry, which remains shaky and may need further federal intervention

as foreclosures mount. Another important issue will be the availability of loans for small businesses, which help drive job creation. Finally, it remains to be seen whether the U.S. economic recovery has sufficient momentum to become self-sustaining as federal fiscal stimulus spending winds down.

Absent a renewed U.S.

<b>Total Revenue and Expenditure Projections</b>						
<i>Dollars in millions</i>						
	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>Average Change</b>
Total Revenues	\$63,194	\$64,148	\$66,381	\$70,026	\$72,470	3.5%
<i>Total Taxes</i>	<i>36,186</i>	<i>38,241</i>	<i>40,674</i>	<i>43,580</i>	<i>45,860</i>	<i>6.1%</i>
Total Expenditures	63,194	64,026	69,001	71,777	73,555	3.9%
<b>IBO Surplus/(Gap) Projections</b>	<b>-</b>	<b>\$123</b>	<b>\$(2,620)</b>	<b>\$(1,751)</b>	<b>\$(1,085)</b>	
<i>Adjusted for Prepayments and Discretionary Transfers:</i>						
<i>Total Expenditures</i>	<i>\$65,875</i>	<i>\$66,984</i>	<i>\$69,001</i>	<i>\$71,777</i>	<i>\$73,555</i>	<i>2.8%</i>
<i>City-Funded Expenditures</i>	<i>\$44,576</i>	<i>\$46,594</i>	<i>\$48,920</i>	<i>\$51,078</i>	<i>\$52,716</i>	<i>4.3%</i>

SOURCE: IBO  
 NOTES: IBO projects a surplus of \$2.958 billion for 2010, \$75 million above the Bloomberg Administration's forecast. The surplus is used to prepay some 2011 expenditures, leaving 2010 with a balanced budget. Estimates exclude intra-city revenues and expenditures. Figures may not add due to rounding. City funded expenditures exclude state, federal and other categorical grants, and interfund agreement amounts.

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

Items that Affect the Gap

Dollars in millions

	2010	2011	2012	2013	2014
<b>Gaps as Estimated by the Mayor</b>	-	-	<b>\$(3,160)</b>	<b>\$(3,665)</b>	<b>\$(3,849)</b>
<b>Revenues</b>					
Taxes					
Property	(11)	22	57	365	692
Personal Income	83	57	32	778	1,133
General Sales	135	163	298	410	471
General Corporation	(229)	(177)	(14)	67	102
Unincorporated Business	(124)	(33)	(14)	43	116
Banking Corporation	213	(24)	67	154	188
Real Property Transfer	26	50	80	96	117
Mortgage Recording	9	71	84	42	9
Utility	6	13	13	17	18
Hotel Occupancy	(8)	(7)	1	6	9
Commercial Rent	7	33	40	43	43
Cigarette	1	1	2	2	4
	108	169	646	2,022	2,901
Tax Proposals					
Aviation Fuel	-	(11)	(12)	(13)	(17)
Co-op Mortgage Recording Tax	-	10	7	(1)	(3)
STaR Reimbursement	(4)	2	16	24	25
<b>Total Revenues</b>	<b>\$103</b>	<b>\$170</b>	<b>\$656</b>	<b>\$2,031</b>	<b>\$2,906</b>
<b>Expenditures</b>					
Public Assistance	(3)	(25)	(30)	(30)	(30)
Homeless	-	(7)	(7)	(7)	(7)
Police Overtime	(25)	(75)	(75)	(75)	(75)
Correction (including overtime)	-	(15)	(5)	(5)	(5)
Campaign Finance	-	-	-	-	(25)
<b>Total Expenditures</b>	<b>(28)</b>	<b>(122)</b>	<b>(117)</b>	<b>(117)</b>	<b>(142)</b>
<b>Total IBO Pricing Differences</b>	<b>\$75</b>	<b>\$48</b>	<b>\$539</b>	<b>\$1,914</b>	<b>\$2,764</b>
<b>IBO Prepayment Adjustment 2010/2011</b>	<b>(75)</b>	<b>75</b>	-	-	-
<b>IBO Surplus/(Gap) Projections</b>	-	<b>\$123</b>	<b>\$(2,620)</b>	<b>\$(1,751)</b>	<b>\$(1,085)</b>

SOURCE: IBO.

NOTES: Negative pricing differences (in parentheses) widen the gaps, while positive pricing differences narrow the gaps. Figures may not add due to rounding.

downturn, the current recession will be for New York City one of the *mildest* since World War II. IBO is now projecting an employment loss of 173,000 jobs (4.5 percent of total city employment) from the third quarter of 2008, when employment last peaked, through the first quarter of this year. While these job losses have had consequences for the city and particularly for the individuals and families most directly affected, the number of jobs lost was actually considerably below what IBO and other forecasters had expected a year ago and well below the losses suffered during the last two recessions.

The relative mildness of the recession in the city is surprising, especially given that the national downturn spread from the housing market to an implosion of the financial industry, which is centered here. There are a number of reasons the recession has not hit the city as hard as expected. Among the most important are the federal bailout of major financial firms and the firms' low borrowing costs that have helped return the industry to unexpected profitability and also helped limit financial industry job losses. Additionally, although local real estate values have declined, they have not fallen at the catastrophic rates seen in some parts of the country.

Another set of reasons for the comparatively mild recession here is longer-term structural changes in the makeup of local employment. Although the recession gave the nationwide decline in manufacturing an extra push, by calendar year 2008 the city's manufacturing sector made up such a small share of total employment that the additional losses did not have a major effect on overall employment here. Conversely, health

and education jobs comprise a growing share of New York City employment, and these jobs have proven to be comparatively recession-proof. The current recession is the city's first in which manufacturing job losses are more than offset by job gains in education and health.

In fact, as employment begins to grow again in the city, IBO expects the health and education sectors—now almost a quarter of private-sector employment—to lead the way. We expect



that job losses will end in the first quarter of this calendar year, followed by modest job growth of 14,000 during the rest of this year. IBO forecasts year-over-year job growth of 39,000 in 2011 and 64,000 in 2012. The health and education sectors will generate nearly 31 percent of these new jobs through the middle of 2013, when city employment is expected to return to its peak of 3.8 million jobs before the recession.

Just as job losses have not been as steep as anticipated, the falloff in tax revenues has also not been as sharp as expected. Last year, IBO was projecting two years of declining tax revenues. While fiscal year 2009 did indeed experience a \$2.7 billion decline in tax revenues from 2008, we now expect tax revenues to rise by 3.9 percent to \$36.2 billion this year. But the rise in 2010 is the result of an number of tax changes such as increases in the property and sales taxes as well as the elimination of homeowner rebate, as well as federal and state actions. Without these changes, we estimate tax revenues would be \$2.1 billion lower this year and would have fallen for the second consecutive year.

As job growth and the local economy pick up, we estimate tax revenues will grow by \$2.1 billion to \$38.2 billion in fiscal year 2011. This growth will be spread fairly evenly among all the major taxes, with a proposal to extend the sales tax to aviation fuel and another to include co-ops under the mortgage recording tax expected to play comparatively minor roles in the projected increase.

**Spending Grows Despite Substantial Cutbacks.** Expenditure growth has been tempered by a series of agency actions that began in April 2007, including nearly \$484 million in gap closers proposed by the Mayor for this year and \$1.1 billion for next year. Some of the spending cuts for 2011 such as the cutback in child care slots, the replacement of fewer firefighters and police officers who leave the uniformed forces, and reduction in the upkeep of city parks are looked at in more detail inside this report.

IBO projects that total city spending will rise from \$63.2 billion in 2010 to \$64.0 billion in 2011, and \$69.0 billion in 2012. Looking just at city funds and adjusting for the use of surpluses for prepayments and discretionary transfers, we expect spending to rise from \$44.6 billion in 2010 to \$48.9 billion in 2012.

Under the Mayor's Financial Plan, total spending for most city services would remain relatively flat. As in past years, growth in spending on pensions and fringe benefits for public employees is expected to outpace the overall rate of city expenditure growth. Likewise, debt service, adjusted for prepayments, is also expected to grow faster than most other spending.

Another exception is spending on public assistance, which is

expected to rise sharply this fiscal year and remain higher than in the recent past. Public assistance expenditures are projected to increase from \$1.2 billion in 2009 to \$1.6 billion this year and a similar level in 2011. A number of factors are driving this growth such as a rise in the welfare caseload from 334,000 in September 2008 to 358,000 in December 2009, the expansion of the Mayor's Advantage Rental Assistance program, and a state-mandated increase in the welfare grant.

Also adding to the spending increase is the rising cost of energy. The Bloomberg Administration estimates that energy costs will rise by nearly 13 percent from 2010 to 2012 and reach \$1.1 billion. This increase is fueled in part by a rise of nearly \$95 million (12 percent) in the cost of heat, light, and power for city offices and buildings and a \$15 million rise (18 percent) in the cost of gasoline for city vehicles.

Conversely, spending on city schools is not projected to rise to previously expected levels. We now project school spending to total \$18.5 billion in 2011, about \$500 million less than anticipated last spring. IBO projects that school spending will then drop by about \$250 million in 2012. These changes are due to a combination of city cuts and a decrease in state aid that was part of Albany's midyear budget reductions and do not reflect steeper reductions proposed in the Governor's budget.

**The "X" Factors.** While there are ample reasons for concern about the sustainability of the national recovery and the effects a renewed downturn may have on the city's fiscal condition, actions by the state may pose the greatest near-term risk for the Mayor's budget plan.

The Governor's proposed budget eliminates at least \$800 million in state aid, including \$493 million in education aid and more than \$300 million in unrestricted aid. The Mayor's Preliminary Budget for 2011 and Financial Plan through 2014 does not take into account the Governor's proposals, although the Bloomberg Administration released a contingency plan that illustrates their potential effects. On March 23, the Mayor asked most agencies to propose spending cuts of 7.2 percent, with a target of 3.6 percent for uniformed forces, and 2.7 percent for the education department.

Another factor that could substantially affect the Mayor's budget plan is the upcoming expiration of contracts with municipal labor unions. Contracts with the United Federation of Teachers and Council of Supervisors and Administrators have already expired. The Mayor has proposed deviating from the recent labor settlement pattern to cut wage increases budgeted for 4 percent down to 2 percent. This would save \$350.4 million in 2011. The contract with District Council 37, the largest municipal

labor union, also expired earlier this month and all other major contracts expire over the next two years. It remains unclear that the unions will agree to settlements meeting the Mayor's plan to fund future wage increases through increased productivity or givebacks. Without these concessions from the unions each additional 1 percent in wage increase for city workers costs about \$300 million.

Under a Governmental Accounting Standards Board rule that phases into effect in 2011 the city may have a liability estimated by the state Comptroller at about \$200 million that the Preliminary Budget does not recognize. This rule requires that beginning in 2011 the city must pay the cost of pollution

remediation measures out of the Expense Budget rather than the Capital Budget. The city committed \$176.4 million in capital funds for pollution remediation (not including water-related projects covered by water and sewer fees) in 2009, according to the most recent Comprehensive Annual Financial Report by the city Comptroller's office.

Although the effects of the national downturn may prove not to be as steep in New York City as many had forecast, the Mayor and City Council are likely to face significant challenges in balancing the local budget while meeting the public's demand for services.

## ECONOMIC OUTLOOK

### ON THE ROAD TO RECOVERY

Economic growth returned to the U.S. economy in the second half of 2009, signifying the end of a recession whose widespread effects were felt throughout the nation. (Unless otherwise noted, all references to years in the Economic Outlook section refer to calendar years.) But the recovery currently underway is fragile. The nation's output has been expanding, but so far it has led to only a slowdown in job losses, not employment growth. Efforts to stabilize the financial system have been successful, but credit remains constrained, particularly for small businesses. Finally, the ongoing foreclosure crisis remains a major impediment to U.S. economic recovery.

Still, with the expectation that the Federal Reserve will continue its near-zero interest rate policy this year, IBO expects the recovery to gather steam in the coming year and strengthen, producing substantial employment and income growth by next year. IBO forecasts real GDP growth of 2.8 percent this year, 3.6 percent in 2011, and 5.0 percent in 2012, with slower growth thereafter.

New York's City's recession has not been as deep or long as once feared, nor as bad as the last two downturns. New York City entered the recession later than most parts of the country, when the housing market's troubles spread to the financial sector, which accounts for a disproportionately large share of local employment, income, and tax revenue. But with low interest rates this past year and other assistance from the federal government, Wall Street firms earned a record-breaking \$61.4 billion in profits in 2009, essentially reversing the losses the industry incurred over the second half of 2007 and all of 2008. Though compensation in the financial sector has been slashed, job losses in the industry—and in the city as a whole—have been far less than once feared, with added jobs in education and health partly offsetting losses in other industries.

IBO forecasts a net loss of 172,900 jobs—including 152,500 private-sector jobs—in the city since city employment peaked in the third quarter of 2008. We project jobs increases beginning in the second quarter of 2010. As the nation's economy recovers and solid growth resumes, local employment and income growth will accelerate after 2010, though as city is not expected to regain all the jobs lost in the downturn until the third quarter of 2013.

**U. S. Economy.** The U.S. economy moved from recession to recovery in the second half of 2009, although IBO forecasts that it will take another year for the nation to reach a self-

sustaining expansion. The current recovery is expected to remain fragile at least through the middle of 2010, and there are risks to this outlook that could slow the recovery or even pull the economy back into recession. While acknowledging these risks, IBO's outlook is for the economic expansion to continue throughout the forecast period, with the growth rates of output, employment, and personal income all peaking in 2012.

*The Current Recovery.* Output and employment data indicate that recovery is underway. Economic growth returned in the second half of 2009, when real (inflation-adjusted) gross domestic product (GDP) increased at an annual rate of 2.2 percent in the third quarter and then a strong 5.9 percent in the fourth quarter. Real GDP had declined in five of the six preceding quarters. The strong fourth quarter performance was fueled mainly by businesses increasing output in order to replenish inventories that had become depleted.

Since U.S. employment peaked in December 2007, 8.4 million jobs have been lost; in the private sector, the total loss has been 8.5 million jobs.<sup>1</sup> But the labor market is finally showing signs of stabilizing. The unemployment rate fell from 10.0 percent in December to 9.7 percent in January and stayed there in February, as the number of people unemployed increased by 34,000, but the number employed increased by 308,000. Although the number of involuntary part-time workers rose from 8.3 million to 8.8 million in February, the number of long-term unemployed (defined by the Bureau of Labor Statistics as those jobless for at least 27 weeks) declined from 6.3 million to 6.1 million.

Jobs data collected from employers about their payrolls are also encouraging. Although December had a one-month loss of 109,000 jobs, the U.S. gained 64,000 jobs in November and lost just 26,000 jobs in January and 36,000 jobs in February. In sharp contrast, monthly job losses in November 2008 through March 2009 exceeded 725,000 in four out of five months, and averaged 731,800. Two employment measures that typically provide early signs of an economic expansion are temporary hires and hours worked, and the recent data for each are also encouraging. The temporary help industry added 284,300 jobs in October through February, a 16.5 percent gain from its trough in September 2009. The average workweek for all employees has stayed between 33.8 hours and 33.9 hours for four months, after falling from 34.7 hours in March 2008 to a low of 33.7 hours in October 2009.

Not all recent economic data are encouraging, however. Overall,

<b>IBO versus OMB Economic Forecasts</b>						
	2009	2010	2011	2012	2013	2014
<b>National Economy</b>						
Real GDP Growth						
IBO	-2.4	2.8	3.6	5.0	3.5	2.6
OMB	-2.5	2.3	2.8	3.7	3.2	2.8
Nonfarm Employment Growth						
IBO	-4.3	-0.7	1.7	3.2	3.2	1.6
OMB	-3.7	-0.7	1.7	2.7	2.4	1.7
Inflation Rate (CPI-U)						
IBO	-0.3	2.1	2.1	2.8	2.5	2.2
OMB	-0.3	2.2	1.9	1.9	1.7	1.9
Personal Income Growth						
IBO	-1.7	2.5	4.3	6.2	6.2	5.2
OMB	-1.4	3.4	4.3	5.2	5.6	5.7
Unemployment Rate						
IBO	9.3	10.2	9.5	7.3	5.9	5.6
OMB	9.3	10.2	9.6	8.6	7.7	7.2
10-Year Treasury Bond Rate						
IBO	3.3	4.0	5.0	5.6	4.9	4.6
OMB	3.2	4.2	4.9	5.5	5.8	6.5
Federal Funds Rate						
IBO	0.2	0.3	2.1	3.9	4.4	4.4
OMB	0.2	0.3	1.7	3.4	3.6	4.7
<b>NYC Economy</b>						
Nonfarm New Jobs (thousands)						
IBO	-106.1	-45.4	39.1	64.1	64.8	51.0
OMB	-85.0	-102.0	22.0	50.0	49.0	36.0
Nonfarm Employment Growth						
IBO	-2.8	-1.2	1.1	1.7	1.7	1.3
OMB	-2.3	-2.7	0.6	1.4	1.3	1.0
Inflation Rate (CPI-U-NY)						
IBO	0.2	1.7	2.3	2.9	2.7	2.6
OMB	0.4	2.3	2.2	2.1	1.9	2.2
Personal Income <i>Dollars in billions</i>						
IBO	419.7	434.5	452.4	480.4	510.6	538.7
OMB	410.7	422.8	438.5	455.1	476.1	499.3
Personal Income Growth						
IBO	-3.6	3.5	4.1	6.2	6.3	5.5
OMB	-3.0	2.9	3.7	3.8	4.6	4.9
Manhattan Office Rents (\$/sq.ft)						
IBO	69.53	57.98	53.54	52.45	54.04	56.97
OMB	66.57	56.78	55.74	55.70	55.86	55.47

SOURCES: IBO; Mayor's Office of Management and Budget

NOTES: Rates reflect year-over-year percentage changes except for unemployment, 10-Year Treasury Bond Rate, Federal Funds Rate, and Manhattan Office Rents. The local price index for urban consumers (CPI-U-NY) covers the New York / Northern New Jersey region. Personal income is nominal.

fourth quarter. Also, despite an extension of the federal government's first-time homebuyer tax credit, residential fixed investment grew by just 5.0 percent in the fourth quarter, as compared to 18.9 percent in the third quarter. Government spending declined by 1.2 percent in the fourth quarter after growing at an annual rate of 2.6 percent during the prior quarter.

Although unprecedented efforts by the Federal Reserve and fiscal policy makers have stabilized large segments of the financial system, problems persist in others. Credit remains constrained, particularly for small businesses which have historically provided a large share of job growth during expansions. Small businesses typically borrow from small banks, and small banks have yet to loosen lending standards in response to regulatory pressure and mounting loan losses. Although recently released data from the Federal Deposit Insurance Corporation (FDIC) show fewer loans going bad at the end of 2009 compared with earlier in the year, the percentage of loans more than 90 days past due continued to rise. Small banks continue to fail in large numbers.

*Future Economic Growth.* Looking forward, IBO expects the nation's output to grow slowly through late 2010, with GDP rising 2.8 percent for the year. Some of this growth will come from restocking of inventories, but the forecast also assumes an important role for fiscal and monetary policy again this year. The Federal Reserve is expected to keep interest rates on reserves and the funds rate effectively at zero through much of the year. On the fiscal policy front, additional stimulus is likely to gain support as remaining programs funded by last year's American Recovery and Reinvestment Act wind down. Both the first-time homebuyer tax credit and unemployment benefits have been extended, and the President recently signed a new jobs bill with the goal of jump-starting hiring. The programs created by this new legislation will temporarily exempt employers from payroll taxes for

personal consumption grew at an annual rate of 1.7 percent in the fourth quarter of 2009, down from 2.8 percent in the third quarter. While spending on durable goods increased at an annual rate of 20.4 percent in the third quarter, it barely moved in the

new workers who had been unemployed at least 60 days, provide an additional tax credit for employers who retain such workers for 52 weeks, allow immediate expensing for businesses

investing in certain tangible assets during 2010, and fund more infrastructure. Although these programs would increase the federal deficit and debt, they could help insure against a possible backslide into recession.

Employment is expected to rise this year, but the growth will be slow. With such slow hiring, IBO projects the monthly unemployment rate will reach 10.5 percent by the end of 2010 and average 10.2 percent for the year. A jump in unemployment is typical in the early stages of an expansion, because the number of people encouraged to search for employment greatly exceeds the number of new jobs being created. One factor helping the employment picture will be the hiring of thousands of temporary workers for the 2010 census.

Stronger, self-sustaining growth is forecast for 2011 and beyond, as financial markets finally stabilize and healthy lending resumes, hiring accelerates, incomes rise, consumers gain confidence and spend more, and employers respond by stepping up hiring and investing more. IBO projects a rebound of GDP growth to 3.6 percent in 2011 and an acceleration of growth to 5.0 percent in 2012, before moderating to 3.5 percent and 2.6 percent, respectively, in 2013 and 2014. Similarly, annual employment growth accelerates from 1.7 percent in 2011 to 3.2 percent in 2012 and 2013. With the resumption of strong employment growth, the unemployment rate is expected to fall below 10 percent by mid-2011, declining continually from 7.3 percent in 2012 to 5.6 percent in 2014.

Critical to this takeoff of the economy will be recovery of the housing industry, which has staggered to date. The FDIC reports that at the end of 2009, nearly 40 percent of construction loans for single-family homes were either delinquent or had been written off as uncollectible, and one-eighth of the dollars in home mortgage loans were troubled. But the housing loan market is expected to improve as credit loosens, hiring begins, and incomes rise, although some additional federal policy intervention in the housing market may be necessary. One upside of the extraordinarily weak pace of construction is that the housing surplus created by the current crisis is no longer expanding; as a result depleting the excess supply will be easier when demand rises.

Consumer prices fell last year by 0.3 percent, as measured by the consumer price index; they are expected to rise 2.1 percent in 2010 and again in 2011. High unemployment and excess productive capacity are expected to dampen inflationary pressures as the U.S. economy starts to grow. Although the Federal Reserve has indicated that it will not raise interest rates any time soon, both monetary and fiscal policies are expected to tighten when the

economy finally moves into full-blown expansion.

While IBO expects the economic recovery currently underway to gradually gain momentum, several conditions must be satisfied for the expansion to become self-sustaining as the effect of federal fiscal stimulus wanes. Job growth will need to accelerate to fuel consumer spending. The lack of credit, particularly for small businesses, and the loss of confidence across all businesses, will have to be addressed. Finally, residential and commercial real estate markets must resume healthy functioning.

The risks to the forecast are primarily in the policy realm. Decisions by the Federal Reserve as it disentangles itself from its various emergency market support operations and brings the federal funds rate back to more normal levels will influence inflation and interest rates for the rest of the economy. Whether a new federal stimulus package focuses on job creation or fiscal relief for the states will play a large role in determining whether there are cutbacks in state and local services and private sector job growth. An overarching problem for the federal government is how to balance the need for near-term deficit spending with the strains on long-term growth from persistent large annual federal deficits.

*Comparison with the Mayor's U.S. Forecast.* IBO's forecast for the U.S. economy is similar to the Mayor's Office of Management and Budget (OMB) for 2010 and 2011, but it is relatively more optimistic for 2012 and 2013. For the current year, both IBO and OMB expect employment to contract by 0.7 percent and an unemployment rate of 10.2 percent. Both also project real GDP and personal income to resume growing this year. OMB's forecast for personal income growth this year is higher than IBO's, but IBO expects relatively stronger GDP growth this year (2.8 percent, compared with 2.3 percent for OMB) and next (3.6 percent for IBO versus 2.8 percent for OMB). For 2011, the two agencies' projections for income and employment growth are equal: 4.3 percent and 1.7 percent for, respectively, income and employment growth.

Both IBO and OMB project an acceleration of output, income, and employment growth after 2011, with IBO projecting relatively faster growth rates for all three in 2012 and 2013. The difference between IBO's and OMB's forecasts of GDP growth widens to 1.3 percentage points in 2012 when IBO projects 5.0 percent growth, compared with 3.7 percent for OMB. Personal income increases at annual rates of 6.2 percent in 2012 and 2013 in the IBO forecast, while OMB's projects annual income growth rates in the 5.2 percent to 5.6 percent range. IBO forecasts 3.2 percent employment growth each year, compared to OMB's projections of 2.7 and 2.4 percent

growth in, respectively, 2012 and 2013. With IBO projecting faster employment growth, it forecasts a greater fall in the unemployment rate—to 5.9 percent by 2013, compared with 7.7 percent in the OMB forecast. With faster output and employment growth after the current year, IBO's projected inflation rates are generally higher than OMB's.

**THE LOCAL FORECAST**

Contrary to what forecasters, including IBO, were anticipating a year ago, New York City's current recession—measured by the number of jobs lost—has not been as deep nor as long as most recent downturns, although the rapid growth in the city's unemployment rate—it was 10.4 percent in January—suggests that for a large share of city residents this downturn remains quite severe. Job losses have been concentrated in construction, trade and transportation, government, financial services, and to a lesser extent in manufacturing.

Federal aid helped Wall Street return to profitability in 2009 and probably limited job losses there, but steep declines in average and aggregate compensation in the financial services sector—which is the engine of the city's economy—has put a measurable dent in the total amount of earnings in the city. In addition to the federal assistance for Wall Street, longer term structural changes in the city's economy are likely lessening the severity of this recession. These include the growing share of jobs in education and health services and the declining share in manufacturing. Another factor behind the city's better than expected performance is the relative stability of the local housing market, which has avoided some of the disastrous gyrations in other parts of the country, although some neighborhoods have seen foreclosure rates that are much higher than in the city as a whole.

IBO expects that it will take the city three and a half years to recoup the jobs that have been lost in the past year and a half. This is broadly in line with the city's experience in past recoveries.

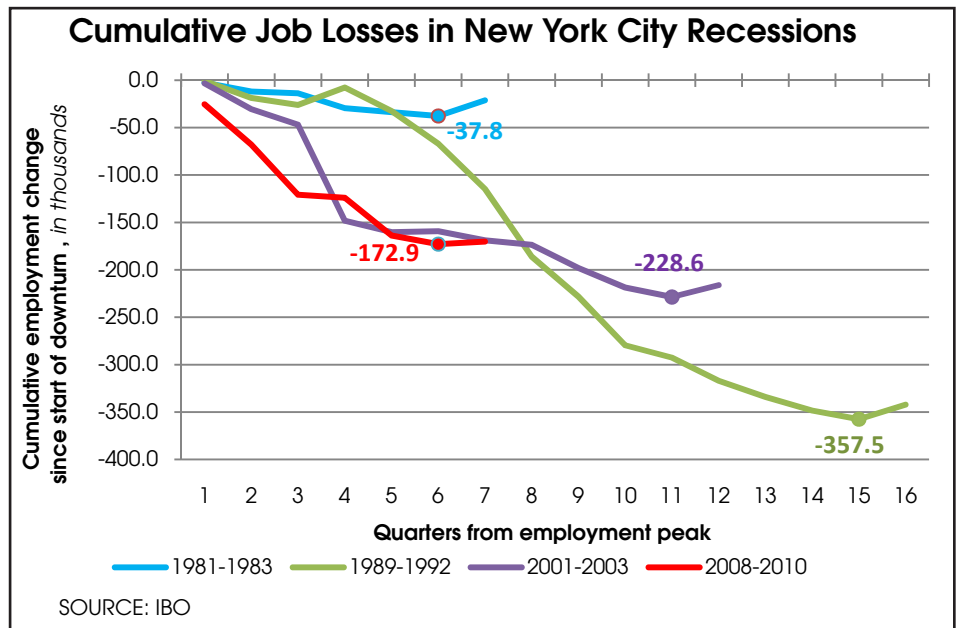
*The Recession in New York City.*

Nationwide, the Great Recession has been the worst economic crisis in 80 years. But in New York City, barring an unforeseen 'double-dip,' the current recession will go down as one of the *mildest* in terms of job losses since World War II. IBO is now estimating a net loss of 172,900 jobs—including 152,500 private-sector

jobs—in New York City from the most recent employment peak in the third quarter of 2008 to what we now project to be the overall employment trough, the first quarter of 2010. This loss is close to what IBO estimated last October, but considerably less than the 254,500 job loss (through the second quarter of 2010) we projected last May. (Employment figures in this section incorporate recent benchmark revisions for 2008 and 2009).<sup>2</sup>

In comparison with previous downturns, which we define as periods of consecutive quarters of declines in local payroll employment, the city lost 228,600 jobs in the 2001–2003 recession (6.1 percent of payroll jobs), and 357,500 jobs (9.9 percent of the total) in the 1989–1992 downturn. What distinguishes the current recession in the city, however, is not just that it is relatively shallow, but that it is relatively *brief*—lasting just six quarters. Indeed, six quarters into the recession that began in 2001, the city had lost 159,300 jobs. But then the slump dragged on for five more quarters, during which the city shed another 69,300 jobs. Six quarters into the recession starting in 1989, the city had lost only 67,000 jobs. Then the bottom really fell out, and over the next nine quarters employment contracted by an additional 290,500. The longest and deepest period of job losses in the post-war era was 1970–1977—which spanned a period of brutal structural change in the city's economy, two national recessions, and the city's near bankruptcy—during which the city lost 635,200 jobs.

