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Analysis of the Mayor's Preliminary Budget for 2012

IBO's Reestimate Of the Mayor's Preliminary Budget for 2012 And Financial Plan Through 2015

IBO

New York City
Independent Budget Office
Ronnie Lowenstein, Director

110 William St., 14th floor
New York, NY 10038
Tel. (212) 442-0632

Fax (212) 442-0350
iboenews@ibo.nyc.ny.us
www.ibo.nyc.ny.us

Preface

As required under the New York City Charter, this report provides IBO's review of the Mayor's Preliminary Budget for 2012 and Financial Plan through 2015. The report presents our own economic and revenue forecasts and examines some of the Mayor's key budget proposals.

As we have for the past 10 years, IBO will also produce a companion volume to this report, *Budget Options for New York City*. The budget options report will be released within the coming weeks. As in past years, the new edition will present dozens of ways to reduce spending or increase revenue. For each measure presented, IBO will offer pros and cons and provide 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.

This report is crafted through the hard work and dedication of much of IBO's staff. 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, Ray Domanico, 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 Elizabeth Brown and Doug Turetsky provided editorial assistance.

Ronnie Lowenstein

Director

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Overview

While the recent recession has left many statehouses and city halls awash in red ink, New York City is currently in comparatively good fiscal condition. But comparisons do not tell the full story. While the city's fiscal picture may look relatively good, it is partly due to steps to cut costs and raise revenue that were already well under way, and also because the fiscal implications of some potential new problems were ignored for now.

A quick review of the Bloomberg Administration's February 2011 budget plan can leave a reader with a sense of complacency. This is in part because many of the more controversial actions to close the city's projected budget gap for 2012, from eliminating thousands of teaching positions to closing 20 fire companies, were announced in prior plans. At the same time, the Mayor's acknowledgement of substantially more tax revenue than he projected last fall for this year and next eased the need for additional cost-cutting measures.

The February budget plan also sidesteps some potential issues. Fiscal turbulence in Albany and Washington means the city will likely lose substantial amounts of aid from the state and federal governments in the upcoming fiscal years. Some of these losses are not addressed in the Mayor's budget plan and would affect many popular programs—from providing summer jobs for teens to keeping senior centers open. City Hall is already facing pressure to ensure the preservation of the affected programs.

But New Yorkers should not expect a surge in local tax revenues like the city experienced in the middle of the last decade to make up for the lost aid. The financial industry may become less profitable, and therefore generate less tax revenue for the city, as it adapts to the Dodd-Frank regulations as well as new bonus restrictions proposed by the Securities and Exchange Commission. Local employment in health care, which has grown right through several past downturns, may be curtailed by proposed state Medicaid cuts and as federal health care reform takes shape.

Based on IBO's latest revenue and expenditure estimates under the Mayor's Preliminary Budget for 2012 and Financial Plan through 2015, the city will end the current fiscal year with a surplus of $2.9 billion, $258 million below the Bloomberg Administration's projection. The projected fiscal year 2011 surplus results from a variety of sources: higher tax revenue collections than expected when the budget was adopted, a delay in changing how the city's pension contributions are calculated, accounting adjustments, and $585 million in agency initiatives to reduce spending or increase revenues are among the major factors.

With the expectation that the 2011 surplus will be used to prepay some of

Total Revenue and Expenditure Projections

Dollars in millions

	2011	2012	2013	2014	2015	Average Change
Total Revenues	$65,656	$66,228	$68,229	$70,298	$72,630	2.6%
Total Taxes	*39,020*	*41,319*	*43,320*	*45,312*	*47,616*	*5.1%*
Total Expenditures	65,656	66,423	72,166	73,715	75,625	3.6%
IBO Surplus / (Gap) Projections	**-**	**$(195)**	**$(3,937)**	**$(3,416)**	**$(2,996)**	
Adjusted for Prepayments:						
Total Expenditures	$66,409	$69,316	$72,166	$73,715	$75,625	3.3%
City Funded Expenditures	$44,783	$50,062	$53,036	$54,572	$56,487	6.0%

SOURCE: IBO

NOTES: IBO projects a surplus of $2.893 billion for 2011, $258 million below the Bloomberg Administration's forecast. The surplus is used to prepay some 2012 expenditures, leaving 2011 with a balanced budget. Estimates exclude intra-city revenues and expenditures. City funded expenditures exclude state, federal and other categorical grants, and interfund agreement amounts. Figures may not add due to rounding.

Pricing Differences Between IBO and the Bloomberg Administration

Items that Affect the Gap

Dollars in millions

	2011	2012	2013	2014	2015
Gaps as Estimated by the Mayor	-	-	$(4,852)	$(4,813)	$(4,977)
Revenues					
Taxes					
Property	$(8)	$(94)	$69	$336	$703
Personal Income	(221)	(15)	509	365	550
General Sales	98	143	289	445	305
General Corporation	18	84	142	341	488
Unincorporated Business	(61)	68	132	123	150
Banking Corporation	(61)	22	(154)	(135)	(104)
Real Property Transfer	(25)	5	14	51	25
Mortgage Recording	(5)	(4)	(4)	(2)	(21)
Utility	24	24	28	28	31
Hotel Occupancy	4	(5)	44	41	30
Commercial Rent	(2)	(11)	(21)	(33)	(47)
Cigarette	3	(1)	(1)	(1)	(1)
	(236)	217	1,046	1,561	2,110
STaR Reimbursement	(5)	(10)	(7)	(6)	(4)
Total Revenues	**$(241)**	**$208**	**$1,039**	**$1,556**	**$2,106**
Expenditures					
Public Assistance	$8	$8	$11	$11	$11
Police	(25)	(100)	(100)	(100)	(100)
Fire	-	(25)	(25)	(25)	(25)
Correction	(10)	(10)	(10)	(10)	(10)
Campaign Finance	-	-	-	(34)	-
Parks and Recreation	-	(9)	-	-	-
Small Business Services	9	(9)	-	-	-
Total Expenditures	**$(18)**	**$(145)**	**$(124)**	**$(158)**	**$(124)**
Total IBO Pricing Differences	**$(258)**	**$63**	**$915**	**$1,397**	**$1,981**
IBO Prepayment Adjustment 2011 /2012	**$258**	**$(258)**	-	-	-
IBO Surplus / (Gap) Projections	-	**$(195)**	**$(3,937)**	**$(3,416)**	**$(2,996)**

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.

next year's expenditures and that the Mayor's plan will be approved for $1.0 billion in agency gap-closing measures first announced in November—on top of $4.2 billion in gap-closing actions previously announced for 2012—we estimate the city faces a small shortfall of $195.0 million, or less than 1 percent of tax and other city-generated revenues, next year. The modest 2012 shortfall presumes the city receives $400 million in aid not currently in the Governor's budget plan as well as legislative action by Albany to allow the city to save $200 million by eliminating Variable Supplement Fund benefit checks for future police officer and firefighter retirees. Winning this additional aid from Albany is far from certain given the state's $10 billion shortfall and how controversial legislation to curtail the supplement fund benefit is likely to be. Without this help from the state the Mayor says further cuts by the city will be necessary.

Even if the Mayor gets the additional assistance from Albany, the city's fiscal picture becomes murkier after

next year because expenditure growth is outpacing revenues and there is no expectation of a substantial surplus that can help prepay some 2013 expenses. Although IBO's forecast of 2013 tax revenues exceeds the Mayor's by more than $1 billion, we still project a budget gap of $3.9 billion in 2013.

A Stronger Local Economy, Rising Tax Revenues. The city fared better during the recession than many observers—including IBO—had expected and the strength of its rebound has also been surprising. The city has already regained nearly half of the 131,700 private-sector jobs it lost during the downturn. IBO's latest economic forecast expects this growth to continue, with the city adding about 73,200 private-sector jobs from the fourth quarter of 2010 through the fourth quarter of 2011 followed by gains of 50,000 to 60,000 jobs annually through 2015.

But many of the new jobs the city is adding do not pay as well as the ones that were lost, which means less of a boost for the local economy and city tax revenues. Additionally, the city's unemployment rate remains stubbornly high at 8.9 percent as of January 2011. And for those who are unemployed for long spells, finding work is increasingly difficult. Long-term unemployment has increased, with 50.7 percent of the unemployed in January 2011 jobless for more than 26 weeks, up nearly 11 percentage points from January 2010.

Based on our economic forecast and the expectation of continued job growth, IBO projects tax revenues will increase by 6 percent in 2012, rising from $39.0 billion in 2011 to $41.3 billion. This increase is fueled in dollar terms by the personal income tax, which will grow by $900 million and reach $8.2 billion, and the property tax, which will grow by $710 million and total $17.5 billion. We anticipate tax revenues will increase another $2.0 billion in 2013 and total $43.3 billion. IBO's tax revenue estimates are similar to those of the Bloomberg Administration for 2011 and 2012, but ours are substantially higher for 2013 and the ensuing years of the financial plan.

Gap-Closing Measures. A series of gap-closing measures totaling $5.2 billion are planned for 2012. With budget gaps widening early in the recession, the Bloomberg Administration first presented proposals to close the gap in the January 2008 Financial Plan. Some of the most recent measures planned for 2012 range from eliminating more than 6,100 teaching positions to cutting the city's subsidy for public libraries by $19.7 million (8 percent) to reducing the work year for roughly 1,470 parks employees (about half the agency's full-time staff).

City spending is also being supplemented this year and next by the use of funds set aside for retiree health benefits. The Mayor is drawing down $395 million in 2011 and $672 million in 2012 from the Retiree Health Benefits Trust Fund.

Spending Tempered, But Continues to Grow. While most of the planned gap closers generate recurring savings in the ensuing years, city spending continues to grow. IBO projects that total city spending, adjusted for the use of surpluses for prepayments, will rise from $66.4 billion this year to $69.3 billion in 2012 and $72.2 billion in 2013. Looking just at city funds and again adjusting for the use of surpluses, IBO expects spending to increase from $44.8 billion in 2011 to $50.1 billion next fiscal year and $53.0 in 2013.

This spending growth occurs even though under the Mayor's February 2011 Financial Plan total spending by most city agencies would remain relatively flat. A large share of the expected growth in spending is confined to just a few portions of the budget: debt service on the money the city borrows and pension, health, and other fringe benefits for city workers. The city's share of Medicaid costs is also expected to jump substantially in 2012 as the temporary increase in the federal portion of Medicaid expires.

City spending could be further affected by diminished state and federal aid. The Mayor's recent budget plan does not account for a number of proposed aid reductions that could have substantial effects on city programs. The Governor's budget, for example, does not include funding for the Advantage rental subsidy program for individuals and families leaving the city's shelter system. If the city does not replace the $140 million in state and federal funds to maintain the program, the number of people in the city's shelter system will almost certainly be higher than currently projected, which would require the city to spend more on shelter—spending that is not included in the Mayor's budget plan. Issues related to state and federal aid for

Advantage and other programs are looked at in more detail in this report.

On the federal level, funding has not kept up with the rising cost of providing subsidized child care, which the Mayor says will mean the elimination of more than 16,600 child care slots for working families in 2012 (more details are provided in this report). The President's proposed budget for the next federal fiscal year includes cuts to programs such as the Community Development Block Grant, which supplies much of the funding for the city's emergency housing repair programs as well as supports other services, and the Community Services Block Grant, which funds neighborhood-based antipoverty programs in some of the poorest communities in the city. City Hall is already feeling the pressure to preserve the child care slots and will face similar pressures if the block grants and other funding streams are reduced without the city itself stepping in to pay for the services.

Matters for Concern. While City Hall faces difficult decisions on whether and how to maintain funding for any or all of the programs threatened by eroding state and federal aid, the Mayor's budget plan for 2012 counts on $600 million in assistance ($400 million in direct aid) from Albany that was not part of the Governor's budget. The Mayor says that without the additional state aid—which is far from a certainty given that the state is wrestling with its own $10 billion shortfall—the city will need to make commensurate cuts on top of the cumulative $5.2 billion in gap-closing actions already proposed for 2012. The Mayor has since instructed most agencies to submit proposals by March 24, one week before the state budget is due to be passed.

Another matter that could substantially affect the city's budget is settlements with the municipal labor unions. Contracts have already expired with major unions such as District Council 37, and the teachers, police officers, and firefighters. Agreements with sanitation workers and correction officers end early in the upcoming fiscal year. The Mayor has not budgeted for raises for any contract settlements during the current round of negotiations. The Bloomberg Administration is counting on productivity to offset any raises, a position that has proven difficult to maintain in the past—particularly when productivity would have to achieve savings retroactively. Each 1 percent increase in salary not paid for with labor savings would cost the city about $290 million, including additional pension costs.

The Mayor is also seeking changes in the pension programs for city workers that would have to be approved by Albany. Although these changes are politically fraught, the Mayor has included the expected savings in his budget plan. One pension-related change, to the Variable Supplement Fund, is expected to save $200 million in 2012, and is part of the $600 million in additional help the Bloomberg Administration is seeking from Albany to balance next year's budget. Other proposed pension changes would not generate savings until 2013 and beyond.

While spending uncertainties pose a number of threats to the budget plan, there are also economic issues that could weaken tax revenues and affect budget shortfalls in the coming years. New financial regulations under the Dodd-Frank Wall Street Reform and Consumer Protection Act are only just getting implemented. As regulations restructuring the financial industry take effect, they are likely to have long-term implications for Wall Street profitability and compensation—and local tax revenues.

The implementation of national health care reform as well as efforts to reduce state Medicaid spending may also have economic and tax revenue consequences for the city. Health care is a significant part of the city's economy and the number of health care jobs here grew right through the 2008-2009 recession, just as they did through several prior downturns. Proposals recently announced by the Governor's Medicaid task force, along with the national health care reforms that take shape over the next few years, may change the trajectory of this longtime growth sector in the city's economy.

Broader current events could also take a toll on the city's economy. The uprisings roiling the Middle East have led to a spike in oil prices. If fuel prices remain high, the city's tourism industry could be adversely affected and the local leisure and hospitality sector, which gained 10,600 jobs last year, could see its growth slowed or reversed. And the still developing tragedy in Japan, one of the largest economies in the world and a major U.S. trading partner, may have significant consequences on a local and global scale.

A Precarious Balance. While New York City's fiscal picture looks stronger at the moment than that of many states or municipalities, that continued strength is far from certain. Although IBO's projected budget gap for the upcoming year is quite small, the $3.9 billion shortfall we forecast for 2013 is nearly 8 percent of tax and other city-generated revenues.

Ongoing state and federal cutbacks pose significant and growing challenges. The city's current budgetary strength was built in part on successive and substantial rounds of local budget cuts over the past three years. The city's ability to deliver needed and expected services while maintaining budget balance may be severely tested if state and federal cutbacks continue to mount.

Economic uncertainties could also undo the city's current strength. Although we weathered the recession better than most expected and over the past year job growth here exceeded the national rate, factors ranging from regulatory reform of Wall Street to Medicaid cuts and health care reform to rising oil prices could substantially affect the city's employment growth and tax revenues.

Economic Outlook

Sustained Recovery

The U.S. economy resumed growing well over a year ago, first in terms of output and now in terms of employment. (All years in this section refer to calendar years, unless otherwise noted.) Economic growth has been halting, in spite of the federal stimulus spending and tax cuts, and the Federal Reserve's highly stimulatory monetary policy. Recent economic data, however, are encouraging. By the end of 2010, increases in personal consumption, nonresidential investment, and net exports were all contributing to real GDP growth. Despite the continued loss of government jobs, by February total employment had increased for five consecutive months.

Conditions for a long-awaited acceleration of the economy's expansion are in place—high profits and strong balance sheets of businesses, reduced indebtedness of households, increased nonresidential asset values, and recapitalization of lenders. IBO forecasts faster economic growth beginning in the second half of this year, with real GDP growth reaching an average annual rate of 3.5 percent in 2012 and remaining at a still-robust 3.4 percent and 3.3 percent in 2013 and 2014, respectively.

In contrast to previous downturns, the 2008-2009 recession was shorter and had a less severe impact on employment in New York City than it did in the nation as a whole, and the recovery to date has been stronger. Newly revised employment data reveals that the city regained about half of the 131,700 private-sector jobs it lost in four quarters—the fourth quarter of 2008 through the third quarter of 2009. IBO forecasts a total of 73,200 private-sector jobs will be added to the city's economy from the fourth quarter of 2010 through the fourth quarter of 2011, followed by annual employment gains of 50,000 to 60,000 jobs through 2015.

But in terms of income, the collapse of earnings in the city during the recession was on a scale more consistent with the extent of the dislocations for the U.S. economy as a whole. In contrast to the loss of 4.1 percent of private-sector jobs, real average wages fell a total of 12.2 percent during 2008 and 2009, with the industry with the highest pay, securities, accounting for two-thirds of the loss. The recession battered the securities industry and the financial sector as a whole, but the maintenance of rock-bottom interest rates by the Federal Reserve generated enormous profits on Wall Street, averaging $44.5 billion in 2009 and 2010. These rates will not be maintained, and IBO forecasts Wall Street profits to fall gradually, from $21 billion this year to the $11 billion at the end of the forecast period, constraining both employment and wage growth in the industry. Still, the industry accounts for 28.7 percent of forecast wage growth through 2015 yet only 4.5 percent of the projected employment growth. The three sectors that account for 69.1 percent of employment growth—business and professional services, education and health, and leisure and hospitality—will account for only 43.6 percent of expected wage growth.

The risks to IBO's forecasts of the nation's and the city's economies are many including long-term increases in oil prices, the question of long-term federal fiscal sustainability, the sufficiency of government stimulus to propel the economy to self-sustained growth, potential implementation of financial regulation that could substantially constrain employment and/or profits of New York-based financial firms. These and other risks are highlighted after discussions of the national and local economic outlooks.

U.S. Economy

The economy continues to recover, albeit at a more halting rate than in past recoveries and unemployment remains stubbornly high. Real gross domestic product (GDP) rose in the third and fourth quarters of 2010 at annualized rates of 2.6 percent and 2.8 percent, respectively, after dipping to 1.7 percent in the second quarter. Although government spending and private inventory investment, which had lifted the economy earlier, declined in the fourth quarter of 2010, increases

IBO versus Mayor's Office of Management and Budget Economic Forecasts

	2010	2011	2012	2013	2014	2015
National Economy						
Real GDP Growth						
IBO	2.8	3.3	3.5	3.4	3.3	3.0
OMB	2.9	3.2	2.8	3.2	3.4	3.0
Nonfarm Employment Growth						
IBO	-0.7	1.1	1.7	1.8	2.9	2.4
OMB	-0.5	1.4	2.0	2.1	2.1	1.7
Inflation Rate (CPI-U)						
IBO	1.6	1.2	1.8	2.6	2.7	3.3
OMB	1.7	1.6	1.9	2.0	2.3	2.2
Personal Income Growth						
IBO	3.0	5.1	6.5	7.7	5.4	4.7
OMB	3.0	4.9	3.3	4.7	5.7	5.9
Unemployment Rate						
IBO	9.6	9.3	8.3	7.1	5.7	5.5
OMB	9.7	9.3	8.8	8.0	7.3	6.7
10-Year Treasury Bond Rate						
IBO	3.2	3.7	5.0	5.1	4.9	5.0
OMB	3.2	3.6	4.2	4.6	4.8	5.6
Federal Funds Rate						
IBO	0.2	0.2	1.0	3.0	3.8	4.0
OMB	0.2	0.2	1.3	3.4	3.6	4.7
NYC Economy						
Nonfarm New Jobs (thousands)						
IBO	14.7	43.2	64.5	63.3	67.0	57.4
OMB	-10.0	32.0	39.0	41.0	44.0	43.0
Nonfarm Employment Growth						
IBO	0.4	1.2	1.7	1.7	1.7	1.5
OMB	-0.3	0.9	1.0	1.1	1.1	1.1
Inflation Rate (CPI-U-NY)						
IBO	1.5	1.6	2.1	2.5	2.3	2.3
OMB	1.7	1.7	2.0	2.1	2.4	2.4
Personal Income ($ billions)						
IBO	433.3	460.1	486.2	521.2	549.0	580.5
OMB	429.5	446.2	455.0	472.7	496.7	522.5
Personal Income Growth						
IBO	5.2	6.2	5.7	7.2	5.3	5.7
OMB	3.3	3.9	2.0	3.9	5.1	5.2
Manhattan Office Rents ($/sq.ft)						
IBO	62.7	65.0	65.7	66.2	67.1	68.7
OMB	61.6	63.0	66.2	66.6	68.3	72.6

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. IBO's 2010 employment figures are based on "benchmarked" Bureau of Labor Statistics data released March 9, 2011.

in personal consumption expenditures (particularly on durable goods), net exports, and nonresidential fixed investment helped raise GDP. Real personal consumption expenditures finally returned to the peak level they had reached in the fourth quarter of 2007, and private fixed investment in equipment and software came closer to where it had been. The temporary 2 percentage-point cut in payroll taxes and higher expense allowances likely pushed consumption and investment up, while the weaker dollar helped raise exports and lower imports.

In the labor market, February's private sector gain of 222,000 jobs was certainly welcome news after the discouraging gain of 68,000 jobs in January. Despite continued losses of government jobs, total employment has increased for five consecutive months, with average gains per month of 138,700 jobs. At this point, 1.3 million (14.5 percent) of the 8.8 million jobs lost between January 2008 and February 2010 have been regained. The unemployment rate also dropped slightly from 9.0 percent in January to 8.9 percent in February as the number of Americans employed increased by more than the decrease in the number unemployed. The unemployment rate was last below 9.0 percent in April 2009.

This recent news on the labor market strengthens IBO's view that conditions are finally in place for economic growth to accelerate this year. Businesses are enjoying high profits and healthy balance sheets. Households continue to improve their balance sheets as well, thanks partly to very low interest rates and partly to improved stock market returns. Although home values have continued to decline, households have reduced their indebtedness and seen the value of their nonresidential assets rise again. Lenders, as a group, are well capitalized and face higher quality credit applicants and profitable lending margins. Business and consumer confidence remains fragile, but shows signs of improvement. IBO expects businesses to step up hiring and investment in the first half of this year.

IBO forecasts real GDP growth of 3.3 percent this year, with growth accelerating through the year, to reach an annualized rate of 4.1 percent in the fourth quarter,

before slowing slightly next year. Annual real GDP growth is expected to peak at 3.5 percent in 2012 and then stay at 3.4 percent and 3.3 percent in the next two years.

Employment growth is projected to jump sharply in the second quarter of 2011, and then stay at moderate levels through the end of 2012. IBO forecasts an annual employment growth rate of 1.1 percent this year and 1.7 percent next year, and stronger growth in the out-years of the forecast. At least initially, hiring could be constrained because of a substantial mismatch between the skills employers require and the skills of the long-term unemployed. Reduced home values may also limit migration of workers to job locations, particularly those workers whose mortgages exceed the value of their homes. Cuts in state and local payrolls will continue to be a drag on overall employment and continue to offset private-sector employment gains. The prerecession employment peak of 137.9 million jobs in first quarter 2008 is not expected to be reached until the first quarter of 2014. The unemployment rate is expected to continue its decline at a slow pace through 2013, because of slow job growth and return of discouraged workers to the labor force.

IBO forecasts accelerating annual personal income growth of 5.1 percent in 2011, 6.5 percent in 2012, and then 7.7 percent in 2012, as more people become employed, work longer hours, and earn more. Although oil prices are projected to remain high as demands of emerging economies grow and continuing political unrest in the Middle East threatens to disrupt oil supplies, inflation is expected to stay at moderate levels of 1.2 percent this year and 1.7 percent in 2012. IBO expects the Federal Reserve to raise interest rates sharply beginning in 2012 to keep inflation at bay.

