Review of the Five-Year Financial Plan for the City of New York

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I. Executive Summary

In November 2002, New York City projected a record $6.4 billion budget gap for FY 2004. The gap represented 24 percent of City fund revenues and was the largest gap faced by the City, both in absolute dollars and as a percentage of City fund revenues, since the 1975 fiscal crisis. The City has closed about half the gap since then, but it is relying on the State and federal governments, the Port Authority of New York and New Jersey, and the municipal unions to close the remaining gap.

The current financial crisis began during FY 2002 and was precipitated by several factors, including past fiscal policies, slowdowns in the national and local economies, the attack on the World Trade Center, and revenue and pension fund investment losses due to the stock market downturn. Wall Street economic activity, which accounts for 21 percent of all wages paid in the City, generated an estimated $7 billion in profits in calendar year 2002—45 percent less than forecast in June 2002—down from $21 billion in 2000.

To ensure budget balance in FY 2003 and to narrow the FY 2004 budget gap, agencies cut planned spending in November 2002 and the City Council approved a mid-year property tax hike of 18.5 percent. These actions restored budget balance in FY 2003 and cut the FY 2004 budget gap to $3.1 billion. The gaps, however, have grown since November due to continued weakness in the economy and failure to achieve $223 million in savings from the City's labor unions.

The January Plan shows budget gaps of $486 million in FY 2003 and $3.4 billion in FY 2004 (see Table 1). To close them, the Plan assumes that the State and federal governments, the Port Authority, and the municipal unions will take actions to provide the City with $3.8 billion during fiscal years 2003 and 2004. In a positive development, the City will receive as much as $650 million in federal aid related to the attack on the World Trade Center.

The Governor, however, opposes the Mayor's proposal to extend the City's personal income tax to non-City residents who work in the City, which would generate $962 million in FY 2004. The Mayor's tax proposal, which is also opposed by suburban legislators, would require commuters to pay about $2,750 a year—five times more than the old commuter tax. Alternative tax proposals, such as reinstating the old commuter tax or placing a surcharge on resident personal income taxes, may be more palatable to the State.

The State is facing a fiscal crisis of its own. The Governor projects a two-year budget gap of $11.5 billion, which he would close with tobacco bond proceeds ($3.8 billion), cuts in Medicaid and education spending ($2.4 billion), taxes and fees

($1.4 billion), and other actions. The Governor's budget, however, must still be negotiated with the State Legislature.

Rather than helping the City, the Governor's budget would widen the FY 2004 gap by about $200 million. A $753 million loss in anticipated education aid would be only partly offset by other proposals. The Governor's health care proposals also would reduce revenues to the Health and Hospitals Corporation by up to $200 million.

Our review has identified $175 million in budget risks for FY 2003, but the City could draw upon reserves if needed to maintain budget balance (see Table 2). The risks to the FY 2004 budget are far more substantial, totaling $3.4 billion. Most of the risk involves City proposals that require action by the State ($1.7 billion), the Port Authority ($690 million), and the municipal unions ($600 million). Although the City could ultimately receive a substantial amount of assistance, a serious concern remains that many of these risks may not be resolved before the new fiscal year begins on July 1, 2003. For example, the State's fiscal year begins on April 1, but the State has a long history of adopting late budgets.

Any shortfall in anticipated assistance would have to be covered by City actions and the Mayor has directed agencies to prepare a $600 million contingency program. The Mayor has already threatened to lay off 12,000 employees unless the municipal unions produce $600 million in savings, and to lay off 1,900 teachers if the Governor's education budget is adopted. Staffing levels are currently projected to decline by only 5,400 positions between June 2002 and June 2004, but most of the reduction is concentrated in public safety agencies, such as the Police Department.

Even after balancing the FY 2004 budget, the City will continue to face budgetary constraints for the foreseeable future. Pension costs are projected to rise by $2.8 billion by FY 2007, an annual rate of 28 percent, which reflects pension fund investment losses. Debt service costs, despite deep cuts to the capital program, are projected to grow at an annual rate of 12 percent. In addition, the January Plan assumes that future wage increases will be funded entirely with productivity savings, a strategy the City has been unable to implement since the 1970s fiscal crisis.

The size of the budget gap in FY 2005 and in subsequent years will depend on the pace of the economic recovery and whether the FY 2004 budget is balanced with recurring resources. The FY 2003 budget is balanced with $4.2 billion in nonrecurring resources, including $1.5 billion in bond proceeds from the Transitional Finance Authority to reimburse the City for revenue losses related to the attack on the World Trade Center, and the FY 2004 budget already includes $1.6 billion in nonrecurring resources. The City made progress in narrowing the structural balance between recurring revenues and expenses when it raised property taxes and reduced the cost of City government, but bridging the remaining gulf is a formidable challenge.

Table 1
New York City Five-Year Financial Plan
Revenues and Expenditures
(in millions)

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
REVENUES					
Taxes					
General Property Tax	$ 9,926	$11,167	$11,583	$12,006	$12,459
Other Taxes	12,620	12,715	13,518	14,441	15,263
Tax Audit Revenue	502	502	502	502	502
Miscellaneous Revenue	4,230	3,804	3,785	3,765	3,784
Transitional Finance Authority – 9/11	1,500	- - -	- - -	- - -	- - -
Unrestricted Governmental Aid	754	555	555	555	555
Anticipated Federal & State Aid	230	- - -	- - -	- - -	- - -
Other Categorical Grants	1,075	770	673	694	710
Less: Intra-City Revenue	(1,107)	(1,039)	(1,036)	(1,034)	(1,033)
Grant Disallowances	(15)	(15)	(15)	(15)	(15)
Subtotal City Funds	**29,715**	**28,459**	**29,565**	**30,914**	**32,225**
Inter-Fund Revenues	332	321	320	320	320
Total City & Inter-Fund Revenues	**30,047**	**28,780**	**29,885**	**31,234**	**32,545**
Federal Categorical Grants	5,386	4,192	4,158	4,151	4,161
State Categorical Grants	8,477	8,295	8,381	8,445	8,478
Total Revenues	**$43,910**	**$41,267**	**$42,424**	**$43,830**	**$45,184**
EXPENDITURES					
Personal Service					
Salaries and Wages	16,850	16,366	16,311	16,330	16,336
Pensions	1,904	2,731	3,366	4,194	4,687
Fringe Benefits	4,700	4,856	5,121	5,404	5,704
Subtotal – Personal Service	**23,454**	**23,953**	**24,798**	**25,928**	**26,727**
Other Than Personal Service					
Medical Assistance	4,006	4,240	4,388	4,532	4,536
Public Assistance	2,255	2,073	2,080	2,080	2,080
All Other	12,720	12,026	12,258	12,472	12,677
Subtotal - Other Than Personal Service	**18,981**	**18,339**	**18,726**	**19,084**	**19,293**
Debt Service	1,933	3,082	3,447	3,575	3,788
Budget Stabilization & Prepayments [1]	621	- - -	- - -	- - -	- - -
Municipal Assistance Corp. Debt Service	214	23	490	492	494
General Reserve	300	300	300	300	300
Subtotal	**45,503**	**45,697**	**47,761**	**49,379**	**50,602**
Less: Intra-City Expenses	(1,107)	(1,039)	(1,036)	(1,034)	(1,033)
Total Expenditures	**$44,396**	**$44,658**	**$46,725**	**$48,345**	**$49,569**
Gaps To Be Closed – January Plan	**$ (486)**	**$ (3,391)**	**$ (4,301)**	**$ (4,515)**	**$ (4,385)**
Gap-Closing Program	**486**	**3,391**	**2,806**	**2,507**	**2,351**
Remaining Gap To Be Closed	**$ - - -**	**$ - - -**	**$ (1,495)**	**$ (2,008)**	**$ (2,034)**

Source: NYC Office of Management and Budget

[1] The FY 2003 budget stabilization and prepayments reflect $508 million in MAC debt service and $113 million in debt service costs that would have been paid in FY 2004.

Table 2
OSDC Risk Assessment of NYC Financial Plan

(in millions)

	Better/(Worse)				
	FY 2003	**FY 2004**	**FY 2005**	**FY 2006**	**FY 2007**
Gaps per January 2003 Plan	**$ - - -**	**$ - - -**	**$ (1,495)**	**$ (2,008)**	**$ (2,034)**
OSDC Budget Risks					
Outside the City's Direct Control					
Personal Income Tax Proposal (State)	- - -	(962)	(658)	(159)	- - -
State Education Aid	- - -	(275)	(275)	(275)	(275)
Regional Transportation Initiatives (State)	- - -	(200)	(600)	(800)	(800)
Other State Actions	- - -	(252)	(236)	(236)	(236)
Port Authority Airport Lease Payments		(690)	(93)	(96)	(99)
Federal Assistance	- - -	(200)	(250)	(250)	(250)
Labor Savings	- - -	(600)	(600)	(600)	(600)
Transfer of City Assets	(100)	- - -	- - -	- - -	- - -
Subtotal	**(100)**	**(3,179)**	**(2,712)**	**(2,416)**	**(2,260)**
Estimation					
Police Overtime	(75)	(100)	(100)	(100)	(100)
Medicaid Costs	- - -	(50)	(150)	(150)	(150)
Reevaluate Sanitation Routes	- - -	(42)	(64)	(64)	(64)
Subtotal	**(75)**	**(192)**	**(314)**	**(314)**	**(314)**
OSDC Risk Assessment	**(175)**	**(3,371)**	**(3,026)**	**(2,730)**	**(2,574)**
Remaining Gaps to be Closed	**$ (175)**	**$ (3,371)**	**$ (4,521)**	**$ (4,738)**	**$ (4,608)**
Other Risks and Offsets					
Reserves[2]	500	300	300	300	300
Pension Fund Investment Losses[3]	- - -	(45)	(115)	(210)	(335)
Wage Increases at the Projected Inflation Rate	(280)	(775)	(1,300)	(1,800)	(2,300)
President's Tax Proposals	- - -	(161)	(190)	(228)	(264)

[2] The January Plan includes reserves of more than $500 million in FY 2003: potential savings of at least $200 million from overestimating prior years' expenses; and $300 million annually in the general reserve.