Of the post-war downturns, only the 1981–1982 recession was—for the city—milder than the current recession. The net job loss then was only 37,800 (1.1 percent) over six quarters. Nationwide the decline in payroll employment lasted only five quarters, but employment shrank 3.0 percent over that period.



In both 1989–1992 and 2001–2003, the employment contraction in the city was longer and steeper than the United States as a whole experienced during overlapping contractions. While New York City lost 9.9 percent of its payroll jobs over 15 quarters (1989–1992), the nation as a whole lost only 1.4 percent of jobs over five quarters (1990–1991). In 2001–2003, as city employment fell 6.1 percent over 11 quarters, in the U.S. overall the employment decline was 2.0 percent over nine quarters. But in the current crisis, national employment began to drop two quarters before city employment did, and the estimated 6.0 percent nationwide employment contraction over eight quarters is larger than the city's 4.5 percent drop over six quarters.

This is all the more surprising given that the national crisis was intensified by credit market shockwaves emanating from a string of financial institution failures. Given the significance of the financial sector in the city's economy, why has the city itself not been battered more severely by the ensuing economic turmoil?

One major reason has been how rapidly financial services and particularly the securities industry has swung from huge losses to huge profits. New York Stock Exchange (NYSE) member firms made an estimated, and unprecedented, \$61.4 billion in profits in 2009, all but erasing the (also unprecedented) \$62.7 billion in losses incurred over the previous six quarters (from mid-2007 through the end of 2008). This huge rebound has occurred even as member firm revenues remain far below pre-crisis levels, dropping almost by half from 2007 (\$352.0 billion) to 2008 (\$178.1 billion), but then ticking up only slightly in 2009 (\$188.1 billion). But while revenues were falling, so were expenses, especially interest costs, which plunged from \$249.8 billion in 2007—an all-time high 71.0 percent of revenues—to \$114.5 billion in 2008 and then to \$19.5 billion in 2009, an all-time low 10.4 percent of revenues. These extraordinarily low interest costs are the result of the near-zero federal funds rate maintained by the Federal Reserve.

Not only the profitability but also, in several significant cases, the very survival of major New York City financial institutions was aided by changes in accounting rules (modified mark-to-market requirements) and, of course, by the Troubled Asset Relief Program (TARP) bailouts. The combination of the return to profitability, changes in accounting rules, and TARP bailouts have mitigated the city's financial industry job losses. IBO estimates that the city lost “only” 40,600 jobs (11.6 percent) in finance and insurance from that sector's peak in the fourth quarter of 2007 to what appears to be its trough in the last quarter of 2009—bad, but not as bad as the 56,800 (16.3 percent) hit IBO projected a year ago, when losses were expected to continue through mid-2012, and not as bad as the 55,300 (14.9 percent) that was lost between

the end of 2000 and end of 2003.

Despite government assistance to Wall Street firms, firms' record profits, and less-than-expected job losses in finance, during this downturn personal income generated by the industry has fallen by unprecedented amounts. Wall Street bonuses from 2009 earnings are up 17 percent compared to the previous year but still 38 percent lower than for 2007, and average bonuses are down 50 percent over the two years. Reflecting the effect of both reduced earnings and layoffs, total cash compensation including bonuses plunged 30.0 percent last year to an estimated \$21.5 billion. The income decline is an estimated 7.2 percent of total wages and salaries for the city in the prior year and accounts for the bulk of the decline in wages and salaries in all industries—substantial enough to have major effects on spending and employment in the rest of the city and on city tax revenues.

Another reason New York City has not been hit as hard as expected is that the city has not been exposed to the calamitous foreclosure levels experienced in other parts of the country after the bursting of the housing bubble. The foreclosure rate for the New York City metropolitan statistical area (MSA) was 1.14 percent in 2009, far below the combined 2.81 rate for the other MSAs. To be sure, foreclosures did climb sharply in the city in 2007 and 2008, placing communities such as southern Queens and the north shore of Staten Island under especially heavy stress. But the number of foreclosed properties stabilized in 2009, and the blight of large swaths of houses abandoned by their owner-occupants, which has been widespread in some parts of the country, has—at least for now—been limited to specific pockets in the city.

Housing prices did appreciate sharply here during the boom, though not as sharply as in other regions and the real estate boom in New York City was not accompanied by as much purely speculative buying and over-building as in Florida, Southern California, and other regions. Unsold apartments and unfinished buildings are sprinkled throughout the city and clustered in neighborhoods like Williamsburg that had seen intensive residential development. “Ghost buildings” can be neighborhood nuisances and depress the value of occupied apartments, but by definition, stalling these projects has not displaced tenants.

The city's relatively low homeownership rates also contributed to limiting the effect of the housing collapse: two-thirds of New York City households rent, including four-fifths of households with incomes less than 200 percent of the poverty rate. This has limited the vulnerability for much of the local population to the fall off of home values and accompanying wealth effects that reduce household spending. Some highly leveraged investors,

particularly in rent-regulated properties, have encountered cash-flow problems and defaulted, although so far they have not resulted in significant abandonment of—or evictions from—occupied apartment buildings. There is a risk that services in these buildings will begin to deteriorate as the financial workout of the building proceeds.

The shockwaves emanating from Wall Street were also buffered by longer-term structural changes in the makeup of local employment. These include the declining importance of manufacturing, which represented only 2.9 percent of the city's private payroll jobs going into the recession (20 years ago it was 9.0 percent, and 40 years ago more than twice that), and has consequently accounted for a relatively small portion (15,400) of the losses during this downturn.

Countering the decline in manufacturing, education and health services have been an inexorably growing force in the city economy, and now comprise nearly a quarter of all private-sector jobs. This sector has expanded through every past city recession and has added another 22,600 jobs during the current one. The 2008–2010 recession is the city's first in which education and health job gains more than offset manufacturing job losses.

But there are also sectors where employment trends in this recession differ from those of the recent past. The information sector is losing an estimated 11,400 jobs (7.1 percent) in the current recession, but lost 30,800 (15.9 percent) during the last one, when the industry was reeling from the DotCom bust. Similarly, professional and business services, including legal services and company management, were also much harder hit last time. This sector is generally seen as being closely tied to financial services in New York City, but more driven by Wall Street than the other way around. Estimated business services losses in the current recession have been revised upward to 42,500 (7.0 percent), but this is still less than the 62,800 hit in 2001–2003 (although about the same as the 44,900 lost through the first six quarters of that recession). It appears that, as in finance, the recent pain within business services has been expressed to some extent, in the form of compressed pay, rather than as lost jobs and activities. Total wages for the business services sector dropped by 9.4 percent in 2009, while employment dipped only 5.4 percent.

Construction is another sector where the patterns have differed somewhat from other recent downturns. Given the contraction in housing development, it is not surprising that construction has been hard hit this time—it is expected to lose 20,500 jobs (15.4 percent). The job losses were smaller (9.2 percent of its job base) in 2001–2003 but much larger in 1989–1992 when the sector lost

33.2 percent of its jobs in the aftermath of a speculative boom in commercial buildings.

Leisure and hospitality are now expected to lose 5,200 jobs (1.7 percent) during this downturn; not that different from 2001–03, but a much smaller hit than during the 1989–1992 downturn, when losses were 30,600 (13.7 percent). The trade, transportation, and utilities sector is expected to shed 35,800 jobs (6.2 percent), not too dissimilar from the last downturn when the decline equaled 7.0 percent of the base. As with leisure and hospitality, the share of jobs lost during the 1989–1992 downturn was much larger (15.0 percent) than we expect for the current downturn. Retail trade accounts for almost half of the expected losses (14,600) this time and the shares were similar in 1989–1992 and 2001–2003.

The unemployment rate has risen markedly in the last two years, from a low of 4.6 percent in the first quarter of 2008, to 10.2 percent in the fourth quarter of 2009. The city's unemployment rate has not been above 10 percent since the 1989–1992 downturn, and, for the affected households, the current recession has not been mild at all. An estimated net 131,600 New Yorkers have lost jobs from the fourth quarter of 2008 to the first quarter of 2010, but a secondary factor behind the rise in the unemployment rate is the entry of an estimated 54,300 people into the labor force during the same period.

## THE RECOVERY

IBO expects employment growth to resume in New York City in the second quarter of 2010. The recovery will be in many respects typical: initially weak, then picking up more steam, although at this point we do not anticipate expansion boiling over into boom within our forecast horizon. After the loss of jobs in the first quarter, the city is forecast to add 14,000 jobs in the remainder of 2010. Job growth gains momentum thereafter, with the city adding 39,000 jobs in 2011, 64,000 jobs in 2012, 65,000 in 2013, and 51,000 in 2014.

In this projection, the previous employment peak of 3,807,000 in the third quarter of 2008 will finally be regained in the third quarter of 2013—after five years. In other words, IBO forecasts that it will take 14 quarters of employment growth to make up for six quarters of decline. This is not especially slow by historical standards: after the 2001–2003 recession, it took 16 quarters of employment growth to make up for the previous 11 quarters of decline; following the 1989–1992 contraction, it took 27 quarters of growth to make up for 15 months of decline. Following the much milder and shorter local downturn in 1981–1982, it took four quarters of employment growth to recover the previous peak.



## Return-to-Peak Changes in New York City Payroll Employment 2008–2013

Employment in thousands

Industry Title	Actual		Forecast		Percent	
	Q3: 2008	Share	Q3: 2013	Share	Change	Change
<b>TOTAL Nonfarm</b>	<b>3,807.0</b>	<b>100.0</b>	<b>3,816.1</b>	<b>100.0</b>	<b>9.1</b>	<b>0.2%</b>
Total Private	3,241.6	85.1	3,259.8	85.4	18.2	0.6%
Natural Resources, Mining and Construction	133.1	3.5	114.9	3.0	(18.2)	-13.7%
Manufacturing	94.9	2.5	76.9	2.0	(18.0)	-19.0%
Trade, Transportation, and Utilities	575.6	15.1	550.5	14.4	(25.1)	-4.4%
Information	167.8	4.4	158.6	4.2	(9.2)	-5.5%
Financial Activities	465.2	12.2	452.2	11.9	(12.9)	-2.8%
Professional and Business Services	609.0	16.0	607.9	15.9	(1.2)	-0.2%
Educational and Health Services	721.8	19.0	799.6	21.0	77.8	10.8%
Leisure and Hospitality	312.1	8.2	332.6	8.7	20.5	6.6%
Other Services	162.1	4.3	166.7	4.4	4.6	2.8%
Government	565.4	14.9	556.2	14.6	(9.1)	-1.6%

SOURCE: IBO

NOTE: Total NYC employment peaked in the third quarter of 2008, and is not projected to return to that level until the third quarter of 2013. The dates of peak employment and when (and if) employment returns to the prior level differ slightly for some industries.

As the city recoups its lost jobs, more than half of the growth will come from health and education (30.4 percent of the jobs added through the third quarter of 2013) and business services (22.7 percent). Smaller contributions will come from leisure and hospitality (14.1 percent of the jobs added) and financial activities (13.2 percent). Manufacturing will continue to shrink, as it has during past recoveries, but, as discussed above, this sector now makes up such a small part of the overall city economy that it can no longer exert much of a drag on the whole.

The crisis and recovery are likely to accelerate the long-term structural changes in the city economy. As shown in the table, by the third quarter of 2013, when the city has regained the number of jobs it had during its recent peak (the third quarter of 2008), the industrial composition of city employment will be much different. Only three major sectors are expected to show net employment growth over this period: education and health services, leisure and hospitality, and other services. These sectors, which by 2013 are forecast to account for a third of total city payroll employment, are only loosely linked to the fortunes of Wall Street. In the case of leisure and hospitality, this is because so much of the activity is driven by tourists visiting from overseas and elsewhere in the U.S. whose spending is more dependent on

the state of the U.S. economy and international exchange rates, as opposed to just local economic factors.

On Wall Street itself, revenues are expected to remain far below pre-crisis levels. Indeed, NYSE member firm revenues are projected to be lower in 2010 (\$155 billion) than in 2009, and to grow only very slowly in subsequent years. But interest expenses are also expected to increase only slightly in 2010 and 2011 as the Federal Reserve very slowly edges away from its near-zero funds rate policy. The upshot of all this is that Wall Street profits are expected to subside to moderate levels in the coming years: \$16 billion in 2010, and ranging between \$11 billion and \$13 billion in years following. Average overall wages in the securities industry will not climb back to the 2007 peak until 2012. Employment in financial services is not expected to recover its pre-downturn peak before the end of the forecast period.

### ENDNOTES

<sup>1</sup>Unless otherwise noted, all labor market data are seasonally adjusted and percentage changes are annual rates.

<sup>2</sup>IBO's testimony on March 4, 2010, IBO before the City Council Finance Committee hearing on the Mayor's Preliminary Budget reported jobs figures from before the benchmarking.



## TAXES AND OTHER REVENUE

A large increase in federal aid plus sales, property, and other tax policy changes that took effect this year are generating a projected \$2.4 billion increase in total city revenue this year—3.9 percent more than 2009 revenues. IBO's 2010 revenue forecast is \$63.2 billion, rising to \$64.1 billion in 2011 and \$72.5 billion in 2014. Total non-tax revenues are expected to decrease in the next two years and then increase again, leaving non-tax revenues in 2014 little changed from

their levels in 2010. In contrast, total baseline tax revenues (total tax collections not including the potential effects of proposed changes to tax law) are expected to grow steadily over the forecast period, at an average annual rate of 5.9 percent. The growth IBO forecasts results from the economic expansion that is expected to last throughout the forecast period, with personal and business income taxes and real estate transfer taxes having the fastest rates of growth. The two tax increases currently proposed

by the Bloomberg Administration are relatively modest, together increasing city revenue roughly \$218 million in 2011, rising to \$264 million in 2014.

### *Non-tax Revenues.*

The city's non-tax revenue sources plus categorical state and federal aid provide about 40 percent of the funding in the city's budget. The city's own non-tax revenue sources include unrestricted intergovernmental aid, other categorical grants, School Tax Relief (STAR) reimbursements, inter-fund capital transfers, and miscellaneous revenue from a variety of both recurring and nonrecurring revenue sources. Fines and fees are examples of recurring non-tax revenue sources, while asset sales are one source of nonrecurring non-tax revenue.

IBO's forecast of non-tax revenues for this year is \$27.0 billion, a \$2.1 billion (8.3 percent

<b>IBO Revenue Projections</b>						
<i>Dollars in millions</i>						
	2010	2011	2012	2013	2014	Average Change
<b>Tax Revenue</b>						
Property	\$16,023	\$16,937	\$17,590	\$18,107	\$18,571	3.8%
Personal Income	6,900	7,377	7,865	9,029	9,800	9.2%
General Sales	5,016	5,285	5,659	6,070	6,446	6.5%
General Corporation	2,059	2,463	2,879	3,182	3,388	13.3%
Unincorporated Business	1,494	1,627	1,720	1,863	2,034	8.0%
Banking Corporation	907	625	820	1,010	1,087	4.6%
Real Property Transfer	615	690	771	871	966	12.0%
Mortgage Recording	390	536	622	683	753	17.9%
Utility	400	411	424	438	452	3.1%
Hotel Occupancy	341	352	361	343	353	0.8%
Commercial Rent	585	584	588	600	611	1.1%
Cigarette	97	95	94	92	92	-1.3%
Other Taxes, Audits, and PEG's	1,358	1,042	1,045	1,044	1,045	-6.4%
<b>Total Taxes</b>	<b>\$36,186</b>	<b>\$38,023</b>	<b>\$40,438</b>	<b>\$43,332</b>	<b>\$45,596</b>	<b>5.9%</b>
<b>Tax Proposals</b>						
Aviation Fuel	-	\$158	\$171	\$178	\$189	n/a
Co-op Mortgage Recording Tax	-	60	65	70	75	n/a
<b>Total Taxes Including Tax Proposals</b>	<b>\$36,186</b>	<b>\$38,241</b>	<b>\$40,674</b>	<b>\$43,580</b>	<b>\$45,860</b>	<b>6.1%</b>
<b>Other Revenue</b>						
STAR Reimbursement	\$905	\$944	\$995	\$1,078	\$1,080	4.5%
Miscellaneous Revenues	4,479	4,248	4,306	4,344	4,366	-0.6%
Unrestricted Intergovernmental Aid	340	340	340	340	340	0.0%
Disallowances	(15)	(15)	(15)	(15)	(15)	0.0%
<b>Total Other Revenue</b>	<b>\$5,709</b>	<b>\$5,517</b>	<b>\$5,626</b>	<b>\$5,747</b>	<b>\$5,770</b>	<b>0.3%</b>
<b>Total City Funded Revenue</b>	<b>\$41,895</b>	<b>\$43,758</b>	<b>\$46,300</b>	<b>\$49,327</b>	<b>\$51,631</b>	<b>5.4%</b>
State Categorical Grants	\$11,454	\$11,808	\$12,457	\$13,106	\$13,245	3.7%
Federal Categorical Grants	7,978	6,875	5,980	5,949	5,948	-7.1%
Other Categorical Aid	1,369	1,236	1,194	1,194	1,196	-3.3%
Interfund Revenues	497	471	450	450	450	-2.5%
<b>TOTAL Revenues</b>	<b>\$63,194</b>	<b>\$64,148</b>	<b>\$66,381</b>	<b>\$70,026</b>	<b>\$72,470</b>	<b>3.5%</b>

SOURCE: IBO.

NOTES: Estimates exclude intra-city revenues. Figures may not add due to rounding.

increase) over 2009 revenues. A projected \$2.0 billion boost in federal categorical aid, mostly a result of the economic stimulus program, plus other increases together are more than offset by a projected \$800 million decline in state and nongovernmental grants. Non-tax revenue is projected to decline in 2011 and 2012 and then increase in the next two years, leaving the non-tax revenue forecast for 2014 slightly less than amount expected this year. The forecast of declines in federal categorical aid—averaging 7.1 percent annually over the forecast period—is the largest constraint on non-tax revenue. Declines in federal aid are expected mostly in 2011 and 2012, as aid returns to its 2009 level and changes little after 2012. Steady increases in state categorical grants averaging 3.7 percent during the forecast period offset some of the loss of federal funds in 2011 and 2012.

**Tax Revenues.** In contrast to IBO's forecast of non-tax revenue, we expect steady growth in tax revenue over the forecast period. IBO forecasts \$36.2 billion in tax revenue this year, growing to \$45.6 billion in 2014—an average annual growth of 5.9 percent, excluding any possible effects on revenue due to proposed but not yet enacted tax policy changes. Current-year collections are expected to be \$314 million higher than 2009 revenue. A variety of tax policy changes taking full effect this year—including large property and sales tax increases and federal and state actions affecting business and personal income taxes—are increasing 2010 collections by an estimated \$2.1 billion relative to last year. Had these revenues not been enacted, revenue would have declined by 5.0 percent this year.

IBO's current forecast for 2010 is higher than we forecast in November, the result of an improving near-term economic outlook. Employment declines have not been as steep or as protracted as we had anticipated, and forecasts of the personal income, general corporation, and banking corporation taxes have all increased substantially since November. Of all the city's major taxes, only the mortgage recording tax forecast is now much lower for the current year than we had previously projected.

With the national and local economies gaining momentum after 2010, IBO forecasts faster tax revenue growth for 2011 and beyond. Much of the growth is from the most economically sensitive of the city's taxes: the personal income tax, the three business income taxes, and the general sales tax. Local real estate activity is expected to pick-up and result in double-digit annual growth rates in collections of the real property transfer and mortgage recording taxes, though this growth will reverse less than a third of the revenue collapse of these taxes in recent years. Due to the structure of the real property tax—in which changes in billable assessment values lag behind changes in market values by several years—revenue

from the city's largest tax will continue to increase during the forecast period, but at slower rates each year.

In the Preliminary Budget, the Bloomberg Administration presented two new tax proposals which would increase tax revenue and address inequities in the taxation of similar entities. One proposal would eliminate the current city sales tax exemption on fuel sold to airlines—a benefit which other types of transportation companies do not receive. The other would extend the mortgage recording tax to loans taken out for buying coop apartments, so individuals borrowing to purchase a coop (a form of borrowing that is not technically a mortgage) would be treated the same as individuals taking out mortgages to buy condos and houses. The revenue-raising potential of the two proposals together is relatively modest—an estimated \$218 million in 2011, rising to \$264 million by 2014—and enacting the proposals would increase the average annual increase in baseline tax revenues from 5.9 percent to 6.1 percent.

## REAL PROPERTY TAX

IBO projects that property tax revenues will grow from \$16.0 billion in 2010 to \$16.9 billion in 2011, a 5.7 percent increase. The current 2011 revenue forecast is about \$260 million lower than our December 2009 forecast mainly because the billable assessed value on the tentative 2011 assessment roll was lower than expected. Property tax revenue will grow throughout the plan period at an average annual rate of 3.1 percent, though the rate of growth is expected to slow over time.

Because the structure of the real property tax creates a lag between changes in market conditions and assessments, the robust market value growth of the real estate boom has contributed to the stability of property tax revenues during the downturn. It also may put revenues beyond 2014 at risk. During the real estate market boom, market values grew rapidly, and from 2005 to 2010 the aggregate market values of large residential buildings and commercial properties increased at annual average rates of 9.5 and 8.6 percent, respectively. For large residential buildings and commercial property those increases have been phased in over a five-year period and have led to the build-up of a large pipeline of increases.

Now that market values are declining or growing more slowly—with aggregate values projected by IBO to increase during the 2011–2014 period at annual average rates of 2.8 percent for residential buildings and 2.4 percent for commercial properties—that pipeline is providing a cushion that will result in continued assessment increases. As slow growth from recent years replaces the strong growth of four and five years

ago, however, the pipeline is projected to contract. While IBO forecasts that assessed value will increase through 2014, if the city were to see either a sustained decline or very slow growth in market values of large residential buildings and all commercial property, the contraction of the pipeline, especially for commercial property, could be a significant risk for assessments and revenues beyond 2014.

**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 value), and the applicable tax rate.<sup>1</sup> Under property tax law, there are four tax classes: 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, comprising all other commercial and industrial property.

The method of assessing properties and recognizing market value appreciation differs by tax class, so each class can have its own assessment ratio (the share of market value actually subject to tax) and tax rate. Generally, Class 1 homes account for a much smaller share of the assessment roll's total assessed value than its share of market value (10.2 percent of assessed values on the 2010 roll compared to 50.5 percent of total market value in the city). The other classes, especially Class 4, bear a disproportionate share of the property tax burden because their shares of assessed value and tax levy are larger than their shares of market value.

**Outlook for Market and Assessed Values in 2011.** In January the Department of Finance released the tentative 2011 assessment roll. After taxpayer challenges and other department adjustments are processed, the assessment values will be finalized in May and used for setting 2011 tax bills. Because the timing of the assessment process results in a lag in recognizing changes in market conditions, the market values on the 2011 roll reflect the recent housing market crash and credit and foreclosure crisis during calendar years 2008 and 2009. Aggregate market value on the tentative 2011 roll is just 0.1 percent more than the value on the final 2010 roll. But IBO projects a reduction in the 2011 roll when it is finalized and forecasts total market value in the city to be \$791.7 billion, 0.5 percent less than in 2010. Compared to the 1.8 percent decline from 2009 to 2010, this year's decline is projected to be smaller.

In contrast to the projected decline in aggregate market value, aggregate assessed value for tax purposes (billable taxable assessed value) is expected to grow a moderate 4.3 percent this year and reach \$148.0 billion on the final 2011 tax roll. Assessed values

for tax purposes can increase even if market values decline because the methods used to determine assessed value for most property types incorporate both past and current market value changes.

**Class 1.** The aggregate market value of Class 1 properties is expected to decline for a third year in a row, by 2.7 percent in 2011 following declines of 5.0 percent and 1.0 percent in 2009 and 2010, respectively. But IBO projects 3.8 percent growth in aggregate assessed values of Class 1 properties, even with three years of market-value declines. In Class 1 the assessed value of a property moves toward a target of 6 percent of market value, with assessment increases capped at 6 percent a year or 20 percent over five years. If a parcel is assessed at less than 6 percent of market value, its assessed value grows until it hits the target ratio of 6 percent of market value or it reaches the cap on annual assessment increases—even if the market value stays flat or declines.

During the recent period of surging real estate prices, many Class 1 properties benefited from the assessment increase caps which kept assessed value growth below market growth, and the median assessment ratio for single-family homes outside Manhattan fell from 5.4 percent in 2004 to a low of 3.7 percent in 2008, well below the 6 percent target. Since 2009, when Class 1 market values started to decline, the median assessment ratio has been increasing to 4.0 in 2009 and 4.6 percent in 2010. In 2011, IBO forecasts a median assessment ratio of 5.0 percent. From 2012 through 2014, billable taxable values are expected to increase and recapture more of the market value growth that was above the cap in the prior years, getting closer to but remaining below the 6 percent target.

**Class 2 and Class 4.** The market value of Class 2, which declined by 2 percent from the 2009 roll to the 2010 roll, is expected to grow by 3.3 percent in 2011. Class 4's market value is expected to decrease by 0.4 percent from the 2010 roll to the final 2011 roll, compared to an increase of 4.6 percent last year.

In each class, however, aggregate billable assessed value will also grow faster than market value, the result of the method for capturing changes in market value. Increases or, in many cases, decreases in parcels' market values are phased in over five years. The assessed value changes from the preceding four years that have yet to be recognized on the tax roll are called the pipeline. The pipeline of market value growth from 2007 to 2009, particularly in 2007 and 2008, continued to buttress taxable assessed value in Classes 2 and 4 in 2011.

**Outlook for Market and Assessed Values in 2012 to 2014.** For 2012, IBO forecasts a decline in aggregate market value of

0.8 percent, driven by a projected 4.2 percent decline in market value in Class 1. Market values for the other three classes are expected to grow, though more slowly than from roughly 2005 to 2009. Market value growth for Class 2 is forecast to be just 2.1 percent in 2012, while the projection for growth in Class 4 is 2.4 percent. For the rest of the forecast period, these classes are expected to see market value growth averaging less than 3 percent a year.

IBO projects growth of 4.3 percent in aggregate billable assessed value in 2012, comparable to the growth expected for 2011. With the pipeline of prior assessed value increases in Class 2 and Class 4 largely exhausted after 2011, the billable assessed value growth rate slows to an average of 2.6 percent a year for the rest of the plan period.

*Class 1.* IBO projects that after declining from 2009 through 2012, Class 1's aggregate market value will be essentially flat in 2013 and resume slow growth in 2014. Aggregate market value in Class 1 will total \$374.5 billion in 2012, a decline of 12.3 percent over from its peak—\$426.9 billion—in 2008.

Total billable taxable assessed value in Class 1 is expected to grow an average of 2.1 percent a year, as assessed values inch towards the 6 percent assessment ratio.

*Class 2 and Class 4.* In 2012 billable assessed value in Classes 2 and 4 will grow moderately, in large part due to the final phase-in of robust market value growth in 2008. The Class 2 pipeline is estimated at \$2.3 billion following the 2011 final roll. With slow growth in the forecast period, the pipeline is expected to grow gradually to \$2.6 billion in 2012 and \$3.2 billion in 2013. IBO projects the total pipeline in Class 4 to be \$4.9 billion after the 2011 roll is finalized, before declining to \$2.8 billion by 2013. Given the expected decline in the Class 4 pipeline, and slow growth in the Class 2 pipeline, further declines, or anemic growth, in market value would pose a serious risk to the city's property tax revenue in 2014 and beyond.