In the near term, IBO's U.S. economic forecast is somewhat more optimistic than that of the Mayor's Office of Management and Budget (OMB). Unlike IBO, OMB expects GDP growth to slow sharply in 2012 and their forecast of personal income growth—particularly in 2012 and 2013—is considerably below IBO's. Conversely, OMB expects more rapid employment growth than IBO in 2011 and 2012.

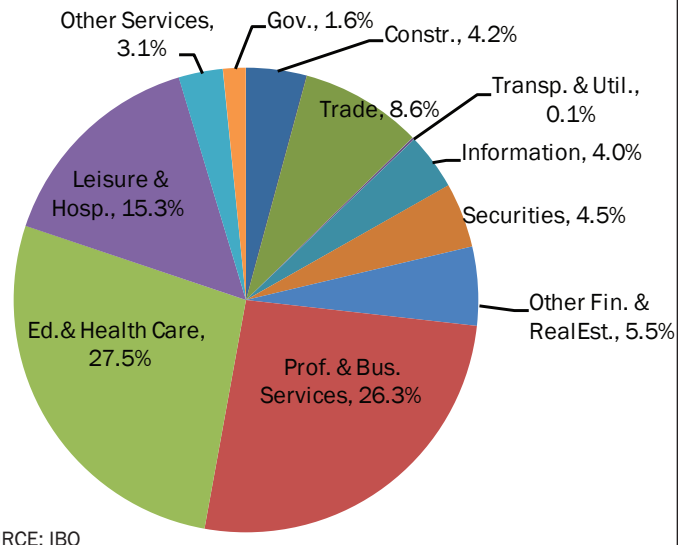
The Local Forecast

Employment and Income in Recession and Recovery. New York City's job losses during the recession of 2008-2009 were less protracted and less severe than the rest of the nation's, and the city's recovery since the beginning of 2010 has been stronger. Indeed, newly revised payroll employment data show that the city's private sector shrank by 131,700 jobs (4.1 percent) over four quarters (the fourth quarter of 2008 through the third quarter of 2009)—20,000 fewer jobs lost and one less quarter (three months) of job losses than previously estimated.[1] Through the end of 2010, the city has already recovered close to half of the private payroll jobs lost—though not the same jobs as were lost.

That the overall losses were not much worse was especially surprising given the convulsions engulfing the city's critical financial sector (which on its own lost 33,000 jobs) during the crisis. That the rebound has gained traction here—and is expected to remain solid—also seems a bit unexpected given the modest projected job gains on Wall Street.

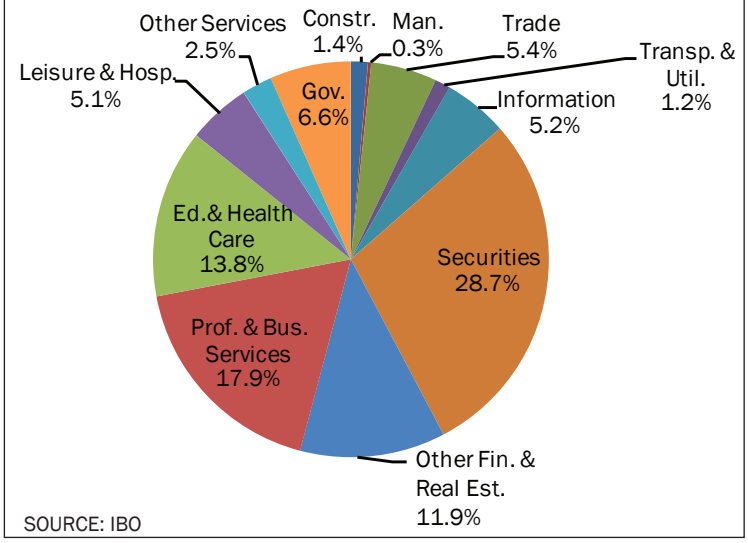
A notably different picture emerges, however, when we move from jobs to incomes. The collapse of earnings in the city was on a scale more consistent with the extent of the dislocations for the U.S. economy as a whole. Real average wages in New York City fell a total of 12.2 percent during 2008 and 2009, by far

Shares of New York City Employment Growth, 2010-2015



SOURCE: IBO
NOTE: Manufacturing contributes -0.01% to 2010-2015 New York City employment growth.

Shares of New York City Aggregate Real Wage Growth, 2010-2015



SOURCE: IBO

the steepest drop on record in the city. And while wages slumped across most of the city's industries, the small but highly paid securities industry alone accounted for close to two-thirds of the aggregate decline. Real average wages in securities nose-dived 27.2 percent over two years (including 23.4 percent in 2009 alone)—again a drop off without precedent, even going back as far as the Great Depression.

Turning to the recovery of the local economy—at least measured by employment—we see a pattern similar to that during the downturn: the city is once again, doing better than the nation. Payroll employment in New York City slipped in the fourth quarter of last year but was still up 55,200 from the fourth quarter of 2009. IBO's forecast calls for another 64,700 jobs to be added by the fourth quarter of 2011, followed by average gains of 61,000 per year through 2015. Education and health care services are expected to generate over a quarter of that job growth (averaging 16,800 jobs added per year from 2010 through 2015) and professional, technical, and business services another quarter (+16,000 jobs per year), while the leisure and hospitality industries (including eating places, hotels, and entertainment) account for another 15 percent (+9,300 jobs per year).

In contrast, the securities industry accounts for less than 5 percent of the city's recent and projected employment gains (averaging 2,800 jobs added per year)—but at the same time close to 30 percent of the aggregate wage gains, nearly as much as will be contributed by business, education, and health care services combined.

Wall Street and Main Street. The securities industry share of aggregate city wage growth in IBO's forecast is actually well below this industry's share of overall wage growth in recent decades (37.3 percent in 1995-2001 and 57.6 percent in 2004-2007). This reflects IBO's outlook for low securities employment growth and for average real wage growth—8.1 percent per year over 2010 through 2015—that is itself relatively tame for this industry. Looking just at the recent and anticipated performance of New York Stock Exchange (NYSE) member firm profits, more might have been expected.[2] Wall Street firms bounced back from catastrophic losses from mid-calendar year 2007 through 2008 (a combined loss of $63.9 billion) to stratospheric profits in 2009 ($61.4 billion), followed by another exceptional year for profits in 2010 ($27.6 billion). IBO's forecast for 2011 is also relatively strong ($21.0 billion).

However, while NYSE member firms' profits have rebounded from the crisis, there has been no such recovery in terms of firms' *revenues*. Wall Street revenues fell almost in half from 2007 ($352.0 billion) to 2008 ($178.1 billion), and had drifted even lower by 2010 ($160.9 billion). Nor do we anticipate much of a rebound over the next few years: only by 2015 do forecast revenues (barely) top $200 billion again. This does not lend itself to rapid growth in hiring.

With revenues so depressed, it has been the extraordinary plunge in interest costs—the result of federal funds rates being reduced to nearly zero to combat the fiscal crisis—that generated the enormous Wall Street profits of the past few years, and it is the gradual return towards something approaching normal interest rates and costs that gradually squeezes profits in our forecast (down to $14.9 billion in 2012 and $11 billion to $12 billion per year thereafter).

Turning to Main Street, the forecast for New York City employment growth from 2010 through 2015 also includes contributions from wholesale and retail trade (averaging a combined 5,200 jobs added per year), other financial services and real estate (a combined 3,400), construction (2,600), and information (2,400). Except for information, projected employment growth in these industries lags below prerecession levels. In

part, this reflects our tempered expectations regarding Wall Street—and how many dollars Wall Street firms and their employees are pumping into the broader city economy—but other factors are at play as well.

The moderate gain in construction (and real estate) employment flows directly from conditions in the city's commercial and residential property markets, where prices have been firming but activity remains sluggish. This is especially true on the commercial side, where even with significantly increased activity in the second half of the year, aggregate sales revenue for the whole of 2010 was barely a quarter of the peaks reached in 2007 and 2008.

New York City retail trade employment recovers a bit more slowly than might be expected given the forecast for growth in real personal income (a robust 5.3 percent per year average over 2010–2015) and continued strength in tourism coupled with increases in business travel. But average growth in the city's real after-tax disposable income is a full percentage point lower (4.3 percent). This is a consequence of the expiration of federal tax cuts included in the recent stimulus packages and to other projected policy impacts.

Policy Boosts and Risks in the Forecast

There are considerable downside risks to IBO's national economic forecast. Sustained upward pressure on oil prices because of concerns about political instability could constrain economic growth both here and abroad. Home construction is usually a major factor in economic recoveries, but not in the current recovery. IBO expects the decline in home prices to continue as the glut created in the housing boom is gradually depleted. Although office employment is expected to rise, incentives for new commercial construction are expected to stay low until office vacancy rates come down.

Both our national and local growth forecasts for 2011 has been strengthened somewhat by the federal tax cut extensions and additions enacted in December—an additional stimulus package in all but name. These measures, however, have exacerbated the already fraught federal deficit and debt outlook, and uncertainty over what this may imply for future federal spending and taxes—and for inflation and interest rates—hangs over the out-years of our forecast.

There is also some uncertainty about what happens after the December round of stimulus ends. Demand is receiving a boost through the temporary 2 percentage-point break in employment taxes, but employment and earnings growth could weaken after the cut expires at the end of this year, just as consumption slackened in early 2010, in part due to the waning of the 2009 stimulus program. Similarly, the December stimulus package provides a boost to business investment through a short-term loosening of expensing rules. This may shift some investment into this year, but once the stimulus is withdrawn the pick-up in business investment may weaken.

Closer to home, New York State is also grappling with daunting budget gaps, and the response to this includes probable large cuts in state aid to the city (discussed elsewhere in this report) and an attempt to curb the growth—and actually cut the costs—of Medicaid.

The cuts in state aid and in direct state outlays are likely to have consequences for government employment in the city. Government payrolls have already fallen by 4,800 in 2009 (fourth quarter to fourth quarter) and 1,600 in 2010. A larger decline of 8,500 is projected for 2011, with local government accounting for most of the drop, after which we anticipate a return to fairly tepid growth. IBO's forecast anticipates impending state cutbacks, but it remains to be seen if we have been sufficiently guarded in this part of our outlook.

Also unknown at this point is how Medicaid funding changes and cuts may impact health care services employment. Over the past four decades nothing has interrupted or even appreciably slowed the growth of this sector in New York City—not crisis, not recession, not the shifts in comparative advantage that have winnowed other industries here. But this has been in no small part due to the ever rising tide of mandated public health spending (principally in Medicaid and Medicare) through all these years.

If part of that funding tide is now dammed (at least temporarily) by implementation of the Governor's Medicaid reform program, retrenchments among hospitals, managed care providers, and other

health care institutions may follow. In the slightly longer term, federal health care reform introduces further unknowns with respect to funding and cost containment in the industry.

Wall Street is also the locus of major policy uncertainty, in the form of potential restructuring needed to comply with the Dodd-Frank legislation, as well as new bonus restrictions recently proposed by Securities and Exchange Commission. On top of the revenue crunch discussed above, the fallout from the crisis has already impelled a shift away from cash bonuses in the financial sector, with more pay channeled into deferred compensation and (to some extent) baseline salaries. Bonus regulation and other elements of the Dodd-Frank financial overhaul would appear to further reduce the prospects of a return to former rates of wage growth on Wall Street.

Endnotes

[1]When government jobs are included, the downturn had about the same depth (134,700 total payroll jobs lost) but lasted through the fourth quarter of 2009. A large drop in reported local government employment at the end of 2009 was due to an unusually large summer youth employment program in July and August 2009.

[2]Note that the member firm revenues, expenses, and profits reported by the NYSE encompass the broker/dealer operations, including investment banking, trading, underwriting, and commissions, but not asset management.

Taxes and Other Revenue

Large revenue increases from a variety of taxes plus a rise in federal categorical grants are fueling a projected $2.3 billion increase in 2011 total revenues—3.5 percent greater than 2010 revenue. In this section, all references are to fiscal years, unless otherwise noted. Revenues are projected to increase in subsequent years as well, from $66.2 billion in 2012 rising to $72.6 billion in 2015. The average annual rate of revenue growth in the forecast period is 2.6 percent—the result of a forecast of faster growth in tax collections offset by a projected decline in revenues from nontax revenue sources. A slight decrease in nontax revenue is projected this year, to be followed by a 8.7 percent decrease in 2012 and little growth thereafter. In contrast, 7.5 percent growth of tax collections is forecast for 2011, followed by average annual tax

IBO Revenue Projections

Dollars in millions

	2011	2012	2013	2014	2015	Average Change
Tax Revenue						
Property	$16,839	$17,549	$18,266	$18,968	$19,765	4.1%
Personal Income	7,256	8,156	8,943	9,290	10,071	8.5%
General Sales	5,607	5,941	6,228	6,531	6,650	4.4%
General Corporation	2,433	2,809	3,021	3,333	3,586	10.2%
Unincorporated Business	1,644	1,867	2,005	2,079	2,191	7.4%
Banking Corporation	1,184	1,128	856	883	922	-6.1%
Real Property Transfer	743	775	799	901	996	7.6%
Mortgage Recording	439	498	548	616	684	11.7%
Utility	407	422	440	453	470	3.7%
Hotel Occupancy	422	393	425	441	457	2.0%
Commercial Rent	601	611	621	630	639	1.5%
Cigarette	75	71	69	68	66	-3.1%
Other Taxes, Audits, and PEGs	1,371	1,099	1,099	1,119	1,119	-4.9%
Total Taxes	**$39,020**	**$41,319**	**$43,320**	**$45,312**	**$47,616**	**5.1%**
Other Revenue						
Anticipated State Aid	-	$600	$600	$600	$600	n/a
STaR Reimbursement	722	808	880	879	880	5.1%
Miscellaneous Revenues	4,289	4,250	4,302	4,367	4,397	0.6%
Unrestricted Intergovernmental Aid	14	12	12	12	12	-3.7%
Disallowances	(15)	(15)	(15)	(15)	(15)	0.0%
Total Other Revenue	**$5,010**	**$5,655**	**$5,779**	**$5,844**	**$5,875**	**4.1%**
Total City-Funded Revenue	**$44,030**	**$46,974**	**$49,099**	**$51,156**	**$53,491**	**5.0%**
State Categorical Grants	$11,525	$11,300	$11,321	$11,367	$11,368	-0.3%
Federal Categorical Grants	8,212	6,252	6,119	6,088	6,087	-7.2%
Other Categorical Aid	1,330	1,201	1,197	1,195	1,191	-2.7%
Interfund Revenues	559	500	493	493	493	-3.1%
Total Revenues	**$65,656**	**$66,228**	**$68,229**	**$70,298**	**$72,630**	**2.6%**

SOURCE: IBO

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

revenue growth of 4.8 percent, through 2015. IBO's forecast that the current economic recovery will lead to continued economic growth throughout the forecast period underlies the tax forecast.

Nontax Revenues. The city's nontax revenue sources plus categorical state and federal aid provide 40.6 percent of the funding in the city's budget this year, and about 35 percent in each of the subsequent years. The city's own nontax revenue sources include unrestricted intergovernmental aid, other categorical grants, School Tax Relief (STAR) reimbursements, interfund capital transfers, and miscellaneous revenue from a variety of sources, including fines, license fees, interest and rental income, water, and other charges.

IBO's forecast of nontax revenues for this year is $26.6 billion, a $118 million decrease (-0.4 percent) from 2010 revenues. A $512 million increase in federal categorical grants to $8.2 billion accounts for most of the change from 2010 to 2011. But in 2012, projected federal grant revenues decline by $2.0 billion and remain at that lower level throughout the forecast period, bringing total nontax revenues down to $24.3 billion in 2012, with little growth in subsequent years. Most of the decline in federal revenue comes from the winding down of the American Recovery and Reinvestment Act stimulus money, which totaled $1.6 billion in 2011. The act's funding for expenditures in education, public safety, neighborhood stabilization, energy efficiency, infrastructure, and debt service for bond programs falls from $1.3 billion this year to $34 million in 2012. Stimulus funds for health and social support, community development, economic and workforce development, the city university system, and COBRA, which totaled $155 million in 2011, are eliminated altogether in the 2012 budget.

State categorical and other categorical grants are also expected to decline, though not at as fast a pace as federal grants. Only STAR reimbursements and miscellaneous city revenues are expected to increase after the current year, but their annual revenue together increases by only $266 million from 2011 through 2015.

Tax Revenues. In contrast to IBO's forecast of modest growth of nontax revenue, for this year we expect a large 7.5 increase in tax revenue over 2010 collections. The forecast of total tax collections (including audit revenue) in 2011 is $39.0 billion, $2.7 billion greater than 2010 collections. Eliminating STAR's personal income tax (PIT) rate cut for filers with $500,000 or more taxable incomes is boosting 2011 collections relative to 2010 by an estimated $228 million, but this is the only substantial tax policy change affecting 2010-2011 growth. After 2011, growth is projected to be steady if more moderate, at an average annual rate of 4.8 percent. Projected tax revenue is $41.3 billion in 2012, rising to $47.6 billion in 2015.

IBO's 2011 forecast is $285 million higher than our December forecast. Though the economic outlook has improved, collections so far in the year have prompted downward revisions in forecasts of the PIT, unincorporated business tax (UBT), and the banking corporation tax (BCT). These revisions, however, are more than offset by higher projections, relative to the December forecast, of the real property, general corporation, general sales, and real estate transfer taxes.

With an outlook for accelerating economic growth this calendar year and next, IBO's forecast of total revenues in 2012 is $2.3 billion (5.8 percent) greater than the 2011 forecast. Revenue from all the major taxes is projected to increase in 2012, with the exceptions of the highly volatile BCT and the hotel occupancy tax; in the latter the expiration of a temporary tax increase will reduce 2012 collections relative to 2011. For 2013 through 2015, revenue growth slows, but receipts of all the major taxes, are expected to steadily increase throughout the forecast period.

IBO's forecast for the current year is $236 million less than the Preliminary Budget forecast, due mostly to lower PIT, UBT, and BCT projections. Only our sales tax forecast is substantially higher than that of the Mayor's Office of Management and Budget (OMB). In 2012 and beyond, our forecast of faster economic growth compared with the Mayor's leads to a total revenue forecast $217 million greater than OMB's in 2012, and greater by much large amounts thereafter. Higher levels of income and employment in our forecast, relative to the Bloomberg Administration's, fuel our greater forecasts of PIT and sales tax growth, and higher rates of economic growth are fueling more general corporation tax (GCT) and UBT growth compared with the Bloomberg Administration's. IBO's

stronger forecast of market values and assessments, relative to OMB, account for our higher property tax forecast in 2013 and especially in the following years.

Real Property Tax

IBO projects that property tax revenues will grow from $16.8 billion in 2011 to $17.5 billion in 2012, a 4.2 percent increase. The current 2012 revenue forecast is roughly the same as our December 2010 forecast, with higher than expected assessed value for tax purposes on the tentative 2012 assessment roll offset by a higher reserve for abatements, delinquencies, and other adjustments. Property tax revenue will grow throughout the plan period at an average annual rate of 4.0 percent.

Numerous changes instituted by the Department of Finance (DOF) led to some significant—and somewhat unexpected—changes in market values this year. The tentative assessment roll for 2012 showed higher than expected market value growth, especially among larger residential properties (defined as residential buildings with 11 or more units) at 12.8 percent. Conversely, smaller residential buildings saw market value declines of almost 15 percent. There has been considerable pushback against these increases, especially from owners of apartment buildings, coops, and condominiums in Manhattan and Queens. As reported by the *New York Post*, the Department of Finance has already adjusted the market value of more than 2,000 apartment buildings by limiting market value increases to 50 percent in response to complaints by property owners. To account for these and other changes that IBO expects as the finance department continues its review, we have projected a larger than usual reduction from the tentative to final roll, about $1.6 billion or 1.0 percent in assessed value for tax purposes.

The robust market value growth of the real estate boom which was still being phased into assessments helped maintain property tax assessments during the downturn so that annual growth in assessed value for tax purposes averaged 5.4 percent from 2009 through 2011, down only moderately from the average of 6.0 percent a year from 2002 through 2009. For large residential buildings and all commercial property, the rapid growth seen during the boom is being phased in over a five-year period—this backlog of accumulated growth waiting to be phased in is called the pipeline. When market values declined or grew more slowly in recent years, that pipeline provided a cushion and assessments continued to increase. The pipeline would have been largely exhausted if market values on the 2012 assessment roll had at least sustained the trend of slowly declining market values. However, the very robust growth seen on this year's tentative assessment roll will replenish the pipeline and lead to continued growth in assessed value for tax purposes over the forecast period.

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.[1] Under New York State property tax law, there are four tax classes for the city: 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 (10.1 percent of assessed values on the 2011 roll compared with 49.2 percent of total market value in the city). The other classes, especially Classes 3 and 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.

The Tentative Assessment Roll for 2012. In January, the Department of Finance released the tentative 2012 assessment roll. After taxpayer challenges and other department adjustments are processed, the assessment values will be finalized in May and used for setting 2012 tax rates and bills. Implementation of updated computer models, automation of comparable building selection, and a switch in assessment methodology for certain residential properties resulted in some dramatic increases and decreases in market values, although as noted, IBO expects that a

somewhat greater share of these changes (at least the increases) may be reversed this year after review by the department and the city's independent Tax Commission.

Excluding utility property, which is assessed by the state in April, overall market value grew just 3.9 percent. Aggregate market value on the tentative 2012 roll grew robustly for large apartment buildings and commercial properties, 12.8 percent and 10.0 percent, respectively, while one-, two-, and three-family homes saw modest growth and smaller apartment buildings saw a decline of 14.8 percent. Comparing market values on the tentative roll with the final roll for 2011, IBO found that 7.3 percent of apartment buildings and 4.6 percent of commercial properties saw their market values increase by more than 50.0 percent, while 4.7 percent of residential buildings in Class 2 saw market value decline of more than 50.0 percent.

Excluding Class 3 utility property, aggregate assessed value for tax purposes grew 7.1 percent on the tentative 2012 roll. Assessed value for tax purposes, used to calculate property tax bills, grew more slowly than market value—8.5 percent for large apartment buildings and 7.3 percent for commercial property—because certain features of the property tax moderate growth in assessed value. Assessed value for tax purposes grows at a different rate than market value because the methods used to determine assessed value for most property types incorporate both past and current market value changes (see Stabilizing Revenue Collection During the Downturn: How Assessment Phase Ins and Caps Affect the City's Property Tax).

Apartment Buildings with More than 10 Units. Two changes were implemented simultaneously that affected assessments for residential buildings with more than 10 units. First, the Department of Finance went back to using the more traditional income capitalization method which had been replaced by gross income multipliers (GIMs) beginning with the 2009 tax roll. (Income capitalization had remained the approach to value most Class 4 properties.) At the same time, the department implemented a computerized system for selecting comparable rental buildings for valuation of cooperative and condominium buildings (use of income from comparable rentals rather than sales prices is required for valuing these properties under state law). Additionally, increased compliance in reporting required income and expense statements (the number of nonfilers has declined by 64 percent since 2007) may have factored in as well.

The gross income multiplier is just as it sounds—market value equals gross income times a multiplier, which is set annually by the finance department. Under income capitalization, gross income less expenses is divided by a capitalization rate (set by DOF each year) to determine market value. Income capitalization is often preferred for estimating market value because it incorporates more information, considering not only the income of a building, but also its expenses. For example, two buildings of equal size could have similar income and therefore similar market value under GIMs. However, if their expenses differ significantly, because of building characteristics such as age or services, this would not be reflected in their valuation. In contrast, under income capitalization, both factors would be considered in setting the value.