[3] The pension funds lost 7.5 percent on their investments through January 31, 2003. Our estimates of increased contributions assume no improvement during the remainder of the fiscal year.

II. Closing the Gap

The current financial crisis was precipitated by a number of factors, but the most significant were the slowdown in the national and local economies, the effects of the attack on the World Trade Center, and the downturn in the stock market that affected both revenues and pension fund investment performance.

As a result of these developments, between June 2001 and November 2002 the projected budget gap for FY 2004 grew by $3.8 billion to reach $6.4 billion. The out-year gaps grew by even larger amounts, reaching over $7 billion by FY 2006. Tax revenue losses account for about $2 billion of the annual growth in the projected gaps, and pension costs account for $1.9 billion of the increase by FY 2006. Higher costs for health insurance and welfare programs—most notably Medicaid—and other unplanned expenses account for the remaining increase in the budget gaps.

Table 3
Changes Since the November 2002 Plan
(in millions)

	Better/(Worse)			
	FY 2003	**FY 2004**	**FY 2005**	**FY 2006**
Budget Gaps per November 2002 Plan	**$ (1,073)**	**$ (6,360)**	**$ (6,736)**	**$ (7,020)**
City Actions				
Increase Property Taxes by 18 Percent	837	1,727	1,810	1,875
Agency Actions	844	1,108	1,130	1,205
General Reserve	(100)	(100)	(100)	(100)
Prepayments	(508)	508	- - -	- - -
Subtotal	**1,073**	**3,243**	**2,840**	**2,980**
Gaps After City Actions	**$ - - -**	**$ (3,117)**	**$ (3,896)**	**$ (4,040)**
Changes per January Plan				
Shortfall in Labor Savings	(223)	- - -	- - -	- - -
Tax Revenue Forecast	(108)	(289)	(282)	(412)
Education	11	(91)	(42)	(43)
Debt Service	48	52	(22)	(20)
Other	(101)	(59)	(59)	- - -
Subtotal	**(373)**	**(387)**	**(405)**	**(475)**
Prepayments	**(113)**	**113**	**- - -**	**- - -**
Budget Gaps per January 2003 Plan	**$ (486)**	**$ (3,391)**	**$ (4,301)**	**$ (4,515)**

Source: NYC Office of Management and Budget

The November Plan projected budget gaps of nearly $1.1 billion for FY 2003 and $6.4 billion for FY 2004 (see Table 3). The FY 2004 budget gap represented 24 percent of City fund revenues and was the largest gap, both in absolute dollars and as a percentage of City fund revenues, that the City has faced since the 1970s fiscal crisis. To balance the FY 2003 budget and to narrow the FY 2004 budget gap, the

City enacted a mid-year property tax increase of 18.5 percent and reduced planned agency spending. These actions restored budget balance in FY 2003 and slashed the projected budget gap for FY 2004 by more than half, to $3.1 billion.

However, the budget gaps have grown since November because the City has been unable to negotiate savings of $223 million with the municipal unions in FY 2003; and tax revenue forecasts have been reduced due to continued economic weakness. Consequently, the January Plan projects gaps of $487 million in FY 2003, $3.4 billion in FY 2004, and about $4.4 billion in fiscal years 2005 and 2006.

As shown in Table 4, the Mayor is relying heavily on actions that require approval by the State and federal governments ($1.7 billion and $850 million, respectively) and the municipal unions ($600 million) to close the projected budget gaps. In addition, the City hopes to reach a settlement with the Port Authority of New York and New Jersey that covers retroactive ($600 million) and future airport lease payments (an increase of about $90 million annually).

Table 4
FY 2004 Gap-Closing Program
(in millions)

	Better/(Worse)			
	FY 2003	**FY 2004**	**FY 2005**	**FY 2006**
Budget Gaps per January 2003 Plan	**$ (486)**	**$ (3,391)**	**$ (4,301)**	**$ (4,515)**
City Actions	**64**	**487**	**369**	**366**
State Actions				
Personal Income Tax Proposal	- - -	962	658	159
Transportation Initiatives	- - -	200	600	800
Education Aid[4]	- - -	275	275	275
Education Aid	- - -	(275)	(275)	(275)
Other State Actions	2	252	236	236
Total	**2**	**1,414**	**1,494**	**1,195**
Federal Actions				
Federal Aid[5]	420	- - -	- - -	- - -
Other Actions	- - -	200	250	250
Total	**420**	**200**	**250**	**250**
Port Authority Airport Lease Payments	**- - -**	**690**	**93**	**96**
Labor Actions	**- - -**	**600**	**600**	**600**
Total January Gap-Closing Program	**$ 486**	**$ 3,391**	**$ 2,806**	**$ 2,507**
Remaining Gaps to be Closed	**$ - - -**	**$ - - -**	**$ (1,495)**	**$ (2,008)**

Source: NYC Office of Management and Budget; OSDC analysis

4 The January Plan assumes the receipt of an additional $275 million in State education aid, but rather than using these resources to balance the City's budget they would be allocated to the Department of Education to maintain services.

5 The financial plan anticipates a total of $650 million in additional federal aid in FY 2003.

City agencies have identified additional actions that will reduce the City's costs by $486 million in FY 2004 and by about $370 million in subsequent years. Since June 2002, agency actions have reduced City-funded costs projected for FY 2004 by a total of $2.8 billion. For the most part, the City has been able thus far to shield municipal services from draconian budget cuts. Reductions in funding to the Department of Education account for about one quarter of the savings, but so far classroom services have been spared. The Department expects to meet its target by reducing administrative costs and gaining flexibility in the use of State and federal funds. The other mayoral agencies have reduced costs or increased revenues by $2.1 billion since June 2002. Funding shifts and re-estimates account for about one third of that amount, and various revenue initiatives, such as higher fees and fines, are expected to generate $520 million in FY 2004. Service reductions, such as reducing the size of the police force, temporarily suspending glass and plastic recycling, and reducing subsidies to libraries and cultural institutions, will save $450 million in FY 2004.

The City has made substantial progress since November in closing the projected budget gaps, but the FY 2004 gap-closing program includes substantial risks because it relies so heavily on actions outside the City's control (outlined below). Although the City could ultimately receive a substantial amount of outside assistance, a serious concern remains that many of these risks may not be resolved before the City is scheduled to adopt its budget on June 6, 2003. Any shortfall in anticipated assistance would have to be covered by City actions and the Mayor has recently directed agencies to prepare a $600 million contingency program. The size of the budget gap in FY 2005 and in subsequent years will largely be determined by whether the actions taken to balance the FY 2004 budget generate recurring benefits.

- Restructuring the personal income tax to treat residents and nonresidents of the City equally and to lower tax rates by 25 percent over four years would raise revenues by a net of $962 million in FY 2004, $658 million in FY 2005, and $159 million in FY 2006. In the first year, the proposal would raise taxes on non-City residents by $2.2 billion, or about five times the old commuter tax. The proposal requires State approval and faces stiff opposition from the City's suburbs and the states of New Jersey and Connecticut. If opposition continues, alternative tax proposals could come under consideration.

- Labor productivity savings of $600 million require negotiations with the municipal unions. The City and the municipal unions have worked cooperatively in the past, but achieved only half of the $500 million savings target for FY 2003. The City believes the FY 2004 target can be met by extending the workday, providing fewer vacation days, allowing more flexible work rules, or reducing pension or other fringe benefit costs. The City has often suggested that employees contribute to the cost of providing health insurance as a way to obtain savings.

- Regional transportation initiatives, such as placing tolls on the East River bridges and shifting responsibility for the private bus lines to the Metropolitan Transportation Authority (MTA), would generate $200 million in FY 2004 and up to $800 million by FY 2006. The MTA intends to raise fares and tolls to close its budget gaps, and arrangements could be made between the City and the MTA that would provide both with financial benefits. For example, in 1995 the City received $250 million in cash from the MTA in exchange for $500 million in bond proceeds to help finance the MTA's capital program. Such arrangements, however, would require State approval, and the Governor has already stated his opposition to placing tolls on the East River bridges.
- The Mayor is seeking $275 million in additional education aid to continue funding for an agreement with the City's teachers to extend the school day. The Governor's Executive Budget, however, would reduce aid to educational programs by $478 million (see "Impact of the State Budget" for a detailed discussion of the Governor's proposed budget).
- For years, the City has sought additional payments from the Port Authority of New York and New Jersey for leasing LaGuardia and Kennedy airports. The Port Authority is a bistate agency, which is effectively controlled by the governors of New York and New Jersey. Newark recently reached a settlement with the Port Authority for a retroactive payment and an increase in future payments. The Governor promised to obtain $500 million for the City—almost $200 million less than reflected in the financial plan for FY 2004—and the Port Authority has set aside $350 million in its capital budget in the event an agreement is reached with the City.
- The gap-closing program anticipates $420 million in aid from the Federal Emergency Management Agency (FEMA) in FY 2004 for costs related to the attack on the World Trade Center, in addition to $230 million already assumed in the Plan. These costs include the base salaries of police officers and other emergency personnel assigned to the World Trade Center site ($350 million), security activities ($100 million), and other expenses such as Disaster Relief Medicaid. FEMA was unable to reimburse the City for these costs under its guidelines until Congress passed legislation that gave FEMA the authority. As a result of congressional action, the City will now obtain as much as $650 million in FEMA grants.