**Revenue Outlook.** After the Department of Finance completes the assessment roll, the actual property tax levy is determined by the City Council when it sets the tax rates for each class. IBO's baseline property tax revenue forecast, and the Bloomberg Administration's, assume that the 2011 average tax rate will be 12.28 percent, the rate set by it in December 2008 when the Council enacted the Mayor's proposal to rescind a short-lived 7 percent rate reduction. Rescinding the 7 percent cut required a 7.5 percent increase measured from the reduced rate, and the increase was phased in over two fiscal years: a 3.75 percent increase for 2009 and another 3.75 percent increase for 2010.

The amount of property tax revenue in a fiscal year is determined not only by the levy, but also by the delinquency rate, abatements granted, refunds for disputed assessments, and collections from prior years. Taking these other factors into account, IBO projects that property tax revenue for 2010 will total \$16.0 billion, 11.5 percent above revenue for 2009. This robust growth in revenue results not only from increases in assessed value, but also from the full phase-in of the enacted higher tax rate. For 2011 IBO forecasts property tax revenue of \$16.9 billion, \$260 million below our December 2009 forecast. From 2012 through 2014, growth is projected to average 2.8 percent a year, with revenue totaling \$18.6 billion by the last year of the forecast period. This projected revenue growth is markedly slower than projected growth over the 2010-2012 period (an average of 4.8 percent a year) and far less than the average annual growth of 10.8 percent from 2008 through the current year.

IBO's property tax revenue forecast is just \$11 million (0.1 percent) below that of the Mayor's Office of Management and Budget (OMB) for 2010 and only \$22 million above OMB's for 2011. This difference stems mainly from IBO assuming slightly smaller reductions from the tentative to the final roll and from slight differences in estimates of the property tax reserve. There is a somewhat larger difference in the revenue forecasts in 2012, with IBO about \$57 million above OMB. The difference widens because IBO is not as pessimistic about market values and assessments as OMB in 2012. In 2013 and 2014, IBO's forecast further diverges from OMB due to different projections of the real estate market.

**Tax Policy Changes.** There are a number of tax policy issues affecting the forecast of property tax revenue.

*Rescinding the Tax Rate Cut.* With the city enjoying robust fiscal conditions, the City Council and the Mayor agreed to a 7 percent, one-year reduction for 2008. In the November 2008 Financial Plan, the Mayor proposed rescinding the tax rate reduction, and the Council subsequently enacted the proposal, effective January 1, 2009. Half of the cut was repealed in 2009, increasing revenues by \$591 million. In 2010 the rest of the cut was repealed and property tax revenue increased by another \$653 million. The total effect of the repeal of the tax cut was \$1.3 billion in 2010.

*STAR Program Changes.* Last year, Governor Paterson proposed and the state Legislature adopted the elimination of the Middle Class STAR program that had provided a direct rebate to homeowners in 2007 and 2008. This change did not have any effect on New York City property tax revenue, since the rebate

was mailed directly to homeowners to offset property taxes already paid to the city.

Two new changes to the STAR program were proposed by Governor Paterson in his 2010-2011 Executive Budget. One change is a technical adjustment to the calculation of the maximum exemption for a county. According to the state Division of the Budget, the change would save \$40 million a year, about 1.5 percent of the \$2.6 billion the state expects to spend on STAR property tax exemptions in 2011, while decreasing disparities in the exemption across communities. This change would have a minimal effect on New York City homeowners.

The second change would eliminate the STAR exemption for homes worth more than \$1.5 million. If the exemption is eliminated for certain properties, those homeowners would see an increase in their taxable assessed value, and by extension, their tax bill. Based on the 2011 tentative roll, about 6,700 owners of one-, two- and three-family homes in New York City would lose their exemption because the value of their homes exceed \$1.5 million and their tax bills would increase by \$284, or by \$581 for seniors with incomes below the statewide threshold making them eligible for a higher exemption. The net effect on the city's revenue would be zero because the reduction in state STAR revenue to the city, as a result of eliminating the exemption on certain properties, would be offset by increases in taxes paid by affected homeowners.

## MORTGAGE RECORDING AND REAL PROPERTY TRANSFER TAXES

A decline in revenue from the real property transfer tax (RPTT) and the mortgage recording tax (MRT) is projected to continue into 2010—the third fiscal year in a row. IBO projects that combined revenues from both taxes will barely surpass \$1.0 billion in 2010, 20 percent less than 2009 receipts and a drop of 70 percent from the peak collections of \$3.3 billion in 2007. With a weak real estate market that shows signs of only a slow recovery, transfer tax revenues are not expected to increase until 2011. IBO forecasts a 70 percent increase from 2010 through 2014 in total collections from the two taxes. Still, projected revenue in 2014—\$1.7 billion—is barely half of the record amount collected in 2007.

**Background.** The RPTT is levied directly on the sale price and is typically paid by the seller, and the MRT is levied on mortgages used to

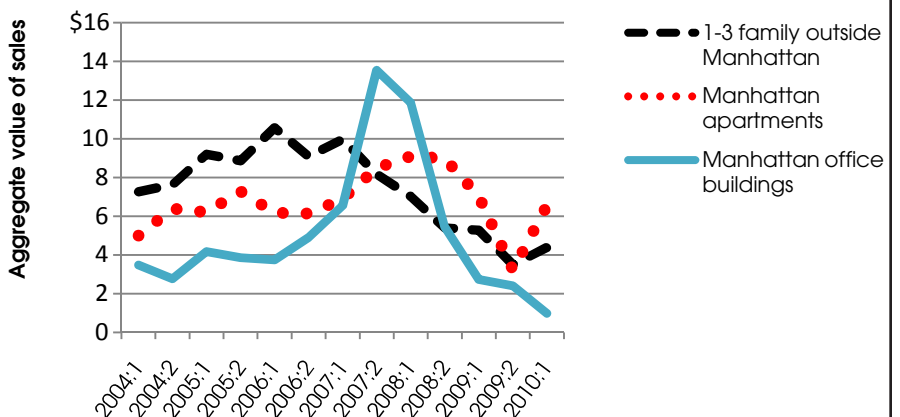
finance the purchase of real property and is paid by the buyer. The portion of a mortgage refinancing that involves new money (“cash out”) is also subject to the MRT, as are mortgages that are refinanced with a different lender unless the former lender “assigns” the mortgage to the new lender. Changes in the terms of an existing mortgage involving the same lender are generally not subject to the MRT. The intense level of refinancing activity during the early 2000s caused MRT revenue to exceed that from the RPTT. Beginning in 2007, however, RPTT revenue has been higher than MRT receipts, and IBO expects it to stay that way for the remainder of the forecast period. A portion of RPTT and MRT levied on commercial transactions over \$500,000 is dedicated to the Metropolitan Transportation Authority (MTA)—revenue that is sometimes referred to as “the urban tax” and is distinct from the recently initiated payroll tax in the counties served by the MTA (see [next page](#)).

**Real Estate Markets.** All sectors of the real estate market continue to be weak compared with the boom period of a few years ago, but there are signs of a slow recovery, propelled by residential markets. The aggregate value of real estate sales from July through December 2009 was around \$19.5 billion, an increase of 19 percent over the sales of \$16.6 billion recorded during the previous six months. This rate of increase over the prior six-month period was the highest recorded since 2004, and was greater than would be expected just from seasonality.<sup>2</sup>

**Residential Properties.** The trends in sales of both one- to three-family houses outside Manhattan and apartments in Manhattan, illustrate the upturn in the residential market. The aggregate value of house sales outside Manhattan, excluding sales with prices of \$25,000 or less, was around \$4.4 billion during the first half of the current fiscal year, an increase of 26 percent

### Aggregate Value of Sales for Selected Property Types, 2004-2010

Dollars in billions, fiscal years by six-month periods



SOURCES: IBO; Department of Finance

over the aggregate value of sales in the previous six months.<sup>3</sup> The number of transactions increased around 22 percent, while the median sales price increased about 4 percent, to \$450,000. The turnaround in the Manhattan coop and condo market was even more dramatic. The aggregate sales value was roughly \$6.5 billion during the half year ending December 31, 2009, more than double the \$3.2 billion in sales registered during the previous six months. The number of transactions also more than doubled, while the median price rose slightly.

While the performance of residential markets during the July-December 2009 period was much improved over the prior six months, the aggregate value of sales remained well below the typical levels of recent years. For one- to three-family properties outside Manhattan, the aggregate value of sales was similar to the levels of 2002. For Manhattan apartments, the aggregate value was similar to the second half of 2006. The sales data provide compelling evidence that the residential market has reached bottom, but as IBO's transfer tax forecast indicates, recovery will be slow.

**Commercial Properties.** The commercial real estate sector remains very weak. There have been only two large (over \$100 million) commercial transactions this fiscal year: 815 Eighth Avenue (\$590 million) in July and 66 Pine (\$150 million) in August. The fundamentals of the commercial market are not good: office vacancy rates are high, retail sales are weak, and high unemployment rates persist. Until recently, there was anecdotal evidence that foreign investors were increasingly interested in New York City commercial real estate. Since the beginning of December 2009, however, the euro has declined in value against the dollar by around 10 percent, and this may discourage potential overseas buyers. Distress sales are another potential source of commercial transactions. The transfer of Peter Cooper Village/Stuyvesant Town to new owners will potentially generate a large amount of transfer tax revenue.

**Real Property Transfer Tax.** The current forecast of RPTT receipts in 2010—\$615 million—is 17.2 percent less than 2009 collections. The forecast also is \$48 million less than what IBO had projected in November. Though greater than collections during the first-quarter of the fiscal year, second-quarter collections did not meet increased expectations generated by the combination of improved credit markets and continued low interest rates.

With continual improvement in real estate markets expected over the next several years, IBO forecasts annual increases in RPTT beginning in 2011. After the current year, the RPTT forecast is \$690 million for 2011, growing to \$966 million in

2014. During the 2011-2013 period, the growth rate each year is relatively constant, averaging 12.2 percent. Still, projected 2014 revenue is dwarfed by the \$1.7 billion the city collected in 2007. IBO's forecast of RPTT revenue is \$26 million (4 percent) above OMB's for 2010. IBO projects more rapid growth than OMB during the forecast period, and by 2014, IBO's forecast is \$117 million (14 percent) higher than OMB's.

**Mortgage Recording Tax.** The current MRT forecast for 2010—\$390 million—is 24.2 percent less than 2009 collections. Since November IBO has lowered its current-year forecast by \$147 million because strong first-quarter collections of the tax were followed by an unexpected decline.

Although the MRT has fallen more steeply than the RPTT since 2007, IBO expects the MRT to recover more rapidly. For 2011, IBO forecasts a 37.4 percent increase in MRT receipts, to \$536 million. Mortgage recording tax growth slows down over the next three years but is still relatively strong, averaging 12.0 percent during the 2011-2014 period. Similar to the RPTT, though, the 2014 MRT forecast—\$753 million—is far below the \$1.6 billion collected in 2007.

IBO's MRT forecast for 2010 is \$9 million (2 percent) above OMB's. Compared with OMB, IBO projects faster growth in 2011 (37 percent vs. 22 percent), similar growth in 2012 (16 percent), and slower growth in 2013 and 2014. By 2014, IBO's forecast is again just \$9 million (slightly more than 1 percent) above OMB's.

**MTA-dedicated Revenue.** A consequence of the inactivity in the commercial real estate market is that receipts from the portions of the RPTT and MRT dedicated to the Metropolitan Transportation Authority have dropped precipitously. The MTA's final estimate of urban tax revenues for calendar year 2009 is only \$150 million, a stunning drop from the 2007 peak of \$883 million. The MTA projects that urban tax receipts will begin to recover in calendar year 2010, and will reach \$402 million by 2013. Before 2009, the last year that urban tax receipts had been this low was 2004, when they came in at \$338 million.

**MRT Proposal.** Under current law, loans to purchase coop apartments are not considered mortgages, since technically the purchaser is buying shares in the corporation owning the apartment building rather than a specific apartment. Since the loans are not mortgages, they have been exempt from the MRT. The Governor's Executive Budget included a proposal to make coop loans subject to the MRT and the Mayor's Preliminary Budget assumes this proposal will be approved by the state Legislature. (A similar proposal is considered in IBO's *Budget*



*Options for New York City.*) IBO estimates that the tax would bring in \$60 million in 2011, increasing to \$75 million by 2014—more revenue in 2011 and 2012 but slightly less in 2013 and 2014 than the Bloomberg Administration projects.

## PERSONAL INCOME TAX

Based on trends in current collections data and further improvements in the economic outlook, IBO has raised its forecast of personal income tax (PIT) revenue for 2010 and beyond. The 2010 PIT forecast is \$6.9 billion—\$311 million (4.2 percent) more than 2009 collections. This moderate growth follows a nearly 25 percent decline in PIT revenue from 2008 to 2009, and projected 2010 revenue is still less than receipts in each of the three previous years. As the economic recovery solidifies over the next few years, PIT growth is expected to quicken. But it will take another two years before revenue exceeds the 2008 collections peak of \$8.7 billion.

The IBO and OMB forecasts for PIT revenue are very similar for 2010 through 2012. Because OMB projects far less economic growth after calendar year 2012 than IBO does, however, OMB's forecast for PIT revenue is substantially less than IBO's for 2013 and 2014.

**Background and Recent Changes.** The personal income tax is levied on the incomes of city residents. Marginal tax rates, which incorporate a base rate and a surcharge, range from 2.907 percent in the lowest of four brackets to 3.648 percent in the highest bracket. These rates have been in effect since January 2001, although for calendar years 2003 through 2005 a temporary increase affecting high-income households was enacted, creating two additional upper brackets with taxable incomes in the highest bracket (above \$500,000) having a 4.45 percent rate. The temporary PIT increase reversed the substantial revenue declines of 2002 and 2003. PIT collections swelled after 2003 and continued to grow strongly even after the expiration of the tax hike, when revenue increased by an average of 9.4 percent in 2007 and 2008.

**Revenue in the Current Year.** IBO is forecasting a 4.9 percent increase in PIT collections in the current year, although year-to-date receipts for 2010 are less than revenue during the comparable period last year. Revenue from withholding, which accounts for at least two-thirds of gross collections, is down from last year although since the end of January it has received a boost from bonus payments paid by financial firms. The state Comptroller's office has estimated bonuses will be just 17 percent higher this year compared with last year, despite Wall Street's record-breaking profits in calendar year 2009.<sup>4</sup> Still, employment

losses, including many jobs in high-paying industries like financial activities and business services, are constraining withholding revenue, which IBO projects will be only slightly higher (0.4 percent) in 2010 than in 2009.

Estimated payments through the end of February also are down from the same period last year. Unlike withholding, which is a contemporaneous indicator of employment and income, estimated payments are made by investors and the self-employed in anticipation of their future tax liabilities. Relying on Internal Revenue Service "safe harbor" rules, most taxpayers make payments consistent with prior-year liabilities. The sharp fall-off in tax year 2008 of PIT liability for many taxpayers has led to a marked decline in estimated payments during the current fiscal year, in spite of the rebound in the stock market that has added to capital gains realizations in tax year 2009. Estimated payments for tax year 2010, which will be received from April to June of 2010, will be relatively higher on average, giving some boost to 2010, but not enough to outweigh the drag earlier in the fiscal year. Overall, the IBO 2010 forecast for estimated payments is 11.8 percent lower than 2009.

Many taxpayers' estimated payments for 2009 are falling short of their total 2009 liability, and this is expected to result in taxpayers either paying more or getting less of a refund when they file their final tax returns. Compared to 2009, IBO forecasts a substantial increase in final returns payments and a substantial decline in refunds in 2010. Through the third week in March, the average value of refunds issued for 2009 tax returns is 21.2 percent less than the average refund for 2008 tax returns processed during the same period last year. Payments made with the filing of 2009 final returns also are running ahead of last year's payments.

IBO's 2010 forecast is \$83 million (1.2 percent) greater than OMB's projection. While IBO's forecast of withholding is a little less than OMB's and its refund projection a little higher, IBO expects relatively more revenue from estimated payment and final returns.

**The Forecast for 2011 and Beyond.** With city employment growth expected to resume by the middle of calendar year 2010, IBO projects a 6.9 percent PIT increase in the next fiscal year, bringing total 2011 revenue to \$7.4 billion. The growth will be faster next year than in 2010, for the PIT as a whole and for each of its principal components.

Despite the strengthening of the economic recovery by the end of next fiscal year, IBO forecasts only 1.0 percent growth in withholding in 2011. While the steady employment growth forecast for 2011 is expected to boost withholding revenue, the return of Wall Street profits to a more moderate level in calendar

year 2010 will restrain compensation in the industry and in turn dampen withholding receipts, especially during the December-March bonus period.

The increase in taxpayers' average liabilities in tax year 2009, compared with the previous tax year, will increase estimated payments against 2010 liabilities, lifting PIT revenue in fiscal year 2011. In IBO's forecast, estimated payments in 2011 will get a further boost from the expected run-up in capital gains realizations at the end of calendar year 2010, prior to the expiration under current law of preferential federal tax rates on capital gains income. OMB's and IBO's withholding forecasts for 2011 are almost the same, though they vary somewhat with respect to the other PIT components. For the PIT as a whole, OMB predicts slightly faster growth than IBO for 2011, although IBO's forecast still exceeds OMB's by \$57 million.

The difference narrows further for 2012, when IBO's PIT forecast exceeds OMB's by only \$32 million. With national and local economic growth expected to accelerate, IBO projects that PIT collections will increase 6.6 percent to reach \$7.8 billion in 2012. IBO forecasts 7.3 percent growth in withholding and a continued increase in final returns payments. Estimated payments are the exception, the result of an expected fall-off in capital gains realizations that the current preferential rates will be allowed to expire as scheduled under current law. Local economic growth is forecast to peak in calendar years 2012 and 2013 leading to continued strong growth of PIT revenue in the last two years of the forecast period. By 2014, IBO forecasts that PIT collections will reach \$9.8 billion, exceeding the 2008 revenue peak by over \$1 billion. With OMB projecting far slower economic growth than IBO after calendar year 2011, especially in the city, their 2013 and 2014 PIT forecasts are far lower—by nearly \$778 million in 2013 and \$1.1 billion in 2014.

**Proposed Change to PIT STAR Benefit.** The 2010-2011 New York State Executive Budget contains several state deficit-reducing proposals relating to the School Tax Relief program, including a proposal to limit the benefit of the STAR-related reduction of city PIT rates to the first \$250,000 of city residents' personal incomes. (The per-return PIT credit provided by STAR would not be affected.) Beginning in tax year 1999, STAR phased in a 6.0 percent reduction in marginal tax rates over three years. Reversing this rate reduction for any taxable income over \$250,000 would effectively add a fifth tax bracket at the top of the city's tax table, with a marginal tax rate of 3.876 percent.

If enacted, this proposal would not have an impact on the city's budget because any increase in PIT revenue from upper-income taxpayers facing a higher marginal rate would be exactly offset

by the corresponding decrease in STAR aid to New York City. If the limits on city rate reduction were made retroactive, to the beginning of the current calendar year, IBO projects that roughly 103,700 city tax filers—4.5 percent of taxpayers and 2.9 percent of all city residents filing tax returns—would see their city PIT liabilities for tax year 2010 rise by a total of \$265 million. Many of these taxpayers are subject to the federal alternative minimum tax and, therefore, can no longer deduct state and local taxes when determining state and federal liability. As a result, few of these taxpayers would be able to offset the city tax increase through the use of itemized deductions. If the Governor's proposal is adopted, IBO estimates that the benefits lost by affected taxpayers would amount to about 40 percent of the total benefit to all city residents currently provided by STAR's reduction of PIT rates to all city residents.

### BUSINESS INCOME TAXES

After peaking at \$6.0 billion (excluding audits) in 2007, business income tax revenues dropped by \$600 million (10.0 percent) in 2008 and \$209 million (3.9 percent) in 2009, and are projected to fall by another \$744 million (14.3 percent) in 2010. (Except where specified, all the revenue numbers below are without audits.)

The 2009 and 2010 losses are as not as large as was expected a year ago (principally because of unanticipated strength in the bank tax), but still large enough to bring the three-year decline to close to \$1.6 billion (25.8 percent)—in both absolute and relative terms, the biggest in the history of these taxes. Nonetheless, the 2008-2010 slide in these tax revenues offsets well under half of the spectacular \$3.7 billion run-up in revenues from 2004 through 2007. Indeed, the three-year decline does not even fully wipe away the nearly \$1.7 billion increase in 2007 *alone*. The expected 2010 revenue trough of \$4.5 billion is almost double the previous 2002 trough of \$2.3 billion.

Business tax revenue growth is expected to resume in 2011, albeit at a more moderate pace than following the 2001–2003 recession. Projected gains of \$255 million (5.7 percent) in 2011, \$704 million (14.9 percent) in 2012, and \$635 million (11.7 percent) in 2013 will recoup the nominal losses of 2008, 2009, and 2010. In real (inflation-adjusted) terms, however, the old 2007 revenue peak will not finally be surpassed until 2015.

**Background.** New York City levies three entity-level taxes on business net income: the general corporation tax (GCT), the banking corporation tax (BCT), and the unincorporated business tax (UBT). These three taxes were established (along with now defunct city insurance and transportation corporation taxes) in 1967, replacing the city's previous taxes on general and

financial business gross receipts. New York City is almost unique among localities in imposing substantial business income taxes at the local level.

Over four-fifths of the GCT is collected through an 8.85 percent tax on entire net income allocated to New York City; the remainder is collected through alternative tax bases: income plus compensation (which starting this year is being partially phased out), capital allocated to the city, and a minimum tax. The principal rate and base of the BCT is similar to that of the GCT. Over nine-tenths of collections are derived from a 9.0 percent tax on entire net income allocated to the city, the remainder from alternative tax bases. The city's UBT imposes a 4.0 percent tax on the income of partnerships, proprietorships, and (since 1994) limited liability corporations.

Today about half of total city business tax revenues are derived from "flow-through entities"—S-corporations taxed under the GCT, and limited liability corporations, partnerships, and proprietorships taxed under the UBT. For federal and state tax purposes, the net income of such entities is for the most part subject only to personal income taxation and not business income tax at the federal and state levels. The city taxes this income at the personal level as well if it is received by city residents, but it somewhat mitigates double-taxation by providing a partial credit in its personal income tax for UBT liabilities of city residents. There is currently no comparable relief for resident shareholders of city-taxed S-corps.

The business taxes differ from the city's other tax sources in that audits undertaken by the Department of Finance account for a significant portion of revenues. Audit collections surged to nearly \$1.0 billion in 2007 and remained above \$800 million in 2008 and 2009, a level they are expected to approach again in 2010. For 2011 and after, the Mayor's budget office assumes a return to previously typical levels (around \$500 million per year), but since overall business tax liabilities are *not* returning to old (pre 2006) levels, that audit projection may be low.

The city's business income taxes are highly pro-cyclical, meaning that their revenues tend to grow very strongly during an economic upswing and fall sharply during a downswing. This has been particularly true of collections stemming from the financial services sector. The BCT's inherent volatility is exacerbated by very large fluctuations in refunds, the result of adjustments to tax liabilities based on losses and gains not recognized until a year or more after they are incurred.

**Current Year Projections.** IBO projects double-digit declines in all three business income taxes in 2010—in contrast to

2008, when the bank tax was hit particularly hard but the UBT continued to grow, and 2009, when the GCT took sizable losses but the BCT unexpectedly rebounded with a large gain.

*General Corporation Tax.* A little more than midway through the current fiscal year the GCT is off \$272 million (24.5 percent) from the comparable period last year but is projected to finish 2010 with an overall \$261 million (11.3 percent) decline in net revenues. Revenues are expected to strengthen by the end of the fiscal year—especially as tax year 2010 collections start to come in—but still end up under \$2.1 billion for the year, the lowest total since 2005. This estimate includes the partially offsetting effects of allowing faster deductions of certain investments under the American Recovery and Reinvestment Act (ARRA) of 2009, which lowered the GCT by \$42 million in 2009 and \$79 million in 2010, and the newly implemented package of business tax conformity reforms, which is increasing 2010 revenues by an estimated \$132 million. Absent these recent policy changes, the projected GCT decline in 2010 from economic factors alone would be \$356 million (15.1 percent).

An exception to the overall weakness of the New York City economy in calendar year 2009 was the rebound from huge losses to huge profits on Wall Street. This has stabilized tax collections from the finance industry. Current tax year GCT collections from finance in the first two quarters of 2010 slipped only \$5.3 million (2.0 percent) compared to the same period in 2009; at the same time collections from all other industries dropped \$250.0 million (24.8 percent). This reverses the pattern of a year ago, when the first two quarter collections from finance plunged \$174.8 million (40.3 percent) from the same period in 2008, while all other current tax year collections dropped only \$17.1 million (2.1 percent). Some of the improvement in finance industry collections is due to provisions of the business tax conformity reforms, including the new rules for the sourcing of broker-dealer receipts.

*Banking Corporation Tax.* The BCT is also expected to finish 2010 with a \$191 million decline in net revenues, but in this case focusing on the year-over-year change is misleading. The \$907 million in revenues projected for the current fiscal year are the third highest in the bank tax's history—but 2009 revenues were, against expectations, the second highest. In both years bank tax refunds—reflecting reestimations of prior tax year liabilities—have run very high, continuing a surge that began in 2008. Nonetheless, current tax year collections have continued to be very strong, especially for commercial banks, although foreign bank collections lagged. This suggests the effect of the Troubled Asset Relief Program bailout and related interventions. Note that in 2010 the effects of the BCT of ARRA (a \$42

million decrease in the BCT) and city business tax reform (a \$46 million increase) almost exactly cancel out.

*Unincorporated Business Tax.* The pattern in the UBT is similar to that in the GCT: overall year-to-date collections are down in 2010 compared to the comparable period last year—by 13.8 percent through January—but collections from financial services are slightly up. IBO projects net revenues of just under \$1.5 billion for the year, a drop of \$291 million (16.3 percent) from 2009. Of this, \$21 million is due to the negative effect of the business tax conformity reforms on UBT revenue.

Compared to Bloomberg Administration projections, IBO's forecasts for 2010 are lower for both the GCT and UBT, by \$229 million and \$124 million, respectively. On the other hand, our BCT projection is \$213 million greater than OMB's because of the strength of actual collections through January, and even more because very large bank tax refunds expected by the Mayor's budget office have not fully materialized.

*Forecast for 2011 and Beyond.* With the city economy as a whole returning to weak growth in calendar year 2010, IBO forecasts rebounds in GCT and UBT revenues in 2011, while the bank tax falters. GCT revenues are forecast to rise to under \$2.5 billion, an increase of \$404 million (19.6 percent). The UBT is expected to grow by \$133 million (8.9 percent) to over \$1.6 billion. Absent the effects of the stimulus act and business tax reform, projected GCT growth in 2011 would have been a bit weaker (18.4 percent) and UBT growth a bit stronger (9.8 percent).

The anticipated 2011 drop in the BCT to \$625 million (a \$282 million decline) is the combined result of the inherent 'lumpiness' of bank liabilities producing highly volatile or 'noisy' collections, and ongoing large corrections to prior year accounts yielding very high refunds. Somewhat mitigating what would otherwise have been an even greater drop, business tax reform net of the stimulus act is expected to add \$37 million to BCT revenues in 2011.

The BCT drop will hold overall business tax revenues in 2011 to a combined \$4.7 billion, \$255 million (5.7 percent) above 2010. Starting in 2012, however, and for the remainder of the Financial Plan period, all three business taxes are projected to grow, and the combined growth rates will be higher. Business tax revenues are forecast to rise to \$5.4 billion in 2012, a \$704 million (14.9 percent) increase, to \$6.1 billion in 2013, a \$635 million (11.7 percent) increase, and to \$6.5 billion in 2014, a \$454 million (7.5 percent) increase.