Under state law, cooperative and condominium buildings are valued based on the income and expenses of a comparable rental building. With this tentative roll, DOF implemented a new computer model to select comparable rental buildings. It appears that selection of comparable buildings, especially in certain areas of the city, such as northeast Queens, led to dramatic increases in market value this year.

However, because we do not have comparable data for 2011 and 2012, we cannot determine how much of the change seen on the tentative 2012 roll stems from change in net operating income (actual growth as well as changes stemming from selection of the comparable building) versus the change in assessment methodology. A detailed comparison would require that we have income and expenses data for both years, as well as know what the capitalization rates would have been in 2011 and the GIMs in 2012. Furthermore, the database of comparable buildings used in 2012 has not yet been made public by DOF. Since we only have gross income data in 2011, it is not possible to parse out how much of the increase results from changes in income, rather than the change in methodology. Given that the shift to GIMs in 2009 appeared to redistribute market value within the class, with certain groups of properties seeing significant increases or decreases,

it is reasonable to assume that the shift back would also redistribute market value among large buildings (see March 2008 report for IBO's analysis of change to GIMs).

Rental Buildings with Four or Five Units. A change in assessment methodology also appears to have resulted in dramatic declines in market value for small rental buildings with four or five units in Class 2A. Last year, these buildings were assessed based on comparable sales, like one-, two-, and three- family homes in Class 1. Rental buildings with six units, also in Class 2A, however, were assessed based on projected income and a GIM. However, since state law requires that all properties in a tax class be assessed the same way, in 2012 DOF switched to assessing rental buildings with four and five units using GIMs. This switch appears to have led to major reductions in market values for these buildings. The assessed value for tax purposes was much less likely to decline because the cap limiting increases in assessed value to 8.0 percent a year or 30.0 percent over five years had left many of these buildings under-assessed relative to the target assessment ratio of 45.0 percent of market value. In most cases, the lower market value for 2012 still left the properties below the target ratio which allowed assessed value to grow until it hit the target ratio or the cap. Just 1.2 percent of properties in Class 2A saw lower assessed value for tax purposes on the 2012 roll compared with 2011.

Commercial Property. For commercial properties, the increase in aggregate market value stems from higher income as well as lower capitalization rates. The market value of a commercial property is estimated by dividing the net operating income by the capitalization rate, so lower capitalization rates translate into higher estimated market value at the same level of income. Across different types of commercial property, 2012 cap rates as set by the finance department declined by about 90 basis points to 110 basis points for properties with median income.

Projected Tentative to Final Roll Changes. As noted, IBO projects a larger than usual reduction on the 2012 roll resulting from departmental changes and decisions by the Tax Commission. A downward revision to aggregate market value is expected, reducing the tentative roll by about 1.2 percent. The final roll is expected to show assessed value for tax purposes of $157.0 billion, a reduction of $1.6 billion (1.0 percent) from the tentative roll. Looking at assessed value for tax purposes, projected tentative roll reductions of $1.3 billion in Class 2 and $1.0 billion in Class 4 are partly offset by tentative roll increases of $655 million in utility property (in anticipation of the state assessment due in April) and $73 million for one-, two-, and three-family homes.

The Outlook for Market Value and Assessed Value in 2012. When the roll is finalized in May, IBO forecasts total market value in the city will be $813.4 billion, 2.5 percent greater than 2011. This growth follows two years of aggregate market value decline in the city. Even with a larger than usual tentative to final roll reduction expected, assessed value for tax purposes is still projected to grow 5.5 percent over 2011.

Class 1. The aggregate market value of Class 1 properties is expected to resume growth, albeit at just 0.3 percent this year. This reverses the trend of the last three years, 2009 through 2011, when aggregate market value declined by 5.0 percent, 1.0 percent, and 2.8 percent, respectively. But IBO projects stronger growth in assessed value for tax purposes, an increase of 3.2 percent over 2011. In Class 1, the assessed value of a property moves toward a target of 6 percent of market value, with assessment increases capped at 6.0 percent a year or 20.0 percent over five years. If a parcel is assessed at less than 6.0 percent of market value, its assessed value grows until it hits the target ratio of 6.0 percent of market value or it reaches the cap on annual assessment increases—even if the market value stays flat or declines.

During the period of surging real estate prices, many Class 1 properties benefited from the caps on assessment increases that kept their 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 6.0 percent target. Since 2009, when Class 1 market values started to decline, the median assessment ratio has been increasing, to 4.0 in 2009, 4.6 percent in 2010, and 5.0 percent in 2011. In 2012, IBO forecasts a median assessment ratio of 5.1 percent. From 2013 through 2015, assessed 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 6.0 percent target.

Class 2 and Class 4. On the final roll for 2012, aggregate market value for all properties in Class 2 is projected to total $191.0 billion, 1.1 percent greater than 2011. This relatively slow growth overall reflects the divergent changes seen on the tentative roll—12.8 percent growth for large apartment buildings and a 14.8 percent decline for residential buildings with 4 to 10 units. In Class 4, market value is expected to reach $205.0 billion, an 8.1 percent increase over 2011. Class 2 aggregate assessed value for tax purposes is expected to be $53.9 billion, 5.2 percent higher than 2011, and Class 4 is expected to be $75.1 billion, 5.9 percent higher than 2011. Growth in assessed value for tax purposes is less variable than growth in market value and the projected growth in 2012 is in line with average annual growth rates from 2006 through 2011 of 5.6 and 6.9 percent, in Classes 2 and 4, respectively.

This more stable growth in assessed value for tax purposes stems partly from the method for capturing changes in market value. Increases, and 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. While slower growth in the last few years had gradually shrunk the pipeline, the strong growth this year will replenish it. IBO expects the pipeline to reach $13.3 billion in 2012, up from $6.7 billion this year.

Outlook for Market and Assessed Values in 2013–2015. For 2013, IBO forecasts an increase in aggregate market value of 2.1 percent. Growth in market value is projected at 1.1 percent in Class 1, 3.9 percent in Class 2, and 2.1 percent in Class 4. For the rest of the forecast period, these classes are expected to see market value growth averaging about 3.1 percent a year.

IBO projects growth of 3.6 percent in aggregate assessed value for tax purposes in 2013, slightly slower than the last few years corresponding with the slower projection for market value growth. With the pipeline of prior assessed value increases in Class 2 and Class 4 replenished by the strong growth in 2012, the growth rate for assessed value for tax purposes averages 4.0 percent a year for the rest of the plan period.

Class 1. IBO projects that following declines from 2009 through 2011 and essentially flat market value in 2012, Class 1's aggregate market value resumes modest growth of about 2.0 percent a year from 2013 through 2015. Total assessed value for tax purposes in Class 1 is expected to grow an average of 2.6 percent a year, as assessed values inch toward the 6.0 percent assessment ratio.

Class 2 and Class 4. From 2013 through 2015, market value in Class 2 is forecast to grow an average of 4.4 percent a year. In Class 4, market value is expected to grow at an average annual rate of 3.8 percent a year from 2013 through 2015.

In 2013, assessed value for tax purposes in Classes 2 and 4 will grow moderately, 3.5 percent and 3.9 percent, respectively, in part due to the phase-in of robust market value growth in 2012. The Class 2 pipeline, estimated at $6.1 billion in 2012, is expected to grow gradually to $6.4 billion in 2013 and $6.7 billion in 2014. IBO projects the total pipeline in Class 4 to be $7.3 billion after the 2012 roll is finalized, declining slightly to $6.1 billion and $6.2 billion in 2013 and 2014, respectively. While modest growth in market value expected during the plan period will keep the pipeline steady, the significant increases in this year's assessment roll that doubled the value of the pipeline will be a major source of growth in assessed values as they phase in through 2016.

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 average tax rate during the forecast period will be 12.28 percent, the rate set by the City Council in December 2008 when it enacted the Mayor's proposal to rescind a short-lived 7 percent rate reduction. The rate in each class differs from the average rate based on formulas in state law intended to limit changes in the share of the overall tax burden borne by each class.

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 2011 will total $16.8 billion, 4.0 percent above revenue for 2010. For 2012, IBO forecasts property tax revenue of $17.5 billion, roughly the same as our December 2010 forecast. An increase of $207 million in IBO's forecast of the levy is offset by a $193 million increase in our forecast of the reserve. The adjustments to the reserve reflect expected increases in certain abatements, decreases in overpayments and payments for prior years, and higher refunds.

From 2013 through 2015, growth is projected to average 4.0 percent a year, with revenue totaling $19.8 billion by the last year of the forecast period. This projected revenue growth is slower than the average annual growth of 6.6 percent from 2005 through the current year.

IBO's property tax revenue forecast is just $8 million (0.1 percent) below OMB's for 2011 and $94 million below OMB's for 2012. This difference stems mainly from IBO assuming a slightly greater reduction from the tentative roll to the final roll and from modest differences in estimates of the property tax reserve. With IBO forecasting stronger growth in market values and assessments in 2013, our revenue forecast for that year is $69 million higher than OMB's. In 2014 and 2015, IBO's forecast further diverges from OMB's due to differences in our outlook for the real estate market.

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

STAR Eliminated for High-Income Households. New York State has eliminated the STAR property tax exemption for owners with income over $500,000. Income is based on the federal adjusted gross income (AGI) calculated for income tax purposes, less taxable individual retirement account distributions. IBO estimates that this change makes about 31,000 city household ineligible for STAR (roughly 4.7 percent of current STAR recipients) and affects mainly owners of cooperatives and condominiums in Manhattan. The change does not impact overall city revenues because the state reimburses the city for tax revenue lost to the STAR exemption. Removing these property owners from STAR means that their property tax will go up and the city's reimbursement from the state will decline by an equivalent amount. Owners no longer eligible for STAR would see their property taxes increase by about $290. In effect, about $8.9 million in property tax liability is being shifted from the state to city taxpayers.

Property Tax Incentives for Construction Have Expired. Certain major property tax exemption programs have expired. Benefits under 421a, the costliest tax exemption for residential construction, expired in December 2010. Applications for the Industrial and Commercial Abatement Program, the successor to the largest commercial tax exemption, the Industrial and Commercial Incentive Program (ICIP), established in 2008, were due by March 1, 2011. In 2011, foregone tax revenue from 421a and ICIP was $920 million and $623 million, respectively. Extension of both programs requires legislative action in Albany. IBO expects that these programs will be on the agenda once the state budget is resolved. IBO's forecast assumes continuation of the programs.

Coop-Condo Abatement. The coop-condo abatement provides a reduction in property taxes for owners of cooperative and condominium units. Established in 1997, the abatement is intended to reduce some of the disparities in tax burdens between owners of apartments and houses. It was conceived as a temporary fix while the Department of Finance resolved technical challenges and considered ways to permanently address the disparities. The abatement was due to expire in 2008, but the state Legislature extended it for another four years. The abatement, which will cost the city about $450 million in foregone revenue this year, is slated to expire next year, thereby affecting the 2013 tax roll, unless the state passes a further extension. IBO's forecast assumes continuation of the abatement.

IBO has documented shortcomings of the abatement—it was supposed to be temporary, does not address disparities among apartment owners, and is inefficient (if the goal was to equalize tax burdens for apartment and homeowners, the abatement provides more relief than needed to some owners and less to others). The legislation creating the abatement directs the city to prepare a report with recommendations for addressing the disparities between owners in Class 1 and owners of coop and condo apartments in Class 2. The city missed the initial report deadline of June 30, 1999, and

it has missed several others set by the Legislature since then. Although the most recent (2008) extension of the abatement pushed back the deadline for the city's report on disparities between Class 1 and Class 2 owners to February 2011, no report has yet been released.

Mortgage Recording and Real Property Transfer Taxes

After peaking in 2007 and then declining for three straight years, revenues from the real property transfer tax (RPTT) and the mortgage recording tax (MRT) are recovering. IBO projects that RPTT revenue in 2011 will be $743 million, 20.8 percent above the level of 2010. MRT revenue is projected to increase by 19.9 percent, to $439 million. RPTT revenues are projected to rise an additional 34.1 percent in 2012 through 2015, and MRT revenues an additional 55.8 percent. Despite this robust growth, however, IBO expects transfer tax revenue in 2015 to total $1.7 billion, just over half the record amount collected in 2007.

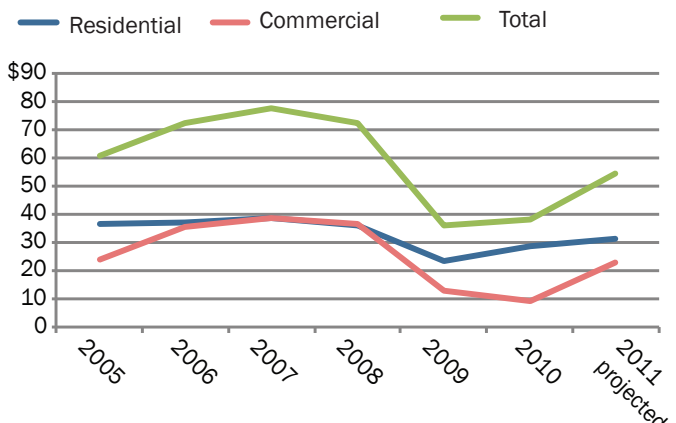
Background. The RPTT is levied directly on the sale price when property is sold and is typically paid by the seller, and the MRT is levied on mortgages used to finance the purchase of real property and is paid by the buyer. The portion of a mortgage refinancing that involves new money ("cash out") is also subject to the MRT, as are mortgages that are refinanced with a different lender unless the original 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. Since 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 above $500,000 (commonly referred to as the "urban tax") is dedicated to the Metropolitan Transportation Authority (MTA)—the urban tax is discussed separately and is not included in the RPTT and MRT revenues shown in this report.

Real Estate Markets. Real estate markets continued to show signs of recovery during the first half of the current fiscal year. The aggregate value of taxable real estate sales from July through December 2010 was around $28.4 billion, a 18.8 percent increase over the prior six months. There was a similar increase in real estate sales between the second half of (fiscal year) 2009 and the first half of 2010. The difference is that in July-December 2009 the growth was driven primarily by residential sales, while in July-December 2010 the main driver was the commercial sector.

Residential Properties. The total value of residential real estate sales in New York City is projected to increase 10.1 percent in 2011, compared with a 22.2 percent increase in 2010, which was artificially inflated by the federal homebuyer tax credit that is no longer available. A combination of pent-up demand, low mortgage rates (for buyers who qualify), and prices that are below their peak of a few years ago will continue to provide growth in aggregate sales in the coming years. IBO projects that the value of residential sales will increase at an average annual rate of 6.2 percent during 2012 and 2013, and 12.1 percent during 2014 and 2015. Because prices of residential properties are forecast to increase at a lower rate, IBO expects the increase in aggregate sales value to be driven primarily by volume.

Commercial Properties. Sales of commercial real estate in New York City rebounded sharply in the first half of 2011. There were 17 sales of commercial properties valued at more than $100 million during this period, compared with 11 sales during all of 2010. Google's $1.77 billion purchase of its new New York City headquarters at 111 8th Avenue has been by far the largest transaction this fiscal year. The surge

Aggregate Value of Property Sales, 2005-2011
Dollars in billions



SOURCES: IBO; Department of Finance

of high-valued commercial transactions since the beginning of July 2010 has pushed the total value of commercial sales well above the levels of the previous two years. IBO projects commercial sales for the current fiscal year will reach $22.8 billion, compared with only $9.4 billion in 2010. The average annual rate of growth of commercial sales during 2012-2015 is projected to be a much more modest 3.5 percent.

Real Property Transfer Tax. IBO's forecast of RPTT receipts in 2011—$743 million—is 20.8 percent above 2010 revenue. It is also around 10.1 percent above what IBO had projected in December, primarily due to the surge in sales of commercial properties valued at more than $100 million.

With slow but steady improvement in real estate markets expected over the next several years, IBO forecasts increases in RPTT revenue of 4.3 percent in 2012, 3.1 percent in 2013, 12.8 percent in 2014, and 10.5 percent in 2015. By 2015, RPTT revenue is projected to be $996 million, almost two-thirds higher than the 2010 trough, but still only 57.8 percent of the 2007 peak of $1.7 billion.

IBO's RPTT forecast for 2011 is $25 million (3.3 percent) below OMB's; unlike the Bloomberg Administration, IBO assumes that sales of commercial real estate will not be as strong in the second half of the fiscal year as they were in the first. Beginning in 2012, IBO's RPTT forecast exceeds OMB's by $5 million (0.6 percent) in 2012, $14 million (1.8 percent) in 2013, $51 million (6.0 percent) in 2014, and $25 million (2.6 percent) in 2015.

Mortgage Recording Tax. IBO's MRT forecast for 2011—$439 million—is 19.9 percent above 2010 revenue. Since December, IBO has raised its current-year forecast by 9.8 percent due to strong second-quarter collections.

MRT revenues fell an unprecedented 77.1 percent between their peak in 2007 ($1.6 billion) and their trough in 2010 ($366 million). IBO expects MRT revenues to increase 13.4 percent in 2012 and 10.0 percent in 2013, higher than the forecast rate of RPTT growth. MRT growth is expected to be faster than RPTT growth in part because residential sales are projected to grow faster than commercial sales, and residential sales are assumed to rely more on conventional mortgage financing than transactions involving commercial buildings. Strong growth in MRT is expected to continue in 2014 (12.4 percent) and 2015 (11.0 percent), propelled by increases in both residential and commercial real estate activity. The MRT increases for 2014 and 2015 are similar to the forecast trend in RPTT. However, because the MRT begins from such a low base, by 2015 forecast collections are only expected to reach $684 million.

IBO's MRT forecasts for the years 2011-2015 are slightly below OMB's. Compared with OMB, IBO's forecasts are lower by 1.1 percent in 2011, less than 1.0 percent in 2012 through 2014, and 3.0 percent in 2015.

MTA-dedicated Revenue. The Metropolitan Transportation Authority receives a portion of the city RPTT and MRT levied on commercial transactions valued above $500,000. These revenues, referred to collectively as the urban tax, peaked at $883 million in calendar year 2007. By 2009, urban tax revenues had plummeted to $145 million, less than one-sixth of the peak level reached just two years earlier. Thanks to the recovery in the commercial real estate market, urban tax revenues began a comeback—albeit slight—in 2010, with revenues of $188 million (subject to final revision). The MTA projects that urban tax revenues will rise to $250 million in calendar year 2011, and reach $353 million by 2014.

Personal Income Tax

Though economic growth has continued as expected, trends in current collections has led IBO to lower its 2011 personal income tax forecast to $7.3 billion, $329 million less than the December projection. Still, the new forecast is 5.8 percent greater than 2010 revenue. With local economic growth expected to accelerate in the next few years and income growth peaking in the first half of calendar year 2013, we forecast faster revenue growth in the next two years. PIT revenues will reach $8.2 billion in 2012 and $8.9 billion by 2013, the first year in which collections will exceed the record amount collected in 2008. We expect the PIT to continue to increase in the two subsequent years, but at a slower pace averaging 6.1 percent annually, and reach $10.1 billion in 2015.
Our 2011 forecast is $221 million below OMB's

estimate in the Preliminary Budget. For 2012, there is little difference in the two forecasts. Due to the generally faster economic growth in IBO's forecast, after 2012 IBO's PIT forecasts are substantially higher than OMB's, by $509 million in 2013, $365 million in 2014, and $550 million in 2015.

Background and Recent Changes. The personal income tax is levied on the incomes of city residents. For most of the past decade, taxable income was subject to four marginal rates but last year the state Legislature added a fifth bracket, retroactive to the beginning of calendar year 2010.[2] The marginal rates in the city's tax table reflect not only a base rate plus a surcharge but also take into account the state-financed tax cut under the School Tax Relief program. Since the beginning of calendar year 2001, STAR established marginal rates ranging from 2.907 percent in the lowest of four brackets to 3.648 percent in the highest bracket. Under STAR the state reimburses the city for the PIT revenue forgone due to the tax cuts—an amount estimated to have been $462 million in 2010.[3] Thus, the net effect of STAR on total city revenues is zero.

In seeking to address the huge deficit in New York State's budget, last summer the Legislature in Albany eliminated STAR's rate cut for filers with incomes above $500,000, effectively creating for these filers a fifth bracket with a 3.876 percent marginal rate. The law was written to make the change retroactive to the start of calendar year 2010. This change is increasing the liabilities of high-income taxpayers by an estimated $175 million a year—an amount offset by an equal reduction in STAR aid.

Fueled primarily by a strong economy bouncing back after the 2001-2003 recession, PIT receipts grew from $4.5 billion in 2003 to $8.7 billion in 2008, at an annual average rate of 14.4 percent. While the recent recession had relatively less of an effect on local employment or economic growth than it did nationwide, it led to a sharp drop in personal income and a 24.7 percent drop in PIT revenue in 2009, to $6.6 billion. PIT growth resumed in 2010, with a total of $6.9 billion in revenue (4.1 percent growth).

Revenue in the Current Year. With the local and national economic recovery under way, IBO forecasts 5.8 percent growth in PIT revenue in 2011, to $7.3 million. Withholdings, estimated payments, and final returns payments are all expected to be greater this year than in 2010, while refunds are expected to be lower.

Withholding payments, which usually account for at least two-thirds of gross collections, are projected to reach $6.1 billion, 5.2 percent higher than 2010 withholdings. Revenue during the traditional bonus-paying months (December–March) this year suggest that a greater share of withholdings from bonus compensation have come earlier than in recent years. Withholdings through February 2011 were 6.1 percent greater than in the comparable period last year, with a disproportionate share of the growth coming from withholdings in December, which set a new collections record for that month. This pattern supports the notion that bonus compensation for some employees in finance and other high-paying industries was shifted from the beginning of calendar year 2011 to the end of 2010 due to the uncertainty—until almost the end of the year—as to whether federal tax cuts would be extended after December 31st. January receipts were also strong, but February withholdings were 7.6 percent less than a year ago. We expect withholding growth to slow in the remainder of 2011.

Unlike withholding, estimated payments to date in 2011 are lower, by 5.3 percent, than in the same period last year. Still, for this year IBO forecasts $1.8 billion in estimated payments, 5.9 percent more than in 2010. For the most part, quarterly payments made so far in 2011 have been based on estimated liability for calendar year 2010, when personal income began to expand again. But many taxpayers rely on "safe harbor" rules, which permit taxpayers to make quarterly payments consistent with their prior-year liability—which in this case was 2009, when liabilities were quite low. These rules have constrained estimated payments growth so far this year and led to a substantial underpayment of overall liability. Our 2011 forecast is premised on much higher first- and second-quarter payments for calendar year 2011 liability, to be made by most taxpayers in April and June, relative to the payments made earlier in the fiscal year. Consistent with substantial underpayment of calendar year 2010 liabilities, IBO also expects estimated payments made by taxpayers filing extensions this coming April to be greater than last April.

For 2011, IBO forecasts a 20.1 percent increase of final returns revenue, to $346 million, and a 9.1 percent decline in refunds, to $1.2 billion. These predictions are also consistent with the premise of substantial underpayment of current-year liabilities thus far. Refunds to date in 2011 are 12.8 percent less than in the same months last year, primarily due to a decline in refunds given for calendar year 2009 liability.

IBO's 2011 forecast is $221 million (2.6 percent) lower than OMB's. About half the difference is due to our lower forecast of withholding revenue, and the rest results from IBO projecting more refunds and less estimated payments than OMB.