- The City has prepared a menu of suggestions, from which the federal government can choose, to provide the City with $200 million in assistance in FY 2004 and $250 million in subsequent years. These proposals include flexible use of funding under the Hazard Mitigation Grant, First Responder, and Community Development Block Grant programs. The City is also seeking relief from the minimum spending requirements of the current welfare reform act, as well as a relaxation in the administrative requirements that restrict the City's efforts to enroll homeless families residing in City shelters in the federal welfare program.

  The President's proposed budget, however, would cut programs that help fund the police force and other criminal justice initiatives, and community development block grants. While the President's budget would increase education aid to the City, the increase is less than promised last year. In addition, we estimate that enactment of the President's proposal to stop taxing dividend income would reduce City personal income tax collections by $125 million in the first year and by $525 million over four years, because the City's personal income tax is linked to the federal definitions of income. Another facet of the proposal would reduce taxable capital gains realizations (by $50 million over four years). Debt service costs would also increase as interest rates on municipal bonds rise to keep these investments competitive with stocks offering tax-free dividends (a cost of $266 million over four years).

- The City submitted a menu of suggestions to the State to help meet a target of $252 million in FY 2004 and a slightly smaller amount in subsequent years. The Governor has expressed support for a number of these proposals, such as authorizing the City to issue an additional 900 taxi medallions (generating $196 million over three years), debt reform ($80 million in FY 2004) and additional traffic-light cameras ($63 million over three years).

III. Impact of the State Budget

The Governor is projecting a budget gap of $2.3 billion for the fiscal year ending March 31, 2003, and $9.2 billion for the fiscal year beginning April 1, 2003. To help close these gaps, the Governor would securitize proceeds from the State's share of the national tobacco settlement ($3.8 billion), increase taxes and fees ($1.4 billion), and cut spending for education ($1.2 billion), Medicaid ($1.2 billion), and agency operations ($1 billion).

The City is seeking $1.7 billion in assistance from proposals that require State approval, including the Mayor's proposal to restructure the personal income tax to treat residents and nonresidents of the City equally, which is valued at $962 million in FY 2004 (see Table 5). The January Plan assumes that the balance of the assistance would come from an increase in education aid, approval of certain transportation initiatives such as placing tolls on the East River bridges, and other actions, such as a cap on Medicaid spending, that would benefit the City.

Table 5
State Actions Proposed by New York City
(in millions)

	FY 2004	FY 2005	FY 2006	FY 2007
Commuter Tax	$ 962	$ 658	$ 159	$ - - -
Education Aid	275	275	275	275
Transportation Initiatives	200	600	800	800
Other	252	236	236	236
Total	**$ 1,689**	**$ 1,769**	**$ 1,470**	**$ 1,311**

Source: NYC Office of Management and Budget

The Mayor's proposals to extend the City's personal income tax to nonresidents and place tolls on the East River bridges would generate nearly $1.2 billion in FY 2004. The Governor, Senate Majority Leader, and many suburban legislators, however, oppose the Mayor's tax proposal because it would cost commuters $2.2 billion in FY 2004 while reducing the amount paid by City residents. While the Majority Leader has indicated that he would consider alternative tax proposals, such as a personal income tax surcharge for City residents, he opposes reinstating the old commuter tax, which would raise revenue by about $450 million annually and is supported by the Assembly Speaker. The Governor also opposes placing tolls on the East River bridges, which the Senate Majority Leader has indicated he would support.

Overall, the Governor's proposed budget would increase the City's costs by a net of almost $200 million during fiscal years 2003 and 2004, which would widen the FY 2004 gap by an equal amount (see Table 6). A $753 million loss in education aid would be only partly offset by other proposals. The Mayor has stated that 1,900 teachers would be laid off and class sizes would increase if the Governor's proposal were adopted. The Governor's budget also would reduce Medicaid revenues to the Health and Hospitals Corporation by up to $140 million, which could necessitate budget cuts or an increase in City funding; and would cut State funding to the City University of New York, which could increase tuition by as much as $1,200 or 38 percent. The Governor is also proposing to defer one third of Tuition Assistance Program payments to low-income families, which would require students to take out loans; scaling back eligibility for the Family Health Plus program, which provides health insurance to the working poor; and diverting surplus federal welfare funds from the localities to the State.

Table 6
Impact of the Governor's Executive Budget
On New York City's Financial Plan
($ in millions)
Better/(Worse)

	FY 2003	FY 2004
Education Aid	$ - - -	$ (753)
Welfare	- - -	(40)
Revenues	49	225
Battery Park City	- - -	200
Mandate Relief	- - -	20
Medicaid	47	24
All Other	5	29
Total	**$ 101**	**$ (295)**

Source: NYS Division of the Budget; OSDC analysis

The Governor's budget includes proposals that would help the City balance the FY 2004 budget, such as scaling back the sales tax exemption on clothing and footwear to increase City revenues by as much as $184 million, and obtaining $200 million from the Battery Park City Authority from refinancing debt and the purchase of adjacent City properties. The Governor has indicated that he would support other proposals that would benefit the City but were not included in his budget, such as increasing the number of taxi medallions.

The Governor has also promised to help the City obtain more than $500 million in retroactive airport lease payments from the Port Authority of New York and New Jersey, and to support the City's efforts to obtain flexibility in the use of $650 million in federal assistance related to the attack on the World Trade Center. The City, however, already reflected these resources in its financial plan and considers them separate from the Plan's target for State assistance.

The following discussion highlights the impact of the Governor's budget.

Education Aid

The Governor's budget would reduce aid to educational programs by $478 million from the current level. Funding for the universal prekindergarten program—which serves 42,000 children—would be eliminated, as would funding for minor maintenance and class-size reduction. Funding for the teacher support program, which helps pay teacher's salaries, would be cut by two thirds. The January Plan, however, assumes that the Governor would allocate $275 million to continue to fund an extension of the school day. These resources were not included in the Governor's budget, which raises the financial plan impact to $753 million.

Welfare

While the Governor would reduce aid to New York City by $151 million, the financial plan impact would be limited to $40 million in FY 2004, which reflects the Governor's proposal to reduce State reimbursement for administrative costs. The Governor's proposal to eliminate future reimbursement for spending beyond the federal maintenance-of-effort requirement would not affect the City's financial plan because the plan had not counted on these resources.

Revenues

The Governor has proposed revising the year-round sales tax exemption on the purchase of clothing and footwear costing less than $110. While the Governor would raise the exemption for items costing less than $500, he would limit the exemption period to four one-week periods. This revision would increase City sales tax revenue by $184 million in FY 2004. In addition, the Governor would increase the surcharge on parking tickets from $5 to $15 ($22 million), raise the charge to insure motor vehicles ($11 million), and increase moving violation fines by 50 percent ($7 million).

Battery Park City

The City would realize about $200 million if the Battery Park City Authority restructured its outstanding debt and purchased adjacent City-owned property.

Mandate Relief

The Governor has proposed repealing the Wicks Law, which requires localities to hire separate contractors (e.g., plumbing and electrical) for capital projects valued at more than $50,000. While the repeal would allow the City to hire general contractors to oversee construction projects and could reduce capital costs by an estimated $100 million annually, significant operating budget savings would not be realized for a number of years. The Governor also would transfer jurisdiction for tort claims from juries to the State Court of Claims, as well as other initiatives, which could reduce awards by an estimated $20 million.

Medicaid

In general, the federal government pays half the cost of the Medicaid program and, in New York State, the State and the counties split the other half. The rapid growth in Medicaid has become a significant burden for the State and counties, and the Governor has proposed a large number of initiatives that would reduce these costs. Most of the Governor's proposals would reduce the City's costs by cutting Medicaid reimbursement rates to hospitals and other providers, but one initiative could greatly increase the City's costs (see Table 7).

Table 7
State Medicaid Initiatives
(in millions)

Better/(Worse)

	FY 2003	FY 2004
Medicaid Swap	$ (68)	$ (255)
Cap Overburden Aid at FY 2002 Level	(3)	(13)
Loan Forgiveness	49	- - -
Maximize Federal DSH Cap	15	57
Restructure Graduate Medical Education Rates	9	40
Eliminate Hospital Inflation Factor	8	34
Reduce Hospital Per Diem Reimbursement Rates	6	28
Medicaid Crossover	6	27
Reduce Nursing Home Payments	5	20
Limit Family Health Plus Rates and Eligibility	6	31
All Other	14	55
Total	**$ 47**	**$ 24**

Source: NYS Division of the Budget; OSDC analysis

The Governor has proposed that the State assume financial responsibility for pharmaceutical costs if the counties increased their shares of fee-for-service hospital, outpatient, and clinic expenses from 25 percent to 37 percent. The State would realize large savings because the Governor has also proposed far-reaching pharmaceutical cost-containment initiatives.