The GCT accounts for about half of the projected out-year

(2012-2014) business tax revenue growth, with an average annual growth rate of 11.2 percent over the three years that brings GCT revenue close to \$3.4 billion by 2014. Somewhat slower out-year growth averaging 7.7 percent a year is expected for the UBT, but this will carry revenue above \$2.0 billion by 2014. The ever-volatile BCT is projected to grow at 20.3 percent on average after 2011, to approach \$1.1 billion by 2014.

All three IBO business tax forecasts for 2011 are below OMB's, with the bulk of the combined \$234 million gap stemming from the GCT forecast. Starting in 2012, however, IBO's business tax forecasts run increasingly above the Mayor's Financial Plan numbers. IBO's forecast for 2012 is \$39 million above plan; our forecast for 2013 is \$263 million above plan, and our forecast for 2014 is \$405 million above plan. In IBO's forecasts, relatively greater refunds are more than offset by even larger differences in gross collections. In all three years, the bank tax accounts for most of the additional business tax revenue anticipated by IBO.

All this is the cumulative consequence of the difference between the moderate out-year economic growth forecast by IBO and the slower and weaker recovery anticipated in the Financial Plan. The greater business tax liabilities accompanying IBO's stronger economic forecast yield more collections growth directly, and (as taxpayers revise their initial liability estimates) higher refunds with a lag.

## GENERAL SALES TAX

IBO forecasts \$5.0 billion of city general sales tax revenue in 2010, a \$422 million (9.2 percent) increase over 2009 revenue. The projected growth results primarily from tax increases in the last year. Had the increases not been enacted, sales tax collections would have fallen for a second year in a row. After 2010, as the economic recovery proceeds and strengthens, IBO forecasts annual revenue increases averaging 6.5 percent through 2014, when sales tax receipts reach a projected \$6.4 billion. IBO's 2010 estimate is \$135 million higher than OMB's, and with IBO forecasting a more rapid recovery than OMB, this difference grows over time. Neither the IBO nor the OMB forecasts include the potential effects of the Bloomberg Administration's proposal to include fuel sold to airlines in the sales tax base (see next page).

*Background.* Sales in the city of most retail goods, utility charges, and a variety of personal and business services are currently subject to a combined sales and use tax rate of 8.875 percent. The tax rate is the sum of the city's 4.5 percent rate, a 4.0 percent state tax rate, and a 0.375 percent Metropolitan Commuter Transportation District surcharge. The city rate, which had been 4.0 percent for many years, was recently increased to 4.5 percent, effective August 2009, and the increase

is adding an estimated \$468 million to 2010 revenue and greater amounts in subsequent years. Two recently enacted changes that broaden the sales tax base are also boosting current and future city sales tax revenue: the repeal of the tax exemption on clothing costing more than \$110, which is expected to bring in \$108 million this year and more in later years; and the repeal of a tax exemption on the distribution of electricity and natural gas, which is projected to add \$75 million in 2010 and increase over time.

Sales tax revenue is determined primarily by the consumption spending of city residents, but also by sales to businesses, commuters, tourists, and business travelers. Among the many variables that determine spending, household income, consumer confidence, and foreign exchange rates all play a major role. From 2003 through 2008, sales tax revenue grew at an average annual rate of 6.6 percent, reflecting economic growth and a number of tax policy changes which on balance increased sales tax collections. During those years, local personal income and consumer expenditure rose in conjunction with the securities industry's soaring profits and bonus compensation. With personal income growing nationwide and favorable exchange rates during the period, sales tax revenue was further bolstered by increases in domestic and foreign visitors to the city. The number peaked at 47 million in calendar year 2008, and NYC & Co, which promotes tourism for the city, estimates that visitors spent \$32.1 billion in the city that year.

In contrast to the nation's economy, which slipped into recession after December 2007, the city's personal income and its sales tax receipts continued to grow until the last quarter of calendar year 2008. It was not until the city's employment and income began to fall in the wake of shocks to the financial system that sales tax collections were affected. Revenue for the October-December quarter was 4.7 percent lower than it had been for the same quarter the year before, and same-quarter sales tax continued to decline into fiscal year 2010.

**Revenue in 2010.** Collections to date this fiscal year plus continued improvements in the economic outlook have led IBO to raise its forecast of 2010 sales tax revenue, to \$5.0 billion—9.2 percent greater than 2009 collections. The fast growth results mostly from the tax rate increase and the broadening of the tax base to include clothing items above \$110 and electricity and natural gas distribution. Without the enactment of these increases in August 2009, IBO estimates that sales tax collections would be 5.0 percent lower this year than in 2009.

But the tax hikes are not the only factors responsible for IBO's higher revenue forecast. The downturn of the local economy has not been as bad as previously projected: fewer local jobs

have been lost and Wall Street has rebounded much faster and more strongly than expected. Also, the number of visitors to the city declined by less than feared to 45.3 million (a drop of 3.7 percent), and consumer spending during the all-important holiday season was markedly improved relative to its dismal performance in 2008. By the last quarter of calendar year 2009, sales tax collections resumed growing, and December receipts were 15.7 percent greater than in December 2008, indicating growth above and beyond that due to the tax increases.

**Revenue in 2011 and Later Years.** As the economic recovery gains momentum and growth accelerates in the coming years, solid though not unprecedented revenue growth is projected throughout the forecast period. For 2011, IBO forecasts \$5.3 billion in sales tax revenue, 5.6 percent greater than projected revenue this year. This growth rate is comparable to growth seen before the local economy entered into the recession (2007 to 2008). In addition to increased local consumption fueled by an upturn in employment, national economic growth is expected to increase domestic tourism and visitor spending in the city.

With economic growth expected throughout the forecast period, IBO projects sales tax revenue to grow at an average annual rate of 7.2 percent in 2012 and 2013 before moderating in 2014. The IBO forecast for 2014 is \$6.4 billion. Due to IBO's forecast of a more rapid recovery than OMB expects, out sales tax forecast exceeds OMB's in all years, with the difference growing over time—from \$135 million in 2010 to \$471 million in 2014.

**Proposal to Tax Airline Fuel.** In the Preliminary Budget, the Bloomberg Administration presents a proposal to tax the sale of aviation fuel sold to airlines, which is currently exempt from sales tax. This exemption has been termed an unfair "loophole" because fuel sold to other transportation firms is taxed. Proponents of the change argue there would not be a significant shift of departures from LaGuardia and Kennedy to other nearby airports because other airports are too inconvenient for passengers, already too crowded to handle extra flights, or have runways that are not long enough to accommodate large jets. If the sales tax were extended to airline fuel by the beginning of the next fiscal year, IBO estimates that city tax revenue would increase by \$158 million in 2011, rising to \$189 million in 2014—forecasts that range from \$11 million to \$17 million below OMB's own projection in any year.

## HOTEL OCCUPANCY TAX

While tourism in New York is expected to rise as the economic recovery proceeds, revenue from the hotel occupancy tax is not expected to increase substantially over the forecast period. The

temporary increase in the hotel tax rate enacted a year ago has avoided a steep drop in revenue. Still, IBO's forecast of 2010 hotel tax revenue—\$341 million—is slightly less (0.2 percent) than 2009 revenue. Even with our forecast of economic recovery, hotel tax revenue is projected to hover in the \$341 million to \$360 million range throughout the forecast period. Revenues will be constrained by downward pressure on room rates and the expiration of the tax hike after November 30, 2011. IBO's hotel tax forecasts are initially slightly lower than OMB's but become slightly higher after 2011.

**Background.** Since 1970, New York City has imposed a hotel occupancy tax, which is levied in addition to the combined city, state, and commuter district sales taxes. The hotel tax currently equals a flat fee of \$2 per night for rooms with daily rates of \$40 or more plus 5.875 percent of total room charges. Before the temporary rate increase took effect in March 1, 2009, the rate was 5.0 percent.

Revenue from the hotel tax soared during the last economic expansion, more than doubling from 2002 to 2008. The number of domestic and foreign visitors grew by a third, peaking at 47 million in calendar year 2008, raising hotel occupancy rates and putting upward pressure on room prices. The number of visitors to the city fell with the recession, but not by as much as once expected. Hotel operators adjusted room rates quickly in response to changes in demand, thereby bolstering occupancy rates. But the reduction in average room rates took its toll on hotel tax receipts, which fell from \$379 million in 2008 to \$342 million in 2009, a decline of 10.0 percent.

**The 2010 Forecast.** IBO's forecast of hotel tax revenues for 2010 is \$341 million, virtually the same as last year. IBO estimates that without the recent rate increase, which is expected to add \$46 million to hotel tax receipts this year, revenue would have decreased 10.1 percent, mirroring last year's decline. Room rates that remain well below their pre-recession levels are keeping hotel tax revenues down as are the continued addition to the

city's inventory of hotel rooms from projects already underway prior to the decline in tourism.<sup>5</sup>

**The Forecast in 2011 and Beyond.** IBO forecasts that hotel tax revenue will rise 3.1 percent in 2011, to \$352 million. Even with an economic recovery underway, hotel room rates are not likely to increase much with the scheduled opening of more hotel rooms next year and only modest personal income growth. It is only after 2011, when U.S. economic growth quickens, that room rates are expected to rise significantly. The increased revenue from higher room rates, however, will be largely offset by the expiration at the end of November 2011 of the temporary tax rate increase. In 2012 hotel tax collections are projected to grow by 2.6 percent, to \$360 million. If the increase were to be extended through the end of 2012, revenue would grow strongly, by 8.2 percent. The expiration of the rate increase also leads to a 4.9 percent decline in hotel tax revenue in the IBO forecast for 2013. For 2014, IBO forecasts \$353 million in hotel tax revenue, which still falls short of the revenue peak in 2008.

#### ENDNOTES

<sup>1</sup>For additional information about the complications of the city's real property tax, see *Twenty-Five Years After S7000A: How Property Tax Burdens Have Shifted in New York City*, Independent Budget Office for New York City, December 2006. When IBO refers to market values and assessments, the reference includes only taxable property. The assessed value for tax purposes (also referred to as billable taxable value) reflects the required phase-in of assessment changes for apartment, commercial, and industrial buildings. In this report the billable taxable values are shown before applying the STAR exemptions.

<sup>2</sup>There is a seasonal effect, particularly in residential sales, in which sales during the latter half of a calendar year are higher than January through June sales, absent any other influences on sales. In calendar years 2007 and 2008, however, this seasonality was not sufficient to prevent declines of sales from the previous six months.

<sup>3</sup>Sales of properties with small or zero-dollar prices usually reflect transfers of property within families.

<sup>4</sup>Partly in response to negative publicity about large bonuses paid by financial firms that received public financial support, many firms are shifting a portion of their bonus compensation from cash to deferred stock options, which are not taxable until they are exercised and capital gains are realized. With the payout determined by future stock performance, bonus recipients have an incentive to weigh long-term profitability for the firm over short-term results.

<sup>5</sup>In a recent update on hotel development, NYC & Co. reported that more than 5,100 hotel rooms had been added in the city from January through October 2009, mostly in luxury and boutique hotels in Manhattan. Their inventory of hotel projects under development or proposed counted almost 10,900 rooms scheduled to open by 2012. But the number of rooms will actually be added during that time is likely to be lower because of hotel closings and, as the report cautioned, plans for new construction and renovations that "change frequently."

## FEDERAL STIMULUS UPDATE

Last February, with the U.S. economy mired in what would become the worst recession since World War II, Congress and the Obama Administration enacted a \$787 billion stimulus package known as the American Recovery and Reinvestment Act of 2009 (ARRA). The act included a variety of mostly temporary measures, including tax cuts, funding for infrastructure and other investments, and money to help state and local governments avoid layoffs in the face of plummeting tax revenues. Funding for most of the programs in the bill is for two years, so that significant parts of the federal stimulus will dry up during the city's next fiscal year.

The city's budget has received substantial assistance from ARRA, much of it indirectly through Albany, although in some cases the assistance comes directly to the city. The role of ARRA funds in the budgets of city agencies—and the problem of replacing them once the appropriations run out—is a recurring theme in the various sections of this report. In this section, we highlight some cases where ARRA funds are playing a particularly important role in an agency or program budget this year.

### EDUCATION: STIMULUS PARTIALLY OFFSETTING STATE AID CUTS, FOR NOW

ARRA funding for education is more heavily targeted at fiscal stabilization than job creation. There are three types of ARRA funds used by the Department of Education (DOE): stabilization, Title I ARRA, and Individual with Disabilities Education Act (IDEA) ARRA. The latter two use preexisting federal aid programs that are targeted at students from low-income households and students with disabilities, respectively. By compensating for shortfalls in this year's state budget, the ARRA funds have helped avert a major reduction in the DOE's 2010 budget and prevented—by the Bloomberg Administration's accounting—the loss of 14,000 teaching jobs.

The Mayor's Preliminary Budget for 2011 includes \$227 million in Stabilization Funds, \$335 million in Title I ARRA, and \$166 million in IDEA ARRA for a total of \$839 million in federal stimulus support. For 2012, the city expects that virtually all of that money (\$825 million) will be lost to the DOE budget, as stimulus appropriations dry up. As a result, the Preliminary Budget projects a loss of 14,190 teacher positions beginning in that year.

### ENVIRONMENTAL PROTECTION PROJECTS

The state's Department of Environmental Conservation received

\$432 million in ARRA funding for its Clean Water State Revolving Fund. The funding is being allocated to municipalities and New York City is able to access stimulus funds as direct loans for qualifying capital projects. The city's Municipal Water Finance Authority (MWFA) entered into an agreement in November 2009 to receive up to \$217.5 million from the fund over the next few years, or almost half of the state's allocation. The MWFA will secure a no-interest loan through the state's Environmental Facilities Corporation to provide the funding during construction of several projects, which are expected to take about three years to complete. Once the \$217.5 million has been spent, the principal on the loan will be forgiven. The city will recognize savings both for the capital expenditures and the long-term debt service that would have resulted from bond financing these projects.

The city plans to spend \$84 million on sludge loading docks at the Newtown Creek wastewater treatment plant. Reconstruction of digesters at the Hunts Point treatment plant will run about \$35 million, while \$32 million will be spent on emergency generators. Other projects at city Department of Environmental Protection facilities include boiler reconstruction at Port Richmond for \$27 million, replacement of the primary sludge system at Wards Island for \$16 million, and reconstruction of the substation at Oakwood Beach for \$8 million. The agency will also put \$15 million of the stimulus funds toward ecological restoration of the Paerdegat Basin Natural Area Park.

### DEPARTMENT OF TRANSPORTATION PROJECTS

The city's Department of Transportation (DOT) is receiving stimulus funding for both operating and capital expenditures. According to the *Stimulus Tracker* maintained by the Mayor's Office of Operations, DOT's operating budget will receive \$46.7 million in ARRA funding, all for the Staten Island Ferry. As of January 2010, \$34.9 million in stimulus funds had been appropriated for ferry maintenance: \$14.7 million in 2010, \$10.1 million in 2011, and \$10.1 million in 2012. Of the 2010 amount, \$4.7 million is funding that was originally intended for ferry capital expenditures, but is being shifted to operating needs.

The *Stimulus Tracker* lists six DOT capital projects that are slated to receive a total of \$215 million in ARRA funding. The project receiving the largest amount, \$175 million, is the rehabilitation of ramps at the St. George Ferry Terminal in Staten Island. A total of \$30 million is slated for rehabilitation of the Brooklyn Bridge. The remaining projects all involve bridge rehabilitation

or upgrades: two Bruckner Expressway bridges (\$3.5 million), the Greenpoint Avenue Bridge over Newtown Creek (\$2.5 million), 12 roadway bridges (\$2.5 million), and the Wards Island pedestrian bridge (\$1.5 million).

**HOUSING AID**

The Department of Housing Preservation and Development (HPD) has benefited from ARRA and the Housing and Economic Recovery Act (HERA) which was enacted in 2008. In 2009 and 2010, HPD received a total of nearly \$160 million from three ARRA and HERA programs: the Tax Credit Assistance Program (TCAP), the Community Development Block Grant (CDBG), and the Neighborhood Stabilization Program (NSP). The funds have allowed HPD to finance projects supported by low income housing tax credit (LIHTC) that were at risk of stalling, increase code enforcement and emergency repairs, and rehabilitate foreclosed homes. The goal of these programs is to stabilize neighborhoods and to ensure the continued development of affordable housing.

New York City was the first jurisdiction in the country to use funds from the stimulus act's Tax Credit Assistance Program. TCAP provided federal grants for low income housing tax credit projects that stalled or had financing gaps due to the recent decline in the value of the credit. In total, HPD received \$85 million in TCAP funds. To date it has awarded \$82 million to nine LIHTC projects containing 935 low-income units in Brooklyn, the Bronx, and Manhattan. The remaining funds will be awarded soon. Only tax-credit projects are eligible to receive TCAP grants and the units must be affordable to families earning less than 60 percent of the area median income, or \$46,100 for a family of four.

Through ARRA, the housing department received \$28 million in Community Development Block Grant (CDBG) Recovery

funds. These funds are above and beyond the significant level of regular CDBG funds the agency receives every year and will support existing HPD programs that normally receive CDBG funds. With the additional funds HPD will increase the work being done by the Emergency Repair Program, including lead removal activities, and the provision of emergency fuel and utilities. In addition, the Emergency Demolition Program and Neighborhood Preservation Offices will benefit.

HERA created the Neighborhood Stabilization Program in response to the foreclosure crisis throughout the country. A second round of funds was competitively awarded through the stimulus act (NSP II). In total, HPD will receive over \$45 million in NSP funds. The funds may be used for the acquisition, renovation, and disposition of abandoned and foreclosed homes in specific distressed neighborhoods as defined by the federal Department of Housing and Urban Development (HUD). Twelve percent of census tracts in the city are classified as distressed and eligible for the funds. While New York has had relatively few foreclosures compared to other areas of the country, several neighborhoods such as Jamaica, Queens and East Flatbush and Bushwick, in Brooklyn have been hard hit by the foreclosure crisis.

Through the first round, NSP I, the city was awarded \$25.6 million. A quarter of these funds will be used to acquire and rehabilitate multifamily buildings that are facing foreclosure or have been abandoned by their owners. The remaining funds will be used to support the acquisition and rehabilitation of foreclosed homes by Restored Homes, a nonprofit with experience rehabilitating and selling HUD-foreclosed homes, where HUD has taken possession of a one- to four-family home because a federally insured mortgage has entered foreclosure. Once Restored Homes has rehabilitated the homes, they will be sold to families earning less than 120 percent of area median income, with oversight from HPD.

<b>Stimulus Related Housing Funds</b>		
<i>Dollars in millions</i>		
	<b>2009</b>	<b>2010</b>
<b>Housing and Economic Recovery Act (HERA)</b>		
Neighborhood Stabilization Program	-	\$25.6
<b>American Recovery and Reinvestment Act (ARRA)</b>		
Tax Credit Assistance Program	46.8	38.2
Community Development Block Grant	-	28.0
Neighborhood Stabilization Program II*	-	20.0
<i>ARRA Total</i>	<i>46.8</i>	<i>86.2</i>
<b>TOTAL</b>	<b>\$46.8</b>	<b>\$111.8</b>
SOURCES: IBO; Mayor's Office of Management and Budget; Department of Housing Preservation and Development		
NOTE: Award was announced by HUD in January 2010. However, funds were not reflected in the Preliminary Budget.		

In January 2010, HPD was awarded an additional \$20 million through the NSP II program. Like the previous award, the funds must be used in specific distressed neighborhoods. HPD has not announced exactly how the NSP II funds will be used. The program allows the funds to be used to acquire and rehabilitate foreclosed and abandoned homes and apartment buildings. Funds can also be used to assist in the development of stalled and vacant sites. IBO's analysis of the Department of Buildings' Stalled Sites list this summer showed that there are several dozen sites with primarily one- to four-family homes, that the city could target with NSP II funds because they are located in the distressed census tracts.



## EXPENDITURE OUTLOOK

IBO projects that under the Mayor's Preliminary Budget for 2011 and Financial Plan through 2014 spending will grow from \$63.2 billion in 2010 to \$73.6 billion in 2014, an average annual increase of 3.9 percent.

For many city agencies, projected spending (excluding labor) remains relatively flat under the Mayor's Financial Plan. Among the larger city agencies, the health department, fire department,

police department, Administration for Children's Services, and Department of Homeless Services all experience budget declines from 2010 through 2014. Much as in past years, some of the largest areas of spending growth are municipal labor costs, including wages, pensions, and health and other fringe benefits, and debt service on the money the city borrows for its capital plan.

The agency with the largest growth in dollar terms over the

2010–2014 period is the Department of Education, which is projected to have its budget (excluding the reserve for labor settlements) increase \$1.1 billion, from \$18.2 billion in 2010 to \$19.3 billion in 2014. Another exception to the flat spending projections for most major agencies is the sanitation department, which is expected to see its budget increase \$155 million to \$1.4 billion from 2010 through 2014.

The Mayor did not include the effect of the Governor's budget proposals in his Preliminary Budget for 2011 or Financial Plan through 2014. As a result, IBO's spending projection does not reflect the Governor's budget proposals, which would reduce aid to the city by more than \$800 million, including \$493 million in school aid.

In addition, the Mayor did not include in his budget plan an expenditure of about \$200 million that phases into effect in 2011 under a rule change that requires the city to pay for pollution remediation costs out of the Expense Budget rather than the Capital Budget.

<b>IBO Expenditure Projections</b>						
<i>Dollars in millions</i>						
	2010	2011	2012	2013	2014	Average Change
<b>Health &amp; Social Services</b>						
Social Services						
Medicaid	\$5,095	\$5,791	\$6,260	\$6,440	\$6,625	6.8%
All Other Social Services	3,136	3,092	3,128	3,116	3,116	-0.2%
HHC	11	96	122	122	122	n/a
Health	1,695	1,604	1,617	1,620	1,626	-1.0%
Children Services	2,721	2,568	2,571	2,573	2,573	-1.4%
Homeless	770	711	701	701	701	-2.3%
Other Related Services	692	513	481	481	481	-8.7%
<b>Subtotal</b>	<b>\$14,120</b>	<b>\$14,374</b>	<b>\$14,880</b>	<b>\$15,053</b>	<b>\$15,244</b>	<b>1.9%</b>
<b>Education</b>						
DOE (excluding labor reserve)	\$18,214	\$18,462	\$18,215	\$18,987	\$19,340	1.5%
CUNY	714	678	664	665	665	-1.8%
<b>Subtotal</b>	<b>\$18,928</b>	<b>\$19,140</b>	<b>\$18,879</b>	<b>\$19,651</b>	<b>\$20,005</b>	<b>1.4%</b>
<b>Uniformed Services</b>						
Police	\$4,512	\$4,362	\$4,399	\$4,373	\$4,373	-0.8%
Fire	1,749	1,639	1,625	1,621	1,619	-1.9%
Correction	1,019	1,019	1,022	1,018	1,018	0.0%
Sanitation	1,283	1,354	1,383	1,382	1,438	2.9%
<b>Subtotal</b>	<b>\$8,563</b>	<b>\$8,374</b>	<b>\$8,429</b>	<b>\$8,394</b>	<b>\$8,449</b>	<b>-0.3%</b>
<b>All Other Agencies</b>						
	<b>\$6,743</b>	<b>\$6,495</b>	<b>\$6,576</b>	<b>\$6,655</b>	<b>\$6,720</b>	<b>-0.1%</b>
<b>Other Expenditures</b>						
Fringe Benefits (excluding DOE)	\$3,730	\$3,834	\$3,825	\$4,816	\$5,168	8.5%
Debt Service	3,404	2,578	6,286	6,579	6,815	n/a
Pensions	6,636	7,143	7,570	7,716	7,825	4.2%
Judgments and Claims	663	717	775	835	898	7.9%
State Education Building Aid (TFA)	250	319	431	518	609	n/a
General Reserve	200	300	300	300	300	n/a
Labor Reserve:						
Education	217	350	369	367	367	n/a
All Other Agencies	271	338	457	552	707	n/a
Expenditure Adjustments	(531)	64	225	340	449	n/a
<b>TOTAL Expenditures</b>	<b>\$63,194</b>	<b>\$64,026</b>	<b>\$69,001</b>	<b>\$71,777</b>	<b>\$73,555</b>	<b>3.9%</b>

SOURCE: IBO.

NOTES: Debt service expenditures, if adjusted for prepayments, would grow at an annual average rate of 6.9 percent from 2010-2014. Similarly, fringe benefits would grow at an annual average rate of 6.4 percent. Expenditure adjustments include energy, lease, prior year payable adjustments and non-labor inflation estimates. Estimates exclude intra-city expenses. Figures may not add due to rounding.



## EDUCATION

### AS CLASSROOM SPENDING FALLS BELOW THIS YEAR'S LEVEL, STATE AID IS FROZEN

The 2011 Preliminary Budget for the Department of Education (DOE) totals \$18.8 billion, \$382 million higher on a year-over-year basis than the current budget for 2010, but \$546 million less than was planned for 2011 when the 2010 budget was adopted last spring.

The changes since last spring for 2011 all stem from the Preliminary Budget (there were no changes to the 2011 budget in the November 2009 plan). The net effect of gap-closing actions was \$317 million in city funds, although the proposed reductions potentially avoid cuts to the classroom by giving DOE staff smaller-than-planned salary increases. State-funded spending will fall by \$167 million as the result of reestimates and adjustments on the part of the city for previously enacted state policies. The Preliminary Budget does not reflect the impact of the cuts in state education aid that were proposed in the Governor's Executive Budget.

Another significant change is the shift of \$129 million in federal stimulus money that had been budgeted for use in 2011 into the current year. This shift was the result of state policy as the Governor and the Legislature struggled to close gaps in the current state fiscal year. State leaders chose to offset the cuts they were making in state aid with the federal stimulus money that they had planned to use in the 2010–2011 state budget, although absent new stimulus money to use next year, this leaves a hole in the education aid budget for the city's upcoming fiscal year.

For the current fiscal year, there has been little change from the Adopted Budget. The Governor withheld some school aid payments for all districts across the state in December. The delay appears to have been temporary, although there is talk of another delay in May or June. Although the department's midyear adjustment exercise revealed that enrollment had climbed by 14,000, schools with unanticipated enrollment increases will not receive commensurate increases in funding.

The education department also announced another reorganization of how schools receive operational and administrative support through its central bureaucracy, the effects of which have not yet been fully accounted for in the operating budget.

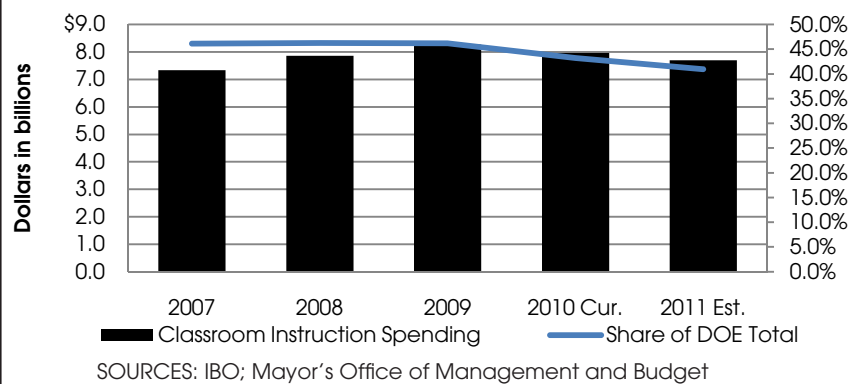
Under the Mayor's Preliminary Budget, year-over-year spending on classroom instruction would decline by \$261 million (3.3 percent) from 2010 to 2011. The decline is even larger (\$267 million) for general education classroom instruction—special education instruction is projected to have a small increase in funding. Spending is slated to increase by \$314 million for nonpublic schools (primarily contracted special education institutions) and for charter schools. Systemwide costs (fringe benefits and central administration) will also grow by \$261 million next year.

### City Changes

**"Pegging" Labor Negotiations.** The United Federation of Teachers' contract expired at the end of October and the contract with the Council of Superintendents and Administrators expired this month. The Mayor's Preliminary Budget includes a proposal to limit the salary increase in new contracts to 2 percent annually for two years on the first \$70,000 of salary, so that the maximum raise over two years would be \$2,828. Nonunion managers and certain other professional staff at DOE—whose raises usually track the major union settlements—will face a similar cap on salary increases, although in their case the change can be imposed without collective bargaining.