The Forecast for 2012 and Beyond. IBO's outlook of accelerating income and employment growth starting in the latter half of calendar year 2011 will boost PIT revenue in the coming fiscal years. We forecast 12.4 percent growth in PIT collections in 2012, to $8.2 billion, mostly the result of increases in withholdings and estimated payments. Withholding is expected to increased slightly faster in 2012 than in 2011 (6.3 percent v. 5.3 percent), but estimated payments growth will increase substantially, to 23.4 percent in 2012—a large but hardly unprecedented rate of growth. A sharp increase in capital gains realizations is projected in calendar year 2011, boosting 2012 estimated payments. Also contributing to the growth in estimated payments is the projected increase in overall PIT liability in 2010, which will boost estimated payments made for calendar year 2011. It will also reduce underpayment of liability, and as a result, the forecast includes a modest (4.9 percent) increase in refunds.

IBO's 2012 PIT forecast is only $15 million dollars less than OMB's. We project more revenue from withholdings and estimated payments than does OMB, offset by less revenue from final returns and a higher forecast of refunds.

IBO forecasts $8.9 billion in PIT revenue in 2013, 9.7 percent more than 2012 revenue, based on the outlook for solid economic growth throughout calendar year 2012 and continuing into 2013. This forecast revenue growth stands in contrast to OMB's projections of only 3.2 percent PIT growth; IBO's forecast is $509 million greater than OMB's. With a projected 6.1 percent average annual growth rate in the next two years, PIT revenue is expected to reach $10.1 billion in 2015. OMB predicts slightly faster growth in 2014 and 2015, averaging 6.3 percent, but the Bloomberg Administration's forecast for 2015 is still $550 million less than IBO's.

Business Income Taxes

After a record three-year, $1.5 billion (25 percent) decline, business tax revenues resumed growing in 2011. Through January (a little past the midpoint of the fiscal year), revenues were up 15.2 percent over the year before, and IBO projects a gain of $756 million (16.8 percent) for the year as a whole. This is followed by forecast growth of $543 million (10.3 percent) in 2012, and then slower growth (averaging a little under $300 million, or 4.9 percent, per year) for 2013-2015.

Background. New York City levies three entity-level taxes on business net income: the general corporation tax, the banking corporation tax, and the unincorporated business tax. 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 corporations' 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 banks' 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 is 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 credit for resident shareholders of city-taxed S-corps.

All the revenue numbers provided in this section do not include revenues generated by audits undertaken by the Department of Finance. The business taxes differ from the city's other tax sources in that audits account for a significant portion of revenues. Nearly $750 million in audit collections are expected in 2011. After that, OMB assumes a drop to around $500 million per year, but this would be well below the $800 million per year averaged over the past six years. Since overall business tax liabilities are *not* returning to old (pre-2006) levels, the more recent audit amounts may well indicate a "new normal" of audit revenue greater than what OMB projects. 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 growth in all three business income taxes in 2011, though considerably less for the UBT than for the other two business taxes.

General Corporation Tax. A little more than midway through the current fiscal year the GCT is up $139 million (16.4 percent) but even stronger gains are projected over the remainder of the year, resulting in annual growth of $458 million (23.2 percent) for 2011 overall.

Wall Street whipsawed from record losses from mid-calendar year 2007 through 2008 (a combined -$63.9 billion) to supernormal profits in 2009 ($61.4 billion), followed by another very strong year for New York Stock Exchange member firm profits in 2010 ($27.6 billion). But it is difficult to find evidence of all the rebound of securities industry's profits in GCT collections. Current tax year collections from the finance sector did plunge by more than 40 percent the first part of fiscal year 2009 (that is, September–December 2008) compared with the same period the year before, but subsequently grew only 5.2 percent in the same months of fiscal year 2010 and then another 8.4 percent in the same months of 2011. It is possible that the enormous profits recorded in the past two years by Wall Street firms have not really shown up yet in city tax coffers because operating losses from previous years are being carried forward to offset current liability. Another possible explanation, as discussed immediately below, is that the profits are showing up in the collections of another tax.

Banking Corporation Tax. One of the major fiscal surprises of the last several years has been the strength of the bank tax. BCT revenues indeed fell sharply from a record $1.22 billion in 2007 to $628 million in 2008—but even the latter number was only $28 million below the previous BCT record *high* set in 2006. Then, defying expectations, BCT revenues shot up again to $1.10 billion in 2009, followed by a still very strong $969 million in 2010. IBO is projecting another 22.1 percent jump, back up to $1.18 billion, in 2011 (midway through the year, the BCT is up 40.1 percent), and then only a slight dip to $1.13 billion in 2012.

It is possible that we are seeing the effects of crisis-driven finance sector consolidation, in which heretofore free-standing financial activities firms have been brought under the umbrella of bank holding companies, resulting in liabilities being created under the BCT rather than the GCT (and UBT). But we have no direct confirmation of this yet.

Unincorporated Business Tax. The UBT has historically shown much less downside cyclical sensitivity than the other business income taxes, making last year's 12.4 percent revenue drop unusual—indeed, it was by far the worst in the history of this tax. Things are not looking much better so far this year: through January revenues are basically flat (up just 0.7 percent), though we expect a somewhat stronger second half, resulting in overall revenue growth of 5.3 percent for 2011, to $1.6 billion.

Finance and real estate were major contributors to last year's UBT debacle and this year's pallid recovery. This again raises the question of whether liabilities are being shifted to the BCT.

Forecast for 2012 and Beyond. IBO projects another year of solid if unspectacular business tax revenue growth in 2012, an overall increase of $543 million (10.6 percent). This gain will be divided between the GCT (up $376 million, or 15.5 percent) and UBT (up $223 million, 13.6 percent), while the BCT is projected to lose a bit—still another very strong year, but not quite as strong as 2011.

Growth falls off after 2012, but this belies the continued overall strength in the business taxes. In the GCT we project gross collections growth of 8.8 percent, 10.5 percent, and 7.8 percent over 2013-2015, but net revenues increase somewhat more slowly because of rising refunds—the latter connected to the previous rebound in collections. Still, growth is expected to be strong enough to bring GCT revenues back over $3.0 billion in 2013 and then over $3.3 billion in 2014—finally back above the old 2007 peak. In the BCT, gross collections fall back in 2013, but only to $1.2 billion, a level they remain at or above in succeeding years—and a level that was simply unknown prior to 2007. With refunds breaking old bounds, net revenues slip a little further—back to $856 million in 2013, then climbing slowly to $922 million in 2015—but these too are much higher than anything seen before the 2007 peak.

The UBT is projected to finally rebound in 2012, growing 13.6 percent to $1.87 billion, surpassing its previous 2008 high. This is followed by a slow but steady climb, growth averaging 5.5 percent over 2013-2015. IBO's business tax forecasts are collectively $103 million below OMB's in 2011, but higher than OMB's thereafter, the difference rising from $175 million in 2012 to $534 million in 2015. For 2012-2015, IBO projects substantially higher gross collections in the GCT and UBT and about the same levels of gross collections in the BCT, but also substantially higher refunds in all three taxes. The higher collections forecast reflect IBO's generally more bullish forecast for the city economy, while the higher refunds merely recognize the historical (lagged) relationship between collections growth and refunds growth.

General Sales Tax

IBO forecasts $5.6 billion of city general sales tax revenue in 2011, a $542 million (10.7 percent) increase above 2010 revenue. The projected growth is due to accelerating local and national economic growth and tax law changes introduced in 2010 and 2011. Had these tax changes not been enacted, collections would be projected to grow 8.9 percent—$177 million lower than the current forecast. After 2011, as the economy continues to recover, IBO forecasts annual revenue increases averaging 3.8 percent from 2012 through 2015 when sales tax receipts reach a projected $6.6 billion. IBO's 2011 estimate is $97 million higher than OMB's, and with IBO forecasting faster growth in personal income than OMB, this difference grows over time.

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 (MCTD) surcharge.

Several recent changes made to the sales tax rate and base are affecting current and future city sales tax revenue. In August 2009, the sales tax rate was increased from 4.0 percent to 4.5 percent, adding $521 million in 2010 and more in later years. Four sales tax base broadeners have also lifted sales tax revenue considerably. First, suspension of the tax exemption on clothing and footwear costing more than $110 dollars added $108 million to city coffers in 2010 and is projected to add more than $118 million in 2011. Second, the city is expected to add $8.6 million in 2011 due to an April 2011 change in the MCTD surcharge exemption that will limit the exemption to clothing costing less than $55—half of the initial cost limit of $110. This decrease in the MCTD tax will help boost clothing sales and city sales tax receipts. Third, hotel room resellers are now required to remit sales tax to New York City, which is estimated to add $11.3 million this year and increase over time. Last, the repeal of a tax credit applicable to private label credit cards is expected to bring in $3.8 million this year, growing to $3.9 million in later years.

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, disposable household income, consumer

confidence, and foreign exchange rates all play major roles. Sales tax receipts continued to grow until the last quarter of calendar year 2008—months after the nation's economy officially slipped into recession. Consumers felt the pinch of the recession in 2009, which saw sales tax revenue fall from $4.7 billion to $4.4 billion—a decline of 5.3 percent. However, sales tax revenue surged 13.9 percent in 2010 to just over $5.0 billion and is on pace to exceed that figure easily in 2011. Notably, fears that Europe's multiple economic crises would slow the city's tourism industry proved unfounded: the number of domestic and foreign tourists combined grew 6.8 percent in calendar year 2010 to 48.7 million—a new record. NYC & Company, which promotes tourism to the city, estimates that visitors spent $32.1 billion in the city that year.

Revenue in 2011. Collections to date this fiscal year plus continued improvements in the economic outlook have led IBO to raise its forecast of 2011 sales tax revenue to $5.6 billion—10.7 percent higher than 2010 collections. The strong growth is due to the momentum of the national and local economic expansion which lifted financial service company profits, compensation, and accelerated personal income growth generally. Without the revenue generated due to changes in tax policy, collections would grow 8.9 percent above 2010.

A significantly improved outlook on job and income growth is the primary reason for IBO's higher revenue forecasts. IBO expects the city to add an average of 59,100 jobs per year for calendar years 2011 through 2015 compared with OMB's projection of 39,800 additional jobs per year for the same period. Personal income is projected to grow at a faster clip too. IBO estimates that annual personal income will grow 6.1 percent on average for the forecast period compared with 4.0 percent for OMB. Sales tax collections recorded during the first two quarters of 2011 suggests that an improved outlook on job and wage growth may be driving higher levels of consumption. Revenue collected during this period registered a 14.4 percent gain in revenue for the same period in 2010. The holiday season in particular proved a robust revenue generator for the city, with December 2010 collections growing 13.8 percent above December 2009 collections.

Revenue in 2012 and Later Years. As the economic recovery gains momentum and growth accelerates in coming years, solid though not unprecedented growth is projected throughout the forecast period. For 2012, IBO forecasts $5.9 billion in sales tax revenue—6.0 percent greater than projected revenue this year. The slower expected revenue growth in 2012 compared to 2011 is due to a number of factors. Among them, personal income growth is expected to slow down slightly between calendar years 2011 and 2012, declining from 6.2 percent to 5.7 percent. In addition, Wall Street profits and compensation are expected to decline significantly from 2011 levels as the Federal Reserve looks to head off inflationary pressure by raising the benchmark Fed Funds rate and rolling back strategic policies that have provided cheap financing to financial service firms which helped stimulate investment, merger, and acquisition activity.

With economic growth expected throughout the forecast period, IBO projects sales tax revenue to grow 11.9 percent from 2012 through 2015. The IBO forecast for 2015 is $6.6 billion. Due to IBO's forecast of a more rapid recovery than OMB expects, our sales tax forecast exceeds OMB's in all years—from $97 million in 2011 to $304 million in 2015.

Hotel Occupancy Tax

Tourism in New York is expected to rise as the economy recovers and revenue from the hotel occupancy tax is expected to increase substantially over the forecast period. Hotel occupancy tax collections for the first seven months of 2011 (July 2010–January 2011) recorded a 20.9 percent increase compared to the same period in 2010 and this strong growth is expected to continue through the second half of the year. For 2011, IBO forecasts tax revenue of $421 million—growth of 16.6 percent above 2010 revenue of $361 million. The strong growth forecast is due to evidence that New York City tourism demand shows no signs of ebbing and that increased city hotel room inventory has not put downward pressure on average daily room rates. In 2012, revenue is expected to fall 6.7 percent to $393 million due to the reduction of the hotel occupancy tax rate from 5.875 percent to 5.0 percent. By 2015, revenue is expected to reach $456 million. Compared with OMB's latest forecast, IBO's tax forecasts are higher over the forecast period, reflecting the outlook that revived business travel and tourism will compensate for the revenue lost due to the shift to the lower tax rate.

Background. Since 1970, New York City has imposed hotel occupancy tax, which is levied in addition to the combined city, state and commuter district sales taxes. The city's 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. Together with the combined city and state sales tax rate of 8.5 percent, and the MCTD surcharge of 0.375 percent, the total tax on hotel occupancy is 14.75 percent. The city's current hotel occupancy tax rate, which took effect March 1 2009, will revert to the previous rate of 5.0 percent after November 30, 2011.

The recent strong growth in city hotel occupancy tax revenue is a notable change from the downturn the hotel industry suffered in 2009. The recession hurt hotel revenue even though hotel operators reduced room rates in order to buoy occupancy rates. The average daily rate of a Manhattan hotel room for the second quarter of 2009 (October through December) fell from $374 to $343—an 8.3 percent decline compared with the same quarter in 2008. Full-year revenue for 2009 fell from $377 million to $341 million—a decline of 9.4 percent.

In 2010, city hotel occupancy tax revenue began to rebound, climbing 5.8 percent to $361 million. The momentum of hotel occupancy tax revenue growth carried over from 2010 into 2011 as the city's hotel industry benefitted from the rising supply of hotel rooms and sustained demand for them. The city added approximately 6,650 rooms in calendar year 2010—a net increase of 8.0 percent since December 2009—while occupancy rates hovered steadily above 85 percent. Even though the number of hotel rooms was increasing, demand was strong enough for hoteliers to raise room rates. Average daily rates during the most recent holiday season (October through December 2010) grew from $287 to $305—a 6.3 percent increase over the same period in 2009. According to NYC & Company, the number of room nights sold in New York City reached a record 21.2 million for the 10-month period January through October 2010. Adjusted for tax policy changes, hotel occupancy tax receipts for the first two quarters of 2009, 2010, and 2011 have recorded year-on-year average annual growth of 5.7 percent. The robust tax revenue growth rate suggests that the impact of the city's hotel occupancy tax rate was more than offset by other factors, such as the growth of tourism and business travel to the city.

The 2011 Forecast. IBO's forecast of hotel tax revenue for 2011 is $421 million—16.6 percent higher than 2010 revenue of $361 million. Data from NYC & Company shows that demand in New York City's tourist industry has continued to flourish and that the addition of new hotel room stock has not depressed room rates.

The Forecast in 2012 and Beyond. IBO forecasts that city hotel tax revenue will decline 6.7 percent in 2012 to $393 million. The decline is due to the November 2011 return of the city's hotel tax rate to 5.0 percent, a decrease of 0.875 percentage points from the current rate. Revenue is expected to grow 8.1 percent in 2013 to $425 million. In 2014 and 2015, revenue growth is projected to slow to an annual average rate of 3.7 percent, with revenue reaching $456 million in 2015.

Endnotes

[1]For additional information about the complications of the city's real property tax, see IBO's *Twenty-Five Years After S7000A: How Property Tax Burdens Have Shifted in New York City.* 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.
[2]A surcharge in effect for calendar years 2003 –2005 added two new brackets affecting high-income filers.
[3]In 2010, the state reimbursed the city $782 million for the state-enacted PIT cuts under STAR—the rate cuts plus per filer tax credits that were not altered when the state's budget was adopted.

Expenditure Outlook

IBO projects that under the Mayor's Preliminary Budget for 2012 and financial Plan through 2015 spending will grow from $65.7 billion in 2011 to $75.6 billion in 2015, an average annual increase of 3.6 percent.

Under the Mayor's plan, projected spending by many large city agencies is expected to be flat or decrease slightly. Police, fire, children's services, homeless services, and health would all decrease over the 2011-2015 period based on IBO's projections under the Mayor's plan. Pension, debt service, and City spending on Medicaid—as the federal share reverts to its prerecession level—are driving the rise in city spending

Spending on education is also expected to grow, from $18.8 billion this year to nearly $20.0 billion in 2015. This increase is driven by city

IBO Expenditure Projections

Dollars in millions

	2011	2012	2013	2014	2015	Average Change	
Health & Social Services							
Social Services							
Medicaid	$5,054	$6,308	$6,493	$6,630	$6,810	7.7%	
All Other Social Services	3,132	3,025	3,028	3,028	3,028	-0.8%	
HHC	60	82	79	79	79	7.3%	
Health	1,650	1,572	1,563	1,562	1,563	-1.3%	
Children's Services	2,710	2,710	2,683	2,680	2,681	-0.3%	
Homeless	846	809	802	802	802	-1.3%	
Other Related Services	614	469	457	457	457	-7.1%	
Subtotal	**$14,066**	**$14,975**	**$15,105**	**$15,238**	**$15,420**	**2.3%**	
Education							
DOE (excluding labor reserve)	$18,775	$19,062	$19,377	$19,762	$19,965	1.5%	
CUNY	720	673	667	668	668	-1.9%	
Subtotal	**$19,496**	**$19,734**	**$20,044**	**$20,430**	**$20,633**	**1.4%**	
Uniformed Services							
Police	$4,688	$4,461	$4,427	$4,423	$4,423	-1.4%	
Fire	1,774	1,693	1,660	1,639	1,638	-2.0%	
Correction	1,046	1,031	1,023	1,023	1,023	-0.6%	
Sanitation	1,399	1,295	1,337	1,420	1,420	0.4%	
Subtotal	**$8,906**	**$8,479**	**$8,446**	**$8,505**	**$8,505**	**-1.1%**	
All Other Agencies	**$6,992**	**$6,622**	**$6,587**	**$6,618**	**$6,711**	**-2.3%**	*
Other Expenditures							
Fringe Benefits (excluding DOE)	$3,892	$3,841	$4,866	$5,258	$5,674	7.3%	*
Debt Service	4,677	3,015	6,672	6,919	7,269	9.5%	*
Pensions	6,875	8,295	8,442	8,320	8,597	6.5%	**
Judgments and Claims	637	675	705	738	774	5.0%	
State Education Building Aid (TFA)	424	252	437	437	437	0.8%	
General Reserve	100	300	300	300	300	n/a	
Labor Reserve:							
Education	12	42	40	40	40	n/a	
All Other Agencies	55	106	270	528	804	n/a	
Expenditure Adjustments	(475)	87	252	383	462	n/a	
Total Expenditures	**$65,656**	**$66,423**	**$72,166**	**$73,715**	**$75,625**	**3.6%**	

SOURCE: IBO

NOTES: *Represents the annual average rate of growth/(decline) after adjusting for prepayments.

**The annual average change excludes estimated savings assumed by the Bloomberg's Administration's pension reform proposal.

Expenditure adjustments include prior-year payables, IT efficiency savings, energy and lease adjustments, and non-labor inflation estimates. Estimates exclude intra-city expenses. Figures may not add due to rounding.

dollars. State aid for city schools is more than $2.0 billion below what the city had been expecting for 2012 under the terms of the 2007 legislation resolving the Campaign for Fiscal Equity lawsuit.

The Preliminary Budget includes a cumulative $5.2 billion in measures to cut costs and raise revenues in order to close the budget gap that had been projected for 2012. These measures range from the closing of 20 fire companies to increasing the cost of parking to the elimination of more than 6,100 teaching positions. The budget plan also includes $400 million in state aid that is not in the Governor's budget as well as legislative action that would save the city an additional $200 million.

The February 2011 Capital Commitment Plan covering 2011–20014 provides $33.2 billion for infrastructure and other capital spending. This is a decrease of $1.9 billion from the level in the September 2010 plan.

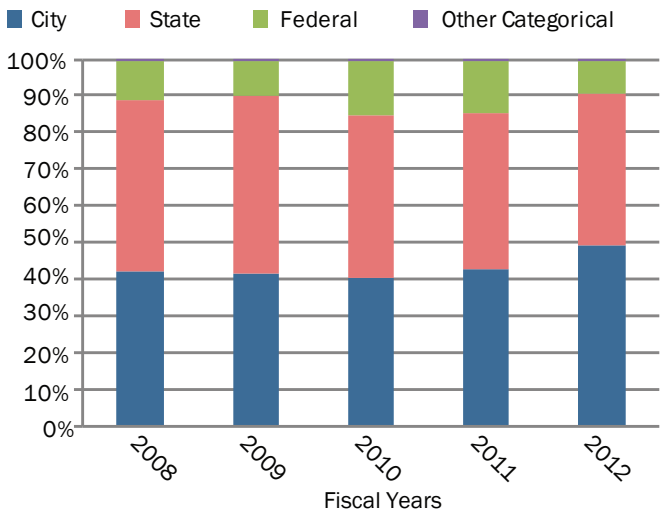
Education

The City Is Spending More, the State Less and Spending Priorities Have Shifted

Classroom spending would decline under the Mayor's proposed budget and the city's ambitious plans to continue to add building capacity is being scaled back. This marks the second year in a row the Bloomberg Administration has presented a budget that would decrease the number of teachers and classes (thereby increasing class size) and cut other school services. At the same time, some areas of the schools budget are growing rapidly, particularly the cost of private special education placements and charter schools. Spending in these areas is likely welcome to the families that use those particular schools, but families of the roughly 1 million students in the traditional public schools may see it as resources lost to their own schools and children.

On the surface, this tension appears to be driven by the current fiscal conditions in New York State, and the state government's response to those conditions. Yet, other factors have contributed as well. In the three fiscal years from 2007 through 2010, the portion of the schools' budget *not* directed toward nonpublic and charter schools increased by slightly more than $1.8 billion, an average of $611 million or 4 percent per year. Under the Preliminary Budget, in the two years since 2010, that portion of the budget would *decrease* by a total of $146 million or 1 percent. Meanwhile, the cost of private special education and public charter schools is slated to grow by an average of 20 percent per year from 2010 through 2012.

City Takes On A Much Higher Portion of Department of Education Budget



SOURCES: IBO; Mayor's Office of Management and Budget
NOTE: Fiscal years 2008-2010 are actual shares, and 2011 and 2012 are projected.

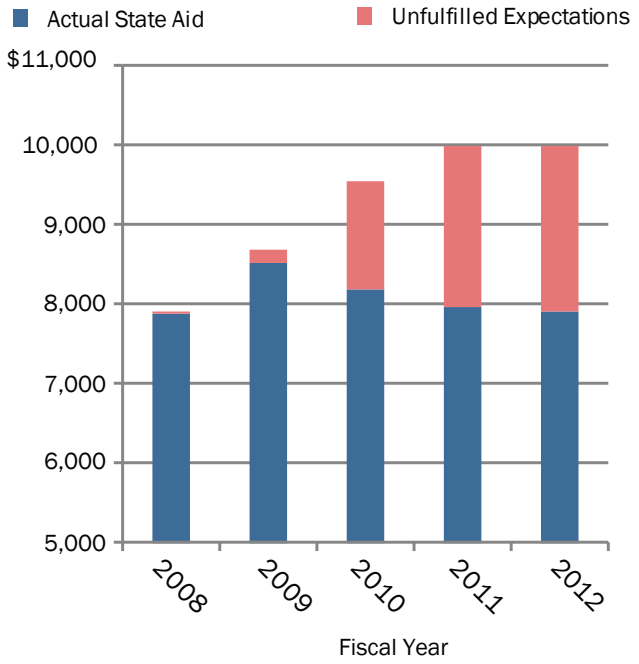
City Funding Replaces State and Federal Support

The 2012 preliminary budget for the Department of Education (DOE) totals $19.1 billion, $482 million higher than the current plan for 2011, and perhaps more notably, $631 million more than had been planned for 2012 at the time the 2011 budget was adopted last spring.