This initiative would have a large up-front cost to the City ($255 million in FY 2004), but the City could break even in FY 2006 and reap long-term benefits if pharmaceutical costs continue to grow three times as fast as fee-for-service expenses. Some counties would reap immediate benefits, but New York City has high inpatient hospital costs and many residents with chronic illnesses, who are not required to enroll in managed care.

The up-front costs would be offset in fiscal years 2003 and 2004 by forgiving counties their Medicaid loans advanced by the State; rolling back eligibility for the Family Health Plus program to 133 percent of the federal poverty level (from 150 percent); allowing counties to increase their Disproportionate Share Hospital reimbursement cap to 175 percent of the federal maximum; and other cost-containment initiatives such as limiting Medicaid reimbursement to the lesser of Medicare or Medicaid rates.

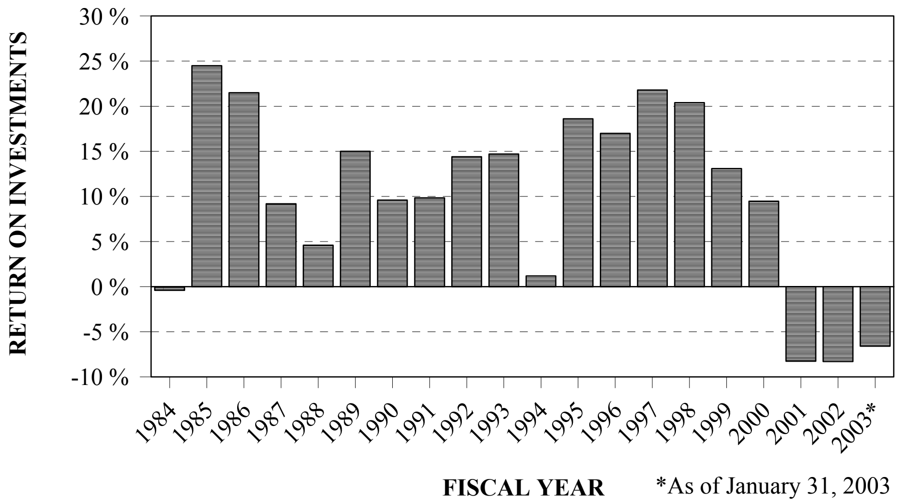
IV. Rising Pension Costs

Rapidly rising pension costs present a significant obstacle to long-term budget balance. The City's contribution to the municipal pension funds is based on a number of assumptions, including an 8 percent annual return on investments. If investment earnings fall short of expectations, New York City is required to make up the difference. Gains and losses are phased in over a five-year period for purposes of calculating the City's contribution, which is a smoothing technique designed to minimize large fluctuations.

The downturn in the stock market in recent years has resulted in large pension fund investment losses. Costs associated with losses during fiscal years 2001 and 2002 and lowered expectations for FY 2003 will increase costs by $800 million in FY 2004 and $2.8 billion by FY 2007.

Graph 1

PENSION FUND INVESTMENT EARNINGS



Source: NYC Comptroller's Annual Reports; OSDC analysis

Between fiscal years 1983 and 1994, the pension funds earned an average of 11.3 percent on their investments (see Graph 1), 2.9 percent more than the assumed rates of return in effect during that period. During fiscal years 1995 through 1999 the pension funds earned more than twice the assumed rate of return on investments, averaging annual returns of 18.2 percent. By FY 2000, assets held by the pension funds had increased by 78 percent since FY 1995, and the assets of the largest pension fund exceeded the amounts needed to fund both present and future liabilities. It was at this time that the State and City decided to enhance pension benefits.

Hoping to tap into these excess resources to help balance the budget and to offset the cost of new, more conservative actuarial assumptions, the City executed a market value restart in FY 2000, which accelerated the recognition of the gains of the five prior years for the purposes of calculating the City's pension contributions. This allowed the City to reduce its planned contribution by $800 million during fiscal years 2000 and 2001. It also had the effect of removing a cushion against future earnings shortfalls.

Investment losses will require the City to increase its contributions to the pension funds by $315 million in FY 2003 and by $2.8 billion by FY 2007, a cumulative increase in unplanned costs of nearly $7.8 billion by FY 2007 (see Table 8). This estimate reflects the Plan assumption that the pension funds break even in the current year, rather than the actuarial assumption of an 8 percent gain. The funds, however, lost 7.5 percent on their investments through January 31, 2003. Unless the pension funds break even by the end of the fiscal year, the City will incur additional costs of $45 million in FY 2004 and by as much as $335 million by FY 2007 because the losses are phased in over a five-year period. These estimates also assume that the pension funds will earn 8 percent on their investments during fiscal years 2004 through 2006. City contributions could be reduced if future investment earnings exceed the actuarial assumption.

Table 8
Cost of Pension Fund Investment Losses
(in millions)

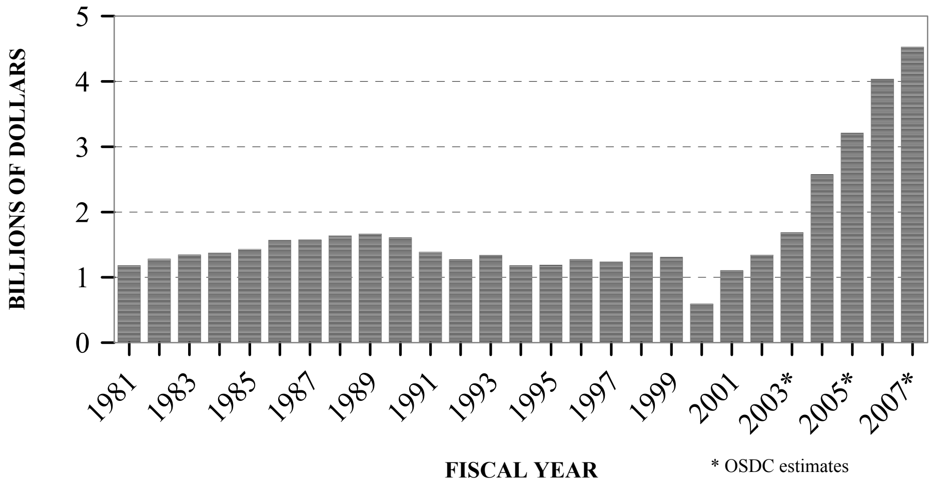
FY 2002	$ 65
FY 2003	315
FY 2004	800
FY 2005	1,480
FY 2006	2,305
FY 2007	2,830
Total	**$7,795**

Source: OSDC analysis

The City's contribution to the pension funds averaged $1.4 billion during fiscal years 1981 through 1999, but contributions are now projected by the City to exceed $4.5 billion by FY 2007 (see Graph 2). Pension costs are projected to increase at an average annual rate of 28 percent during fiscal years 2004 through 2007, eleven times faster than the local inflation rate and almost eight times faster than other City-funded expenditures. About 90 percent of the increase is attributable to poor investment performance, with the balance largely due to benefit enhancements. The City has hired an actuarial consultant, as required under the City Charter, to conduct a biennial review of the methodologies and assumptions used to calculate pension contributions. The consultant's report will be completed before the end of calendar year 2003 and its recommendations could affect future pension contributions. In addition, future contributions could be affected by negotiations between the City and the municipal unions to generate savings of $600 million annually. The Mayor supports the creation of a new pension tier for new employees, which would provide employees with lower benefits than current tiers and reduce City pension fund contributions.

Graph 2

CITY-FUNDED PENSION CONTRIBUTIONS



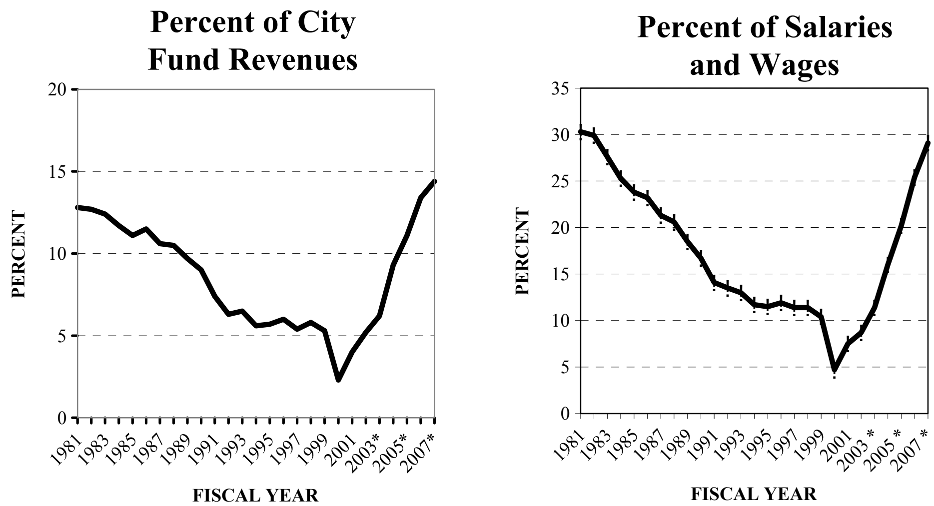
Source: NYC Office of Management and Budget; OSDC analysis

Pension contributions consumed only 4 percent of City fund revenues in FY 2001, but will consume 14.4 percent by FY 2007 (see Graph 3). Similarly, pension contributions are projected to reach nearly 29 percent of salaries and wages by FY 2007, compared with an average of 11 percent during fiscal years 1992 through 2001.[6]

[6] Pension contributions as a percentage of salaries and wages is a widely used measure to determine the burden that pension costs place on the budget. In FY 2000, pension contributions represented less than 5 percent of salaries.