Because the city's budget had originally assumed that new contract and the managerial raises would provide for increases of 4 percent each year, raises at 2 percent would lower the city's labor costs by \$160 million in 2010 and \$357 million in 2011. Most of the labor savings—\$113 million 2010 and \$317 million in 2011—would be transferred from the city's collective bargaining reserve to the DOE to be used to help meet the department's program to eliminate the gap (PEG)

### Classroom Instruction Spending Shrinks: In Dollars and as Share of Total DOE



target. The DOE and Mayor's Office of Management and Budget calculate that if these savings are not produced through collective bargaining, then the schools will have to shed 2,500 teaching positions, largely through attrition, in order to meet the department's PEG targets.

The rest of the labor savings—\$47 million in 2010 and \$40 million in 2011—would be used to meet the growing costs of providing instruction for special education students whose families have successfully brought legal actions claiming that there are no appropriate public school alternatives to a private school placement for their children—even if they have not actually tried using public school services. The cost of services for these students—known as Carter cases—has grown rapidly in recent years from \$47 million in 2005 to an estimated \$143 million in the current year. The costs are expected to grow again next year to \$196 million.

**Another Internal Reorganization.** Another change that will affect DOE's overall budget next year is yet another reorganization of the department's back office support for schools. Although there are expected to be some budgetary impacts from this change, they are not reflected in the Preliminary Budget for 2011; presumably they will be incorporated in the Executive Budget when it is released in April. This reorganization will be the third of its kind since the Bloomberg Administration's Children First agenda was launched in 2003. Initially, the 32 community school district offices were collapsed into 10 Regional Operating Centers (ROCs) which then evolved into Integrated Service Centers (ISCs) which are now expected to transition into Children First Networks.

While the ROCs were operating, a pilot project of Region 8 in Brooklyn established a set of schools that were called the autonomous zone and later the Empowerment Zone. The Empowerment Zone schools were freed from some of the administrative and curriculum mandates of the central DOE bureaucracy. Schools originally were selected to join the Empowerment Zone based largely on academic performance. By 2008 the Empowerment Zone increased in size to 500 schools located across the city, which formed shared networks of schools with similar priorities and vision. These networks are a template for the planned Children First Network structure. The networks are served by teams providing instructional and operational support to the schools in the network.

With the transition to the ISCs, the DOE created school support organizations (SSOs) to provide support, coaching, and guidance to groups of schools. The department offered schools the choice of 11 support organizations that competed by offering

schools different combinations of instructional, budgetary, and organizational support. The SSOs include four internal groups staffed by DOE employees, the original Empowerment Zone staffed by DOE personnel, plus six outside contracted nonprofit organizations.

Department staff have suggested that \$13 million in savings will result from shifting from SSOs to Children First Networks, although it is not clear how, or if, that money will be passed on to the schools. The creation of Children First Networks will eliminate 80 administrative positions and completely close the ISCs as well as disband the DOE's five internal school support organizations. The outside organizations contracted to provide school support services under the ISC administrative model will continue to do so until their contract terms expire, originally set for the end of fiscal year 2012.

**Midyear Enrollment Adjustment.** Individual school budgets are developed in the spring and summer preceding the start of school, and are therefore based on projected rather than actual enrollment for each school. Once school opens and enrollment stabilizes, a count of actual enrollment at each school is taken (usually October 31<sup>st</sup>) and this information is used to adjust school budgets accordingly. With overall enrollment declining in recent years, there have been enough schools with unexpected enrollment declines to cover upward enrollment swings and fund the necessary budget increases of growing schools. This year was an exception and as a result, the midyear adjustments have left schools serving more students than expected short on funds.

Last spring the department projected that enrollment would decline by 2,800 students; instead, public school enrollment rose by 14,000, including 5,000 students in charter schools. Schools needing budget increases to fund unanticipated enrollment growth outnumbered schools in which unexpected enrollment declines had freed up budget resources. Moreover, because most schools had started the year bearing the effects of last year's PEGs on their budgets, many of those with unanticipated enrollment declines used at least some of the freed up money to fund current needs leaving less available to shift to schools with rising enrollments. Because the Bloomberg Administration chose not to add resources to deal with these shortfalls, the midyear adjustment process only generated 55 percent of the funds to which schools with unexpected enrollment were entitled. The result is additional budgetary pressure on those schools.

### State Budget Changes

The Preliminary Budget does not reflect changes proposed in the Governor's Executive Budget that would reduce aid to the

city by \$493 million. State education aid accounts for 45 percent of the DOE budget, and most of that money funds classroom instruction. Classroom instruction is the single largest expenditure area of the DOE's budget, totaling \$7.7 billion in 2011 with \$5.4 billion (70 percent) funded with state revenue sources. Thus, reductions in state aid can translate quickly into cuts to the classroom. The Mayor has claimed that if the Governor's education aid cuts were implemented, the DOE would be forced to cut 8,500 teaching positions, including 7,000 layoffs.

**Frozen Foundation Aid.** Under state legislation enacted in the spring of 2007, state education aid for the city was scheduled to grow by at least \$3.2 billion over four years in order to satisfy the court ruling that ended the Campaign for Fiscal Equity case on the adequacy of funding for the city's public schools. (New York City was required to increase city-funded support for the schools by \$2.2 billion over the same four years.) After the first year under the legislation, the state's increasing fiscal difficulties have led the Governor and Legislature to scale back the promised annual increases in school aid.

Foundation aid was established as part of the 2007 state legislation to consolidate and simplify the formula driven state aid components. It was also intended to drive a greater share of state aid to districts with the greatest need. Foundation aid is now the main source of public school funding from the state; last year the DOE received over \$6.1 billion in foundation aid—more than 70 percent of all education funding received from the state.

Under the Governor's Executive Budget, foundation aid growth would be frozen for a third consecutive year. Freezing foundation aid at a time when the city's enrollment is growing makes the freeze effectively a cut. The freeze also delays the date when the full \$3.2 billion increase in state aid promised under the 2007 legislation is achieved until state fiscal year 2016–2017. Similar to last year, the Governor's budget did not call for stretching out the city's target for increasing its support for DOE, and the city is on track to meet the original target.

**Gap Elimination Adjustment.** In addition to freezing foundation aid, the Governor's budget proposes to help deal with the state's budget deficit by reducing the amount of formula-based aid sent to schools. A so-called gap elimination adjustment (GEA)—based on measures of wealth, student need, administrative efficiency, and residential tax burden measures—would be applied to all aid formulas, except for building aid and universal prekindergarten aid. About 34 percent of the value of the GEA for each district would be offset with federal stimulus funds. For the city, the net effect of the GEA would be a \$442 million decrease in state aid for 2011.

**Other Frozen Aid.** Under the Governor's budget proposal for the upcoming school year, universal prekindergarten funding, another critical aid stream, would continue to be frozen. Universal prekindergarten money funds half-day classes for students who are 4 years of age. A portion of DOE's allocation is used for contracts with community-based organizations. Prekindergarten enrollment in DOE facilities was projected by the Mayor's budget office at about 22,000 students with possibly another 33,000 at community-based organization sites for the 2009–2010 school year. Last year the DOE received over \$213 million to conduct its own prekindergarten classes.

Other aids will also be frozen under the Governor's budget, including supplemental excess cost aid for special education and a small amount for the academic enhancement grant.

**Special Education Funding.** The Governor's Executive Budget includes new criteria for the reimbursement of special education services for students in summer school that results in a reduction in state support for special education programs. Because the mandates to provide the services would remain, the city would have to make up the difference using its own funds. Reimbursement from the state for providing these mandated services would be tied to wealth-based aid ratios. The state budget office estimates that the Governor's proposal would shift \$50 million in expenses from the state to the city in 2011.

## AMENDED PLAN FOR NEW SCHOOL SEATS: MORE, BUT LATER

The School Construction Authority, the body that manages education capital projects for the Department of Education, maintains its own five-year capital plan as mandated by state education law. The current plan for fiscal years 2010 through 2014 was adopted in June 2009. The five-year plan is subject to annual amendment, and beginning in November 2009, the SCA worked on a proposed amendment to the plan, taking into account feedback from the Community Education Councils in each of the 32 community school districts across the city. In February, the proposed first amendment was announced. It was approved by the Panel for Education Policy on February 24<sup>th</sup> and is pending approval by the City Council by the close of this fiscal year.

**June Adopted Capital Plan.** When originally adopted last spring, the 2010–2014 capital plan provided \$11.3 billion for construction and renovation projects for New York City public schools. The budget was divided roughly in half into two categories: Capacity and Capital Investment. Capacity comprised 47 percent of the total budget, and includes New Capacity, Charter and Partnership Schools, and the Facility Replacement

Program. New Capacity projects accounted for over 70 percent of the \$5.2 billion allocated to Capacity. The plan allocated \$6.0 billion (53 percent of the total) for Capital Investment, which includes the Capital Improvement Program (CIP), Children First Initiatives, and Mandated Programs. The Capital Improvement Program and Mandated Programs were allocated over \$2.1 billion each.

**February Proposed First Amendment.** The overall budget in the proposed amendment to the plan increased by about \$400 million to \$11.7 billion, as additional funding from the City Council, the Borough Presidents, joint City Council/Mayoral sources, and the state was recognized. There was a 5 percent increase in Capital Investment bringing the allocation for that part of the plan up to \$6.3 billion. Money was also shifted within the Capital Investment portion, with less money dedicated to the CIP and Children First Initiatives and more money dedicated to Mandated Programs, such as making sure that city schools meet safety regulations and completing projects that were begun under the prior capital plan that covered fiscal years 2005–2009. There was also a 3 percent increase in the amount allocated to Capacity, which would be allocated \$5.4 billion, as more money was dedicated to New Capacity and less money was dedicated to the Facility Replacement Program. Similar to the adopted plan, New Capacity would comprise 34 percent of the total capital budget, the largest allocation to a subcategory in the plan.

**New Capacity.** In the proposed first amendment, 5,183 more seats were added to the 25,194 seats in the adopted plan, bringing the total number of seats funded to 30,377. On net, every borough saw an increase in elementary and intermediate school seats, with more than half of the additional seats going to Queens.<sup>1</sup> Only four districts saw a decline in the number of planned seats—Districts 13 and 14 in Brooklyn and Districts 27 and 28 in Queens. There were no changes made to the 2,671 intermediate and high school seats planned in the adopted plan.<sup>2</sup>

Although the number of new seats increased by over 20 percent, the additional funding for capacity increased by less than \$230 million (6 percent). This difference is partly due to some new seats now expected to occupy preexisting buildings. But more significantly, four projects were funded only for design in the current plan, with construction expected to be funded in the next plan. Therefore, less than 2 percent of the total estimated costs (about \$260 million) for these four projects are accounted for in the current plan. These projects are located in Districts 14 and 15 in Brooklyn and Districts 25 and 29 in Queens. Three of these projects are newly proposed in the amendment, providing 1,660 or about a third of the new

seats. The fourth, in District 14, was scaled back by 126 seats (17 percent) while its cost was scaled back almost completely, from \$74.5 million in the adopted plan to \$920,000 in the proposed amendment. In reality, much of the costs for these four projects will actually be incurred after 2014 as part of the next five-year plan.

The timeline of when seats will begin the design and construction phase, and when they are expected to be completed, has also changed since the capital plan was adopted in June 2009. A few projects will be completed sooner than expected while others have been pushed back.

In the adopted plan, the first new seats were expected in 2012, but some are now scheduled to be completed as early as this year and next. By 2011, 6 percent of the new seats are to be completed. Most notably, two projects were added at Blessed Sacrament in District 30 in Queens to add an elementary school (P.S. 280) that will eventually serve grades K-5 in a former Catholic school building. The first project, providing 199 seats, is expected to be completed by August 2010, in time to open up for grades K-1 in September. The second project, providing 341 seats, is expected to be completed in July 2011. Making use of a preexisting school has kept the estimated cost per seat low, at between \$26,510 and \$47,437, compared to \$116,076 per seat for P.S. 310 in Brooklyn, a school of similar size that is scheduled to be completed about 10 months later. The other project that was pushed up is the high school at Spring Creek in Brooklyn, to be completed in December 2011 as opposed to May 2012 in the adopted plan. In addition, the total estimated cost decreased by almost \$15 million even though the expected capacity remained the same at just over 1,200.

With the exception of these three projects, the timing of when seats are to be completed for all other new capacity projects has

Completed New Seats By Year				
	Adopted Plan		Amended Plan	
	Seats	Cummulative Percent	Seats	Cummulative Percent
2010	0	0%	199	1%
2011	0	0%	1,543	6%
2012	4,075	16%	1,620	11%
2013	7,084	44%	4,459	26%
2014	1,472	50%	1,415	30%
2015	3,845	65%	8,101	57%
2016	4,467	83%	5,925	77%
2017	4,251	100%	5,639	95%
2018	0	100%	1,476	100%
<b>TOTAL</b>	<b>25,194</b>	<b>100%</b>	<b>30,377</b>	<b>100%</b>

SOURCES: IBO; Department of Education 2010–2014 Capital Plan

been pushed back. In the adopted plan, half of the new seats were scheduled to be completed by 2014, but in the amendment, only 30 percent will be completed by then. In the adopted plan, the DOE expected that all new seats would be available by 2017, but that target has also been pushed back to 2018, the expected completion date of two of the four projects not scheduled to begin construction until the next plan.

Similarly, the timing of design and construction starts has been pushed back. In the adopted plan, over half the seats were to have begun the design phase by 2010, but that has been pushed back to 2011 in the amendment. The last of the seats in the current plan to enter the design phase will begin in 2014, as opposed to 2013 in the adopted plan. Similarly, by 2010, 40 percent of seats were expected to be in construction phase in the adopted plan, but that has shrunk to just 20 percent in the amendment. Although the amendment anticipates construction starts to catch up in 2012, with over 7,500 seats to start construction in that year, the latest construction starts have been pushed back to 2015 rather than 2014 in the adopted plan.

**Financing.** The city contribution has increased by 5.9 percent to \$6.0 billion over the five years. The state contribution has increased slightly by 1.2 percent to \$5.7 billion. In 2010, the city is expected to put in slightly more than the state—\$1.5 billion compared to \$1.2 billion. Thereafter, the proportions contributed are expected to be equal. Overall, the city's contribution (51 percent) is expected to be slightly higher than the state's.

**Qualified School Construction Bonds.** In the 2009 calendar year, the city had an additional means to finance the five-year capital plan under the American Recovery and Reinvestment Act—Qualified School Construction Bonds (QSCBs). QSCBs allow state and local governments to issue zero-interest bonds to fund the construction, rehabilitation, or repair of a public school facility, or to fund the acquisition of land on which to construct a school facility. In lieu of interest payments, the bonds provide investors with tax credits. The federal government allocated \$11 billion in 2009 to states and large local educational agencies that have the largest number of children aged 5 to 17 living below the poverty line. States were allocated \$6.6 billion collectively and large local educational agencies were allocated the remaining \$4.4 billion. Of the 100 large local educational agencies, New York City received the largest allocation of almost \$700 million.

Although New York City was expecting to issue QSCBs in the 2009 calendar year to finance the five-year capital plan, none were issued because of the lack of investor appetite for these bonds. Congress has amended the structure of QSCBs in the

jobs bill signed into law by the President on March 18 to make them similar to Build America Bonds, for which the federal government provides a subsidy to the issuer or the investor for 35 percent of the interest payment. Investors generally like this option, as opposed to a tax credit, because of the consistency it offers for interest payments. The bill caps the subsidy at the lesser of the federally set tax credit rate or the bond interest rate.<sup>3</sup> Based on current market rates, this would mean that the government would essentially provide a 100 percent subsidy of the interest payments to the issuer.

The U.S. Treasury and Education Departments also announced the 2010 calendar year allocations for QSCBs on March 17. As in 2009, New York City's 2010 allocation was the largest of any large local educational agency, at \$664 million. Since any unused allocations from 2009 can be carried over to the 2010 calendar year, the city can now issue up to \$1.364 billion in QSCBs in the 2010 calendar year and finance part of the five-year capital plan potentially interest free. The city Comptroller's office intends to issue the QSCBs in multiple bond issues in both Transitional Finance Authority and general obligation debt. The first issue is expected by May.

### **CITY UNIVERSITY: WHILE FUNDING IS EXPECTED TO SLIP, MANDATED COSTS AND ENROLLMENT LIKELY TO RISE**

A June 2008 report by the New York State Commission on Higher Education outlined several proposals for improving both the City University of New York and the state university systems. Key proposals included plans to hire 2,000 additional full-time faculty members statewide over the next five years, to upgrade and expand university infrastructure, and to grant the public universities more autonomy in setting tuition rates as well as in purchasing and contracting.

Under the commission's proposals, funding for ongoing operating expenses and investments in quality upgrades would come from a proposed "New York State Compact for Public Higher Education," which is closely modeled on the "CUNY Compact," a financing plan developed in 2005 by CUNY administrators. Under this plan the new revenues needed for continued improvements at CUNY would come from steady increases in state and city funding, cost-saving efficiency moves by the university, philanthropic sources, student enrollment growth, and regular, relatively modest tuition increases. At least in the short run, however, implementation of this financing plan could be threatened by the recent economic downturn that has contributed to the fiscal challenges currently faced by both the state and city governments. While the compact has never been

officially adopted by the state or city, CUNY officials continue to base their financial planning and budget requests on this model.

**State Budget.** The state and city have different areas of financial responsibility within the CUNY system. The state generally funds the four-year degree programs plus the graduate and professional schools, while both the state and city contribute funds to the community colleges.

In recent years CUNY's quality improvement initiatives have been aided by a significant uptick in state funding support, reversing what had been a long-run downward trend. From state fiscal year 1988-1989 to 2003-2004 total state aid to CUNY decreased from \$725 million to \$719 million in spite of rising costs. Adjusted for inflation, this represented a 43 percent decline in state funding over this period. Over the next five years, however, state aid increased by significant amounts each year, reaching \$1.3 billion in 2008-2009. During this period inflation-adjusted annual growth averaged about 10 percent. The state's Adopted Budget for 2009-2010, reflecting a more difficult fiscal outlook, broke with this upward funding trend. When combined with midyear budget reductions, state funding for CUNY decreased by \$82 million from last year to \$1.236 billion in the current year. The senior colleges saw a reduction of \$92 million or 8.1 percent while state funding for the community colleges increased by \$10 million or 5.5 percent. This increase for the community colleges, however, was only made possible by the inclusion of \$18 million in federal stimulus funds; without the stimulus funds the state allocation would have decreased by \$8 million.

In order to offset these reductions, the state approved a CUNY request for a tuition increase, the first since 2003-2004. Beginning in the fall of 2009, tuition for full-time, in-state undergraduate students at the senior colleges increased by \$600 per academic year, from \$4,000 to \$4,600. This increase, along with rising student enrollment, has provided the senior colleges with an additional \$116 million in tuition revenues, resulting in an overall revenue increase of \$24 million after accounting for the decrease in state funds. (A similar tuition increase for the community colleges was included in the city's Preliminary Budget.)

The reduction in state funds coupled with a significant increase in tuition diverges from the formula presented in the CUNY Compact, which proposed steady annual increases in public funding combined with more modest regular tuition increases. Instead, tuition was held flat for the first three years of the plan, and then increased by 15 percent in the fourth year. This pattern of tuition freezes followed by sudden, substantial increases has characterized CUNY's funding history over the

last two decades. On the other hand, the 2009-2010 state budget did implement a key proposal in the compact by allowing the university to keep a portion of the tuition increase for quality improvements. In previous years tuition increases went solely to offset cuts in state funds.

The state's continuing fiscal difficulties are reflected in the Governor's 2010-2011 Executive Budget proposals for CUNY, which would increase overall state funding by a modest \$16 million or 1.3 percent. State funding for the senior colleges would increase by \$18 million or 1.7 percent, while state aid to the community colleges would decrease by \$1.8 million or 1.0 percent. The proposed budget would also deny CUNY's request for a 2.0 percent tuition increase.

While providing for a second consecutive year of reduced state aid for CUNY, the Governor's Executive Budget proposes legislative action to grant more autonomy to CUNY and the state university system in administrative and fiscal decision-making. Of particular significance is a proposal to grant the public universities the authority to raise tuition, subject to a predetermined annual cap, and to spend the resulting revenues without having to seek the approval of the Legislature. The proposal would also allow the universities to implement differential tuition rates for programs and campuses within their systems. If enacted, this proposal has the potential to significantly alter CUNY's funding pattern in future years.

**City Budget.** The city's 2011 Preliminary Budget includes budget cuts that reduce city funding for CUNY by \$9.5 million in city fiscal year 2010 and \$15.4 million in 2011. These reductions come on top of previous baselined reductions that have been restored only for 2010. As a result, the 2011 Preliminary Budget includes a reduction of \$23 million or 9.4 percent in city funds for the community colleges compared to the current year. The budget assumes that CUNY's request for a 2 percent tuition increase will not be approved by the state.

The city budget for CUNY also includes funding for programs other than the direct operation of the community colleges, such as the Vallone Academic Scholarship program. Many of these programs have historically been funded one year at a time. Because funding for these additional programs has not yet been added for 2011, the overall level of city funding for CUNY for 2011 is projected to be about \$35 million below that for 2010. This situation is not that unusual for this point in the budget cycle; CUNY is generally not fully funded until the Adopted Budget. Over the last two years, however, with the city's fiscal situation beginning to deteriorate, not all of the programs were funded at prior-year levels when the final budget was adopted.



**Combined Effect.** While the state and city budgets for next year have not been finalized, the combined effect of proposals in the state Executive Budget and city Preliminary Budget would result in a reduction of \$7 million (0.3 percent) from the current year in total CUNY operating funding. While a small decrease in percentage terms, the effect of the funding reduction would be magnified by the need to cover about \$90 million in mandatory cost increases such as collective bargaining and fringe benefits. In addition, funding will need to be stretched to cover what is likely to be a significant increase in student enrollment. Total fall

enrollment for this year increased by 6 percent to 259,000 from 244,000 the previous year, the continuation of a decade-long upward trend.

#### ENDNOTES

<sup>1</sup>These are seats in intermediate schools that generally serve students in prekindergarten through eighth grades.

<sup>2</sup>These intermediate seats generally serve students in grades six through twelve.

<sup>3</sup>The federally-set tax credit rate is updated daily by the U.S. Treasury Department based on outstanding bonds from the previous business day with a similar maturity and a credit rating between A and BBB.



## SOCIAL, COMMUNITY SERVICES, AND PUBLIC SAFETY

### PUBLIC ASSISTANCE GRANT SPENDING EXPECTED TO RISE SIGNIFICANTLY

The Preliminary Budget projects that total cash assistance grant spending will be \$1.6 billion in 2010, an increase of 19 percent over 2009, and remain at roughly that level for the remainder of the Financial Plan. This represents the largest annual increase in the budget since welfare reform began in the mid 1990s. In order to fund this higher level of spending, the budget adds \$180 million in funds from all sources in 2010, \$271 million in 2011, and about \$300 million in each of the remaining years of the plan.

**Increase in Basic Grant.** The bulk of welfare expenditures are for the traditional grants that cover basic expenses, shelter, and utility costs. These costs are projected to grow significantly, reaching \$1.3 billion in 2010 and increasing to \$1.4 billion in 2013. This increase will result in part from an uptick in the welfare caseload. The current economic downturn has interrupted the long-term downward trend in the public assistance rolls. From September 2008 to December 2009 the number of city residents receiving cash assistance increased by 24,000, from 334,000 to 358,000. The Preliminary Budget projects that the number of recipients will reach 362,000 by June 2010 before leveling off. This forecast might prove to be too conservative; IBO projects that the number of cash assistance recipients will peak at 379,000 in December 2010. If the IBO forecast proves to be correct, spending in 2011 would exceed the Preliminary Budget by \$57 million in total funds, including \$25 million in city funds.

In addition to caseload increases, public assistance expenditures are being pushed upward by a state mandate to increase the size of the basic grant. After being frozen for nearly two decades, the state increased the basic grant by 10 percent in July 2009. Similar percentage increases are scheduled in July 2010 and again in July 2011. While the state's 2010–2011 Executive Budget proposes to spread out the remaining increases over four years rather than two, the Mayor's Preliminary Budget assumes that the grant adjustments will take place at the more rapid pace prescribed in current law. In order to limit the impact of this mandated increase on local budgets, the state has agreed to cover the local share of the incremental costs through 2012, using state and federal funds. Starting in 2013, however, the city will be responsible for its share of the costs, adding significantly to the city's welfare expenditures from that point on.

**More Rent Subsidies.** A second factor driving the cost increases

is the Advantage Rental Assistance program, which provides rent subsidies for up to two years to families and individuals moving out of the city's shelter system. The program is administered by the Department of Homeless Services although the rent subsidies are paid from the cash assistance budget at the Human Resources Administration. The city is responsible for about a third of the program's costs with federal and state funding accounting for the rest. To initially qualify, a client must have lived in a shelter for at least 90 days and be receiving cash assistance while working at least 20 hours per week. Clients who eventually earn too much to retain eligibility for public assistance but whose income remains within program limits can continue to receive the rent subsidy.

As the shelter population has increased, the Advantage program has emerged as a key component of the city's strategy for reducing homelessness. Currently, there are about 13,000 households receiving rental subsidies. While the program offers an effective strategy for moving people out of shelters, its cost is growing rapidly. In 2009 the city spent \$122 million in total funds on Advantage subsidies; the Preliminary Budget projects that spending will increase to \$188 million in 2010 and \$207 million in 2011. While the Preliminary Budget assumes that expenditures will level off after that point, it is likely that the program will continue to expand as the supply of federal Section 8 vouchers and other forms of subsidized housing continues to stagnate, and large numbers of families and individuals continue to enter the shelter system. Because the city pays a part of the program costs, any further expansion would result in direct costs to the city budget. (See page 47 of this report for more details on the Advantage programs.)

**Back to School Grants.** A third factor driving the increase in grant outlays is the new Back-to-School grant program announced by Governor Paterson last August, which makes use of federal stimulus funds to provide one-time grants of \$200 per child for families receiving public assistance or food stamp benefits, to purchase school-related clothing and supplies. The state became eligible for the federal funds when philanthropist George Soros provided the required 20 percent matching funds. The city has budgeted a total of \$102 million for Back-to-School grants for 2010 to cover grants that were distributed this school year. The program is not expected to be repeated in later years. No city funds are required.

**Effect on the Availability of TANF Funds.** In addition to the direct costs to the city, the significant increase in public assistance grant expenditures could further limit the amount of

federal Temporary Assistance for Needy Families (TANF) dollars that the city uses to fund various social programs. Under the 1996 federal welfare law, New York State receives \$2.4 billion in TANF block grant funds each year. These funds are used to pay for the federal share of Family Assistance grants, with the remainder available to pay for other programs aimed at helping low-income New Yorkers. With the size of the block grant frozen at its 1996 level, however, its inflation-adjusted value has decreased over the years by more than a third. As a result, these other TANF-funded programs are competing for a shrinking pool of resources.

The projected increases in grant costs mean that even fewer TANF dollars will be available for the social programs that have come to rely on this funding source. Evidence of this can be seen in the TANF plan included in the state Executive Budget, which proposes to stop funding a number of programs that previously received TANF funds. Of particular significance to the city, the plan would provide no TANF funds for the Summer Youth Employment Program (SYEP). Over the years the city's SYEP has relied on TANF for a significant portion of its funding. The loss of TANF funds could result in a far smaller youth employment program this summer. (See page [next page](#) for more details on the summer jobs program.)

## **CHILD CARE FUNDING AND CAPACITY DECREASE**

The Administration for Children's Services (ACS) provides early childhood education through the federally funded Head Start program and subsidized child care programs for eligible families. As of December 2009, the city provided child care to about 101,000 children, down about 4 percent from the same time last year, and down more than 5 percent from a peak of more than 106,000 children in 2007.

Over the last few years, ACS has been working to reduce the size of the child care budget as child care costs have increased and federal child care funding has stagnated. During the last fiscal year, the agency made a number of proposals to reduce child care spending. Prominent among these were proposals to reduce the number of vouchers available for low priority child care, and to transition 5-year-olds from ACS child care centers to Department of Education kindergarten classes. When the budget for this year was adopted last June, enough funding was added to the 2010 budget to restore some of the low priority child care vouchers and to avoid closing classrooms at child care centers, although the rooms would be used for younger children rather than 5-year-olds.