The share of the DOE budget that will be borne by city funds shifts dramatically in the Preliminary Budget. Faced with a reduction of $948 million in state education aid from what it had projected in the November financial plan, the city has increased its own funding of the schools budget by $983 million over the November projection. In year-over-year terms, city funding of the schools has increased by $1.467 billion while state ($69.3 million), federal ($848 million) and categorical ($67 million) funding have all decreased.

State Foundation Aid is in Deep Freeze. Under state legislation enacted in the spring of 2007, state foundation 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. Under the legislation, New York City was also required to increase city-funded support for public schools by $2.2 billion over the same four years.

State Education Aid Far Below 2008 Expectations
Dollars in millions



SOURCES: IBO; Mayor's Office of Management and Budget; New York City Financial Plan, January 2008
NOTE: Fiscal years 2008-2010 are actual spending, and 2011 and 2012 are projected.

The Mayor's Preliminary 2012 budget and the Governor's Executive Budget for state fiscal year 2011–2012 are each the fifth budget presented after that 2007 legislation. While city funding of schools surpasses the amount specified in the 2007 legislation in this Preliminary Budget, the Governor's proposed budget maintains a freeze on state foundation aid to education for the fourth consecutive year. (Foundation aid includes the lion's share of state education aid.) In the Preliminary Budget, the city now expects state aid for both 2011 and 2012 to be more than $2 billion below what was expected under the 2007 legislation. The Governor's budget now calls for the legislatively mandated increase in state education aid to be stretched out until school year 2016–2017, a full six years past the end of the original four year phase-in period.

As Classroom Spending Drops Again, Spending on Private Special Education and Charter Schools Grows

The influx of city funds, however, does not spare the classroom from cuts in the Preliminary Budget. The 2012 budget for services to schools (services provided directly to public school students and staff, primarily in the school building) is reduced, in year-over-year terms, by $207 million. The Preliminary Budget maintains the Program to Eliminate the Gap cuts announced with the November 2010 Financial Plan, including a 6,158 reduction in the number of teachers employed by the system. This reduction would be accomplished through a combination of layoffs (4,658) and attrition (1,500).

This is the second consecutive year of reductions in these core categories, with the total loss to services to schools over two years totaling $364 million. Meanwhile, in the 2012 Preliminary Budget, the rest of the Department of Education's budget is expected to be $689 higher than in 2011 (current projection) and $981 million higher than projected when the 2010 budget was adopted.

The biggest driver of this shift of funds from services to schools to other uses is the rapid and significant growth in payments made to nonpublic and charter schools, including special education prekindergarten programs, contract schools, foster care programs, and funds passed through to nonpublic schools and the Fashion Institute of Technology. The nonpublic and charter school payments portion of the DOE budget has increased from less than $1.1 billion in 2007 to an anticipated level of $2.6 billion in 2012. Comparing the 2012 projected spending in the Preliminary Budget with actual spending in 2010, growth in payments to nonpublic and charter schools ($764 million) over the two years will outstrip the total growth of the DOE's budget ($548 million), forcing cuts in other areas.

Growth in spending on nonpublic special education schools (special education pre-k, contract schools and "Carter Cases") is driven by entitlements granted to students with special needs by federal law and enforced through the courts. Parents of 4 year olds with special needs are able to petition family court to require DOE to fund their child's placement in private special education prekindergarten. Between 2007 and 2012, the cost of this program will have almost doubled, even though enrollment increased by only 42 percent. Roughly 31,000 students were expected to be served by these vendors during 2011.

The Department of Education operates extensive special education programs beginning in kindergarten, although parents of special needs children in those

Department of Education Budget, by Program Area

Dollars in millions

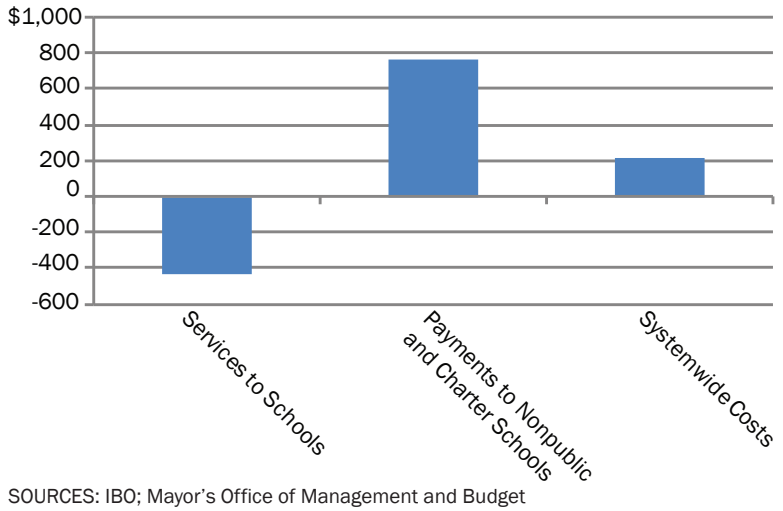
Budget by Selected Agency Programs	2007	2008	2009	2010	2011	2012
TOTAL DOE BUDGET	**$15,888**	**$16,978**	**$17,906**	**$18,502**	**$18,821**	**$19,119**
Services to Schools	**$12,368**	**$12,992**	**$13,611**	**$13,705**	**$13,723**	**$13,341**
Classroom Instruction	**$7,331**	**$7,857**	**$8,362**	**$7,820**	**$7,839**	**$7,824**
General Education Instruction	5,539	6,113	6,384	6,052	6,008	6,028
Special Education Instruction	1,130	1,046	1,270	1,020	1,047	1,024
Citywide Special Education Instruction	663	698	708	748	785	772
Instructional Support	**$2,430**	**$2,389**	**$2,308**	**$2,805**	**$2,916**	**$2,434**
Special Education Support	323	395	395	489	531	598
Categorical Programs	2,107	1,995	1,912	2,315	2,385	1,836
Instructional Administration	**$215**	**$221**	**$221**	**$213**	**$191**	**$207**
Regional/Citywide Instructional Administration	215	221	221	213	191	207
Noninstructional Support	**$2,391**	**$2,524**	**$2,719**	**$2,867**	**$2,776**	**$2,807**
School Facilities	569	576	743	744	596	562
School Food Services	365	379	384	409	405	446
School Safety	180	204	217	295	296	230
Pupil Transportation	938	967	968	996	1,012	1,101
Energy and Leases	340	399	407	423	468	468
Systemwide Costs	**$2,398**	**$2,651**	**$2,731**	**$2,895**	**$2,920**	**$3,112**
Fringes	**$2,007**	**$2,252**	**$2,355**	**$2,536**	**$2,631**	**$2,788**
Fringe Benefits	1,991	2,230	2,314	2,502	2,619	2,747
Collective Bargaining	16	22	41	34	12	42
Central Administration	391	399	376	359	289	324
Nonpublic and Charter Schools	**$1,122**	**$1,335**	**$1,565**	**$1,902**	**$2,178**	**$2,666**
Special Education Prekindergarten Contracts	**$574**	**$644**	**$739**	**$853**	**$964**	**$1,129**
Prekindergarten Transportation	75	86	97	135	148	148
Prekindergarten Tuition	499	557	643	718	816	981
Charter, Contract School & Foster Care Payments	**$490**	**$630**	**$764**	**$978**	**$1,142**	**$1,465**
Charter Schools	165	232	311	418	572	711
Contract Schools (in-state)	245	233	236	268	295	403
Contract Schools (out-of-state)	40	61	32	35	32	44
Carter Cases	0	63	144	215	191	246
Nonresident Tuition/Foster Care	26	27	27	27	37	47
Tax Levy Match for Chapter 683	14	14	14	14	14	14
Nonpublic School and Fashion Institute of Technology Payments	**$58**	**$61**	**$61**	**$71**	**$71**	**$71**
Nonpublic School Payments	20	23	23	26	26	26
Fashion Institute of Technology Payments	37	38	38	46	46	45

SOURCES: IBO; February 2012 Departmental Estimates

NOTES: Fiscal years 2007-2010 are actual spending, 2011 and 2012 are projections. Does not include debt service and pensions. Includes intra-city sales. Numbers may not add due to rounding.

Spending on Services to Schools Shrinks: Everything Else Grows

Change From Fiscal Year 2010 to Preliminary Fiscal Year 2012, *dollars in millions*



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

grades are also entitled to petition the courts for tuition reimbursement for private schools when they feel that DOE's programs do not adequately respond to their child's particular needs. The right of parents to do so without having first enrolled their child in a district school was upheld by the U.S. Supreme Court in 2007. The cost of these Carter Cases is up $55 million, or 29 percent, in the Preliminary Budget over the past year

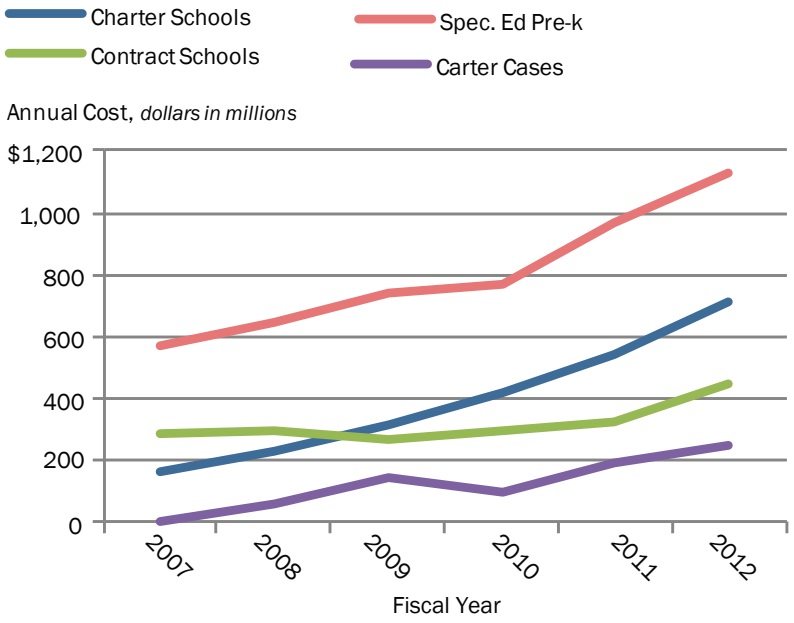
In addition to the Carter Cases, there is rapid growth in the contract costs for a separate group of students served by specialized private schools. DOE has long contracted with residential schools, both in- and out-of-state, to educate particular students whose needs are beyond the expertise of in-city schools. The Preliminary Budget allocates close to $447 million for these contracts in fiscal year 2012. That represents an increase of $119 million or 36 percent over the current budget. In 2011, contract school enrollment was expected to reach 7,700 students.

Growth in spending on charter schools is driven by the ongoing impact of policy initiatives that have had the strong support of the Department of Education. Charter schools are public schools which are operated by individual nonprofit corporations, independently of the Department of Education. Charters are granted to these nonprofits for a maximum of five years. At the conclusion of the term of a charter, the performance and fiscal integrity of the school is examined and a decision to renew or rescind the charter is made. Funding of charter schools is determined on a per-pupil basis through a formula embedded in state law. Currently, the per-pupil amount provided for each student in a charter school is $13,527. Charter school enrollment was expected to reach 39,932 in 2011.

The funding that is provided to charter schools enrolling New York City residents is deducted from DOE's budget. In the Preliminary Budget charter school grants are expected to reach $711 million in 2012, up $166 million or 30 percent from this year. The cost of charter schools has tripled over the last four years, driven by increasing enrollment and the mandated increases in the per pupil funding level.

Although it is not clear why the cost of special education private schools, Carter Cases and contract schools are growing so rapidly, the source of the growth in charter school costs is clear. Enrollment in charter schools, and thus their cost, has been and will be increasing for the

Rapid Increase in Cost of Private and Charter School Placements



SOURCES: IBO; Mayor's Office of Management and Budget
NOTE: Fiscal years 2008-2010 are actual spending, and 2011 and 2012 are projected.

foreseeable future. For much of the last decade, the Department of Education has actively promoted and supported the establishment of charter schools in the city. The department has provided space within New York City public school buildings and has advocated for state legislation which raised the cap on the number of city charters. The cap is currently set at 200 schools and 125 schools are currently operating in the city.

Charter schools typically phase in their operations over a number of years. For example, a school may earn a charter to operate grades kindergarten through eight, but may choose to only operate grades kindergarten and one in its first year. As that first group of children ages, the school will grow by one grade a year (assuming it earns its charter renewal at the end of five years.) Given this growth pattern, there is a pipeline of authorized charter school slots that are not yet in operation. As those grades fill, the amount of funding taken from the DOE and provided to charter schools will grow.

IBO estimates that approximately 65 percent of authorized school grades in charter schools are operating in the 2010-2011 school year. This means that even if no additional charter schools were to open, the maturation of existing charter schools would lead to a 50 percent increase in enrollment, and therefore spending. If charter school creation continues until the current cap of 200 schools is reached, enrollment and funding of charter schools in the city could reach 150 percent of current levels, independent of any increase in the annual per-student funding level.

In theory, the diversion of funds to charters should be offset by a reduction in the number of students being served by the department itself. No estimates exist of the path that students and families in New York follow to charter schools. Are these students who would have been attending public schools or are they students who would have enrolled in private or religious schools? The answer is unknown but is likely some combination of the two. Total enrollment in the public school system has remained relatively stable in recent years as charter enrollment has grown. Regardless of how many charter school students would otherwise have attended public schools, the fact remains that--at least for now--the public schools are being asked to educate roughly the same number of students with a reduced budget available for services to schools.

Spending Shifts in Other Categories. In 2012, general education, special education, and citywide special education classroom instruction would each fall by 1 percent to 2 percent under the Mayor's Preliminary Budget which amounts to a combined $93 million drop in total classroom instruction. Other services to schools that are expected to decline next year include some noninstructional support services such as school facilities ($562 million) and school safety ($230 million) which will both fall by 3 percent and 22 percent, respectively. Despite a 15 percent increase in special education instructional support, which rises to $598 million, spending for categorical programs overall will fall by 15 percent to $1.8 billion, mostly due to the loss of American Recovery and Reinvestment Act funding, which is largely being replaced with city funds. Special education instructional support includes positions for the School Based Assessment Teams and Related Services providers. Although the budget includes an additional $12 million in spending on full-time related services positions, it also calls for a $65 million increase in contracted related services providers as well.

Other areas of budget growth within the category "services to schools" include instructional administration, school food services, and pupil transportation. Spending on school food services is expected to grow by 14 percent next year. The food services budget has traditionally gone mostly to support school cafeteria operations. Recently, DOE considered penalizing schools for uncollected school meal fees from parents and students but collection has always been somewhat difficult to enforce. Although it is estimated that the city could lose roughly $8 million, the plan to place the collection burden on the school has been suspended for now. Pupil transportation will also see its highest levels in eight years, reaching $1.1 billion. Growth is driven by the cost of special education buses which added $86 million to the fiscal year 2012 budget. Fringe benefits—unlike other city agencies most costs for DOE employees are carried in the department's own budget—will reach $2.7 billion in 2012, a 5 percent year-over-year increase. The increase is mostly due to health insurance benefits.

The central administration budget will be below the levels of fiscal years 2005–2010, but 10 percent higher than this year at $324 million. There is still some

restructuring occurring but the general trends show strong budget support for the Division of Instructional and Information Technology, the Division of Assessment and Accountability, and the Office of School and Youth Development. Central administration will grow by 218 positions, adding more than $10 million to the current 2011 budget. Despite this, levels of spending on consultants for administrative professional services will be over $39 million and consultants for computer services will cost another $36 million.

Funding and Priorities Are Also Shifting in the Capital Plan

In February 2011, the School Construction Authority (SCA) issued the latest version of its proposed second amendment to the 2010-2014 Education Capital Plan, calling for significant shifts in both the sources and uses of funds compared with the most recently adopted amendment to the plan. The city-funded portion of the plan would increase significantly to 63 percent, and the portion of the plan dedicated to capital improvement would increase to 69 percent while the share dedicated to new capacity would decrease.

Funding the 2010-2014 Education Capital Plan. According to the SCA's latest version of its proposed second amendment, there would be a decrease of just over $2 billion (or 20 percent) for the 2010-2014 plan compared with the first amendment, which was approved by the City Council in June 2010. The annual amendment process includes a series of revisions to the proposed amendment, first in November and again in February, as it moves through the review process prior to final action by the Panel for Educational Policy and then the City Council in the spring. The first amendment from June 2010 planned for a total of $11.7 billion over the five years, with about half of the funding coming from the state and the other half coming from the city. The current proposed second amendment from February 2011 plans for a total of $9.3 billion, with the city bearing a significantly higher share of the total cost—63 percent—offsetting a decline in the amount projected from the state.

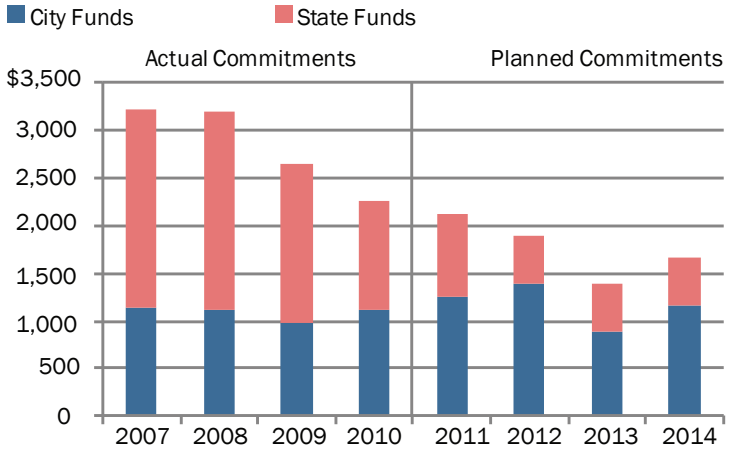
Overall, city funding would decrease slightly (about $100 million, or 2 percent) while state funding would be cut significantly, by 39 percent. SCA's assumption that the state contribution each year would be $500 million is based upon proposed changes to the state's building aid calculations. The Governor's budget bill proposes capping the amount of reimbursable expenses for the city at $1 billion, so the city anticipated receiving $500 million from the state each year for fiscal years 2012 through 2014. However, this is likely to be revised upward from $500 million since the city generally is reimbursed for about 61 percent of its eligible expenses, though it would still result in a level of building aid that is much lower than the state's historical contribution of about $1 billion a year.

The decrease in funding in this proposed amendment is even deeper when compared with an earlier proposed second amendment released in November 2010. Comparing the February version with the November version suggests a decrease in state funding of 56 percent and a decrease in total funding of 42 percent. However, it is important to note that the November version had incorporated 40 percent increases in both city and state funding over the amounts planned when the first amendment was approved in June 2010, despite signs of budget strains for the city and especially the state that made a significant increase in funding improbable.

The stable city contribution to the capital plan is perhaps in part due to the city's ability to issue qualified school construction bonds (QSCBs), which thanks to a federal subsidy of some or all of the interest payments,

Planned State Commitments in 2011 Through 2014 Fall Relative to Historic Levels

Dollars in millions



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

Sources of Funds for the 2010-2014 Education Capital Plan: February 2011 Proposed Second Amendment

Dollars in millions

	2010	2011	2012	2013	2014	TOTAL	Shares of Total Funding	Decrease in Total from June 2010 First Amendment	Decrease in Total From November 2010 Proposed Second Amendment
City	$1,176	$1,247	$1,400	$888	$1,168	$5,879	63%	-1.8%	-29.0%
State	1,071	880	500	500	500	3,451	37%	-39.3%	-56.3%
TOTAL	**$2,247**	**$2,127**	**$1,900**	**$1,388**	**$1,668**	**$9,330**	**100%**	**-20.1%**	**-42.3%**

SOURCES: IBO; School Construction Authority 2010-2014 education capital plan amendments

results in substantial savings for the city. So far, $397 million in QSCBs have already been issued, with $967 million planned in the future, for a total of $1.4 billion. The total city contribution to the capital plan is expected to be $5.9 billion, so a quarter of the total city funds for the capital plan could be raised interest free, assuming market conditions hold steady and the government subsidy for the interest payments on the bonds covers the interest that the buyers demand.

Fewer New School Buildings, More Investment in Existing Buildings. The use of funds within the capital plan would shift significantly away from new capacity and towards improvements in existing buildings. In the past, the plan was divided roughly equally between two main categories—capacity and capital investment. The current proposed amendment would allocate 69 percent to capital investment and just 31 percent to capacity, perhaps reflecting changes in the type of projects likely to be approved for reimbursement under the pending state building aid legislation.

The state legislation under consideration would implement a six-tier system for capital projects, where projects to improve existing buildings would be ranked in tiers one through four and new capacity projects would be ranked in tier five—the second lowest priority. Projects would be ranked by the age of the building, giving preference to older buildings in need of repair. Districts across the state would compete for the maximum of $2 billion that the state education department would allocate for reimbursable capital projects based on the tiered priorities, slightly less than the $2.5 billion that was budgeted for the 2009–2010 school year. The February version of the proposed second amendment allocates $6.4 billion for capital investment over the 2010–2014 period, an increase of 2 percent over the first amendment, and the amount allocated to new capacity would be $2.9 billion, a 46 percent decrease.

This shift in the focus of the plan from new capacity projects to improvements in existing schools means that the planned 30,377 new seats from the first amendment would be scaled back by about a third to 20,560 new seats in the latest version of the proposed amendment. Relative to the June 2010 first amendment, 26 projects that cost more than $1 billion and funding 12,480 seats would be cut, seven projects that would cost $202 million and fund 3,373 seats would be added, and the 31 projects that would remain in the plan would be scaled back, on net, by 710 seats. The degree to which the plan is being scaled back would appear much larger if compared with the earlier version from November, when the SCA planned for 50,000 new seats during the five-year period.

New Capacity Scaled Back in Proposed Second Amendment February 2011

	Seats
Number of Seats in First Amendment (June 2010)	**30,377**
Seats in Projects Dropped From the Plan	-12,480
Seats in Projects Added to the Plan	+ 3,373
Net Change in Seats to Projects Remaining in the Plan	-710
Number of Seats in Proposed Second Amendment (February 2011)	**20,560**

SOURCES: IBO; School Construction Authority 2010-2014 education capital plan amendments

NOTE: The number of seats in each amendment includes a portion of seats funded for design only in this plan and construction in the next. In the first amendment, there were 2,300 such seats and in the proposed second amendment, there are about 6,000 seats.

Environmental Remediation—Some Now, A Lot More Down the Road. Two initiatives within the capital improvement program were highlighted in the proposed second amendment: investment in educational technology, and remediation of light fixtures leaking polychlorinated biphenyls (PCBs). Technological improvements needed to expand the department's Innovation Zone (which provides for individualized instruction for children through the use of technology, online courses, and modified teacher roles) and enable online assessments account for $486 million in the proposed amendment. In addition, the city plans to spend $708 million from 2012 through 2021—all of it city-funded— for the removal of lighting ballasts identified as leaking PCBs. For the 2012-2014 years of the current five-year capital plan, the city is planning for $141 million for this remediation effort, accounting for almost all of the money dedicated to lighting fixtures in the current plan. Since the plan was issued the federal Environmental Protection Agency rejected the city's 10-year timeline for fixing the lights, saying it was too lengthy.