Graph 3

PENSION BURDEN



* OSDC estimate

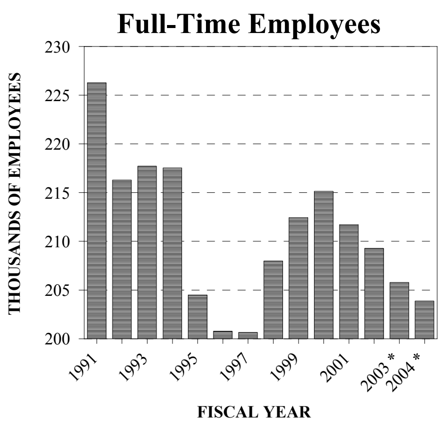
Source: NYC Office of Management and Budget; OSDC analysis

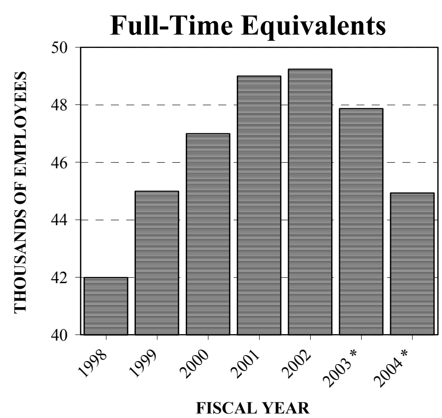
V. Downsizing the Workforce

The City has faced difficult financial times in the past and each time it has responded by scaling back the size of its workforce. During the 1970s fiscal crisis, the City reduced staffing levels by nearly 61,000 employees, or more than 20 percent. This was accomplished through attrition and by laying off tens of thousands of employees, including teachers, police officers, and firefighters. In FY 1991, the City-funded workforce was reduced by about 10,000 employees through attrition, early retirement, and 4,000 layoffs. During fiscal years 1994 and 1995 it was reduced again, by 18,337 employees over an 18-month period, with the assistance of large severance programs funded by the Municipal Assistance Corporation.[7]

Graph 4

CITY-FUNDED WORKFORCE





* City forecast

Source: NYC Office of Management and Budget; OSDC analysis

During fiscal years 1998 through 2000 the full-time workforce grew by 14,000 employees (mostly police officers and teachers), funded with unanticipated tax revenues from the Wall Street boom. The workforce contracted during fiscal years 2001 and 2002, but still remained higher by 8,500 employees than in FY 1996 (see Graph 4). There was also a large increase in the number of part-time employees, as agencies compensated for cuts in staffing during fiscal years 1994 through 1997 and the Department of Education staffed summer and other remedial programs with per session teachers.

7 The MAC-funded severance programs implemented during fiscal years 1994 and 1995 attracted 13,854 employees, producing an estimated $470 million in savings but at an initial cost of $264 million.

The January Plan assumes that the full-time workforce will contract by 5,419 employees between June 2002 and June 2004, reflecting the impact of the FY 2004 gap-closing program. This would reduce the workforce by 2.5 percent to 203,873 employees, about 3,200 employees more than the FY 1997 level. The Mayor has threatened to reduce the workforce by another 12,000 employees unless he obtains $600 million in productivity savings from the municipal unions.

Cutting the workforce without affecting basic municipal services is more difficult now than in the past because a greater percentage of the workforce is comprised of teachers and police officers. In June 2002 they comprised 56 percent of the workforce, compared with 45 percent in FY 1991. Teachers and all uniformed employees comprised 70 percent of the workforce in FY 2002, compared with 59 percent in FY 1991. In contrast, the number of employees assigned to the Parks Department and health and welfare agencies declined from 17 percent of the workforce in FY 1991 to 10 percent in FY 2002, a reduction of 16,350 employees, or 43 percent.

Since June 2002, the workforce has been reduced through a hiring freeze, attrition, early retirement, and layoffs. The early retirement program authorized by the State last June attracted 4,411 participants. Almost half of the participants came from the Department of Social Services (1,031), the Police Department (416 civilians), the Department of Education (372 non-pedagogues), and the Administration for Children's Services (357). Layoffs have occurred in the Department of Education (336 non-pedagogues), Sanitation Department (103 civilians), and the Police Department (109 civilians).

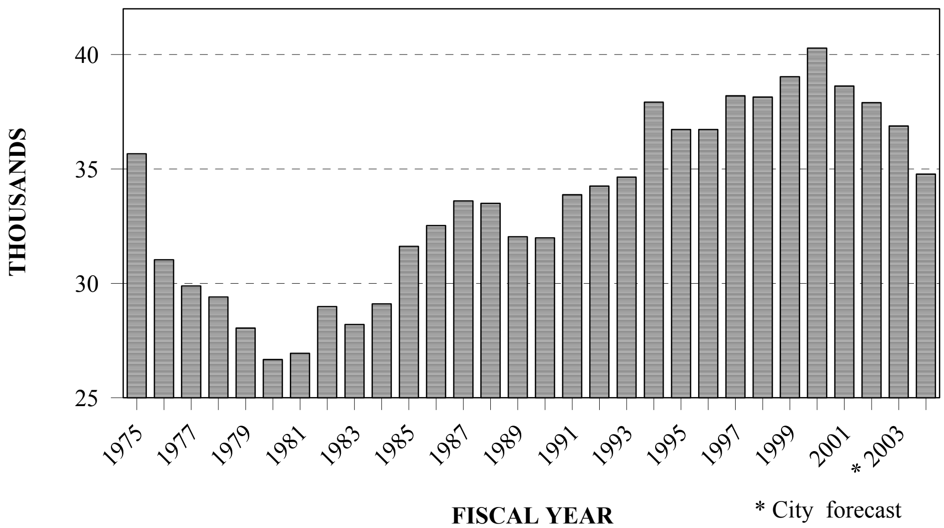
As shown in Table 9, staff reductions would be concentrated in the uniformed agencies, which would reduce their staffing levels by 4,405 employees during fiscal years 2003 and 2004. The Police Department intends to cut the cadet class scheduled for July 2003 by 1,900, reducing the police force to 34,774 officers by the end of FY 2004. This represents a reduction of 5,980 officers from a peak of 40,754 police officers in October 2000, effectively returning the police force to the FY 1993 level (see Graph 5). The Fire Department would cut the number of firefighters by 656 by reducing manning in 49 engine companies and, pending the decision of a special commission, by closing eight engine companies. The Department of Correction would cut the number of uniformed employees by 807 because of a reduction in the inmate population. In total, public safety agencies would reduce staffing levels by 3,788 employees. In addition, the Sanitation Department is expected to reduce the number of its uniformed employees by 877, but it has not yet developed plans to reconfigure collection routes, which accounts for most of the reduction.

The January Plan assumes that the City will add staff in some departments during the next two fiscal years. The Police Department plans to hire 300 traffic enforcement agents in FY 2004 in order to generate an additional $85 million in parking violation revenue. The Department of Education plans to hire another 679 teachers during fiscal years 2003 and 2004 to continue to reduce class sizes.

Graph 5

NEW YORK CITY POLICE FORCE

(Total Funds)



Source: NYC Office of Management and Budget

The January Plan also assumes that the part-time workforce will decline by a net of 4,309 full-time equivalents by June 2004, a reduction of 9 percent. The change primarily reflects a cut of 3,089 full-time equivalents in the Parks Department, and the addition of 850 full-time equivalents in the Department of Education and 458 full-time equivalents in the City University of New York. The net reduction in the part-time workforce would be close to the FY 1999 level (see Graph 4).