The 2011 Preliminary Budget includes additional proposals to

reduce child care spending. ACS is proposing to close 16 child care centers. The targeted centers were selected in part because of their relatively high costs of operation. These closures are expected to decrease capacity in the subsidized child care centers by more than 1,100 slots. While capacity will be permanently reduced, ACS suggests that there are enough vacancies at nearby centers to absorb the affected children. If this assumption is borne out, the action should not result in a decrease in enrollment from current levels. The capacity reduction is expected to save \$9 million in 2011 and \$16 million in future years. In addition to these classroom closures, ACS has reduced its funding for maintenance of child care centers by \$2 million (38.5 percent) in 2011 and \$1 million (19.2 percent) in the out-years.

Even while proposing new reductions for 2011, the Preliminary Budget adds another \$8 million for 2010 to further restore "priority level 7" vouchers that ACS had proposed eliminating last year. Priority level 7 child care is for children whose families are referred by non-ACS social service agencies and whose social service needs are not dependent on work status. The combination of restorations for 2010 and new reductions for 2011 have resulted in a significant funding disparity between the two years; under the Preliminary Budget, the city-funded portion of the budget for child care for next year would be \$38 million lower than this year, a decline of 12.7 percent.

## **CASELOADS TO RISE FOR CHILD PROTECTIVE WORKERS**

The Preliminary Budget includes a proposal to reduce ACS's child protective staffing by 202 through attrition. This includes the elimination of 160 child protective specialists responsible for investigating reports of child abuse and neglect and assessing the risks to children. While recent cuts were directed at supervisors or other staff, this one directly affects frontline workers and will result in growing caseloads.

The staffing reduction is expected to increase caseloads for child protective specialists from about 9.5 to 11. According to the Mayor's Management Report (MMR), the target caseload is 12, so the city would still be below this target. This cut is expected to save nearly \$6 million in city funds; after accounting for the loss of matching state and federal funds, total spending would be reduced by nearly \$14 million annually beginning in 2011.

Child protective services staffing has increased in recent years, and while caseloads, as reported in the MMR, have been below the city's target since 2008, the average caseload was 14.9 as recently as 2007. The proposed reduction in frontline workers has raised concerns among child welfare advocates that these

staffing cuts may mark the start of an upward trend in caseloads. They also note that caseloads in individual ACS offices can vary significantly from the citywide average.

### NEARLY A THIRD OF CITY SENIOR CENTERS COULD CLOSE DUE TO STATE FUNDING SHIFT

The Preliminary Budget assumes that federal Social Services Block Grant (Title XX) funds will continue to be available to help pay for the operation of the city's 301 senior centers, an assumption that could be threatened by a proposal in the Governor's Executive Budget. New York City receives about \$65 million annually in Title XX funds, of which nearly \$40 million is used to provide mandated services, including domestic violence and adult protective services. The remainder, about \$25 million, is discretionary funding for social services that the city has traditionally allocated to the Department for the Aging (DFTA) to fund senior centers.

The Governor's Budget includes a change in the formula that would mandate all Title XX funds be directed to domestic violence and adult protective services programs, replacing state and local funds for these services. While the city would no longer have to put up matching funds for these programs, the savings would be only about half of the funds that were previously available for senior center operations. The Bloomberg Administration has not indicated how much, if any, of the city money freed up from funding mandated services would be shifted to the centers.

This change would result in a loss of \$25 million to DFTA's senior center budget and would likely lead to the closure of many senior centers throughout the city. The department has estimated that in a worst case scenario, approximately 100 senior centers would close along with a loss of 6,000 meals a day provided at those centers.

### SUMMER JOBS AND AFTER-SCHOOL PROGRAMS FACE CUTS

The Mayor's Preliminary Budget for 2011 includes proposed budget reductions to the city's summer jobs and after-school programs administered by the Department of Youth and Community Development (DYCD) totaling \$11.2 million, actions that could result in significantly fewer youth participating in these programs.

**Summer Youth Employment Program.** DYCD's Summer Youth Employment Program (SYEP) is a seven-week summer employment initiative that serves youth between the ages of 14

and 24. Participants work up to 25 hours a week while earning \$7.25 per hour in assignments that include government agencies, hospitals, summer camps, nonprofits, small businesses, and retailers.

Last summer, federal stimulus funding was used not only to offset planned cuts to SYEP but also to create additional slots, enabling the summer jobs program to serve about 52,000 participants, the highest number of youth served in more than 10 years. Stimulus funds made up 40 percent of last summer's \$67.5 million budget.

This summer's program looks to be smaller. With the city and state continuing to face budget constraints, additional cuts to this program have been announced. The city is proposing to cut nearly \$1 million for fiscal year 2011, which would result in 662 fewer city-funded slots. More significantly, the Governor's Executive Budget proposes to eliminate \$35 million in Temporary Assistance to Needy Families funds for SYEP statewide; last summer the city received about \$19 million of this allocation. As a result of these proposed cuts and a much smaller amount of federal stimulus money for this year, the city's SYEP program this summer has a proposed budget of about \$25 million, enough funding to serve approximately 17,200 youth, about 35,000 fewer than last summer.

**Beacons.** DYCD supports 80 Beacon community centers located in public schools. These centers operate six days a week (42 hours) in the afternoon and evenings, including weekends, school holidays and during the summer. Beacons provide a range of activities for young people and adults, such as tutoring, college prep, basketball, martial arts, general equivalency diploma training, and English for Speakers of Other Languages programs.

#### Declining Jobs Program Funds

*Dollars in millions*

Sources of Funding	2009	2010
City Tax Funds	\$13.8	\$13.0
State	19.5	0
Federal Workforce Investment Act	3.0	3.2
Federal Community Service Block Grant	3.0	1.2
American Recovery and Reinvestment Act	28.2	7.4
<b>TOTAL</b>	<b>\$67.5</b>	<b>\$24.8</b>

SOURCE: IBO; Department of Youth and Community Development 2009 Summer Youth Employment Annual Summary.

NOTES: American Recovery and Reinvestment Act funds were distributed through Workforce Investment Act and Community Service Block Grant Programs. Summer 2010 only includes \$7.4 million in additional Community Service Block Grants money.

The Mayor's Preliminary Budget proposes to cut the contracts of 66 of the 80 Beacons by 6 percent in 2010 (\$1.6 million) and 7 percent in 2011 (\$2.7 million.) Only the 14 Beacon programs funded with federal money are exempt from this cut. In addition, the Preliminary Budget includes a proposal that would eliminate planned enhancements to 11 consolidated Beacons/Out-of-School Time (OST) middle school programs.

Beacon programs have relied on discretionary funds added by the City Council each year during the budget adoption process to help pay for the cost of keeping schools open during off hours (\$50,000 per Beacon); these costs are not included in the city's baseline funding for Beacons. In the last two years, the Council has added only a portion of the \$4 million cost, leaving the Beacons to make up the difference. Given the fiscal problems facing the city, it is not clear how much discretionary funding will be added for 2011.

**Out-of-School Time.** The department's OST program provides activities for school-age youth during after-school hours, on weekends and during school vacations. All OST programs are offered at no cost to participants and provide a mix of academics, recreational activities, and cultural experiences for elementary, middle school and high school students. OST service providers operate mostly in public schools and in facilities of the parks department and the New York City Housing Authority.

The Preliminary Budget contains proposed reductions that would have a significant effect on the OST program. The total budget for OST in 2011 is approximately \$101.8 million, 70 percent of it city funds. OST's budget includes proposals that would reduce the budget by \$2.0 million in 2010 and \$7.5 million in 2011 and subsequent years. The cut would result in the elimination of 33 school-year programs providing slots for 4,110 elementary and middle school students. It would also end summer services at 30 middle schools (1,940 slots). Currently, there are 507 OST programs that provide about 61,000 school year slots and 23,000 summer slots.

An even larger effect on services would result from a previous budget action. The January 2009 Preliminary Budget for 2010 included a proposal to eliminate OST Option II, which contracts with 91 providers who supplement public support with 30 percent private matching funds to serve about 10,750 elementary, middle school, and high school youth. DYCD later received about \$14 million in federal stimulus funds distributed through the Community Service Block Grant that enabled the program to continue for the current fiscal year. The stimulus money expires in September 2010 and the contracts in August, with no plan to renew them.

## AGENCY MERGER BEGINS JUVENILE JUSTICE REFORM INITIATIVE

During his State of the City speech in January, the Mayor announced an initiative to overhaul the city's juvenile justice system. This initiative intends to change the focus of the city's juvenile justice system from a punitive model to a model with greater focus on providing services to youth and their families in their communities.

The first step, which was effective immediately, was to merge the Department of Juvenile Justice (DJJ) and the Administration for Children's Services. Pending a formal merger, ACS Commissioner John Mattingly will oversee both agencies. ACS will continue to work with its sister agencies, the Criminal Justice Coordinator and the Department of Probation (DOP), which also play roles in determining whether or not a child enters the juvenile justice system. DOP oversees Esperanza, a community-based alternative-to-incarceration program and runs the Enhanced Supervision Program, an alternative-to-placement program.

**Changes and Savings.** A new division was created at ACS, the Youth and Family Justice Division. Currently, ACS is conducting an analysis of both the DJJ and ACS administrative functions. It is expected that by June one administrative arm will serve both agencies. At a City Council hearing in early February, Commissioner Mattingly said that there will be no change in program staff, although changes will most likely occur to the administrative units of both agencies as they are merged. He offered assurances that no DJJ programs would be interrupted during this transition. The Commissioner mentioned that a data sharing project between ACS and DJJ found that about one-third of the youth in DJJ have an open case with ACS, an example of the overlapping populations served by the two agencies.

The Administration for Children's Services' new Youth and Family Justice Division will bring together programs from both ACS and DJJ. Included in this division will be the ACS Juvenile Justice Initiative and the Person in Need of Supervision family assessment program, as well as all of the programs brought over from the Department of Juvenile Justice.

The Mayor's Preliminary Budget includes a proposed reduction that is associated with savings from the merger of ACS and DJJ, amounting to \$4.7 million in 2011 and \$5.2 million in later years. About half of the savings are in city funds. The budget would reinvest \$1.8 million of these savings each year in expanded Alternative-to-Detention programs.

Another change that is related to the mayor's juvenile justice reform initiative is the hiring of a Commissioner for the Department of Probation. Previously, the Department of Probation and the Department of Corrections shared a Commissioner. In addition, DOP and ACS have been working on a memorandum of understanding that will allow DOP to obtain state funds for Esperanza through ACS, using the State Preventive Services revenue stream that ACS uses for its Juvenile Justice Initiative. This funding stream provides a 65 percent state match. As a result of this interagency cooperation, the Preliminary Budget projects savings of about \$1 million in city funds in 2010 and about \$2 million in later years.

**Funding Issues.** Despite the drop in the number of young people sent to state-run facilities, the cost to the city has not decreased. The city reimburses the state for 50 percent of the cost of placement, at a per diem rate set by the state. In recent years as the number of youth incarcerated has declined, the state has been slow to adjust capacity in the system, and many of the basic costs of the centers remain fixed. This has contributed to the steady growth in the per diem rate, even as the number of youth incarcerated declined. Between 2002 and 2009, the rate increased from \$308 to \$538 per youth per day.

Although alternative programs are less costly than sending young people to upstate facilities and both the city and the state benefit from these savings, the city pays 100 percent of their cost. Legislation has been introduced in Albany that would require New York State to reimburse counties for 65 percent of the alternative program costs.

**State Changes.** Over the last few years several reports by the U.S. Department of Justice, the Civil Liberties Union, and Human Rights Watch, as well as a report by the Task Force on Transforming Juvenile Justice appointed by the Governor, have documented the failings of the juvenile justice system in New York State. In response to these reports, the state Office of Children and Families Services has begun closing underutilized detention facilities.

Also in response to these findings, the Governor's Executive Budget proposes to add \$18.2 million to increase staff-to-youth ratios and improve medical and mental health services to youth in state facilities. It also would close three additional detention facilities, saving the state \$14 million annually beginning in 2011–2012. There are no provisions,

however, for encouraging the use of alternative programs by providing a state match for local government expenditures on these programs.

**VARIOUS HEALTH PROGRAMS FACE CUTS**

The Preliminary Budget includes funding reductions of about \$15 million for health programs run by the Department of Health and Mental Hygiene that will likely have some effect on the direct services the department provides to New Yorkers. These effected services include Animal Care and Control, correctional health, school health nurse coverage, mental hygiene contracts, and tuberculosis clinic services. Some of the services the department provides are mandated by law, including animal sheltering and clinical services in some schools, correctional facilities, and mental health settings. Other services, such as transitional health planning for inmates, family planning in schools, and depression screening, are optional extensions to the health services already provided by the department.

Since many of the changes to nonmandated services will be accomplished through contract reductions, the degree to which services will be affected is not fully known. Among the possible outcomes, however, are increased use of euthanasia and longer wait times for processing at Animal Care and Control shelters, reductions in ancillary correctional health services, and decreases in substance abuse prevention. Among the more certain outcomes, tuberculosis clinics in Jamaica and Bushwick would close with patients redirected to nearby locations for care.

**School Nurses** At present, Local Law 58 requires DOHMH to provide nurses to all public schools and any private school with over 200 students that requests the service. The Preliminary Budget proposes to trim \$4.3 million out of the 2011 school health budget by eliminating nurse coverage for schools with fewer than 300 students through the attrition of 62 full-time equivalent

<b>Proposed Reductions to Selected Health Programs</b>		
<i>Dollars in thousands, all funds</i>		
	<b>2010</b>	<b>2011</b>
Mental Hygiene Contracts	\$(2,400)	\$(7,214)
School Health Nurse Coverage	-	(4,277)
TB Clinics & Healthcare Services and Layoffs*	(592)	(1,799)
Correctional Health Layoffs	-	(1,245)
Animal Care and Control	(316)	(456)
<b>Total direct service reductions</b>	<b>\$(3,308)</b>	<b>\$(14,991)</b>
<b>TOTAL value of all DOHMH Gap Closing Actions</b>	<b>\$(18,764)</b>	<b>\$(37,865)</b>
SOURCES: IBO; Mayor's Office of Management and Budget		
NOTE: *Excludes handicapped children's service spending reductions, which will not result in service reductions.		

nurses. The proposal requires a change to existing law, and if accomplished, the department estimates that 19 public schools and 127 private schools will be left without nursing coverage.

**Early Intervention Program.** The Governor's Executive Budget includes proposals that would affect the funding of the largest program at DOHMH, the Early Intervention Program, potentially producing savings for both the city and state. One proposal would modify Public Health and Insurance law to deem the individual family service plan that is prepared for Early Intervention clients sufficient to meet the medical necessity requirements needed to authorize delivery of Early Intervention services. This change would prohibit insurers from denying payment due to lack of authorization.

A second proposal would require providers billing more than \$500,000 in Early Intervention services annually to bill Medicaid directly. A third would impose a copayment ranging from \$45 for families with incomes between 251 percent and 400 percent of the federal poverty level to \$540 for family incomes above 1,000 percent of poverty. Early Intervention services are currently provided to all families free of charge, and the proposal could make some families less likely to seek services due to the new out-of-pocket costs they would face.

Additional administrative actions would produce savings by standardizing the assessment tools used by evaluators, tightening the threshold for receiving speech services, and allowing paraprofessionals to provide behavioral health services. The state estimates that, taken together, the proposals would save New York City \$16.4 million in 2011.

## PUBLIC HOSPITALS FACE BIG JUMP IN DEFICITS IN 2011

The city's Health and Hospital Corporation (HHC), like many New York area hospitals, is struggling to cope with rising expenses and declining revenues. In 2010 the corporation projects that its total operating expenses will exceed revenues by \$796 million. In 2011, revenue, which includes third-party payments from private and public insurers, state charity pool payments, grants, intracity transfers,

and funds appropriated by the city, is expected to fall by 7 percent. At the same time, expenses including personnel costs, medical malpractice payments, affiliations, depreciation, and postemployment benefits, will grow by 3 percent. After factoring in non-operating revenue and expenses, the corporation expects its budget gap to grow by 86 percent in 2011 and increase further in subsequent years. HHC expects to fill these operating shortfalls through a variety of corrective actions—only some of which have been identified—and by drawing down various reserves including previous cash balances. These actions may include a reduction in staffing of up to 2,600 in the coming year.

HHC is the largest provider of uncompensated care in New York City, which accounts for much of its financial strain. In recent years, HHC has been serving an increasing number of patients without insurance—452,580 in 2009, up 14 percent since 2006. The corporation estimates that it spent \$492 million caring for these patients, spending that is only partially offset by payments from the state's uncompensated care pools. HHC expects to receive large, retroactive Disproportionate Share Hospital (DSH) and Upper Payment Limit (UPL) lump-sum payments in 2010 but similar payments are not expected to reoccur in future years, explaining much of HHC's projected revenue decline in 2011. At the same time that HHC's revenue is declining, operating expenses are increasing. The pension costs and health insurance costs that HHC pays for its own employees have grown by 49 percent and 27 percent, respectively, since 2007.

The state Executive Budget proposals for containing the state's health care spending include a host of changes that would reduce HHC's patient reimbursements. According to HHC, the actions would result in annual cuts of \$66 million to \$74 million from its hospitals, \$600,000 from home care, and \$15 million in premium revenue from Metroplus, HHC's affiliated health plan. Although the state would also increase payments to nursing

<b>Rising Shortfalls Under Public Hospital Financial Plan</b>					
<i>Dollars in millions</i>					
<b>January Plan - Projected</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
Total Operating Revenues	\$6,380	\$5,915	\$6,014	\$6,124	\$6,174
Total Operating Expenses	7,081	7,298	7,533	7,776	8,029
Total Interest Income and Expense	(95)	(100)	(105)	(110)	(109)
<b>Profit/Loss Before other changes in net assets</b>	<b>(796)</b>	<b>(1,484)</b>	<b>(1,624)</b>	<b>(1,762)</b>	<b>(1,964)</b>
Corrective Actions	251	863	1,092	1,217	1,292
<b>Profit/(Loss) After Corrective Actions</b>	<b>(545)</b>	<b>(620)</b>	<b>(532)</b>	<b>(545)</b>	<b>(672)</b>
Prior Year Cash Balance	234	805	515	355	240
Accrual To Cash Adjustment	1,116	330	372	430	453
<b>Closing Cash Balance</b>	<b>\$805</b>	<b>\$515</b>	<b>\$355</b>	<b>\$240</b>	<b>\$21</b>
SOURCES: IBO; Health and Hospital Corporation.					



homes by \$4 million, HHC estimates that its net loss from these and other smaller changes proposed by the Governor would total between \$78 million and \$94 million annually.

As it has in prior years, HHC counts on a variety of corrective actions to ameliorate its fiscal pains which include state and federal actions and significant savings through unspecified efficiency and restructuring changes. The Financial Plan assumes that the corporation will receive DSH maximization payments of \$300 million each year from 2011 through 2014 to cover indigent care costs. DSH maximization payments are special payments made directly to certain facilities, including HHC, and like other DSH payments, they are authorized at the state level but paid for with half city and half federal funds. Such payments have been included in each of the past two years, but the amount HHC will receive this fiscal year and in future years remain in question. HHC also anticipates that annual state and federal actions, including competitive grants, will bring in \$185 million in 2011 and over \$300 million in each of the later years of the plan. The corporation expects to save \$25 million each year in reduced medical malpractice expenses, as the magnitude of their caseload has declined over time.

Finally, the corporation has hired consulting firms to help identify savings through efficiencies and corporate restructuring initiatives. HHC expects to reduce expenses by \$225 million in 2010 and \$353 million in 2011, with even greater savings in the out-years. Achieving operating savings of this magnitude could require cutting units or departments or broader layoffs.

Even after the corrective actions, HHC forecasts a \$544 million deficit in 2010, which grows by 14 percent the following year. After converting from an accrual to cash basis—unlike the city, HHC reports its financial analysis on a cash basis—the financial picture appears less bleak. HHC expects to maintain positive closing cash balances, totaling \$805 million in 2010, then declining gradually to just \$21 million in 2014. HHC's financial

plan leaves little room for error, however, relying on optimistic assumptions about the corporation's ability to achieve both reduced costs and increased revenues.

### SUBSIDIES REDUCED, LIBRARIES CUTTING BACK HOURS

New York City provides support for general operating and energy costs in the form of a subsidy payment to each of the city's three public library systems: the New York Public Library (NYPL), which operates the branch libraries in Manhattan, the Bronx, and Staten Island; the Queens Borough Public Library; and the Brooklyn Public Library. The city also provides a separate funding stream for the New York Research Libraries which are housed within the NYPL system.

Each system has extensive autonomy in deciding how to budget these funds. When adopting the 2008 budget in the spring of 2007, the City Council and the mayor's office agreed to permanently add funding to the libraries' baseline subsidies, so that all of the branches could provide full six-day service. Not long after that agreement was implemented, the economic downturn led to declines in city revenues and, as a result, the library subsidies were reduced and services affected.

Since January 2008 library subsidies have been reduced in six different financial plans. Each year when the budget was adopted the libraries received a partial subsidy restoration for the new fiscal year, offsetting some of the cuts made in earlier financial plans. This past June, even after the restoration, the net result for the libraries was smaller subsidies in 2010 than in 2009. (The New York Research Library, with the smallest budget, was the one exception.) Further complicating the fiscal situation for library managers is that the subsidies they receive in the Adopted Budget are not necessarily final. In both 2009 and 2010, current-year library subsidies were reduced mid-year. After accounting for the latest reductions proposed in the Preliminary Budget,

### Library Subsidies Could Fall Below 2006 Level

*Dollars in thousands*

	2005	2006	2007	2008	2009	2010	2011
New York Research Library	\$18,154	\$19,034	\$20,087	\$24,326	\$24,976	\$26,975	\$19,453
New York Public Library	94,737	96,464	106,356	117,199	121,992	113,759	94,513
Brooklyn Public Library	70,286	73,841	78,775	87,277	90,558	85,410	71,039
Queens Borough Public Library	66,834	71,802	76,770	85,671	89,178	83,681	69,320
<b>TOTAL</b>	<b>\$250,011</b>	<b>\$261,140</b>	<b>\$281,988</b>	<b>\$314,473</b>	<b>\$326,703</b>	<b>\$309,825</b>	<b>\$254,325</b>
Year-Over-Year % Change	5.7%	4.5%	8.0%	11.5%	3.9%	-5.2%	-17.9%

SOURCES: IBO; Mayor's Office of Management and Budget; New York City Comptroller's Comprehensive Annual Reports for 2005–2009

NOTES: Annual allocations have been adjusted to reflect prepayments.

total library subsidies are projected to decrease by 5.2 percent from 2009 to 2010, and by 17.9 percent from 2010 to 2011.

With the recent cuts, some libraries have already reduced hours or cut service days. For example, current funding levels in Queens have led to a reduced workforce and a decreased book acquisition budget. Only the Queens Central library still provides seven-day service; the branches are all closed on Sundays and half of the branch libraries in Queens are open for only five days of service each week. With the latest reductions in the Preliminary Budget, Queens library officials expect that 48 of their 62 libraries will be closed on weekends by the end of the calendar year. While the Queens library has not had layoffs, it has experienced a cumulative workforce reduction through attrition of about 5 percent since fiscal year 2008. If the proposed additional funding cuts for 2011 become a reality, Queens library officials estimate that they would have to lay off 350 employees, a staff reduction of 38 percent.

Similarly, officials from the New York Public Library report that the most recent cuts to the 2010 budget have reduced service hours in the system from an average of 51 hours per week to 45 hours per week at neighborhood libraries. While six-day service has been maintained, Sunday service is being discontinued at all but four sites. At least one location in each borough served by NYPL (Manhattan, Staten Island, and the Bronx) plus the main Research Library building will maintain Sunday service. Library managers estimate that if the NYPL has to absorb the most recent proposed cuts for 2011 there could be 650 layoffs, almost 32 percent of full-time equivalent positions. Service hours would be reduced to an average of 28 hours per week at neighborhood branches.

**FEWER FIREFIGHTERS, FEWER RESPONSE UNITS**

Under the Preliminary Budget, New York City Fire Department (FDNY) firefighter staffing in 2011 would decline through attrition to 10,401, lower than any year since at least 1980. The impact of this reduction in firefighter staffing would be reflected in two ways.

A total of 20 firefighting units, including 19 engine companies (or “pumpers”) and one ladder company would cease operation in 2011. This initiative would allow for firefighter staffing

to decline through attrition by 500 positions given about 25 firefighters are required to staff each fire company on an around-the-clock basis. The particular companies to be taken out of operation have not yet been publicly identified. Because fire companies often operate out of “dual” houses that contain separate engine and ladder companies under one roof, it is not clear at this point whether any firehouses would be entirely closed. Following implementation of this reduction in fire coverage, a total of 179 engine companies and 142 ladder companies would remain in operation across the city.

Under a separate proposal in this year’s Preliminary Budget, minimum staffing on each of 60 remaining engine companies would be also reduced by one post after January 31, 2011, from five firefighters to four firefighters (along with a remaining supervisory officer). That date marks the expiration of a longstanding agreement between FDNY and the firefighters’ union requiring certain engine companies to be staffed with at least five firefighters as long as the citywide absence rate for firefighters remains at or below 7.5 percent. This reduction in engine company staffing would account for 300 firefighter positions to be eliminated via attrition next year.

**NUMBER OF UNIFORMED POLICE TO FALL, MORE CIVILIANS HIRED**

Under the Mayor’s Preliminary Budget for 2011, the New York City Police Department (NYPD) would decline through attrition to 32,817 by June 30, 2011, which would be the smallest force size in any year since 1990. Classes of new police recruits are to be hired in July 2010 and January 2011 sufficient in size to replace attrition and boost staffing in those months to 34,875 and 34,475, respectively, with force size then expected to fall to 32,817 police officers by the end of June 2011.

Current data from the Mayor’s Office of Management and Budget indicates that because attrition has been slower than expected this year, actual police staffing will likely be well over 34,000 at the close of the current fiscal year rather than the “authorized” staffing figure of 33,217. The Preliminary Budget for 2011 calls for adding \$22 million to this year’s budget to pay for the higher staffing level.

*Four Hundred Additional Civilians to Be Hired Next Year.* Under the Preliminary Budget, 400 of the police officer positions lost through attrition from the NYPD will be replaced by 400 additional civilian police personnel. This would allow for the redeployment of

Firefighter Staffing in Past Years								Proposed Staffing	
1980	1985	1990	1995	2000	2005	2009	2010	2011	
11,374	12,356	11,571	11,186	11,521	11,488	11,459	11,201	10,401	

SOURCES: IBO; Mayor’s Office of Management and Budget  
 NOTE: Figures above are either actual or proposed end-of year (June 30) staffing levels.

**Police Staffing Falls Since 2006**

Police Staffing in Past Years								Proposed Staffing	
1990	1995	2000	2005	2006	2007	2008	2009	2010	2011
31,985	36,429	40,285	35,489	35,773	35,548	35,405	35,641	33,217	32,817

SOURCES: IBO; Mayor's Office of Management and Budget.

NOTE: Figures above are either actual or proposed end-of year (June 30) staffing levels. "Police Staffing" refers to uniformed police personnel of all ranks.

police officers currently working in positions that do not require their specialized skills and training.

The police department acknowledged in September 2009 that over 450 "full duty" police officers were assigned to administrative or other support functions that could instead be performed by less costly civilian personnel. Using civilians in these positions saves the city money because their salaries and fringe benefits, particularly pension costs, are lower than uniformed police personnel. Annual savings from this initiative are expected to grow from \$1.3 million in 2011 to \$13.4 million by 2013, the latter representing average savings of about \$33,500 per position.

**CIVILIAN COMPLAINT REVIEW BOARD STAFFING TO FALL AS COMPLAINTS, CASELOADS RISE**

The Civilian Complaint Review Board (CCRB) investigates civilian complaints concerning alleged mistreatment by police officers and, when appropriate, forwards cases to the NYPD for further review and punishment. Under the Preliminary Budget for fiscal year 2011, the agency's budget would fall to \$9.6 million—about 4.5 percent below the current budget for this year. Agency expenditures last year totaled \$11.3 million.