State & Federal Proposals Could Affect the City

City to Eliminate Rental Subsidy Program if State Cuts Stand

The Department of Homeless Services' (DHS) rental subsidy program, Advantage New York, is in jeopardy after Governor Cuomo proposed cutting state and federal funds to the program in his Executive Budget. DHS reports that it will eliminate Advantage—which it says has helped more than 25,000 families and single adults move out of homeless shelters over the past four years—if the state fails to restore the funding. The loss of the rental assistance program would likely drive up the city's emergency shelter costs as families and adults who would have received the subsidy return to or remain longer in the city shelters.

The Advantage program provides up to two years of rental assistance to families and single adults moving out of emergency shelter and into permanent housing. Introduced as a pilot program in April 2007, Advantage was redesigned in 2010 to strengthen work requirements and raise the rental contribution for participants. In order to be eligible for the current program, families and individuals must be in the shelter system for at least 60 days, make less than 200 percent of the federal poverty level, and work at least 20 hours a week. Participating households then pay 30 percent of their gross monthly income for rent (up from $50 a month in the pilot program), with the subsidy covering the balance. Participants are eligible for a second year of the program if they work at least 35 hours a week. Rental contributions increase to 40 percent of their income during participants' second year in the program. About 15,000 households are currently receiving Advantage subsidies, according to the Mayor's Office of Management and Budget.

Advantage has been funded through a combination of city, state, and federal welfare funds, with about a third coming from the city. The program's price tag has grown substantially from $54.2 million in fiscal year 2008 (the first full year of program implementation), to a budgeted $206.9 million in 2011, of which the city is scheduled to contribute $67.2 million. The Bloomberg Administration contends it would be unable to take over the full cost of the program if federal and state funds are cut.

The loss of the rental subsidy program would likely lead to an increase in the cost of the city's emergency shelters, especially for family shelters, as 95 percent of Advantage funds go toward rental subsidies for families. It is likely that some of the 15,000 households currently receiving Advantage would be unable to pay their rent and would return to the shelter system if the program ends. In addition, because Advantage is one of the main subsidy programs DHS uses to move families from shelters and into permanent housing, its elimination would increase the average length of time homeless families stay in the shelter system overall.

To illustrate the possible impact on the city's shelter budget, IBO estimated how much the elimination of the Advantage program could increase emergency shelter costs in 2012 under two scenarios. If 30 percent of households currently receiving Advantage return to emergency shelter, IBO estimates that spending on shelters would increase by $279 million (an increase of 40 percent above fiscal year 2012 budgeted adult and family shelter costs), of which the city would be responsible for $115 million. If 70 percent of households return to shelter, the additional shelter spending would be $455 million (a 66 percent increase), with the city bearing $188 million. These estimates also account for the families and adults currently in shelters whom the city had assumed would move from the shelters into the Advantage program next year. This estimate of the number of families and adults returning to shelters may include some households that would have exhausted their two years of Advantage prior to the elimination of the program.

The potential increase in emergency shelter costs would come after the city has already increased its

spending on adult shelter by $16 million beginning this year to offset the state's cut to its share of funding from $85 million to $69 million.

Senior Centers at Risk of Closure Due to Proposed State Funding Shift

The Governor's Executive Budget proposes a change in the use of federal funds that could result in the closure of more than 100 senior centers supported by the city's Department for the Aging (DFTA). These closures would be in addition to the recent loss of several senior centers due to reductions in city funds.

The department provides services for older New Yorkers to help them maintain their independence and participation in their communities. DFTA administers the contracts of 259 senior centers and provides more than 10 million meals annually, both home-delivered and at senior centers. The Mayor's preliminary budget for DFTA in 2012 is $217 million, down significantly from $270 million in 2011.

The Governor's Executive Budget includes a proposal to change the federal Social Services Block Grant (Title XX) formula. New York City receives about $64 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, $24 million, is discretionary funding for social services that the city has traditionally allocated to DFTA to fund senior centers. The state's proposed funding switch would eliminate the discretionary portion of the Title XX block grant and instead use it to offset the cost of mandated child welfare services for both the city and state. A similar proposal was made in the Executive Budget last year but it was dropped when the budget was finally adopted. The Mayor's Preliminary Budget does not reflect the impact of this proposed change.

The change would mean the loss of $24 million currently in DFTA's senior center budget. Unless the city were to make up for the loss of state funding, spending on senior centers would fall to $77 million in 2012, down 32 percent from 2011. It would likely lead to the closure of many senior centers throughout the city. The department has estimated that a funding reduction of this magnitude would result in the closure of 105 senior centers and a loss of about 8,000 meals a day provided at the centers, affecting about 8,000–10,000 seniors. This would represent a significant reduction in services to a vulnerable population; New York City's Center for Economic Opportunity has estimated that one-third of New York City's seniors are living in poverty.

Although the Mayor's Preliminary Budget did not include any new proposals to cut city funding for senior centers, additional centers may have to close by the end of June 2011. Last year, city funding reductions led to the closure of 27 senior centers. An additional 24 centers that had also been scheduled for closure were restored as part of the 2011 Adopted Budget agreement; seven of these were restored by the Mayor, while 17 received funding from the City Council for 2011 only. The Preliminary Budget does not include funding to maintain these 17 centers after this year and it is not yet clear if City Council funding will be available for 2012.

Funding Shortfall Could Mean 16,000 Fewer Child Care Slots

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. In 2010, the city provided child care for about 102,000 children, down slightly from 104,000 in 2009, and a 12.1 percent reduction from a peak of 116,000 children in 2006. Over the last few years, ACS has been working to control growth within the child care budget as increasing costs have outpaced federal funding, which has stagnated since 2004. In 2010 and 2011 the city used reductions in the supply of vouchers to help control the child care budget and the financial plan assumes an additional reduction of more than 16,000 vouchers for 2012.

From 2004 through 2009 the city increased its own funding by 61 percent in order to maintain service levels, but with a tougher fiscal environment since, the city has not sustained that growth in city funds for child care, and the financial plan assumes that additional city resources will not be available. This has led city officials to reduce the child care system's capacity. These actions have included the elimination of certain categories of child care vouchers. In 2010, ACS eliminated all vouchers in priority level 9, which were

available when child care is needed to enable parents to look for work, and priority level 8, which served families with parents who are sick or incapacitated. Over the course of 2010 and 2011, ACS also eliminated all priority level 7 vouchers, which serve families referred by a social service agency and whose social service needs are not dependent on work status.

Even after these and other reductions, ACS reported a difference of $80 million between the funding available for child care services and the program's expenses for 2011. Federal stimulus money and City Council funding, as well as savings from contract delays, eased the deficit by about $50 million, but a $30 million shortfall remains in this fiscal year. ACS officials are counting on decreased demand for child care services among public assistance recipients and additional contract delays to further reduce costs for 2011. Although there is some evidence of decreased demand for public assistance child care vouchers within the last six months, it is unclear whether this will be sufficient to cover the remaining shortfall for 2011. If it proves insufficient the city would have to allocate additional funding to the program to cover the shortfall.

For 2012, ACS officials project a $100 million difference between funding and program costs. In an initial proposal—not included in the Preliminary Budget because it does not involve any funding changes— the agency would further reduce spending through the elimination of 16,000 priority levels 5 and 6 vouchers and an additional 644 slots through a reduction of eligibility for families with incomes above 200 percent of poverty or $44,000 a year for a family of four. Priority level 5 vouchers serve families with parents who work 20 hours or more per week and families with special needs children; priority level 6 vouchers serve families with parents who are in education and training programs.

An alternative strategy currently being considered by ACS—also not part of the Preliminary Budget—would eliminate 9,800 vouchers and 6,500 classroom slots, reducing the total slots eliminated slightly from 16,644 to 16,300. Priority levels 5 and 6 vouchers and child care for families above 200 percent of poverty remain targets for elimination, although it is unclear how many from each group. ACS will also employ a "first in-first out" strategy to identify slots for elimination. These proposals would reduce the number of child care slots available to nonpublic assistance children by a third, and could make it difficult for some low-income parents to continue to participate in the work force.

Increase in Child Care Copays. In addition, November's financial plan included a proposal to increase the minimum and maximum copayments from parents for contracted child care starting in 2012. The plan increases minimum weekly payments from $5 to $15 and maximum payment levels will rise from 12 percent to 17 percent of adjusted family income. This proposal follows a previous increase in copayments in the spring of 2009. Changes to copayments in November's financial plan reflect a city savings of $13.0 million for 2012 and for each of the out-years.

Budget Proposals Put Funding for Youth Programs at Risk

The Governor's Executive Budget proposes funding changes that could significantly reduce funding for some core programs at the Department of Youth and Community Development, including the Summer Youth Employment Program (SYEP), Out-of-School Time (OST), and the Runaway and Homeless Youth program (RHY). Moreover the Mayor's Preliminary Budget also proposes to cut city spending for these programs, compounding the impact of the loss of state funds.

Changes in the Child Care Populations

	Enrollment Numbers											
	1999	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Public Assistance	30,000	38,000	38,000	35,000	43,000	44,000	52,000	57,000	49,000	47,000	49,000	51,000
Nonpublic Assistance	59,000	56,000	57,000	61,000	60,000	60,000	59,000	59,000	57,000	55,000	55,000	51,000
TOTAL	**89,000**	**94,000**	**95,000**	**96,000**	**103,000**	**104,000**	**111,000**	**116,000**	**106,000**	**102,000**	**104,000**	**102,000**

SOURCES: IBO; Administration for Children's Services; Human Resources Administration; Mayor's Office of Management and Budget

Summer Youth Employment Program Reduction. The Department of Youth and Community Development's (DYCD) Summer Youth Employment Program 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, the total budget for SYEP was $51 million. This included $24 million in city funds, $9 million in state-allocated Temporary Assistance to Needy Families (TANF) funds, $3.4 million in federal Workforce Investment Act funds, $12 million in federal stimulus money, and a $2 million donation from the Mayor's Fund to Advance New York City. The program for summer 2010 had 35,612 youth enrolled, out of more than 140,000 applications received.

The outlook for this summer's program is grimmer. With the city and state continuing to face budget constraints, additional cuts to the program have been announced. The city is proposing to cut about $3.2 million for fiscal year 2012 (summer 2011), which would result in 2,140 fewer city-funded slots. More significantly, the Governor's Executive Budget proposes to eliminate all Temporary Assistance to Needy Families funds for SYEP statewide, a loss of another $9 million for the city's program. As a result of these proposed cuts and the expiration of the short-term federal stimulus money, the city's SYEP program this summer has a proposed budget of about $25 million, enough funding to serve approximately 17,200 youth, about 18,000 fewer than last summer, and about 35,000 fewer than in the summer of 2009 when enrollment topped 52,000.

Youth Program Block Grant. The Governor's Executive Budget includes a proposal to create a block grant called the Primary Prevention Incentive Program block grant. This would combine nine existing youth services funding streams into one $34 million statewide block grant, an overall reduction in state funding for youth development programs of almost 60 percent.

Locally, the consolidation into a block grant would affect services in two programs provided by DYCD: Out-of-School Time and Runaway and Homeless Youth. Additionally, it would affect nonprofit providers who currently receive dollars directly from the state through funding streams such as the Special Delinquency Prevention Program. The block grant program would be operated as a competitive grant, and localities would have to provide a 38 percent match.

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 school buildings and in facilities of the parks department and the New York City Housing Authority.

In 2011, OST received $7.6 million from the state Youth Development Delinquency Prevention program, one of the funding streams that would be subsumed under the new block grant. This represented about 8 percent of OST's 2011 budget. While DYCD may secure some funding for OST from the new block grant, given that the total grant is budgeted at only 40 percent of the combined budgets last year for the funding streams being consolidated, it is quite likely that whatever is received will be less than last year. The Preliminary Budget does not account for the impact of this change.

In addition to the proposed state funding cuts, the Mayor's November financial plan included proposed reductions in city funds that could have a significant impact on the OST program. OST's budget would lose about $6 million in city funds on an annual basis. With the lower funding, the city has proposed reducing OST services on school holidays, from the previous 20 school holidays a year to 15 in 2011 and 14 in 2012 and later years.

Runaway and Homeless Youth. The department's RHY program protects runaway and homeless youth and whenever possible works to reunite them with their families. Services provided include: street outreach, crisis shelters, drop-in centers, and transitional independent living facilities.

In 2011, the RHY program received $1.4 million in state runaway and homeless youth funding to fund transitional independent living beds, accounting for

11 percent of the RHY budget. Under the state budget proposals, the state runaway and homeless youth funding stream would also be subsumed under the block grant, which is likely to result in a reduction in state RHY funding. The Preliminary Budget did not reflect this possible change.

As with OST, this potential cut in state funds comes on top of Mayoral efforts to reduce city funding for the program. The November plan included a proposal to reduce city funding for the five drop-in centers and eliminate city funds for street outreach, beginning in 2011. After negotiations with the City Council, this year's cuts were postponed. However, funding was not restored for 2012 and beyond, and the Preliminary Budget assumes these service cutbacks will proceed.

Changes to State Juvenile Justice Funding Could Increase City Costs

The Governor's Executive Budget proposes several changes in funding and programming for the state's juvenile justice system. Among those changes are a significant reduction in the amount the state reimburses localities for their detention costs and additional funding for enhanced services for youth in upstate juvenile placement facilities. Both proposals would increase the cost to New York City for its care and treatment of troubled youth who enter the justice system.

Decrease in State Detention Funding. The state budget proposal includes a new block grant of about $46 million which will fund up to 62 percent of the total cost to localities for alternative to detention and placement programs. Detention in this context refers to the temporary custody of a youth in a secure, limited secure, or unsecure facility for a period of a few days to several weeks while a court case and sentencing decision is pending. Once a decision is made, a youth is either released back into the community under the supervision of their legal guardian, sentenced to an alternative to placement program, or placed in an upstate facility for a period of time. Alternative to *detention* programs divert youth to community-based treatment programs instead of detaining them in city detention facilities; alternative to *placement* programs divert youth to similar programs after court sentencing has come down and placement is being strongly considered.

City-State Share of Detention Funding

Dollars in thousands

	2010		2011		
	Funding	Share	Funding	Share	2012 Share
City	$33,329	47.4%	$33,801	49.4%	72.2%
State	$36,874	52.6%	$34,659	50.6%	27.8%

SOURCES: IBO; New York City Office of Management and Budget

NOTES: 2011 data is projected; 2012 estimate calculated by adjusting 2010 actual funding totals to reflect new detention funding cap.

Under the current funding structure, half of the costs that are not federally funded are reimbursed to localities by the state. Under the proposal in the Governor's budget, the state would cover 50 percent of the costs incurred by localities; however, reimbursement is capped at $30 million annually statewide. New York City would be eligible for about $19.5 million, or about $15 million less than in prior years. As a result, the city's funding share for detention will increase from about 50 percent to 72 percent in 2012. The Preliminary Budget includes an additional $15 million per year in city funds starting in 2012 to account for the reduction in state funds.

Funding Changes for Placement Facilities. Over the years state officials have been unsuccessful in addressing the problem of unnecessary costs associated with several upstate placement facilities that remain open but are no longer needed due to a sustained decrease in the population of juveniles in placement. Previous proposals to close the empty or nearly empty facilities have failed largely due to political implications associated with the loss of jobs in these upstate facilities and a statutory 12-month notification period imposed on the state before a facility may be closed. Despite these obstacles that have stymied previous efforts to aligning capacity, the Governor's Executive Budget proposes to reduce youth facility capacity from 1,209 beds to 833 beds and eliminate the 12-month notification period—potentially saving about $21.8 million for the state.

As part of the state's broader juvenile justice reform plan, however, the current proposal also includes additional funding of $26.2 million to enhance services for youth in placement. Therefore, despite reducing costs through capacity reduction, the net impact to the system is an overall increase in state spending of $4.4 million. The Bloomberg

Administration has added an additional $1.0 million in city funding for 2012 and an additional $1.3 million for 2013 and the out-years of the financial plan to cover the increase in rates attributable to the enhanced services.

New Funds for Alternative Programs. Diverting lower-risk juveniles to less costly alternative to detention or placement programs is a central component of Mayor Bloomberg and Governor Cuomo's juvenile justice reform proposals. Not only do alternative programs cost less, but they have the potential to do a better job reducing the recidivism rate, which is 80 percent to 90 percent for youth placed in upstate facilities.

The state's proposed Supervision and Treatment Services for Juveniles program provides a fiscal incentive for localities to ramp up alternative programs and prevent more low-risk youth from entering detention and placement. In theory, the city could offset the reduction in state detention funding by increasing the number of low-risk youth it diverts into the newly funded alternative to detention programs. The challenge for New York City will be to get the programming in place quickly in order to begin diverting additional youth into alternative programs. In spite of the fact that this state proposal is consistent with the mayor's proposal to increase the use of alternative programs, the Preliminary Budget assumes no savings from these efforts.

Governor's Budget Plan for Public Assistance: Some City Savings, Some Bigger Cuts

The Preliminary Budget projects that total cash assistance grant spending will be $1.6 billion in 2011, an increase of 9.0 percent over 2010. After falling for many years, grant spending has risen in each of the last three years; the 2011 budget represents a 34 percent increase above 2007 outlays. The Mayor's Preliminary Budget includes small savings in city public assistance spending that would result from three proposals in the Governor's Executive Budget—delaying a scheduled increase in the basic grant, instituting full family sanctions, and a one-year shift in funding sources. In addition, there are several other changes to public assistance spending in the Governor's budget that could impact city spending, but are not acknowledged in the Preliminary Budget.

Delay Basic Grant Increase. The bulk of welfare expenditures are for the traditional cash assistance program, which provides eligible recipients with a basic grant to cover general expenses such as food and clothing, and specific grants to cover shelter and utility costs.

A major factor contributing to increased public assistance spending over the last few years has been a state decision to increase the size of the basic grant. After the basic grant was frozen for nearly two decades, the state increased the grant by 10 percent in July 2009 and an additional 10 percent in July 2010. Under current law, a final 10 percent increase is scheduled for July 2011. In order to limit the impact of this mandated increase on local budgets, the state agreed to cover the local share of the incremental costs through March 31, 2012, using state and federal funds. After that point, however, the city—and other counties across the state—will be responsible for its share of the costs, adding significantly to the city's welfare expenditures.

The Governor's budget now proposes delaying the final round of increases to the basic grant for one year, until July 2012. The city's Preliminary Budget assumes implementation of this delay, reducing overall city grant spending by $40 million in 2012. City-funded savings would be limited to $4 million, however, because the state had been expected to cover the incremental costs for all but the final three months of the city's fiscal year. The proposed delay would have no new impact on the city's budget for 2013, when city costs were already expected to rise as local governments become responsible for their share of the basic grant increase.

Full Family Sanction. Under current state law, benefit payments to public assistance cases in which the head of household fails to comply with work requirements are reduced by the portion of the grant attributable to the head of household. For family cases, this means that the case remains open with the grant payment continuing at a reduced level providing some assistance for other members of the household—in most cases the children. This system varies from that of several other states where work rule violations by the head of household result in the closure of the entire case. Past proposals to extend this type of full family sanction to New York have been rejected by the state Legislature.

The Governor's Executive Budget proposes a variation of a full family sanction; cases with heads of household who are out of compliance for a second time would be closed. The Mayor's Preliminary Budget assumes that this proposal will become law, and that the resulting case closures will save the city $9 million in 2012 and $12 million each year after that.

Public Assistance Funding Shift. Currently there are different funding formulas for New York's cash assistance programs: the Family Assistance program for families with minor children is funded with 50 percent federal, 25 percent state and 25 percent local funds, while the Safety Net programs for single adults and families who have used up their five-year federal limit on assistance are both funded with 50 percent state and 50 percent local funds. The Governor's budget proposes a one-year funding switch: Family Assistance would be funded with 100 percent federal funds, and Safety Net would be funded as 30 percent state and 70 percent local. Because of the present makeup of the caseload, state officials estimate that this switch would save money for both the state and local governments. The Preliminary Budget assumes that this proposal will be enacted, saving the city $5 million in 2012.

Eliminate Funding for Rent Subsidies. Another major factor driving public assistance cost increases over the last few years 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. As the shelter population has increased, the Advantage program has emerged as a key component of the city's strategy for reducing homelessness.

The continuation of the program, however, is threatened by a proposal in the Governor's budget to eliminate all state and federal funding for Advantage, a loss of about $140 million a year. (see page 39 for further details).

Limited Availability of TANF Funds. Under the 1996 federal welfare law, New York State receives $2.4 billion in Temporary Assistance for Needy Families 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.

This year's state Executive Budget includes only two line item allocations in addition to the Family Assistance grants and other base commitments: the Flexible Fund for Family Services block grant to local governments, and the TANF contribution to the Child Care Block Grant. Both of these would be funded at current year levels. Among the programs left unfunded is the city's Summer Youth Employment Program. Over the years the city's summer jobs program 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 42 of this report for more details).

Medicaid Expenditures Are Rising, but Some State and Federal Fiscal Relief

Governor Cuomo's Executive Budget proposes total statewide Medicaid spending (federal, state, and local shares) of $52.8 billion, which is a decrease of approximately 9 percent from the amount projected based on current law in January 2011. Specifically, the Governor proposes to reduce state funds for Medicaid by $2.9 billion, which would trigger a reduction in matching federal funds. In future years, the Governor proposes to limit annual spending growth to the 10-year rolling average of the medical component of the consumer price index (currently 4 percent). While changes of this magnitude would have major implications for Medicaid service delivery for many New Yorkers in the city and across the state, it is unlikely that there would be a major impact on the city's budget. The impact on the city's Health and Hospitals Corporation and its bottom line is more likely to be substantial as Medicaid reimbursement revenue would decline under the Governor's proposals.

Due to a change to the state's Medicaid funding formula that was implemented five years ago,

New York City Projected Medicaid Expenditures, 2011 - 2015
Dollars in millions

February Plan Projected City Funds	2011	2012	2013	2014	2015
Total Medicaid Expenditures	$5,697	$6,206	$6,224	$6,328	$6,508
Federal Medical Assistance Percentage Savings	(999)	(199)	(32)	-	-
Medicaid Expenditures	**$4,698**	**$6,007**	**$6,192**	**$6,328**	**$6,508**

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

growth in the portion paid from the city's budget has been relatively modest. Prior to 2006, New York City paid fixed shares of the costs associated with providing various Medicaid services to its residents. State-level legislation that went into effect that year capped most of the city's Medicaid costs at calendar year 2005 levels, plus a yearly inflation adjustment of about 3 percent. This legislation has significantly reduced the city's Medicaid obligations below what they would have been under the old financing formula, and the Mayor's budget office does not anticipate spending falling below the capped amount.

Another source of fiscal relief for the city in recent years has been an enhanced federal matching rate. The Federal Medical Assistance Percentage (FMAP) for Medicaid is determined by each state's per capita income relative to the nation's and is normally 50 percent for New York. Under several rounds of federal stimulus legislation, Congress temporarily has raised each state's FMAP beginning in October 2008 and now running through June 2011. In New York, the federal share of Medicaid rose to between 59 and 62 percent, an increase that is now being phased out. The state reports a total of $9.9 billion in savings from the enhanced FMAP, some of which has been passed through to the city. Due to payment lags, the enhanced FMAP will continue to provide savings for the city until 2013. The Preliminary Budget includes FMAP savings of $999 million in 2011, decreasing to $199 million in 2012, and $32 million in 2013. As the enhanced FMAP is phased out and the nonfederal portion of Medicaid costs returns to its previous 50 percent share, the city's portion of Medicaid expenditures is projected to increase from $4.7 billion in 2011 to $6.0 billion in 2012, and reach $6.5 billion in 2015.