Table 9
City-Funded Staffing Levels

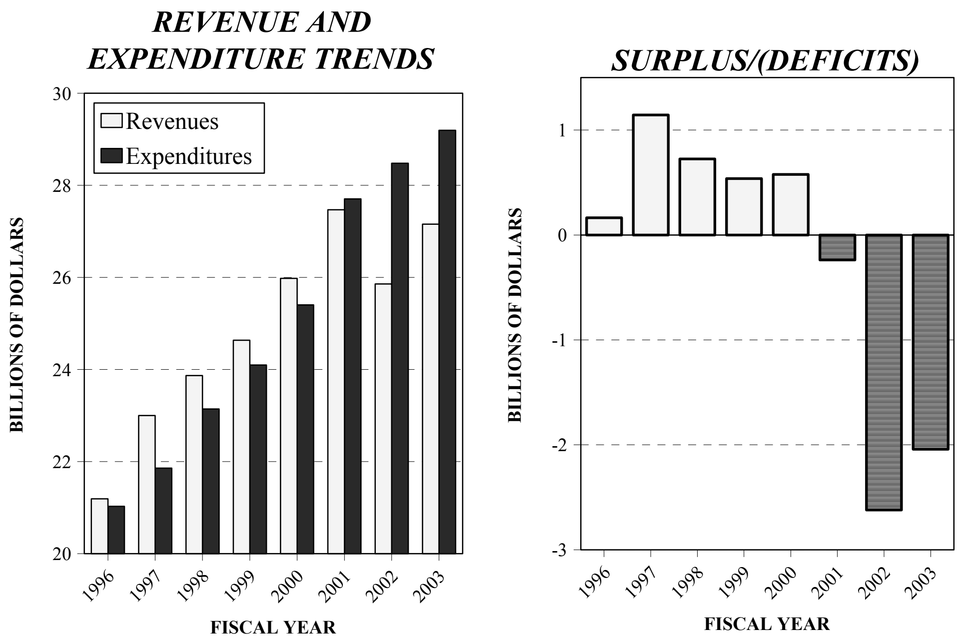
Increase/(Decrease)

		Fiscal Year			Annual Change	
		FY 2002	FY 2003	FY 2004	FY 2003	FY 2004
Public Safety		**77,561**	**75,771**	**73,773**	**(1,790)**	**(1,998)**
Police Department	Uniformed	36,790	36,878	34,774	88	(2,104)
	Civilians	8,600	8,562	8,832	(38)	270
Fire Department	Uniformed	11,314	10,658	10,658	(656)	- - -
	Civilians	4,400	4,370	4,338	(30)	(32)
Dept. of Correction	Uniformed	9,893	9,151	9,086	(742)	(65)
	Civilians	1,454	1,456	1,472	2	16
District Attorneys & Prosecutors		3,815	3,333	3,333	(482)	- - -
Probation Department		904	904	827	- - -	(77)
Other		391	459	453	68	(6)
Health and Welfare		**20,000**	**18,205**	**18,483**	**(1,795)**	**278**
Social Services		8,557	7,636	7,648	(921)	12
Children's Services		7,470	6,871	6,885	(599)	14
Health and Mental Hygiene		2,224	1,965	2,174	(259)	209
Homeless Services		1,505	1,544	1,583	39	39
Other		244	189	193	(55)	4
Environment & Infrastructure		**13,694**	**13,000**	**12,467**	**(694)**	**(533)**
Dept. of Sanitation	Uniformed	7,680	7,382	6,803	(298)	(579)
	Civilians	2,003	1,749	1,766	(254)	17
Dept. of Transportation		2,025	2,070	2,112	45	42
Parks & Recreation		1,722	1,509	1,496	(213)	(13)
Other		264	290	290	26	- - -
General Government		**6,825**	**7,370**	**7,516**	**545**	**146**
Finance		2,000	2,055	2,168	55	113
Law Department		1,110	1,166	1,166	56	- - -
Dept. of Citywide Admin. Services		976	1,101	1,138	125	37
Taxi & Limo. Commission		343	407	422	64	15
Investigations		316	306	285	(10)	(21)
Board of Elections		308	298	302	(10)	4
Info. Technology & Telecomm.		285	463	463	178	- - -
Other		1,487	1,574	1,572	87	(2)
Housing		**1,258**	**1,325**	**1,334**	**67**	**9**
Buildings		737	775	784	38	9
Housing Preservation		521	550	550	29	- - -
Department of Education		**83,889**	**84,106**	**84,326**	**217**	**220**
	Pedagogues	77,530	77,937	78,209	407	272
	Non-pedagogues	6,359	6,169	6,117	(190)	(52)
City University		**3,794**	**3,684**	**3,684**	**(110)**	**- - -**
	Pedagogues	2,253	2,302	2,302	49	- - -
	Non-pedagogues	1,541	1,382	1,382	(159)	- - -
Elected Officials		**2,271**	**2,332**	**2,290**	**61**	**(42)**
Total		**209,292**	**205,793**	**203,873**	**(3,499)**	**(1,920)**

VI. Revenue and Expenditure Trends

Between fiscal years 1996 and 2000, City-funded spending grew by 21 percent, an annual average rate of growth of 4.8 percent—more than twice the local inflation rate.[8] Under normal circumstances, the City would have been unable to support such a rapid rate of growth, but revenues fueled by the Wall Street boom grew even faster (see Graph 6). While expenditures continued their rapid rate of growth in FY 2001—increasing by 9 percent—revenues grew more slowly, by only 5.7 percent. Consequently, expenditures exceeded revenues by more than $200 million in FY 2001—a clear sign of fiscal stress, which was masked by the City's practice of transferring the prior year's surplus to the following year.

Graph 6



Source: NYC Office of Management and Budget; NYC Comptroller's Office; OSDC analysis

Ignoring this warning, the City called for spending to increase by 5.5 percent in the Adopted Budget for FY 2002. The budgetary impact of the economic slowdown and the attack on the World Trade Center, however, resulted in a decline in revenues—the first such reduction since FY 1995 and the largest in more than 20 years. The City balanced the FY 2002 budget, but only after taking into account surplus transfers from prior years and bond proceeds from the Transitional Finance

[8] City-funded expenditures have been adjusted for the City's practice, which can distort expenditure patterns, of transferring the surplus from one year to the next by prepaying a portion of the following year's expenses.

Authority to cover costs that the City would have incurred regardless of the attack on the World Trade Center. In the absence of these resources, the City would have incurred a deficit of $2.6 billion from current year operations[9] (see Graph 6).

The City was on course in November 2002 to incur a current year deficit of $3.5 billion in FY 2003, due to lower revenue forecasts, rising pension costs, and other factors. Since November, the City Council enacted a mid-year property tax increase, and the City took other actions that will generate recurring benefits. These actions reduced the current year deficit to $1.5 billion, which represents bond proceeds from the Transitional Finance Authority to cover revenue losses related to the attack on the World Trade Center. The size of the out-year deficits will depend to a great extent on the pace of the economic recovery and whether the City balances the FY 2004 budget with nonrecurring resources or with actions that generate recurring resources. The budgets for fiscal years 2003 and 2004 already include nonrecurring resources of $4.2 billion and $1.6 billion, respectively (see "Appendix A" for a list of nonrecurring resources). The out-year gaps also will depend on whether the City funds future wage increases with productivity savings as suggested by the Mayor.

A. Revenue Forecasts

Although City fund revenues are expected to grow by 9.6 percent, or $2.6 billion, to reach $29.3 billion in FY 2003 (see Graph 7), most of the additional revenues can be attributed to direct actions taken by the City to close this year's budget gap.[10] In January, the City enacted a mid-year 18.5 percent increase in the real property tax rates to generate $837 million—which, combined with $1.5 billion in TFA bond proceeds, accounted for much of the increase in revenues this year.

Despite the forecast of improvements in the national and local economies (the improvement locally is expected to lag behind the nation by about nine months), City fund revenues are expected to decline by 2.4 percent in FY 2004. Although tax revenues are expected to increase by 6.9 percent that year, the absence of TFA bond proceeds leads to an overall decline in revenues. City fund revenues are then projected to increase by 5.2 percent in FY 2005 and by an annual rate of 4.3 percent in fiscal years 2006 and 2007.

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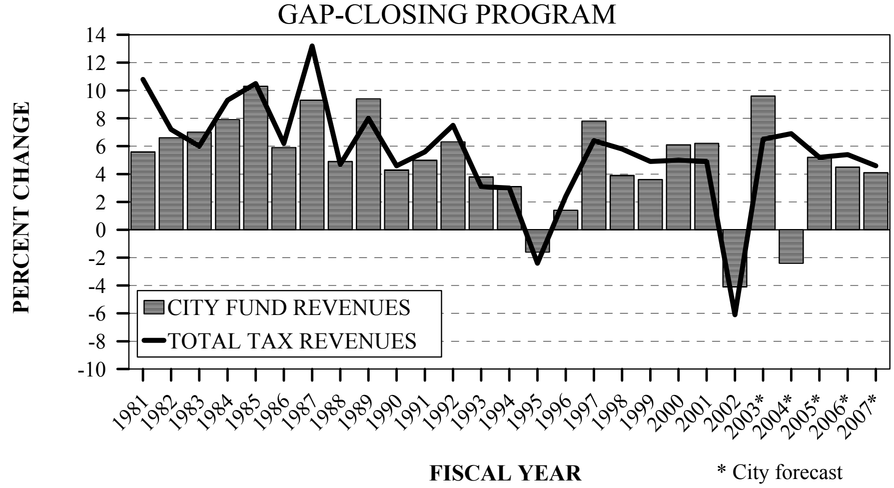
[9] Current year operations measure revenues and expenditures generated in the current fiscal year and exclude the benefits of prior years' surpluses and deficit financing.

[10] Our estimates of City fund revenues include the portion of personal income tax revenues dedicated to pay debt service on bonds issued by the Transitional Finance Authority, and tobacco settlement revenues dedicated to pay debt service on tobacco bonds.

Graph 7

ANNUAL CHANGE IN CITY FUND REVENUES

BEFORE IMPLEMENTATION OF THE GAP-CLOSING PROGRAM



Source: NYC Comptroller's Office; NYC Office of Management and Budget; OSDC analysis

1. Economic Outlook

The growth in City fund revenues projected for FY 2003 comes after a decline of 4.1 percent in FY 2002, pulled down by a 6.1 percent decline in tax revenue collections. These declines reflect the impact of the national recession (which began in March 2001) and the local recession (which began in December 2000), and were further exacerbated by the terrorist attacks in September 2001. Coinciding with the onset of the national recession, employment across the country began to decline. Seasonally adjusted national employment began to fall in April 2001, with a total loss of 1.4 million jobs during 2001 and an additional 229,000 in 2002. As a result, the national unemployment rate rose from a seasonally adjusted 4 percent in December 2000 to 5.8 percent one year later, and reached 6 percent by December 2002. In the City, average annual employment declined by almost 21,000 jobs in 2001 and by 91,600 in 2002. Unemployment in the City experienced an even greater increase, as the seasonally adjusted rate increased from 5.3 percent in December 2000 to 7.3 percent in December 2001, and to 8.4 percent in December 2002.