The proposed decline in CCRB's budget would result in a drop in staffing to a level lower than in any year since at least 2000. While the size of the staff is expected to decline, there is no expectation that the work load will diminish. The number of new complaints against police officers received by the CCRB has been roughly 7,500 a year since 2006, about 50 percent higher than the annual number tallied 10 years ago. If new complaints remain at recent levels while staffing declines, the ratio of complaints per staff member—which has been increasing since

**Further Decline in CCRB Staffing**

	Past Years						Proposed	
	2000	2005	2006	2007	2008	2009	2010	2011
CCRB Staffing	162	184	186	186	179	178	152	156
New Police Misconduct Complaints	5,017	6,358	7,349	7,662	7,488	7,661	--	--
Complaints per Staff Member	31.0	34.6	39.5	41.2	41.8	43.0	--	--

SOURCES: IBO; Mayor's Management Report; Mayor's Office of Management and Budget

NOTE: Staffing figures above are either actual or proposed end-of year (June 30) levels.

2005—will continue to rise.

As the number of cases per staff member has grown, complaints are taking longer to be resolved. According to the Mayor's Management Report, the average number of days needed by the agency to fully investigate allegations of police misconduct increased from 291 days in 2007 to 343 in 2009.

Recently the CCRB and NYPD announced that they have come to an agreement on a pilot program which will allow CCRB attorneys rather than NYPD lawyers to serve as lead prosecutors for some cases involving substantiated cases of police misconduct, although whether and how a police officer is disciplined remains the prerogative of the police Commissioner.

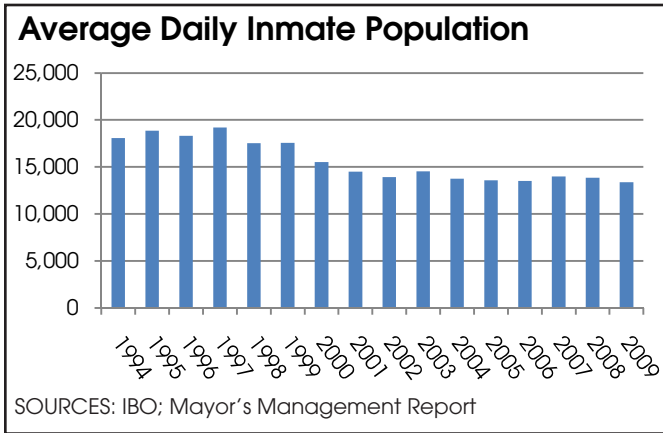
**PLAN TO REDUCE INMATES IN CITY JAILS DELAYED**

The average daily population in New York City jails has continued to decline. In 2009 the average daily population was 13,362—the lowest in recent years and a decrease of 488 inmates per day from 2008. For the Department of Correction to achieve the planned savings in the Preliminary Budget for 2011, the population would need to decline by substantially more.

In the November 2009 Financial Plan, the Department of Correction proposed housing certain city inmates in state prisons. According to the proposal, the department anticipated reducing the average daily population by 1,200 inmates, which would allow it to close one of the jails on Riker's Island and save \$18.8 million in 2010, increasing to \$25.3 million by 2012. As the plan has not yet been implemented, the Bloomberg Administration restored \$17.1 million in city funding to the department's 2010 budget, but left the targets for 2011 and 2012 in place. Yet implementation in the future is not certain. While necessary state legislation allowing city inmates to be housed in state prisons was passed, the city and state have not agreed on the rate that the city would pay the state to house its inmates.

This could continue to be an impediment to the city realizing the budgeted savings.

Two other proposals to reduce city spending on jails have been rejected by the New York City



Board of Correction, which sets the minimum standards for the city's jails. In the 2010 Preliminary Budget, released in January 2009, the Mayor proposed reducing the number of scheduled recreation days for inmates from seven days per week to five days a week (the total number of hours of recreation would remain constant). The second proposal was to compress the weekly visitation schedule from five days to four days a week (the total number of visits permitted per inmate would remain constant). Both proposals failed to get the required approval from New York City Board of Correction. As a result, \$7.4 million in city funding has been restored to the 2010 budget. However, the Bloomberg Administration plans to seek the board's approval again to implement the proposals next year, and funding has not been restored for 2011.

The Mayor and City Council will likely need to increase the Department of Correction's budget by over \$26 million for 2011, and possibly more in 2012, if the savings from these plans once again cannot be realized.

### **CITY PLANS TO BEGIN HOUSING FEDERAL DETAINEES**

In the 2011 Preliminary Budget, the Department of Correction is planning to receive nearly \$4.1 million in 2010 and over \$16.4 million annually thereafter in federal funds for providing detention services for individuals in the custody of the United States Federal Marshals and United States Immigration and Customs Enforcement Agency. The department anticipates that 300 beds a day will be utilized by federal agencies. In some instances, federal officers may staff dorms of federal inmates within city facilities.

This plan to increase the number of beds being used comes at a time when the department is in the midst of a plan to reduce overall capacity in the city's jails. Creating a new population of inmates that use the city's jails may create financial incentives to keep open jails that would have otherwise closed, although the scale of this initiative is such that only a few dorms would be needed, not an entire facility. The program will benefit the city by introducing a new stream of revenue to support the operations of the city's jails, which are almost exclusively funded by city funds.

## HOUSING, ENVIRONMENT, AND INFRASTRUCTURE

### NONMANDATED SERVICES FOR THE HOMELESS FACE CUTBACKS

After reaching record high numbers of people in the family shelter system in 2009, the homeless population in New York City has continued to rise in 2010. According to the *Citywide Performance Report*, there was a 21 percent increase in the number of families with children and a 4 percent increase in the number of single adults entering shelter in the first six months of 2010 compared to the same period in 2009; the average daily population in the shelters increased by 11 percent in the family shelters and 8 percent in the single adult shelters during the same period. The rising shelter population combined with the tightening of city and state budgets has led the Department of Homeless Services (DHS) to focus attention on the responsibility mandated by city and state law to house those who seek shelter, and concurrently reduce funding for nonmandated programs.

For example, services for the street homeless have been reduced, generating about \$3.4 million annually in savings. In the January 2010 Preliminary Budget for 2011, the agency proposed eliminating funding for 40 Safe Haven beds and 50 Stabilization beds for annual savings of \$1 million. Safe Haven beds provide a low-threshold alternative to shelter for chronically street homeless adults who need supportive services to transition from the street to housing. Safe Haven beds apply a “housing first” model with fewer rules than in a shelter; for example, there is no curfew and no sobriety requirements for entrance. Stabilization beds are also for chronically homeless adults and an alternative to shelter, but they provide a lower level of support services than Safe Haven beds. Under the proposed budget, the 40 Safe Haven beds would become beds for homeless single adults who have entered the city shelter system in the traditional manner,

generating savings because shelter beds cost less to operate than Safe Haven beds. While the city will continue to add more Safe Haven and Stabilization beds, it will do so at a slower pace. With 377 Safe Haven Beds currently online, the city is already behind its target to have 500 Safe Haven beds open by June 2009.

An additional change to programs for the street homeless is the announcement that the city will close one drop-in center in Manhattan, the Open Door, for a savings of \$2.4 million a year. Drop-in centers provide a place for street homeless men and women to rest, clean their laundry, have a meal, and connect to social services. Five drop-in centers will remain in operation, two of which are in Manhattan.

These reductions come at a time when the street homeless population is increasing. DHS's annual census of the homeless population found that the approximate number of people living on the streets and subways increased 34 percent from 2,328 in 2009 to 3,111 in 2010.

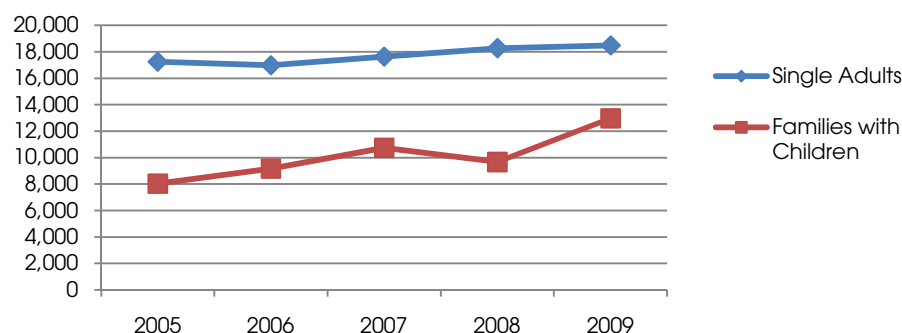
Additional reductions in the family and single adult shelter system include elimination of employment specialists serving families with children and elimination of funding for medical services in 12 adult shelters that do not serve clients with severe medical or mental health needs. When fully implemented these two changes would save the city \$2.1 million a year.

There will also be across the board reductions for contracted providers for all shelters. Shelters that serve adult families—families without children under the age of 21—face a 5.0 percent cut that saves \$703,000 in city funds. Shelters for single adults will have their budgets reduced by 4.2 percent and family shelters will face a 1.4 percent reduction, for combined savings of \$6.3 million in city funds. The rate reductions for family and single adult shelter are in lieu of other reductions proposed but not implemented as part of the budget process last year. In the case of single adult shelter providers, this reduction is a substitute for a performance-based payment plan that had been proposed last year.

### SPENDING INCREASES ON ADVANTAGE PROGRAMS

The Advantage programs, which aim to move families out of shelter and into

**Number of Families and Individuals Entering the Department of Homeless Services Shelter System**



SOURCES: IBO; Mayor's Management Report  
NOTE: Complete 2010 data not yet available.

permanent housing in the community rather than housing them in shelter, are one reason why the number of new entrants to the shelter system increased more rapidly than the average daily population. According to DHS, 146 leases are signed every week under the Advantage programs. The cost of the Advantage programs, which have been successful in moving families into apartments, has risen as the number of participating families has grown. However, with a two-year cap on rental assistance benefits, a shortage of Section 8 housing vouchers, and high unemployment, families in the program are facing challenges in attaining self-sufficiency.

First introduced in 2007, the Advantage programs provide rental assistance to families leaving the city's shelter system. The program serves three distinct groups: working families, families with open Administration for Children's Services cases, and families on fixed incomes. According to the Bloomberg Administration, there are roughly 14,000 families receiving rental assistance through the Advantage program and over 7,500 new families participate in the program every year. The program is funded with a combination of federal, state, and city funds. In 2009 the city spent \$122.2 million on the program and in 2010 the city has budgeted \$188.4 million, a 54 percent increase. The caseload and spending have increased for two reasons: the number of families entering and leaving shelter has increased and the program is now fully implemented.

The Work Advantage program provides rental assistance for families where the head of household works at least 20 hours a week and the family's income is at or below 150 percent of the federal poverty line. Families participating in Work Advantage are assisted by DHS in locating apartments in the community. DHS then pays the landlord a set rent and the tenant pays \$50 a month to the landlord for one year. If the family is still eligible after 12 months, they may extend their participation in the program for one additional year. Families are encouraged to work with HomeBase providers for assistance with staying housed and in some cases they may apply for Section 8 assistance or other rental assistance programs, although the cut back in Section 8 vouchers has limited this option. The initial concept was that Work Advantage families would become self-sufficient at the end of two years. However, high unemployment and the recession have made it more difficult for families to attain self-sufficiency. The recession's effect is especially challenging for families that first entered the program in 2008 and are scheduled to exit the Work Advantage program in 2010.

The Fixed Income Advantage program is for families where the head of household is on a fixed income (for example, social security disability insurance) and has been found eligible by the Human

Resources Administration. The Children's Advantage program is for families who have an open Administration for Children's Services case. Both the Children's and Fixed Income Advantage programs were designed so that families receive priority for Section 8 housing vouchers from the city's public housing authority. DHS forwards a Section 8 application to New York City Housing Authority (NYCHA) on behalf of the client and the goal is to transition families from the Fixed Income and Children's Advantage programs to long-term assistance through Section 8. However, NYCHA is not currently accepting or processing any new Section 8 applications and had to rescind vouchers it promised to about 1,500 families in the Children's Advantage and Fixed Income Advantage Programs (see *Almost 2,600 Section 8 Vouchers Rescinded*, below).

Given the shortage of Section 8 vouchers and that the program is up for review by the state, DHS has indicated that it is planning to seek approval from the state to make changes to the Advantage programs. A key change that the city has requested from the State Office for Temporary and Disability Assistance is authorization to extend the programs' rental assistance to three years. While such a move would increase the cost of operating the Advantage program, the net impact is expected to be a reduction in overall homeless spending. Without rental assistance, families are more likely to return to the shelter system and it is more costly to the city and state to house a family in a shelter than to provide rental assistance in the community. Given the current economic situation and the shortage of Section 8 vouchers, the future housing status for Advantage participants facing the end of their subsidies is uncertain.

### **ALMOST 2,600 SECTION 8 VOUCHERS RESCINDED**

In December 2009 the New York City Housing Authority announced that it would rescind 2,597 vouchers, roughly 1,500 of which were promised to families in Department of Homeless Services' programs (see *Spending Increases on Advantage Programs*, previous page). Other populations effected by the rescission include domestic violence survivors and intimidated witnesses who need to be relocated to protect their safety.

A federal program, Section 8 provides low-income families with rental assistance. Families locate apartments in the community and the voucher covers the difference between 30 percent of a family's income and the fair market rent. With the economic downturn the number of NYCHA vouchers in use has reached a new record—101,895 as of February 2010. (The Department of Housing Preservation and Development administers the allocation of an additional 29,162 Section 8 vouchers.)

This year, the city's Section 8 program has encountered shortfalls

that forced NYCHA to rescind vouchers that had already been issued to families, but where the family had not yet located an apartment (families have 180 days from the time they receive the voucher to find an apartment). The funding formula used by the federal Department of Housing and Urban Development (HUD) to determine the allocation of funding for the federal fiscal year 2009 (which ended September 30, 2009) resulted in a funding shortfall of \$65 million, compared to NYCHA's forecast. The allocation was made in May 2009 and NYCHA had already committed to an applicant pipeline for 2009 that assumed funding would be at levels similar to 2008. At the same time, the number of families that were successful in finding apartments to use their vouchers had increased, and the number of families turning in their vouchers had declined. Because NYCHA forecasts for both program funding and the utilization rate of existing vouchers were off target, NYCHA does not have adequate federal funding for thousands of the vouchers that it had issued. Therefore, NYCHA rescinded 2,597 vouchers for families who had yet to secure housing.

Furthermore, the housing authority has exceeded the cap set by HUD for the number of vouchers it may receive funding for in any given year. The HUD voucher allocation cap for NYCHA is currently 99,732. Therefore, NYCHA is currently managing 2,163 unfunded vouchers. NYCHA estimates that this creates a deficit of roughly \$21 million a year. Currently, \$10 million in federal funds intended to support the administration of the program have been diverted to provide rental assistance and support the unfunded vouchers. Prior to the December announcement, NYCHA made several applications to HUD for supplemental program funding, but all of their applications were denied.

Without a change in federal policy or an increase in federal funds, NYCHA does not have the funds to cover all of the vouchers it is currently managing nor can it honor the vouchers it rescinded. Thus, the outlook for families waiting for a Section 8 voucher is bleak.

While families hoping to transition to Section 8 from DHS programs make up the majority of those whose vouchers were withdrawn, there are some efforts by the city to provide services by extending other programs. The formerly homeless families who were relying on Section 8 to exit the DHS Advantage programs will need to return to Advantage or find other short-term rental assistance. For the city and these families it makes sense to ensure that they do not return to shelter as rental assistance is far less expensive than family shelter. Recognizing this, the city is appealing to the state's Office of Temporary Disability Assistance to change the current Advantage programs and extend the period of the rental assistance for families. DHS

has also announced a new \$1 million fund, the Homebase Housing Flex-Fund, created with stimulus funds. It is not clear what criteria DHS will use in awarding these funds to families or how far these funds will go in addressing the sizable need created by the rescission of the Section 8 vouchers.

On the other hand, no plans have been announced to address the housing situation for the roughly 1,000 families who were not participating in DHS programs and lost their vouchers. The families affected include domestic violence victims and intimidated witnesses whose safety may be in jeopardy.

### **SOLID WASTE MANAGEMENT PROGRAM BEHIND SCHEDULE, BUT HELPS HOLD DOWN WASTE EXPORT COSTS**

Implementation of key components of the city's Solid Waste Management Program (SWMP) is behind schedule. Conversion of the marine transfer stations, which was expected to be complete in 2010, is instead just beginning and costs—reflected in the city's Capital Budget—are higher than projected. Additionally, delays in construction of the marine transfer stations are delaying some long-term waste export contracts, which are actually holding down near-term waste export costs.

In 2006 the city and state approved a 20-year Solid Waste Management Program for New York City with the goal of creating a "cost-effective, reliable, and environmentally sound system for managing the city's waste." One major component of the SWMP is conversion of city-owned marine transfer stations to containerize waste and ship it by barge or rail, rather than trucks. A second component is using long-term contracts for waste export by rail or barge from the city-owned marine transfer stations, as well as privately owned facilities. Implementation of the SWMP, especially the long-term contracts, has implications for the city's waste export costs which continue to rise, albeit at a slower pace this past year.

**Capital Projects.** The timeline in the SWMP envisioned that the four city-owned marine transfer stations would be converted and operational by 2010, a goal that is not going to be met. Due to difficulties in securing the necessary permits, construction at all four facilities has been delayed and the Department of Sanitation (DSNY) currently plans to have the facilities operating in 2013. As of March 2010, \$191 million has been committed (an increase from \$112 million planned in May 2009) for the transfer station on the North Shore of Queens and construction has commenced. The Preliminary 2011 Capital Commitment Plan anticipates that funds for the Hamilton Avenue transfer station in Brooklyn will be

committed this year, though the projected cost has increased from \$116 million in the last plan to \$170 million. The increase in costs is attributable to greater project complexity and higher construction costs than anticipated when the preliminary estimates were prepared. The two remaining transfer stations, at East 91<sup>st</sup> Street in Manhattan and in Southwest Brooklyn, are planned for 2011 at \$125 million and \$108 million, respectively. Given the increase in costs at the first two transfer stations, it is likely that the costs for these two transfer stations will also be higher than initially forecast.

The SWMP also included work at other sites to facilitate the city's management of its waste stream. Waste in Staten Island is being exported by rail from a newly updated transfer station that has been fully operational since April 2007. A recycling center at the South Brooklyn Marine Terminal is planned for 2010, a recycling facility at Gansevoort Pier in Manhattan is planned for 2013, and conversion of the 59<sup>th</sup> Street marine transfer station to handle commercial waste is planned for 2014.

**Waste Export Expense Costs.** The city has made progress in negotiating 20-year contracts to ship waste out of the city by rail. When fully implemented, the plan will eliminate tens of thousands of garbage truck trips per year in the city. Long-term contracts set the terms for adjustments in export costs over the 20-year period, with a fixed cost that is adjusted annually. Additionally, there are variable costs that change each month based on factors such as rail car usage and fuel charges. The first long-term contract was executed for Staten Island in 2006 and currently costs \$109 per ton. In August 2007 the city entered into a long-term contract for waste export by rail from the Bronx, which currently costs \$90 per ton. Recently, the city entered into a long-term contract for parts of Brooklyn using the private transfer station on Varick Avenue, Brooklyn that has a current price of \$127 per ton. The city is negotiating the long-term contract for the privately owned transfer station in Greenpoint. The Department of Sanitation is in the process of completing several environmental reviews as well as getting approval to increase the tonnage limit at the facility. The transfer station is expected to begin operating in March 2012.

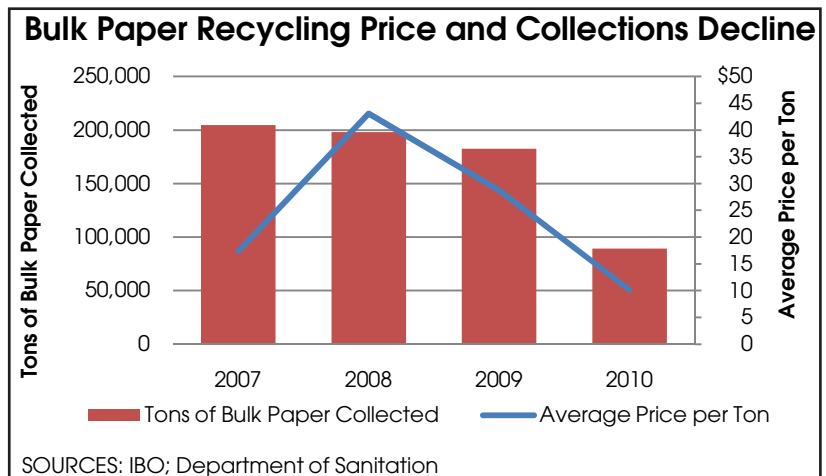
However, implementation of long-term contracts at the marine transfer stations has been slowed by delays in construction. The city continues to use short-term contracts for truck-based export for the waste that will eventually be handled at the new facilities. Short-term contracts are less expensive than long-term contracts because the latter usually involve greater hauling distances, as well as compensation for market

risk associated with locking in certain costs such as salaries and limiting adjustments for some other costs, over a longer time frame. Given the delay in the implementation of several long-term contracts, the average price of \$92 per ton is down slightly from \$94 per ton in 2009, which in turn was 14.8 percent higher than the average for 2008.

Because of the combination of unanticipated declines in export costs and the lower tonnage seen in 2009 and now expected in 2010, the total cost of waste export has not grown as rapidly as projected, allowing the sanitation department to recognize savings in this financial plan of \$16 million in 2010 and \$26 million in 2011. Nonetheless, the waste export budget for 2010, as of January 2010, is higher than in 2009 because the department is allowing for shifts during the remainder of the year. For example, DSNY testified that waste tonnage is beginning to stabilize, possibly because of the local economic downturn is slowing, and expects waste tonnage will remain stable or increase. However, DSNY expects costs per ton for long-term contracts to grow each year and as construction proceeds on the marine transfer stations the further shift to long-term contracts is likely to result in growing waste export costs.

## REVENUE SHRINKS FROM RECYCLED PAPER

Due to declining tonnage of recycled paper and lower prices per ton, the city expects to collect less revenue from the sale of bulk paper.<sup>1</sup> In the last two years, recycled bulk paper has generated an average of \$8 million in revenue annually, but this year revenue has shrunk, and as of March 2010, \$1.7 million of revenue has been collected. The Department of Sanitation has decreased the 2010 paper recycling revenue projection from \$9.4 million last June to \$5.4 million in January's budget plan, but unless price or tonnage increases in the next four months, the city is unlikely to collect even \$5.4 million this fiscal year.





The decline in recycled paper being collected by DSNY mirrors the overall trend in waste tonnage, which has decreased. In 2009 the sanitation department collected approximately 183,000 tons of bulk recycled paper, down 8 percent from 2008. The current fiscal year has seen a decline of 8 percent year over year. Since both the paper diversion rate (share of paper that is diverted from the waste stream through recycling) and the capture rate (amount of paper captured as a percentage of all recyclable paper in the waste stream) have been decreasing since 2007, the decline in tonnage being collected reflects either less paper in the waste stream, lower compliance with recycling, or a combination of the two factors. Given reduced newspaper circulation and a lower demand for paper products associated with the economic downturn, the declines are most likely attributable to lower proportion of paper in the waste stream.

The price paid to the city for recycled bulk paper has also decreased considerably compared to the 2008 peak-commodity price levels. In 2008, when bulk paper recycling revenue reached \$8.7 million, the price per ton for recycled paper was \$43; in 2009 the price decreased to \$29 per ton. The current price paid to the city for paper is just \$10 per ton.

Based on the decreased price for paper and the steadily declining tonnage of paper collected, the city is unlikely to collect the \$5.4 million of revenue planned for the current fiscal year and may have to decrease revenue projections for future years to pre-2008 levels.

**BUDGET GROWS FOR RECYCLING, WASTE PREVENTION EDUCATION PROGRAMS**

The Preliminary Budget for 2011 increases funding for programs in the Department of Sanitation's Bureau of Waste Prevention, Reuse, and Recycling to \$30 million. This unit plans, implements and evaluates recycling, composting, and waste prevention programs and saw cuts of \$6 million in 2009 and \$7 million in 2010. In the November 2008 Financial Plan, the Department of Sanitation proposed a program to temporarily reduce spending on many of the outreach and educational programs run by the bureau. In 2008 the unit spent \$28 million. Actual spending, reflecting both the cutback in education and other adjustments such as increases in wages due to settlements with municipal unions, was reduced to \$24 million in 2009 and currently stands at \$23 million for 2010.

Included in the bureau's programs is funding for the

Household Hazardous Waste Program. This program, an educational effort in conjunction with specialized pick-up of hazardous material, is part of the city's Solid Waste Management Plan and was originally expected to begin in 2009 at a cost of \$1 million per year. In November 2008 the program was delayed until 2011 due to budget constraints. The Preliminary Budget includes \$1 million in funding for the Household Hazardous Waste Program for 2011.

**STATEN ISLAND FERRY: STIMULUS FUNDS, PERSONNEL CHANGES REDUCE CITY COSTS**

The city's Department of Transportation (DOT) operates the Staten Island Ferry between Whitehall Terminal in lower Manhattan and St. George Terminal on the north shore of Staten Island. According to DOT's estimates it carries around 20 million passengers per year, as well as serving as a popular tourist attraction. The Staten Island Ferry has been free to riders since July 4, 1997, when the 50-cent round trip fare was rescinded as part of the state and city's efforts to promote a "one city, one fare" policy.

Operating costs for the ferry have been rising due to new safety and security measures, a City Council-mandated expansion in service implemented in 2005 and 2006, the use of boats with greater staffing requirements, the operation of two newly renovated terminals, and the rising cost of diesel fuel. Since 2002 costs have more than doubled from \$40.2 million to \$92.3 million in 2010 (current projection).

The share of the ferry operating budget funded by state aid has remained around 30 percent in recent years. However, the federal share has grown dramatically. Federal funds made up around 6 percent of the budget in 2007 and 8 percent in 2008. In 2009 the federal share rose to 15 percent and is projected to be 34 percent in 2010. The increase in 2010 is due in large part to stimulus funding. As of January 2010, \$15 million in American Recovery and Reinvestment Act funding has been appropriated for ferry transit and maintenance in 2010, and \$10 million for each of the following two years. The increase in federal aid has allowed the city to reduce its funding for the ferry.

**Staten Island Ferry Actual and Projected Expenses, 2005–2013**

*Dollars in millions*

Actual					Projected			
2005	2006	2007	2008	2009	2010	2011	2012	2013
\$53.9	\$69.3	\$73.7	\$81.8	\$81.0	\$92.3	\$81.7	\$80.9	\$76.9

SOURCES: IBO; Mayor's Office of Management and Budget.

NOTE: Based on past trends, amounts for 2011–2013 will be greater than currently projected, as additional state and federal aid is recognized.

DOT typically underestimates the amount of federal and state aid that it will receive in future years of the Financial Plan. IBO expects that as this aid is recognized, the ferry budget will increase, and as a result, actual expenditures in 2011-2013 will be greater than the current projected amounts. However, if the federal stimulus bill is not renewed, and the state's current fiscal difficulties persist, federal and state aid could decline relative to 2010 levels.

**Controlling Labor Costs.** While increased federal aid has lowered the amount of city funds expended on the Staten Island Ferry, DOT is also making an effort to reduce the overall cost of the service. The main strategies the department is using to meet this goal are reducing overtime, using attrition to replace workers in higher-paid titles with workers in lower-paid titles, and contracting out service. Over half of the ferry expense budget is for labor expenses of DOT employees. The city's municipal ferry program currently has 620 budgeted full-time positions.<sup>2</sup>

DOT began a major effort to control ferry labor costs with the January 2008 Financial Plan, when it proposed saving \$375,000 per year by moving some maintenance work from weekends to weekdays, thereby reducing the need to pay overtime. In November 2008 DOT proposed saving an additional \$1.1 million annually by eliminating non-emergency preventive maintenance overtime, and \$388,000 per year through measures to increase efficiency and productivity in cleaning. These measures included using deckhands for some cleaning tasks.