Although New York City's total Medicaid expenditures include administrative costs and supplemental payments to hospitals, the bulk of the spending is on services for Medicaid enrollees. While state and federal policies have helped insulate the city from the financial consequences of growth in Medicaid costs in recent years, these expenditures have continued to rise rapidly, increasing the burden on the other funders. Spending on Medicaid services in the city totaled $27.1 billion in 2010, a roughly 82 percent increase over spending in 2000. During this 10-year period the average yearly spending growth was 6.2 percent, notably higher than the 4.0 percent annual growth the Governor has proposed. (These increases cannot be explained by inflation alone—total spending grew 24 percent between 2000 and 2010 in real dollars, with average real yearly spending growth of 2.3 percent.)

Total 2010 Spending on Medicaid Services. When Medicaid spending in the city is examined in terms of service categories, the largest component is long-term care services for the elderly and disabled, as neither Medicare nor private insurance provide significant benefits in this area. Total spending on long-term care services was $10.1 billion in 2010, or 37 percent of the total. Of this, the majority of spending—$7.2 billion—was for traditional long-term care services, which include nursing homes and standard home health services such as personal care and home nursing. Smaller, but growing, shares of expenditures were devoted to specialized long-term care services ($1.8 billion)—which include facility-based care for the developmentally disabled and mentally ill as well as enhanced care offered through various home- and community-based waiver programs—and to managed care premiums for long-term care patients ($1.2 billion).

The second largest component of Medicaid service spending in 2010 was managed care premiums for acute care patients, as the state has now moved the majority of this population into managed care. These payments accounted for 23 percent of service spending, or $6.1 billion, in 2010. Although managed care spending has displaced some of the fee-for-service spending on hospitals and other types of acute care in recent years, the former still accounted for a relatively large amount of expenditures in 2010—$5.3 billion (20 percent) of the total.

While the dollars spent on long-term care services are substantial, they do not represent the full costs of the populations using these services, as patients enrolled in long-term care may also use acute care services such as hospitals and pharmacies. When Medicaid spending is parsed in terms of eligibility groups, the role of long-term care-eligible populations in driving expenditures is even more apparent. The elderly and the disabled accounted for 59 percent ($15.8 billion) of Medicaid spending in 2010. However, the two groups combined make up only 22 percent of Medicaid enrollees in New York City.

Due to both recent economic conditions and statewide policy initiatives such as the launch of Family Health Plus, nondisabled, non-elderly adults are now the largest group of Medicaid enrollees in New York City (39 percent of the total), followed closely by children (38 percent). However, spending per adult and child enrollee in 2010 (roughly $5,400 and $3,200, respectively) is dwarfed by per enrollee spending for the elderly and disabled (approximately $24,500).

Proposed State Medicaid Cuts Threaten HHC's Already Strained Finances

In conjunction with his Executive Budget, Governor Cuomo appointed a Medicaid Redesign Team tasked with reforming the statewide program and more specifically with identifying initiatives to reduce state funded Medicaid spending by $2.85 billion in state fiscal year 2011-2012. The team's proposal, accepted by the Governor in late February, contains a mixture of savings through spending shifts and reestimates; across-the-board rate cuts; and short-term reforms geared at reducing spending or costs in specific areas. The proposal would also impose an overall spending cap on Medicaid, limit annual spending growth to approximately 4 percent, and grant the state Department of Health discretion to implement further cuts if this is exceeded.

Although the Legislature has yet to approve the Executive Budget, it is clear that a funding reduction of the magnitude proposed by the Governor would have consequences for the already-strained finances of the city's Health and Hospitals Corporation (HHC). While the overall impact on its finances is still uncertain, HHC has estimated that if the Medicaid Redesign Team's proposal was enacted as is, the public hospital system would lose $52 million in revenue during the coming state fiscal year, an amount equal to approximately 1 percent of total revenue received in 2010. HHC's affiliated Medicaid Managed Care health plan, MetroPlus, would lose an additional $66 million. If the Governor's proposed Medicaid cuts were instead enacted through an across-the-board reimbursement rate cut of 9.0 percent, HHC alone would lose $200 million in revenue. Although such a draconian scenario is extremely unlikely, some level of Medicaid cuts is all but guaranteed given the state's budget difficulties.

As IBO reported last year, HHC's expenses continue to outstrip revenues, leading to growing deficits. While the hospitals corporation has undertaken a number of steps since then to address the shortfalls, including an ongoing restructuring initiative and staff reductions, recent projections show a closing cash balance of $832.5 million in 2011 declining to just $31.1 million in 2015. These forecasts, which include a number of undefined cost savings initiatives, will likely worsen once the state Medicaid budget is finalized due to the outsized share of HHC's revenue coming from Medicaid. Medicaid fee-for-service and managed care payments have consistently been HHC's single largest funding stream, providing more than 40 percent of revenue in recent years; in absolute terms these payments have barely increased, rising a total of 5.4 percent from 2007 through 2010, largely due to several previous rounds of rate cuts at the state level. HHC's reported revenues from state-run indigent care and other pools and from grants and city subsidies and service payments have also declined since 2007.

These changes have coincided with an increased reliance on Disproportionate Share Hospital (DSH) and Upper Payment Limit (UPL) funds. DSH and UPL are federal programs that provide supplementary payments to hospitals serving a disproportionate share of uninsured and Medicaid patients. These programs are paid for solely with city and federal funds, so they should not be greatly affected by state-level Medicaid cuts. However, the public hospitals' DSH and UPL revenues are vulnerable in the future for several reasons. First, the city had previously been able to increase the size of these payments by leveraging the enhanced federal matching rate for UPL funds under the American Recovery and Reinvestment Act, which

Health and Hospitals Corporation Revenues, 2007-2010

Dollars in millions

	2007		2008		2009		2010	
HHC Cash Receipts - Actuals	**Amount**	**Share**	**Amount**	**Share**	**Amount**	**Share**	**Amount**	**Share**
Medicaid Fee-for-Service & Managed Care	$2,255	45%	$2,291	42%	$2,320	47%	$2,376	41%
Disproportionate Share Hospital & Upper Payment Limit Payments*	634	13%	1,099	20%	416	8%	1,379	24%
Medicare Fee-for-Service & Managed Care	556	11%	782	14%	851	17%	907	16%
Indigent Care and Other Pools	487	10%	453	8%	470	9%	454	8%
Grants, City Funds	350	7%	301	6%	296	6%	253	4%
All Other Revenue	728	15%	485	9%	627	13%	429	7%
Total Revenue	**$5,011**	**100%**	**$5,412**	**100%**	**$4,980**	**100%**	**$5,798**	**100%**

SOURCES: IBO; Health and Hospitals Corporation

NOTE: *2010 includes three years of nonrecurring retroactive payments.

expires on June 30, 2011. Second, federal funding for the DSH program is scheduled to be reduced under the Affordable Care Act starting in 2014. The end result is that HHC's Medicaid and DSH and UPL funding streams—which combined account for 60 percent of the hospital system's revenue in 2007 through 2010—are both vulnerable to some extent in the coming fiscal year.

City Budget Initiatives

Fire and Police Staffing Continues to Shrink

Under the Preliminary Budget, fire and police staffing would decline in the coming year. The main impact within the fire department would be a reduction in the number of firefighting units in service. Reductions in uniformed staffing in the police department could be amplified by additional cuts in civilian police staffing.

Fewer Firefighters, Fewer Response Units. Fire Department of New York firefighter staffing in 2012 would decline through attrition to 10,282, lower than any year since at least 1980. The department's staffing needs are lower in part because the city proposes to take 20 firefighting companies out of service beginning in 2012, representing about 6 percent of the total number of engine and ladder companies currently in operation. The particular companies to be taken out of service 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. This initiative would allow firefighter staffing to decline through attrition by 505 positions—about 25 firefighters are required to staff each fire company on an around-the-clock basis. Total savings for 2012 due to closing the 20 fire companies would be $40.9 million. Taken in combination with other planned reductions, firefighter staffing is to fall by a total of 629 positions in the coming year.

Proposed Police Officer Staffing To Fall Again Slightly, Civilian Positions Also To Be Cut. Under the Mayor's Preliminary Budget for 2012, New York City Police Department (NYPD) uniformed staffing would decline through attrition to 34,413 by June 30, 2012, which would represent the smallest size force since 1992.

Likely exacerbating the impact of the drop in uniformed police staffing will be a concurrent decrease in NYPD civilian staffing. In November 2010, the Mayor announced plans to eliminate 350 civilian positions within the agency, thereby saving $29.8 million in 2012. In combination with other actions, full-time civilian staffing within the agency is now scheduled to fall to 14,172 by the close of next year, a drop of about 2.6 percent as compared with the current year.

Observers of NYPD operations often raise concerns that the loss of civilian staff positions may result in police officers being called upon to perform additional administrative or other support functions, thereby taking away from their availability for direct law enforcement activities. The police department acknowledged in September 2010 that there were already 621 "full duty" police officers performing tasks that could instead be performed by less costly civilian personnel.

Proposed Firefighter Staffing to Fall to Lowest Level Since 1980

Actual Firefighter Staffing								Proposed Staffing	
1980	1985	1990	1995	2000	2005	2009	2010	2011	2012
11,374	12,356	11,571	11,186	11,521	11,488	11,459	11,080	10,911	10,282

Proposed Police Staffing to Fall to Lowest Since 1992

Actual Police Staffing									Proposed Staffing	
1990	1995	2000	2005	2006	2007	2008	2009	2010	2011	2012
31,985	36,429	40,285	35,489	35,773	35,548	35,405	35,641	34,636	34,420	34,413

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" and "firefighter staffing" refers to uniformed police and fire personnel of all ranks.

"Extreme" Weather Hits Budget

Like much of the rest of the nation, New York City has experienced unusually harsh weather conditions during the past year. In 2010, the average temperature for the months June through August was 77.3 degrees, the highest ever recorded. This was followed by a tornado in September, and the third snowiest

winter in the city's history, with 60.9 inches of snow recorded at Central Park through the end of February 2011. The city has already added almost $100 million to the 2011 budget to deal with these extreme events, and the city may still see additional disaster funding as a result of the December blizzard.

September 2010 Storm. On September 16, 2010 a powerful storm ripped through Staten Island, Brooklyn, and Queens, causing what the city's Office of Emergency Management referred to as the city's worst storm damage in decades. The storm toppled a large number of trees and inflicted heavy damage on sidewalks. After the storm was a declared a major disaster, the Federal Emergency Management Agency (FEMA) made federal aid available to supplement state and local funds.

In total, the city, state, and federal government have provided $21.2 million to repair damage from September's storm. The November 2010 Financial Plan included $10.8 million in FEMA funding for sidewalk repair, together with a $1.8 million state match. The city's match of $1.8 million was added in the Preliminary Budget for 2012. Additionally, as the storm caused falling trees and other damage in city parks, $6.8 million in city funds was added to the parks department budget.

Snow-Related Expenses. Snow removal costs in 2011 are projected to total $115.5 million, with the city having seen almost 61 inches of snow. This year's spending is well ahead of the $63.5 million spent in 2010, which brought 51.4 inches of snow to the city. The extreme winter weather has led to an increase in the Department of Sanitation's snow removal budget, as well as additional Department of Transportation (DOT) funding for street repair.

The December 26, 2010 blizzard left much of the city's street network unplowed for several days. Staten Island (Richmond County) received a federal disaster declaration for the December blizzard, making it possible for the city to apply for additional federal and state aid to pay for storm clean-up in that borough. Federal disaster declarations are done by county rather than municipality, and none of the city's other boroughs were covered by the declaration. Thus clean-up costs in the other boroughs are not eligible for the extra funds. (Neighboring Nassau and Suffolk counties did receive a disaster declaration.)

In response to the season's near-record snowfall, $76.6 million was added to the sanitation department's snow removal budget for 2011 and brings the total amount budgeted for this year to $115.5 million. The Preliminary Budget for 2012 also upped the department's snow removal budget for 2012, by $4.5 million, in anticipation of an adjustment that will be required by the time of the Executive Budget to meet a mandate in the City Charter. (Section 103 of the City Charter stipulates that funding for snow removal contained in the Executive Budget be the average of snow removal expenditures during each of the five preceding fiscal years, excluding work completed by employees on regular non-weekend shifts and the purchase of equipment.)

The need to conduct critical street repairs, including fixing potholes and other conditions brought about by the severe winter, has prompted the transportation department to add $2.0 million in overtime for its roadway repair and maintenance division. The need to add overtime money was in part the consequence of a DOT savings initiative introduced in the November 2010 Financial Plan. The department assumed it could save about $1.1 million annually by furloughing repair workers the equivalent of one week in winter. DOT estimated at the time that the furlough would result in 9,000 fewer potholes being filled each year, but that even with this reduction, city streets could be maintained in acceptable condition. However, when this year's severe storms took their

Weather-Related Expenses Grow Since 2011 Budget Adopted

Dollars in millions

Agency	Description	2011	2012	Funding
DOT	FEMA Funds for September 2010 Storm Damage	$10.8		Federal
DOT	State Match for FEMA Funding- Sidewalk Repair	1.8		State
DSNY	Increase for Snow Removal	76.6	$4.5	City
DPR	September Storm Damage	6.8		City
DOT	Roadway Repair and Maintenance	2.0		City
DOT	City Match for FEMA Funding- Sidewalk Repair	1.8		City
TOTAL		**$99.8**	**$4.5**	

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

additional toll on the city's roadways, the amount of repairs deemed necessary by DOT exceeded what could be handled without adding overtime.

Parks Department Restores City Funding for Personnel Costs

Limited success in implementing previously planned reductions in city-funded spending by the Department of Parks and Recreation has forced the city to restore about $12 million a year in the parks budget for higher than expected personnel costs. Ongoing challenges in decreasing the number of city-funded positions and uncertainty over the timeline of a collective bargaining agreement to reduce the work year for half of the agency's full-time staff may require additional restoration of city funding for parks department staff for 2012 and beyond.

Since January 2008, the department has seen eight rounds of budget reductions, including hiring freezes and delays, elimination of vacant positions, and reductions in the seasonal workforce. The hiring freezes and vacant positions were projected to save $17 million in 2010, $37 million in 2011 and $61 million in 2012, with a significant portion of the savings coming from maintenance and operations staffing. To date, the parks department has only partially implemented these programs and savings have been less than the budgeted. According to the Mayor's Office of Management and Budget, a combination of factors, such as lower than expected attrition, and differences between the anticipated and actual salaries and positions of individuals leaving city service, led savings to fall short of the levels planned. The agency's staffing level has declined by 9.6 percent from 2008-2010, 5.7 percentage points less than was budgeted. As a result, city funding for personnel has continued to grow, albeit at a slower pace.

Challenges in the implementation of hiring freezes and attrition programs have led the city to restore funds for parks positions over the last two years. In 2010, following restorations, city spending on parks staffing reached $209 million, a 9.3 percent increase above the adopted budget for that year. The Preliminary Budget for 2012 restores $9.3 million to fund 160 positions in 2011 and $8.9 million to fund 153 positions in 2012. The city also restored $3.1 million in 2011 and $2.8 million in 2012 to fund 74 positions that had not been eliminated through the voluntary Accelerated Attrition Program that was instituted last year. This program allowed parks employees to voluntarily leave full-time positions in exchange for a guarantee of several months of seasonal work the following fiscal year. The agency initiated this one-time program in 2010 to reduce spending, yet only about half of the attrition target was achieved. As a result of these restorations, the current year's budget for personnel has already reached $187 million, an increase of 7.5 percent above the adopted budget for 2011.

The city-funded parks department budget for personnel costs is projected to be $159 million next year, 14.8 percent less than this year. In November 2010, the city proposed reducing the work year by three months for 1,467 parks department staff, roughly half of the agency's full-time personnel. This initiative, which is projected to save the city $17.5 million a year, requires collective bargaining and is currently under negotiation with the union. Given the department's challenges with implementation of hiring freezes and attrition programs in recent years as well as the need to negotiate the work year reduction, it is possible that the city will need to restore more funds for personnel for 2012 and beyond.

City Increases Local Support for Job Seekers

One service area in which the city, despite its budget constraints, is increasing its contribution is workforce development. The final $6.5 million of federal stimulus funding for workforce development, which totaled $25.8 million, will be exhausted in 2011. With the stimulus money running out this year, total funding for workforce development has declined from a peak of $80.8 million in 2010 to $62.3 million in 2011, even as the city has increased its contribution from $13.9 million to $17.1 million. The city is also adding significant resources for a new initiative beginning later this year—Express Workforce Centers. The new centers—initial funding starts in 2011 with full funding in place for 2012 through 2014—are aimed specifically at addressing the problem of stubbornly high unemployment, much of it concentrated in specific city neighborhoods.

The stimulus funds provided only a brief reprieve from a trend of declining federal support for workforce development. Federal monies are provided through a variety of programs under the umbrella of the Workforce Investment Act of 1998. The act funds two main initiatives—

one-stop centers and Individual Training Account vouchers. New York City has nine one-stop centers, known locally as Workforce 1 Career Centers, which are required to provide a mix of training, career counseling, and job placement services. The vouchers allow job seekers to access training from eligible outside training providers. These two programs will receive $17.0 and $12.7 million, respectively, in 2011. This, however, is down from their recent peak of $21.0 million each in 2006.

With federal contributions lower after 2006, the city began contributing local funds to workforce development. The stimulus funds that became available for 2010 allowed the city to cut back its contribution, even as the overall budget for workforce development grew. With the stimulus backstop gone, the city has once again increased its contribution for this year and budgeted a similar amount for 2012.

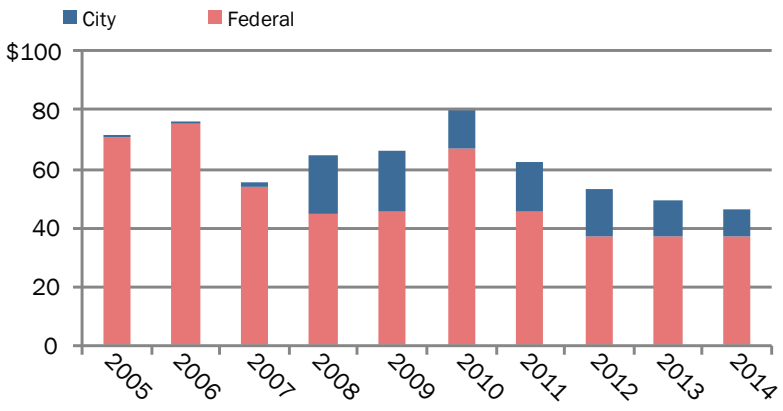
In 2011, the bulk of city funds will be directed toward City Council workforce initiatives and a handful of Center for Economic Opportunity programs, notably three sector-specific Workforce 1 Centers serving job seekers in health care, manufacturing, and transportation. There will also be $700,000 in city funds to begin establishing 10 new Express Workforce Centers. As the program ramps up, funding is expected to grow to $5.5 million a year in 2012 and 2013, and then decline to $2.8 million in 2014. With traffic at the nine existing Workforce 1 Centers (a primary one for each borough, one in Hunts Point, and the three sector-specific centers) still 30 percent to 40 percent above prerecession levels (and placements at 31,000 in 2010 compared with 17,000 in 2008), the Express Centers are intended to serve large numbers of job seekers.

The five primary one-stop centers have annual budgets ranging from $2.2 million to $3.3 million. The Express Centers' budgets will average $500,000 a year. They will focus solely on placement, and will not offer the career counseling and training services that the one-stop centers do. While it is possible that funding will be renewed should there continue to be strong demand in 2014, the Express Centers are expected to be a temporary measure for dealing with very high local unemployment that has persisted even though the city has been adding jobs for over a year.

The Department of Small Business Services (SBS) is working to identify high-need communities in which to locate the centers. SBS staff is currently reviewing data from the state labor department to identify appropriate neighborhoods, and are considering opportunities to locate them within existing community resources like public libraries and City University of New York campuses. The agency expects to identify neighborhoods by the end of March, select exact locations shortly thereafter, and begin openings in May or June.

The identification of and focus on high-need communities is an important component of the program given the large differences in economic opportunities across the city. The citywide unemployment rate is 8.9 percent for January 2011, but in Brooklyn and the Bronx are substantially higher. Specific communities within the boroughs have fared even worse. And these numbers do not reflect the underemployed and those out of the labor force; as the local economy improves, many of these underemployed and discouraged workers are expected to begin searching for jobs, keeping the unemployment rate high.

Shares of Workforce Development Funding
Dollars in millions



SOURCES: IBO; Mayor's Office of Management and Budget
NOTE: 2011-2014 numbers are projected.

Labor Costs and Proposed Savings

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 2012 proposes personal services

expenditures of $37.0 billion, about 55 percent of total planned expenditures and an increase of $612 million (1.7 percent) from this year. This spending level depends on some key assumptions, including wage increases largely funded only through increases in productivity and reductions in pension costs.

Minimal Funding for City Worker Pay Increases. Labor contracts between the majority of city workers and their respective unions have already expired and the remainder will do so by the end of the upcoming fiscal year. The city's financial plan provides no funds for raises during the first two years of new contracts negotiated during the current round of collective bargaining and funding for 1.25 percent raises for each of the subsequent two years.

Adding to the challenge is the fact that the teachers' contract—which the city considers part of the prior round of bargaining—expired in October 2009. Funds that had been budgeted for wage increases for teachers, as well as for school supervisors and administrators, were removed last year. Without funds budgeted for new contracts, the city is assuming that any wage increases for school personnel will be funded through increases in productivity.

While the Mayor has stated that additional raises will have to be offset with increases in productivity (often called "givebacks"), similar efforts in the past to obtain savings have been difficult to achieve—particularly because it is hard to extract productivity savings retroactively. Each 1 percent wage increase costs the city about $290 million annually, including pension costs.

Pension Savings Assumed in Financial Plan. The Mayor's Preliminary Budget for 2012 and updated five-year financial plan includes two key assumptions regarding savings from changes to the city's pension plans. First, the Mayor's proposed budget assumes that Albany will enact modifications to the Variable Supplement Fund (VSF) plans which pay $12,000 each year to members of the police and fire pension funds with 20 years of service. VSF payments are not technically pension benefits, but instead supplement pension benefits. A recent analysis prepared by the city's Chief Actuary estimated that complete repeal of VSF benefits, if made effective July 1, 2011, would generate $970.1 million in city pension savings in 2012.

Rather than proposing complete elimination of VSFs, the Preliminary Budget assumes that unspecified changes to existing VSF benefits will save the city $200 million in 2012. This $200 million in turn is part of the $600 million in state actions the Mayor is counting on in order to bring his proposed 2012 budget in balance—as with regular pension matters, virtually all changes to the city's retirement benefits require state legislation.

Second, the current financial plan also reflects savings associated with the Bloomberg Administration's proposal to change the pension system for new employees. The financial plan assumes that enabling state legislation would cover employees hired beginning in 2012. Because of lags in adjusting the city's required pension contribution, savings would not begin until 2014. Under the proposal, all new employees except police and correction officers, firefighters, and uniformed sanitation workers, would be required to contribute to their pensions for their entire working careers and wait until age 65 before receiving a full pension. The Mayor is also proposing that overtime pay no longer count in the pension calculation for new employees, including uniformed personnel. In addition, the Mayor is proposing to eliminate the guaranteed fixed return on tax deferred annuities offered to teachers and certain other employees of the Department of Education. The Bloomberg Administration estimates that adopting the proposal would save $131 million in 2014 and $252 million in 2015, with greater savings over time.