City revenue collections were also depressed by the difficulties experienced in the financial sector during 2001 and 2002. During 2001, average City employment in finance, insurance, and real estate (FIRE) declined by 0.9 percent, while Wall Street's employment fell by 0.7 percent. The situation further deteriorated during 2002, when employment in the securities industry declined by an additional 7.9 percent. With an average multiplier of 2 jobs for every single job on Wall Street, the impact of declines in Wall Street employment quickly reverberates throughout the rest of the City's economy.

The high incomes on Wall Street—and the spending and tax revenues that flow from them—give Wall Street a proportionally greater impact on the City than other industries. The securities industry accounted for 5.1 percent of the City's jobs in 2001 but comprised 21.3 percent of all City wages, and paid an average salary of over $252,300 compared to an average salary of about $46,700 in nonfinancial industries. Sizable year-end bonuses contributed to the high level of wages on Wall Street. When securities industry profits totaled $21 billion in 2000, we estimated that bonuses totaled $19.4 billion, or over $104,000 per employee. With profits falling to $10.4 billion in 2001 and the City anticipating profits to fall to $7 billion in 2002, we estimate that year-end securities industry bonuses fell by 35 percent in 2001 and by an additional 37 percent in 2002, with the average bonus in 2002 now totaling about $48,000. These are the first consecutive annual declines in Wall Street profits and bonuses since 1989 and 1990, with a magnitude more than twice that of earlier declines. In addition, because of the declines in the financial markets between 2000 and 2002, the City is estimating that capital gains realizations during these years have declined by over 65 percent. Overall, the trends in Wall Street–related earnings show why the current recession has impacted incomes, and thus City revenues, to a much greater extent than the current decline in employment implies.

Beginning in calendar year 2003, the City expects to see improving conditions both in the national and local economies. Nationally, the City is forecasting that the gross domestic product will increase by 2.9 percent in 2003, 4.5 percent in 2004, and then at an average annual rate of 3.4 percent in 2005 through 2007. The City's near-term forecast for gross domestic product growth is somewhat greater than the January forecasts by the Blue Chip Economic Consensus and Economy.com, but somewhat lower than the Global Insight forecast that the City uses as a base for its own projections. National employment is forecast to increase 0.8 percent in 2003, and the unemployment rate is projected to show little change, rising from 5.8 percent to 5.9 percent. Beyond 2003, the City is forecasting national employment growth of 2.5 percent in 2004, 1.9 percent in 2005, and average increases of 1.2 percent in 2006 and 2007. The national unemployment rate is projected to decline in 2004 (to 5.3 percent) and 2005 (to 5 percent) before stabilizing at 5.1 percent in 2006 and 2007. Locally, the City forecasts that total employment will continue to decline through 2003, falling 1.6 percent, before growth resumes in subsequent years with increases of 1.4 percent in 2004 and average annual increases of 1.1 percent in 2005 through 2007.

2. Tax Revenues

Total tax revenues in FY 2003 are projected to increase 6.5 percent to $23.6 billion, primarily driven by a 14.8 percent increase in property tax collections resulting from the mid-year rate increase. For nonproperty taxes, collections are expected to grow by 1.2 percent, to $13.7 billion. Among the nonproperty taxes, business income taxes are projected to decline by 7.6 percent, with losses primarily in the general corporation and banking corporation taxes. Conversely, sales tax collections are expected to grow by 4.9 percent, and because of the increase in the tax rate for the sale of cigarettes, cigarette revenue is projected to increase by 418 percent. Also projected to increase are real estate–related taxes and the personal income tax. However, significant job losses, lower year-end bonuses, and a sizable reduction in capital gains realizations reduce personal income tax collections. Only the restoration of the full 14 percent personal income tax surcharge in 2002—reflected in increased withholding effective in June 2002 and greater final payments and lower refunds in April 2003—is expected to result in a slight increase in the tax in FY 2003. For the first six months of FY 2003, nonproperty tax collections have increased 2.5 percent compared to the same period last year. Based on the current collection trends, we believe the City is likely to achieve its FY 2003 tax collection target.

The increase in the real property tax rate will become fully effective in FY 2004. When combined with growth in billable assessed values of about 6 percent, real property tax revenues are forecast to increase by 12.5 percent. With the average property tax rate holding steady, assessment increases will raise revenues by an average annual rate of 3.7 percent in fiscal years 2005 through 2007.

Table 10
Annual Change in Nonproperty Tax Revenues

(percent change)

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
Nonproperty Taxes	**1.2**	**2.8**	**7.1**	**6.0**	**5.2**
Personal Income Tax	0.7	3.2	7.6	7.2	5.8
Sales Tax	4.9	2.6	5.8	4.7	5.2
Business Income Tax	-7.6	8.5	11.5	7.9	5.0
Real Estate–Related Taxes	2.7	6.5	6.0	4.7	6.9
Other Taxes	9.1	0.6	2.1	3.4	2.1

Source: NYC Office of Management and Budget; OSDC analysis

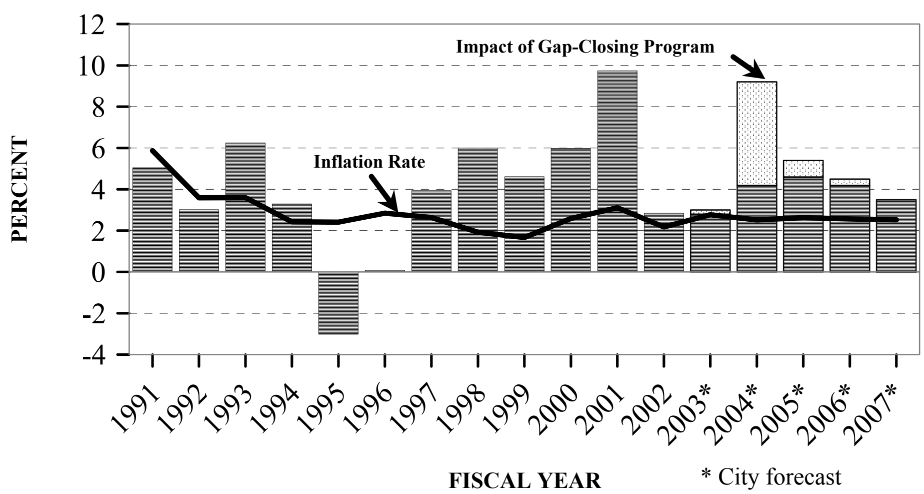
Wall Street profits are forecast to rise modestly, to $9.5 billion in calendar year 2004, and eventually reach $15 billion by 2007. With improvements in the local economy during the later half of calendar year 2003 and into 2004, nonproperty tax revenues are forecast by the City to increase by 2.8 percent in FY 2004. In the following years the recovery is expected to become stronger, and nonproperty tax revenues are forecast to increase by 7.1 percent in FY 2005, 6 percent in FY 2006, and 5.2 percent in FY 2007, with gains in all the major taxes (see Table 10). Given the current economic forecast, the City's revenue projections appear reasonable, with a modest amount of upside potential, especially in the out-years of the Plan period. However, as the City points out in its current Financial Plan, the level of geopolitical risk that could affect the economy is currently much higher than usual, raising the possibility of greater volatility in future revenue collections.

B. Expenditure Forecasts

After growing far faster than the local inflation rate during fiscal years 1997 through 2001, City-funded expenditures have been held to the inflation rate in fiscal years 2002 and 2003 (see Graph 8). City-funded spending, however, is projected to increase by 9.3 percent in FY 2004, 5.4 percent in FY 2005, 4.6 percent in 2006, and 3.3 percent in FY 2007. Overall, expenditures are projected to grow at an annual average rate of 5.6 percent during fiscal years 2004 through 2007.

Graph 8

CHANGE IN CITY-FUNDED EXPENDITURES



Source: NYC Office of Management and Budget; OSDC analysis

The rate of growth, however, would be reduced to 4.2 percent in FY 2004 and to an average of 4.1 percent during fiscal years 2004 through 2007 if the FY 2004 gap-closing program is successfully implemented (see Graph 8). The gap-closing program assumes, however, that actions by the federal and State governments and the municipal unions will reduce the City's costs by $1.6 billion in FY 2004 and about

$2 billion in subsequent years. The Plan also assumes that productivity savings will fund the next round of collective bargaining agreements. Given these optimistic assumptions, spending is likely to be greater during the Plan period than projected by the City.

The major factors behind the growth in spending are presented in Table 11. Debt service costs[11] are projected to increase by $2 billion during the Plan period, an average annual rate of growth of 12 percent despite cuts to the capital budget. Health insurance costs for municipal employees and the indigent (i.e., Medicaid) are also projected to grow faster than the local inflation rate and revenues. These costs could be reduced if the State adopts recommendations for Medicaid cost-containment and if employees share in the cost of health insurance as proposed by the Mayor. Pension costs are projected to grow at an annual rate of 28 percent because the City will have to make up for pension fund investment losses during fiscal years 2001 and 2002, and an anticipated shortfall in FY 2003. Growth rates would be reduced if the City's gap-closing program, particularly proposed actions for the federal and State governments and the municipal unions, were implemented.