The Financial Plan released in January 2009 included further reductions in overtime, as well as more substitution away from higher-paid titles. For example, boiler operators were replaced with lower-paid oilers, and crane operators with derrick operators. Another personnel change implemented was the use of idle deckhands as replacements instead of calling in a substitute when a worker was absent. In addition, the installation of an alarm system in the ferry yards eliminated the need for a security guard. In total these measures to reduce ferry labor costs were expected to save almost \$600,000 per year. The 2010 Executive Budget contained further overtime reduction and title substitution, as well as the elimination of vacant mechanic positions no longer needed after elevator and escalator maintenance was contracted out. The annual savings from these measures (not taking into account the cost of the mechanic outsourcing) was expected to be almost \$700,000.

The Financial Plan released in January 2010 continues DOT's efforts to cut labor costs. Through rescheduling and better management, DOT believes that it can reduce cleaning overtime by \$132,000 per year. By using attrition to replace deckhands

with lower-paid titles, DOT expects to save an additional \$1.2 million per year on cleaning.

Ferry service is labor-intensive, and safety requirements (including many that are federally mandated) limit the potential for reducing the size of ferry crews. By limiting overtime and using lower-paid titles, DOT believes that can reduce its costs without compromising safety or the quality of service.

## CUTS IN CITY PARK REPAIRS, UPKEEP CONTINUE

The Mayor's Preliminary Budget for 2011 includes a 13 percent reduction in city funding for the Department of Parks and Recreation's largest budget area—maintenance and operations—which funds upkeep and repair of all park properties and facilities. Total city funding for maintenance and operations, including some additional adjustments not discussed below, declined by \$8 million from 2009 to 2010 and is projected to decrease by another \$22 million in 2011. Total city funding for maintenance and operations in 2011 is projected to be \$152 million.

The parks department's budget reflects successive rounds of actions planned and implemented since January 2008 which have reduced spending through hiring freezes and the elimination of vacant positions. The department has proposed several additional changes to parks maintenance and operations in the current Financial Plan. The parks department is continuing a hiring freeze, which is expected to save \$3.5 million agency wide in 2011, in addition to savings expected in 2011 from reductions in prior financial plans.

Given that maintenance and operations represents 64 percent of parks department spending, a significant portion of the savings from the hiring freeze is expected to come from maintenance and operations staffing. To date, the hiring freezes and vacancy reductions have come up short as fewer than expected employees have left the department, therefore saving less than budgeted. The Preliminary Budget added \$4.5 million to the parks department in 2010 to cover the shortfall in personnel costs, a significant portion of which are likely in maintenance and operations.

The Preliminary Budget also proposes a delay in seasonal hiring that is expected to save \$470,000 in 2010. The department has already implemented a reduction in its seasonal workforce that eliminated about 300 six-month seasonal positions that had been announced in the January 2009 Financial Plan. This reduction was followed by a cut of 250 seasonal workers planned in the April 2009 Financial Plan. These prior cuts, already reflected in the budget for 2011, are expected to provide savings of \$9.7 million next year. The agency will shorten the outdoor pools

season by two weeks and close four pools entirely, resulting in savings of \$1.4 million per year starting in 2011.

### **HUNDREDS OF JOB TRAINING SLOTS CUT FROM PARKS PROGRAM**

The parks department is restructuring the Parks Opportunity Program (POP), a transitional employment program, by reducing the number of participants. This program, which began in 2001, employs individuals who have been on public assistance over a year with seasonal six-month positions at the parks department. Participants enrolled in the program receive training and employment services. The goal of the program is to provide recipients with real work experience that will ultimately assist them in securing permanent employment. Funding for the program is mainly through the Human Resources Administration. In 2010 additional support is being provided with federal stimulus funds.

According to the parks department, from 2004 through 2008 an average of 1,200 graduates from the program secured

employment each year. In 2009 about 900 program graduates entered the work force, probably reflecting the tightening labor market in the city. In order to realize savings of \$4.6 million, the department will enroll fewer new participants in the program through the end of fiscal year 2010. In 2011 the number of participants—reflected as full-time equivalents—will be reduced by 737 or by 32 percent of the total enrollment. Some of the cuts are offset by stimulus funds. According to the city's Stimulus Tracker, American Recovery and Reconstruction Act funding for the Parks Opportunity Program should total \$2.3 million. Additional stimulus funds will be transferred from the Human Resources Administration.

### **ENDNOTES**

<sup>1</sup>A small share of the revenue source for recycled paper is actually revenue for recycled bulk metal, which is stable and has averaged 9 percent in the last 2 years.

<sup>2</sup>This headcount includes a small number for the Harts Island Ferry. IBO calculates the cost of the Staten Island Ferry by taking the total expenses of the Municipal Ferry Operation and Maintenance budget function, and subtracting out the amounts corresponding to the Harts Island Ferry, which have been around \$1 million in recent years.



## LABOR COSTS

### LESS FUNDING FOR NEW LABOR CONTRACTS—MORE FOR PENSIONS

Labor costs including salaries and wages, pensions, and fringe benefits (primarily health insurance) for municipal workers make up the majority of city expenditures each year. The Mayor's Preliminary Budget for 2011 includes "personal service" expenditures of \$36.2 billion, about 57 percent of total planned expenditures and an increase of \$120 million (0.3 percent) from this year. The budget includes a number of key changes to assumptions that had been incorporated into prior plans.

#### *Salary Increase, Must be Funded by Labor Contributions.*

Funding to cover two consecutive annual salary increases of 1.25 percent in upcoming collective bargaining settlements after current contracts expire has been removed from the Financial Plan, generating annual savings of \$35 million in 2010, \$190 million for 2011, and \$952 million by 2014. The Mayor has stated that any wage increases for employees during the next round of collective bargaining—which effectively begins with the negotiations with District Council 37, whose contract covering most civilian city workers other than teachers expired this month—must instead be generated through productivity enhancements agreed to by the municipal labor unions.

Obtaining productivity-funded raises for city workers will require more than just savings equal to the 1.25 percent increases that were removed from the budget. The Bloomberg Administration has taken the position that before any productivity enhancements are used to fund salary increases, they first must be used to compensate for two thus far unsuccessful attempts to rein in labor costs, both of which have also been removed from the city's updated Financial Plan. One was a Bloomberg Administration proposal that city workers contribute 10 percent of the cost of their health insurance premiums, which would have saved the city \$357 million in the coming year and \$451 million per year by 2014. The city is no longer assuming that this change will be implemented in the near-term.

The second proposal was for the state to establish a new pension tier (Tier V) for new city employees that would offer less expensive and in some cases less generous retirement benefits. Although pension reforms were recently enacted in Albany for state workers and other public sector employees outside New

York City, new teachers are the only city employees affected by the adopted reforms. Key pension reforms the Bloomberg Administration was seeking to incorporate in a new Tier V included requiring employee contributions throughout active service, increasing the minimum retirement age, doubling the vesting period from 5 years to 10 years and excluding overtime from the calculation of final average salary. In the January 2010 Financial Plan, the Mayor removed the \$200 million in annual Tier V pension savings which the city had counted on beginning in 2011.

#### *Funds for Wage Increase for Teachers and Other School Staff Reduced.*

Contracts with the teachers' union and the union for principals and superintendents have already expired (for teachers it was October 31, 2009 and for principals and superintendents it was March 5, 2010). Funding that was previously reserved to provide teachers and other school system employees with 4 percent raises this year and next in their next contracts has been reduced, leaving only enough to pay for raises of 2 percent per year on the first \$70,000 of salary for teachers, principals, and managers, thereby making the maximum raise over two years \$2,828. The resulting savings, totaling \$160 million in 2010 and \$357 million in 2011, would be redirected within the Department of Education's budget to cover special education expenses as well as to preserve 2,500 teacher positions which the Mayor's budget office and DOE contend would have been eliminated in order to meet the department's gap-closing targets.

*Increase Funding for City Pension Plans.* The 2011 Preliminary Budget calls for expenditures needed to fund pension plans for city workers to rise to \$7.1 billion next year, a 7.6 percent increase over planned spending in the current year. Pension funding by the city is based on "valuation estimates" prepared by the Chief Actuary which reflect current funding assumptions, notably annual investment returns of 8 percent, adopted by the trustees of the individual plans. According to the January 2010 Preliminary Budget, the pension plans have experienced two consecutive years of investment losses—5.4 percent in 2008 and 18.3 percent in 2009—which will require additional city contributions to help offset. As mentioned above, the state's failure to enact pension reforms for new city employees will also require the city to spend \$200 million more per year than previously planned.



## CAPITAL PROGRAM, FINANCING, AND DEBT SERVICE

### CAPITAL COMMITMENT PLAN FOR 2010–2013 LOWER THAN IN PRIOR FOUR YEARS

The January 2010 Capital Commitment Plan authorizes \$39.1 billion for the city's capital programs over fiscal years 2010 through 2013, including \$31.2 billion in city funds and \$7.9 billion from other sources. Authorized commitments total \$19.1 billion in 2010, \$7.5 billion in 2011, \$5.8 billion in 2012, and \$6.7 billion in 2013.

Although \$39.1 billion has been authorized, the Bloomberg Administration's commitment target is \$36.3 billion for the plan's four-year period. Recognizing that some capital projects are delayed by unforeseen events, the total commitment target is generally less than the total level authorized. The commitment target for 2010 is \$14.5 billion, which is \$4.6 billion below the authorized total for that year. The commitment targets for 2011, 2012, and 2013 are \$9.0 billion, \$6.3 billion, and \$6.5 billion, respectively. The Bloomberg Administration's total four-year commitment target of \$36.3 billion represents a reduction of \$2.3 billion or 5.8 percent from actual commitments over the prior four years 2006 through 2009.

The \$14.5 billion commitment target for 2010 is \$2.8 billion, or 23.9 percent greater than the total commitments in 2008—the highest year on record. As in previous years, however, some portion of the authorized commitments for 2010 are likely to be deferred to succeeding years in the capital plan. This tendency to push some capital commitments into the future explains why the commitment targets for 2011 and 2012 are higher than the currently authorized amounts for these years.

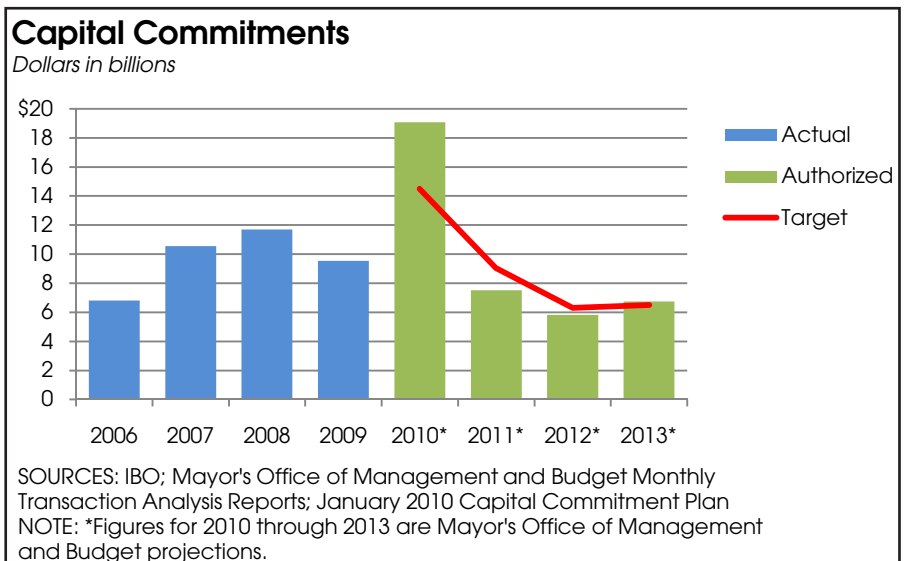
*Overview by Operating Agency.* Overall, the January 2010 Capital Commitment Plan authorizes \$39.1 billion for agency capital projects. As noted above, the city's target for actual commitments is somewhat lower at \$36.3 billion, although how that reduction will be distributed at the operating agency level is not known.

The greatest increases, in dollar terms, in projected commitments are planned for two agencies. The Department of Transportation is authorized to commit \$1.5 billion (43.0 percent) more over the next four years, largely for bridge and highway

projects. The Department of Information Technology and Telecommunications (DoITT) is authorized to commit \$1.1 billion (131.0 percent) more, mainly for two projects—emergency communication systems and facilities and the Public Safety Answering Center 2 (backup site for call-taking and dispatch operations of police and fire departments).

Measured in percentage terms, the current capital plan more than doubles the level of authorized commitments for eight agencies from the prior four-year period. For example, the Department of Health and Mental Hygiene (DOHMH) is authorized to commit \$607 million over the period 2010–2013, which represents an increase of 164 percent over commitments in 2006 through 2009. Two projects account for most of this increase—the new Public Health Laboratory and the agency's new headquarters at 2 Gotham Center. Other agencies whose authorized commitments more than double are juvenile justice, DoITT, sanitation, police, aging, children's services, and correction.

Conversely, under the current capital plan seven agencies have a decline in their authorizations compared to the prior four-year period. The most notable reductions in total dollars involve the Departments of Environmental Protection (DEP) and the Department of Education (DOE). DEP is authorized to commit \$3.2 billion less over the next four years than in the period 2006–2009; most of the reduction is due to fewer commitments in the near term for water mains and pollution control projects. Similarly, DOE is projected to commit \$2.3 billion less over the next four years than in the period 2006–2009; fewer commitments for the rehabilitation of school buildings accounts for much of the difference.



In addition, four agencies are expected to receive federal stimulus funds for their capital programs. These are the Departments of Education, Environmental Protection, Transportation, and Parks and Recreation. See report discussions under [Federal Stimulus Update](#) and [Education](#) for more information.

**Labor Agreements to Reduce Costs.** In November 2009, the Bloomberg Administration and the New York City Building and Construction Trades Council announced several project labor agreements (PLAs) that the Mayor's projects would save the city \$300 million over fiscal years 2010 through 2014.

The PLAs, which cover capital contracts let before June 30, 2014, would include both large-scale new construction projects

(for example, the new police academy facility), and renovation and rehabilitation projects involving public schools and existing city-owned buildings; a total of \$5.3 billion of public infrastructure projects are covered under the agreements. Some projects, such as emergency contracts and small purchases under \$100,000, would not be covered by these agreements.

The savings are expected to be achieved by two means: changes in work rules and practices and an exemption from the state Wicks Law, which requires the city to bid and award separate contracts for general construction, plumbing, HVAC (heating, ventilation and air conditioning), and electrical wiring projects with an estimated cost of more than \$3 million. With this exemption, the city can now use a general contractor rather than have separate

contracts for each trade on capital projects that are subject to a PLA.

As of the writing of this report, all PLAs have been completed except for two: those involving the Departments of Environmental Protection and Parks and Recreation. These agreements are expected to be completed shortly. A total of 14 city agencies are covered by these agreements.

According to the Mayor, any savings achieved under these PLAs will be used to fund capital projects that otherwise would have been cut due to the recession.

### PAYING FOR THE CAPITAL PROGRAM

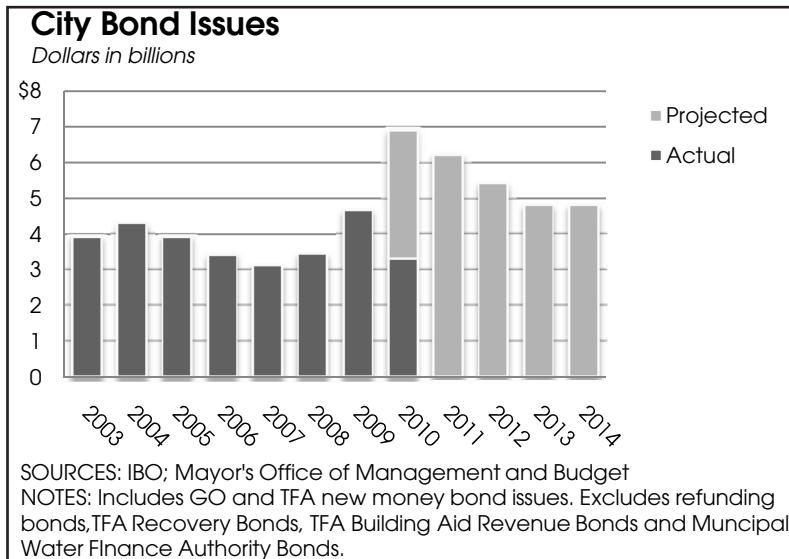
**Borrowing.** To finance the city's 2010–2013 Capital Commitment Plan, the city will borrow money by issuing three types of debt: general obligation (GO), Transitional Finance Authority (TFA), and Municipal Water Finance Authority.

<b>Capital Commitments by Operating Agency</b>				
<i>Dollars in millions</i>				
<b>Operating Agency</b>	<b>Actual Commitments 2006–2009</b>	<b>Authorized Commitments 2010–2013</b>	<b>Amount Variance</b>	<b>Percent Variance</b>
Dept. of Education*	\$11,067	\$8,756	\$(2,311)	-20.9%
Dept. of Environmental Protection*	10,657	7,494	(3,163)	-29.7%
Dept. of Transportation*	3,593	5,139	1,546	43.0%
Dept. of Citywide Admin. Serv.	3,201	2,410	(791)	-24.7%
Dept. of Parks and Recreation*	1,851	1,871	20	1.1%
Dept. of Housing Preservation and Dev.	1,581	1,921	340	21.5%
Dept. of Small Business Services	1,114	1,892	778	69.8%
Dept. of Cultural Affairs	895	891	(4)	-0.4%
Health and Hospitals Corporation	818	506	(312)	-38.1%
Dept. of Information Tech. and Telecom	807	1,864	1,057	131.0%
Dept. of Sanitation	610	1,456	846	138.7%
Fire Department	464	516	52	11.2%
Police Department	410	1,254	844	205.9%
City University of New York	403	302	(101)	-25.1%
Transit Authority	237	411	174	73.4%
Dept. of Health and Mental Hygiene	230	607	377	163.9%
Dept. of Correction	182	1,052	870	478.0%
Dept. of Homeless Services	131	143	12	9.2%
New York Public Library	78	155	77	98.7%
Queens Borough Public Library	70	111	41	58.6%
Human Resources Administration	63	119	56	88.9%
Brooklyn Public Library	44	62	18	40.9%
New York Research Libraries	38	16	(22)	-57.9%
Administration for Children's Services	38	145	107	281.6%
Dept. for the Aging	11	41	30	272.7%
Dept. of Juvenile Justice	5	10	5	100.0%
<b>TOTAL</b>	<b>\$38,598</b>	<b>\$39,144</b>	<b>\$546</b>	<b>1.4%</b>

SOURCES: IBO; Mayor's Office of Management and Budget Monthly Transaction Analysis Reports; January 2010 Capital Commitment Plan

NOTES: \*These four agencies are expected to receive federal stimulus funds for their capital programs. The Department of Environmental Protection includes agency water supply projects.





finance the city's capital program.

The Municipal Water Finance Authority has issued \$900 million in debt so far this year, and expects to issue another \$1.4 billion in new money bonds through the end of the fiscal year. The city will also receive \$217 million from the State Revolving Fund for environmental facilities projects, as a direct loan. This allocation is the result of funding through the American Recovery and Reinvestment Act and effectively amounts to a grant although it is initially structured as a zero-interest loan. (See "[Environmental Protection Projects](#)" on page 23) The city plans to issue an additional \$2.0 billion in water authority bonds each year from 2011 through 2014, which will be spent on the city's water and sewer system.

### ***City Takes Advantage of Stimulus Bonding***

***Opportunity.*** The city has been issuing a new type of bond created by the 2009 federal stimulus bill. Build America Bonds (BABs) were established by ARRA to facilitate funding of capital improvements by state and local governments.

***State Laws Broadens TFA Issuing Capacity.*** The TFA is a city authority established in 1997 to provide the city with additional bonding capacity as it had nearly exhausted the capacity allowed under the state's constitutional limit on general obligation debt. TFA bonds are backed by both the city's personal income and sales taxes, which makes it a very secure municipal credit.

Until this year, TFA issuance of debt for general capital purposes did not count against the city's debt limit and was capped at \$13.5 billion. (The TFA is also authorized to issue a special class of bonds backed by state education building aid—Building Aid Revenue Bonds or BARBs—that were excluded from the cap.) However, the TFA had exhausted that capacity. State legislation in July 2009 allowed TFA to issue additional debt for general capital purposes. With the legislation, total outstanding GO and general TFA debt (beyond the nearly \$13 billion in TFA debt outstanding when the law was passed) are now statutorily capped by the city's debt limit; TFA debt can comprise up to half of city debt issued each year for general capital purposes. With TFA bonds having a better rating than city GO bonds, OMB has indicated that the change will allow the city to save on future debt service costs.

***City Debt Issuance Trends.*** Annual GO and TFA general purpose bond issuance, excluding TFA BARBs, is projected to reach almost \$6.9 billion this year, a record level. As of January 2010, the city had issued \$3.3 billion in GO and TFA for 2010 (excluding refunding bonds) and is expected to issue another \$3.6 billion, split evenly between GO and TFA. In 2011 city debt issuance is expected to exceed \$6.0 billion. The spike is in due in part to the timing of capital spending. Debt issuance for projects lags somewhat behind actual capital commitments. Thus the spike in proposed debt issuance for 2010 and 2011 corresponds to the spike in planned capital commitments in 2010. The city plans to issue \$5.4 billion in 2012 and \$4.8 billion in 2013 and 2014 to

BABs are taxable bonds, unlike most municipal debt, which is tax exempt. However, BABs come with a federal subsidy to compensate for their taxable status. The subsidy is delivered in one of two ways. Either the issuer receives funds from the federal government equal to 35 percent of the interest payments (Direct Payment BABs) or the buyer of the bonds receives a federal tax credit equal to 35 percent of the interest (Tax Credit BABs). In addition to making municipal debt appealing to a broader audience, the federal subsidy makes BABs more cost-effective than tax-exempt bonds; the city estimates savings of between 15 and 94 basis points on BAB offerings.

As of January 2010, the city has issued \$2.6 billion dollars in BABs in 2010—\$1.4 billion through GO, \$7 million through TFA, and the remaining \$500 million by the Municipal Water Finance Authority. There is no cap on BAB issuance, though the bonds are limited to use for new money issues, not refunding of existing bonds. As long as market conditions remain favorable, the city is likely to split the remaining \$3.6 billion of GO and TFA debt planned for 2010 between tax-exempt bonds and BABs.

Currently, the BAB program is set to expire on January 1, 2011. Given the bonds' popularity—about 20 percent of all municipal bonds issued in the U.S. since April 2009 have been BABs—federal lawmakers are weighing options for extending the program. The House Ways and Means Committee has passed a bill to extend the program through April 1, 2013, though with gradually diminishing subsidies. A full House vote on the bill is next.

The direct payment option is the feature of BABs that has proven most successful. Further leveraging this success, the Hiring Incentives to Restore Employment Act (HIRE) recently signed by President Obama allowed for issuers to receive direct payments—similar to those available with BABs—on four additional types of bonds that had previously only offered the tax credit option to investors. The four bonds are Qualified School Construction Bonds (QSCBs), Qualified Zone Academy Bonds (QZABs), New Clean Energy Renewable Bonds, and Qualified Energy Conservation Bonds. The city is expected to take advantage of the new rules for QSCBs and QZABs (see page 31 for a more detailed discussion of QSCBs).

**Debt Service.** The cost of repaying principal and/or interest on outstanding bonds shows up as debt service in the city's expense budget. Debt service is a function of the amount of debt outstanding and the terms of debt issuances. Significant growth in debt service expense has accompanied the rapid growth in capital investment in recent years. This growth is evident both in absolute terms, and in relative terms when debt service expense is compared to tax revenues and to total city expenditures.

Debt service is projected to total \$6.8 billion by 2014, up about 50 percent from 2008, when it totaled approximately \$4.5 billion (adjusted for prepayments). As a percentage of tax revenues, debt service expense is expected to fluctuate between 14.3 percent and 15.5 percent over the years of the 2010–2014 financial plan period, compared with an average of 13.3 percent from 2003–2009. As a percentage of city-funded expenditures, debt service is projected to vary between 11.7 percent and 12.9 percent from 2010 to 2014, as

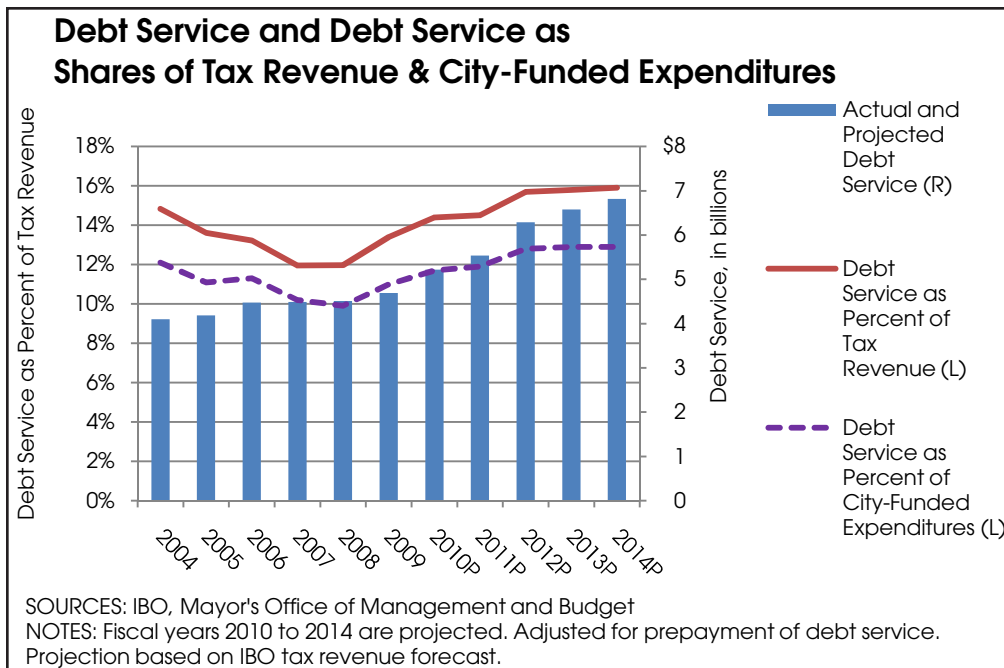
compared to an average of 10.9 percent from 2003–2009.

Both of these indicators have moved closer to the average for 2003–2009 as the city has made a deliberate effort to reduce capital commitments since the 2010–2019 Preliminary Ten-Year Capital Strategy was released in November 2008. For example, debt service as a percentage of tax revenues was projected to average around 16.0 percent from 2009 to 2013 when the strategy was first issued. However, given the tendency of out-year forecasts to understate actual capital expenditures, current projections may underestimate debt service growth in the near and long-term.

**Credit Market Overview.** The recent financial crises and recession badly shook the municipal credit markets. Liquidity dried up as the auction-rate bond market collapsed and the firms providing municipal bond insurance faced significant ratings downgrades on their own finances. State and local governments have faced severe budgetary pressures as revenues plummeted and demand for services rose, weakening their credit ratings and further unsettling the municipal markets.

New York City, damaged less by the recession than many cities, has maintained relatively easy access to credit markets. The city's highly rated general obligation debt—Aa3 by Moody's, AA by Standard & Poor's, AA by Fitch—has allowed issuances to continue in the absence of municipal insurers. The turmoil effected the city's debt issuance patterns, driving more numerous, but smaller, deals to market, and precluding the issuance of variable rate debt, which is typically cheaper than fixed rate. As markets have improved, the city has gradually been able to bring larger issuances to market, and, since January 2010, has offered

variable rate components with each of the last GO and TFA issuances. Federal Reserve Bank policy keeping interest rates low has helped the city to borrow affordably and to refinance more expensive debt. The Mayor's Preliminary Budget reflects debt service savings over the adopted 2010 budget of \$124 million, \$286 million, and \$12 million in fiscal years 2010 through 2012, respectively, due to lower interest rates and refunding savings.



**ENDNOTES**

<sup>1</sup>In addition to BARBs, Recovery Bonds issued to fund reconstruction following the September 11<sup>th</sup> terrorist attack are also not included in the cap.

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