It should be noted that the pension modifications now being sought are in addition to changes in the teachers' pension plan enacted in Albany in 2009 which applied only to new teachers in New York City. The current proposal, which includes more extensive changes to the city's pension system, would cover all new city employees, including teachers.

A Billion Dollars in Pension Reserves. Following completion of a required biennial review of the pension system by an independent auditor, the city's Chief Actuary is expected to recommend changes in actuarial assumptions and methods this spring. These changes are expected to lead to a sharp, but as yet undetermined, increase in city pension contributions in 2012 and beyond. The Preliminary Budget includes a reserve of $1 billion a year from 2012 through 2015 in anticipation of the need for additional contributions.

Capital Spending, Financing, & Debt Service

Four-Year Capital Commitment Plan

The February 2011 Capital Commitment Plan that was released with the Mayor's Preliminary Budget provides $33.2 billion for the city's capital program, covering the period 2011 through 2014. The total represents a decrease of $1.9 billion or 5.5 percent from the level of capital funding planned in September 2010.

Although the capital program is primarily city-financed, in recent years more than 20 percent of its total funding has been comprised of state, federal, and private grants. The February plan reflects a reduction in noncity funding of nearly 25 percent compared with the September 2010 Capital Commitment Plan. Total funding from state, federal, and private sources is down by $1.8 billion, from $7.3 billion to $5.6 billion in the latest plan. This decline is largely due to a reduction of $2.2 billion or 48.1 percent in state grants for the Department of Education's capital program in 2011 through 2014.

The commitment plan provides $13.8 billion for 2011 and the Mayor's Office of Management and Budget (OMB) expects agencies to actually commit (register contracts for) $10.6 billion or 76.5 percent of the amount authorized. In recognition that projects are subject to changes and delays due to unforeseen events, the commitment target tends to be less than the authorized total for the year. When the February 2011 plan was scaled back, the commitment target for 2011 was also lowered by $1.5 billion.

For the remaining years of the February 2011 plan—2012 through 2014—the authorized totals are $7.4 billion, $6.6 billion, and $5.4 billion, respectively.

Total capital commitments for 2011 were reduced by $2.1 billion (13.3 percent) from September. More than 40 percent of the total reduction is within the Departments of Transportation and Education, approximately $450 million each or 25.3 percent and 18.5 percent, respectively. The 2011 capital program of 21 other agencies was also scaled back. Only six agencies did not see a reduction in their capital programs in 2011: the Department of Environmental Protection (DEP), the Health and Hospitals Corporation, New York City Transit, the MTA Bus Company, Staten Island Railway, and the Department of Information Technology and Telecommunications.

Examples of current year projects affected by the proposed reduction in capital commitments include:

- $88.2 million for protection against marine borers (aquatic organisms that feed on wood pilings) was moved from 2011 to 2012; $27.5 million for design and construction of pedestrian bridges was cut from 2011, with about half of the total cut restored in 2014;

New York City Revises Four-Year Capital Commitment Plan

Authorized commitments, dollars in millions

	2011	2012	2013	2014	TOTAL
February 2011 Plan					
City Funds	$11,525	$5,936	$5,581	$4,593	$27,635
Noncity Funds	2,283	1,422	1,018	829	5,552
Total	**$13,808**	**$7,358**	**$6,599**	**$5,422**	**$33,187**
September 2010 Plan					
City Funds	$13,310	$4,628	$4,962	$4,906	$27,806
Noncity Funds	2,621	1,742	1,331	1,633	7,327
Total	**$15,931**	**$6,370**	**$6,293**	**$6,539**	**$35,133**
Change					
City Funds	$(1,785)	$1,308	$619	$(313)	$(171)
Noncity Funds	(338)	(320)	(313)	(804)	(1,775)
Total	**$(2,123)**	**$988**	**$306**	**$(1,117)**	**$(1,946)**
Percent Change					
City Funds	-13.4%	28.3%	12.5%	-6.4%	-0.6%
Noncity Funds	-12.9%	-18.4%	-23.5%	-49.2%	-24.2%
Total	**-13.3%**	**15.5%**	**4.9%**	**-17.1%**	**-5.5%**

SOURCES: IBO; February 2011 and September 2010 Capital Commitment Plans
NOTE: Plan figures exclude interfund agreements, contingency amounts, and the reserve for unattained commitments.

$26.0 million for reconstruction of Broadway was moved from 2011 to 2012; and $22.0 million for reconstruction of West 33rd Street was moved from 2011 to 2014. Highway bridges and highway projects account for 46.7 percent and 25.8 percent, respectively, of the $450.1 million reduction to transportation department's capital program in 2011.

- $79.7 million for citywide information technology projects was eliminated in 2011 although in 2012-2014 the funding was increased by roughly the same amount; $35.3 million and $13.3 million set aside for the capital needs of the Board of Elections and court facilities, respectively, was also eliminated in 2011 and from the entire 10-year strategy (see next column for discussion of the 10-year capital spending strategy). Combined, these three projects account for 44.9 percent of the $285.9 million reduction to the Department of Citywide Administrative Services' capital program in 2011.
- $233.9 million for construction of two waste management facilities—the Marine Transfer Station at East 91 Street and the Southwest Brooklyn export facility—was deferred to 2016. The combined projects explain more than 90 percent of the $256.5 million reduction to the sanitation department's capital program in 2011.
- $83.1 million to convert the James A. Thomas Center on Rikers Island into administrative offices was eliminated from 2011 and the entire 10-year strategy. This reduction explains 57.6 percent of the $144.3 million reduction to correction department's capital program in 2011.
- $11.4 million for construction of a new police academy training facility was eliminated in 2011 and $10.3 million for a radio system in the subways was deferred to 2012 and 2013. The combined projects explain 32.7 percent of the $66.4 million reduction to the police department's capital program in 2011.
- $11.4 million for the Fort Washington Armory to stabilize the building exterior and correct existing code violations was eliminated from 2011 and the entire 10-year strategy. This reduction explains 46.7 percent of the $24.4 million reduction to the Department of Homeless Services' capital program in 2011.

In 2012 and 2013 the commitment plan authorizes an additional $1.9 billion in city funds for agency capital programs. Most of the total city-funded increase represents a shift in planned commitments to 2012 and 2013 from the current year. In addition, nearly 50 percent of the combined increase for 2012 and 2013 occurs within the Department of Environmental Protection; environmental department commitments that were originally planned for 2015-2021 will now be moved up into the 2011-2014 Capital Commitment Plan. Overall total funds increased by 15.5 percent in 2012 and 4.9 percent in 2013. In 2014 the plan is reduced by $1.1 billion (17.1 percent) due to a nearly 50 percent decline in noncity sources of funding for agency capital programs.

Ten-Year Capital Strategy

As required by the City Charter, the Department of City Planning and Office of Management and Budget prepared the Preliminary Ten-Year Capital Strategy for 2012-2021 which accompanied the Mayor's Preliminary Budget for 2012. The upcoming strategy would invest a total of $47.0 billion over the next 10 years—$14.7 billion or 23.8 percent less, compared with the strategy presented in May 2009.

The new long-term capital plan would also rely less on state and federal grants than the May 2009 strategy. State and federal grants are now expected to make up $5.5 billion (11.7 percent) and $2.8 billion (6.0 percent), respectively, of the total funding. An additional $280 million (0.6 percent) is expected to come from private sources. Nearly 82 percent or $38.4 billion will come from the city. A final version of the upcoming strategy is expected to be released with the Mayor's Executive Budget in April 2011.

In December 2010 the Bloomberg Administration asked agencies, except environmental protection, to identify a 20 percent reduction in capital commitments for 2011 and 2012-2021 (the period covered by the upcoming strategy). Instead a reduction of $4.1 billion or 10 percent in city funds was achieved. The capital cut reduces the city's capital investment to $35.8 billion over the 11-year period, excluding environmental protection.

About 35 percent of the total $4.1 billion city-fund reduction occurs over 2011-2014, with the

remaining reduction implemented over the 2015-2021 period. Education projects accounted for the largest reduction—$1.3 billion or 10.1 percent in city funding over the 11-year period. This is followed by transportation department highway and bridge projects which were cut by $567 million and $600 million, respectively (roughly 20 percent) and Department of Housing Preservation and Development projects which were cut by $493 million (14.5 percent).

Capital Commitment Plan Changes for Fiscal Year 2011

Authorized commitments, dollars in millions

Operating Agency	Feb. 2011 Plan	Sept. 2010 Plan	Change	Percent Change
Dept. of Transportation	$1,331.4	$1,781.5	$(450.1)	-25.3%
Dept. of Education	1,974.9	2,421.9	(447.0)	-18.5%
Dept. of Citywide Administrative Services	1,008.4	1,294.3	(285.9)	-22.1%
Dept. of Sanitation	583.0	839.5	(256.5)	-30.6%
Dept. of Small Business Services	965.1	1,127.4	(162.3)	-14.4%
Dept. of Parks and Recreation	1,145.6	1,294.1	(148.5)	-11.5%
Dept. of Correction	256.4	400.7	(144.3)	-36.0%
Dept. of Housing Preservation and Dev.	730.2	822.9	(92.8)	-11.3%
Dept. of Health and Mental Hygiene	368.5	455.3	(86.8)	-19.1%
Police Department	256.3	322.7	(66.4)	-20.6%
Dept. of Cultural Affairs	446.3	503.9	(57.6)	-11.4%
Fire Department	193.7	231.6	(37.9)	-16.4%
Dept. of Homeless Services	56.2	80.6	(24.4)	-30.3%
Administration for Children's Services	87.3	103.7	(16.5)	-15.9%
City University of New York	261.4	275.5	(14.0)	-5.1%
Dept. of Social Services	78.4	91.7	(13.3)	-14.5%
NY Public Library	116.8	125.1	(8.3)	-6.6%
Queens Borough Public Library	100.6	107.4	(6.8)	-6.3%
Dept. for the Aging	30.7	35.0	(4.2)	-12.1%
Housing Authority	92.8	96.8	(4.0)	-4.1%
NY Research Library	13.0	14.1	(1.1)	-7.7%
Dept. of Juvenile Justice	4.3	5.3	(1.1)	-20.0%
Brooklyn Public Library	49.1	49.3	(0.2)	-0.5%
Dept. of Information Tech. and Telecom.	643.4	643.4	0.0	0.0%
MTA Bus Company	39.9	36.7	3.2	8.7%
Staten Island Railway	3.3	2.3	1.0	42.7%
New York City Transit	222.8	212.8	10.0	4.7%
Health and Hospitals Corporation	295.5	225.5	70.0	31.0%
Dept. of Environmental Protection	2,452.9	2,330.2	122.7	5.3%
TOTAL	**$13,808.2**	**$15,931.3**	**$(2,123.1)**	**-13.3%**

SOURCES: IBO; February 2011 and September 2010 Capital Commitment Plans

NOTE: Plan figures exclude interfund agreements, contingency amounts, and the reserve for unattained commitments.

Ten-Year Strategy Includes $732 Million for Green Infrastructure to Reduce Combined Sewer Overflows

In September 2010, the city announced its Green Infrastructure Plan that outlines initiatives to improve the water quality of New York Harbor and reduce combined sewer overflows (CSOs) by investing in alternatives to the traditional approach of adding storage capacity to the sewer system. CSOs are discharges of untreated sewage that occur during storms when the volume of storm water flows exceeds the treatment capacity of a combined sewer system. Basically, the wastewater treatment plants cannot handle the flow volume and untreated sewage and storm water are simply allowed to enter the surrounding waters until the flow returns to more normal levels. The city's preliminary ten-year capital strategy adds $732 million, primarily in 2018-2020, for green infrastructure.

The Green Infrastructure plan aims to capture and retain storm water before it enters and overwhelms the sewer system by increasing the area of natural, permeable surfaces that can absorb the water. Examples of such infrastructure include street side swales (areas along the curb with specific type of soils and native plants

that absorb water), enlarged tree pits, and rooftop surfaces, such as green roofs, that are designed to retain water. The plan calls for investing $1.5 billion in green infrastructure over the next 20 years, in addition to utilizing traditional CSO reduction infrastructure, such as holding tanks and tunnels. The plan has to be approved by the state's Department of Environmental Conservation in order to be considered part of the CSO abatement program required under a consent order negotiated between the city and state.

The preliminary 10-year strategy includes new capital funding for the implementation of the initial phase of the NYC Green Infrastructure plan. Although most city agencies are reducing their capital plans as a result of the 10 percent cut announced by the Mayor in February 2011, capital work performed by the Department of Environmental Protection is not subject to the reduction. DEP projects are financed separately from other city capital improvements, with bonds backed by payments for use of the water system.

The 10-year strategy allocates $732 million of new funds to DEP for installation of green infrastructure throughout the city, with 74 percent of the funding planned for 2018-2020. In addition to green infrastructure, the strategy continues to improve the existing capacity of the storm water retention system through installation of new devices at waste treatment plants, such as gates and inflatable dams, to store wastewater until peak flow decreases. Planned funding for traditional storm water retention system infrastructure is $1.1 billion from 2012-2021, bringing the total planned investment in CSO reduction work to $1.9 billion over the 10-year period. In addition, $202 million was committed in 2010 and $90 million is planned for 2011. The increased level of investment for CSO reduction work from 2012-2021 represents a 52 percent increase over the level of investment from 2001-2011 and is expected to improve the water quality of New York's harbor.

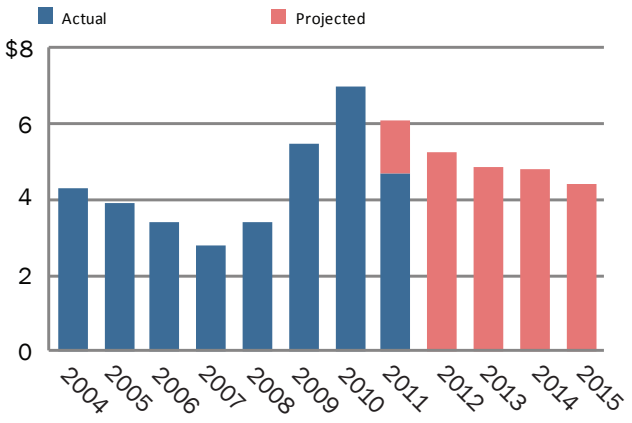
Paying for the Capital Program

Borrowing. To finance the city's 2011–2014 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 (NYW). GO and TFA debt are backed by property taxes and personal income taxes, respectively. NYW debt is backed by fees and charges levied on users of the New York City water and sewer systems. The proceeds of NYW new money debt are pledged exclusively to environmental protection capital projects. GO and TFA debt proceeds fund the remainder of the city-funded capital program.

City Debt Issuance Trends. With the Capital Commitment Plan cut back (see page 55), the city has revised its projected GO and TFA bond issuance for the years 2011 through 2015 downward by $820 million. The $6.1 billion projected new money borrowing in 2011, $200 million less than projected in November, would still be a record annual issuance. The projected issuance for 2012 has been revised downward by $200 million as well, to $5.3 billion. The city plans to issue $4.8 billion in both 2013 and 2014 and $4.4 billion in 2015, downward revisions from November of $160 million, $120 million, and $140 million, respectively.

The reductions in GO and TFA borrowing follow a more consistent pattern than the changes expected in capital commitments (excluding environmental protection), which have been reduced from 2011 through 2014 with the exception of 2012, when planned commitments increased by $1.1 billion. The relatively consistent annual reductions in debt issuance are driven by projected cash needs. Debt issuance for a project begins in the year the

Selected City Bond Issues
Dollars in billions



SOURCES: IBO; Mayor's Office of Management and Budget
NOTES: Includes GO and TFA new money bond issues. Excludes refunding bonds, TFA Recovery Bonds, TFA Building Aid Revenue Bonds and Muncipal Water FInance Authority Bonds.

commitment is made but is typically spread over several years. Projected borrowing in 2012 and later years reflects the increased commitments in 2012. But in each subsequent year, lower borrowing needs associated with the reduction in new commitments offset the increase from 2012.

With capital improvements to the city's water and sewer system not subject to the 10 percent reduction, and with some DEP projects proceeding faster than previously anticipated, the Municipal Water Finance Authority's projected new money bond issuance in 2011 has increased slightly. Borrowing is up over the remainder of the financial plan as well, largely a result of moving up the beginning of repairs to the Delaware-Rondout Aqueduct from 2016 to 2013 and initiating DEP's Green Infrastructure Plan. The water authority has issued $2.4 billion in new money bonds already in 2011, and anticipates issuing another $800 million before the end of the fiscal year. NYW projects new money borrowing of $2.0 billion, $1.7 billion, $1.5 billion, and $1.2 billion in 2012 through 2015, respectively.

Credit Market Overview. Although municipal credit markets experienced severe disruptions at the depths of the financial crisis, the city and its various financing entities continued to have market access on reasonable terms and the city is not expected to have difficulty accessing credit markets in the next few years. The city's highly rated general obligation debt allowed issuances to continue in the absence of municipal insurers, and received a bump in 2010, as "recalibrations" by Moody's and Fitch raised the city's ratings to Aa2 and AA respectively; Standard & Poor's maintained its AA rating on general city credits. New York will benefit from going to market for new money while interest rates remain at historic lows, as well as from continuing to refinance some of its $10.7 billion in variable rate debt to fixed rate, locking in the favorable rates.

Heavily Used Stimulus Bonding Program Expires. The city took advantage of a new type of bond created by the 2009 American Recovery and Reinvestment Act legislation designed to facilitate funding of capital improvements by state and local governments and to provide stimulus to the economy. The bonds, which as of January 1, 2011 can no longer be issued, were known as Build America Bonds (BABs). Unlike most municipal debt, which is tax exempt, BABs were taxable but benefited from 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).

BABs were very popular with issuers and investors, and many analysts believe that they played a significant role in the stabilization and eventual recovery of municipal credit markets. Part of the reason municipal debt issuance has slowed is likely due to the expiration of BABs.

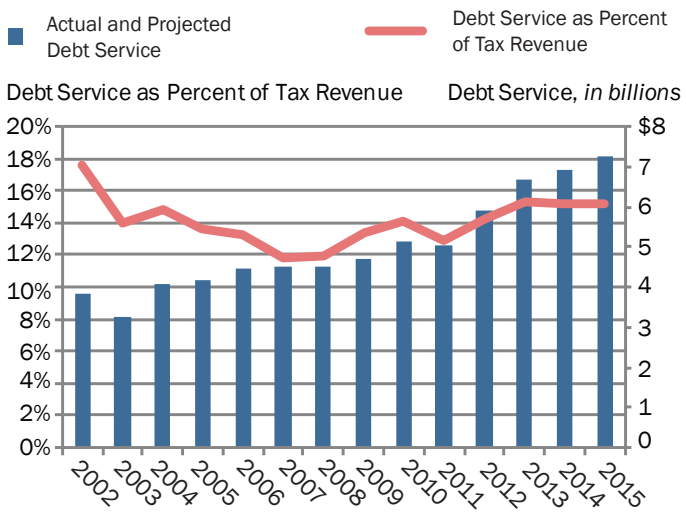
New York City made extensive use of BABs. The bonds have accounted for $7.5 billion of the $11.7 billion in GO and TFA new money debt issued to-date for fiscal years 2010 and 2011. The water authority issued an additional $3.7 billion of BABs. OMB estimates that the city reaped savings of 10 basis points to 100 basis points on the use of BABs over the tax-exempt financing that would otherwise have been used.

Few stimulus benefits for municipal borrowing remain. There is discussion at the federal level of potentially reestablishing BABs, although prospects appear uncertain as Washington focuses on deficit reduction. If BABs are reauthorized, it will almost certainly be with a lower federal interest rate subsidy than the original 35 percent. The city also plans to use its remaining $1.0 billion allocation of another, smaller stimulus bonding program, qualified school construction bonds. Barring a new program, the city expects to rely primarily on traditional tax-exempt financing for its borrowing needs going forward.

Debt Service. Debt service—the cost of repaying principal and/or interest on outstanding bonds—is a function of the amount of outstanding debt and the terms that were obtained when the debt was issued. Debt service in the city budget and financial plan reflects GO and TFA borrowing, as well as several smaller obligations. Because NYW borrowing is repaid from water and sewer fees rather than the city's general fund, debt service in the Preliminary Budget does not reflect NYW borrowing.

In the Preliminary Budget, OMB has recognized significant savings to debt service in 2011 and 2012

Debt Service and Debt Service as Share of Tax Revenue



SOURCES: IBO; Mayor's Office of Management and Budget
NOTES: Fiscal years 2011 to 2015 are projected. Adjusted for prepayment of debt service. Projection based on IBO tax revenue forecast.

due to historically low interest rates, especially with regards to the city's substantial outstanding variable rate debt. Although the decline in future borrowing needs resulting from reductions in the city's Capital Commitment Plan also contributes to lower debt service costs, the annual savings are relatively modest when spread out over the long time horizons of the bonds.

Savings on Variable Rate Debt. The city's projections of interest expenses are conservative and revisions to reflect low interest rates have been done very slowly. The city is only now revising its 2011 interest rate assumptions for variable rate debt from 3.75 percent to 1.0 percent and its 2012 assumptions from 4.25 percent to 2.0 percent—resulting in annual savings of more than $300 million, according to OMB. The new rates are still conservative, with the city currently paying on average 0.25 percent for short-term, tax-exempt floating rate debt and 0.4 percent for short-term, taxable floating rate debt thus far in 2011. As a result, there are likely to be more savings realized in the Executive Budget. And while interest rates on variable rate debt will most likely rise over the next several years, they may not reach the 4.25 percent OMB has maintained as its assumption for 2013 and beyond as quickly, potentially resulting in yet more savings down the road.

Debt Service Trends. Debt service, adjusted for prepayments and defeasances, is expected to total $5.0 billion in 2011, down slightly from $5.1 billion in 2010—the first year-over-year decline since 2007. The $5.0 billion would represent 12.9 percent of IBO's forecast of city tax revenues, the lowest percentage since 2007 and 2008, both years of extraordinarily high receipts. (Prior to 2007, one has to go back to 1990 to find as low of a ratio). This results from the combination of low interest rates and growing tax revenues.

The Mayor's budget office projects debt service growth will resume in 2012, rising to $5.9 billion (14.2 percent of tax revenues), and to $7.3 billion in 2015 (15.2 percent). By comparison, debt service as a percentage of tax revenue averaged 13.8 percent from 2002 through 2010.

Contributors

Eric Anderson	Debt, small business services
David Belkin	Business income taxes, local economic outlook
Elizabeth Brown	Housing, buildings, homeless services
Yevgeniya Bukshpun	Parks and recreation, sanitation, environmental protection
Ana Champeny	Property tax
Theresa Devine	Economic outlook
Chirstina Fiorentini	Health, public hospitals
Michael Jacobs	Personal income tax
Andrew Liebowitz	Hotel, sales, and excise taxes
Paul Lopatto	Public assistance
Kathleen Maher	Child welfare, juvenile justice, child Care, libraries
Bernard O'Brien	Police, fire, labor, Civilian Complaint Review Board
Nashla Rivas-Salas	Youth, seniors, corrections
Yolanda Smith	Education, City University of New York
Sarita Subramanian	School construction
Alan Treffeisen	Property transfer, mortgage recording taxes, transportation
Ana Maria Ventura	Capital plan

IBO

New York City
Independent Budget Office

Ronnie Lowenstein, Director
110 William St., 14th Floor • New York, NY 10038
Tel. (212) 442-0632 • Fax (212) 442-0350
iboenews@ibo.nyc.ny.us • www.ibo.nyc.ny.us
Twitter RSS