Table 11
Growth in City-Funded Expenditures
(Adjusted for Surplus Transfers)

		(in millions)				Increase/(Decrease)
		Financial Plan Period				**Plan Period**
	FY 2003	**FY 2004**	**FY 2005**	**FY 2006**	**FY 2007**	**Growth Rate**
Salaries and Wages	$9,651	$9,809	$9,754	$9,730	$9,747	0.2
Medicaid	3,795	4,092	4,242	4,386	4,390	3.7
Debt Service	3,439	4,578	5,029	5,190	5,408	12.0
Health Insurance	1,972	2,132	2,401	2,642	2,883	10.0
Pensions	1,686	2,576	3,210	4,036	4,528	28.0
Other	9,317	9,435	9,759	9,976	10,171	2.2
Total	**$29,860**	**$32,622**	**$34,395**	**$35,960**	**$37,127**	**5.6**
FY 2004 Gap-Closing Program						
Agency Actions	(56)	(357)	(251)	(248)	(248)	NA
Federal & State Actions	NA	(599)	(1,050)	(1,250)	(1,250)	NA
Labor Savings	NA	(600)	(600)	(600)	(600)	NA
Total	**$29,804**	**$31,066**	**$32,494**	**$33,862**	**$35,029**	**4.1**

Source: NYC Office of Management and Budget; OSDC Analysis

[11] Debt service estimates include City general obligation bonds, revenue bonds of the TFA, MAC, and TSASC, and lease payments.

1. Personal Service Costs

Personal service costs,[12] which include salaries, fringe benefits, and pension contributions, have increased rapidly in recent years (see Graph 9). Between fiscal years 1996 and 2002, personal service costs rose by 41 percent, nearly three times faster than the local inflation rate. The major factors behind the rise in personal service costs include:

- Wages increased by about 23 percent pursuant to agreements negotiated between the City and the municipal unions, which was an average annual rate of 3.5 percent, compared to the inflation rate of 2.4 percent. (The municipal unions, however, took a number of steps during this period to help the City balance its budget and fund new labor agreements, such as supporting a three-year freeze in health insurance premiums and changes in the methodology and assumptions used to calculate pension contributions.)
- Spending for part-time employees rose by 125 percent, growing from $947 million in FY 1996 to more than $2.1 billion in FY 2002.
- A total of 15,700 full-time employees, mostly teachers, were added to the workforce between fiscal years 1996 through 2000. (During fiscal years 2001 and 2002 the workforce contracted by about 3,100 employees.)
- Health insurance costs grew by about $730 million, an average annual rate of 7.9 percent, reflecting the rapid rise in health insurance premiums.

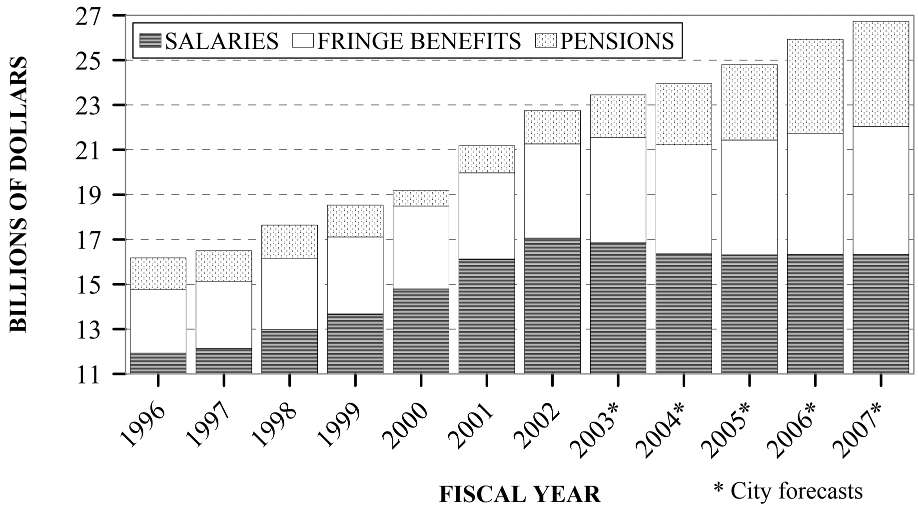
The January Plan assumes that personal service costs will increase from $23.5 billion in FY 2003 to $26.7 billion by FY 2007, an increase of nearly $3.3 billion or 14 percent. The portion funded by the City is projected to increase by $4.1 billion, an average annual increase of 6.1 percent (compared to projected average annual inflation rates of 2.6 percent). These rates of growth would be reduced if the City is successful in negotiating with the municipal unions for $600 million in annual savings. These estimates, however, also assume that future collective bargaining agreements are funded entirely with savings from productivity improvements. The following discussion highlights the major assumptions behind the City's projections and some of the issues that could affect those estimates.

[12] The City funds about two thirds of all personal service costs, with the balance funded by the federal and State governments. Trends in total personal service spending generally reflect those funded by the City.

Graph 9

TRENDS IN PERSONAL SERVICE COSTS

(Total Funds)



Source: NYC Office of Management and Budget; OSDC analysis

Wages and Salaries

City-funded salary and wage costs are projected to grow by $158 million in FY 2004, reflecting the full-year value of raises granted to municipal employees in FY 2003, the last year of the most recent round of labor agreements. In subsequent years, salary and wage costs remain relatively constant, but the Plan does not include resources to fund wage increases for municipal employees after the expiration of current labor contracts.

Pension Fund Contributions

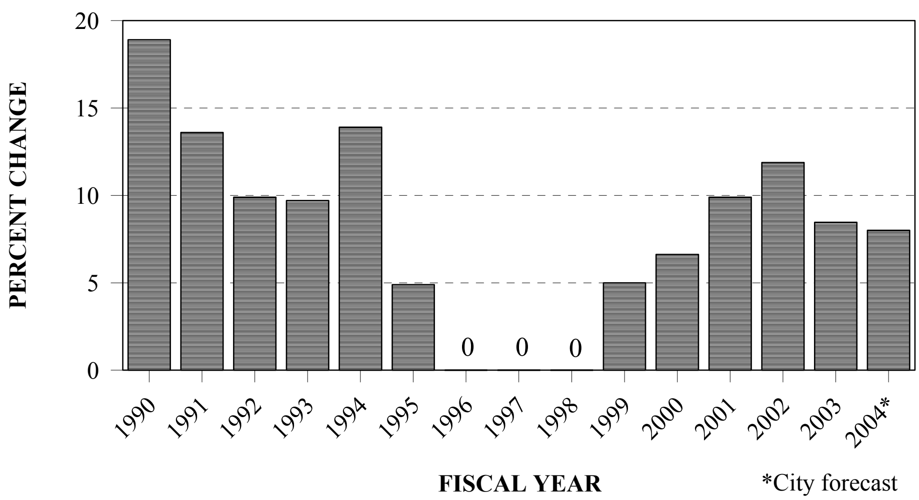
City-funded pension contributions are projected to total $1.7 billion in FY 2003, and then rise rapidly to more than $4.5 billion by FY 2007. About 90 percent of the increase is attributable to poor investment performance during fiscal years 2001 and 2002, as well as the Plan assumption that the funds will break even in the current year—a shortfall from the actuarial assumption of an 8 percent gain. As of January 31, 2003, however, the pension funds lost 7.5 percent on their investments. If there is no improvement during the remainder of the fiscal year, City pension contributions could be higher than forecast by $45 million in FY 2004, $115 million in FY 2005, $210 million in FY 2006, and $335 million in FY 2007.

Fringe Benefits

City-funded health insurance costs are projected to grow from $2 billion in FY 2003 to $2.9 billion by FY 2007, reflecting rapidly rising health insurance premiums. Premiums grew at a double-digit pace during the early 1990s, but the City then negotiated a three-year freeze in rates for fiscal years 1996 through 1998 as part of a package to help the City balance its budget during a period of fiscal stress. Since then, health insurance premiums have increased at a rapid rate, reflecting national medical and hospital care cost trends (see Graph 10). The Health Insurance Plan of Greater New York (HIP) increased premiums by 9.9 percent in FY 2001, 11.9 percent in FY 2002, and 8.5 percent in FY 2003.[13] The January Plan reflects these increases and assumes that premiums will increase by 8 percent annually thereafter. HIP officials have indicated that it intends to increase rates by 7.9 percent in FY 2004.

Graph 10

ANNUAL CHANGE IN HEALTH INSURANCE PREMIUMS



Source: NYC Office of Management and Budget; HIP

Municipal Union Assistance

A January 2001 agreement between the City and the Municipal Labor Committee calls for negotiations on restructuring the funding sources for municipal health insurance, with the goal of reducing the City's contribution by $100 million in FY 2003 and $100 million in FY 2004.[14] The agreement guarantees the savings and states that if the parties are unable to restructure benefits, the committee will provide

[13] Under agreements between the City and its unions, premiums paid to HIP determine the City's cost for all municipal health insurance providers.

[14] For a detailed discussion of this issue see OSDC Report 9-2001, *Review of the Financial Plan for the City of New York: Fiscal Years 2001-2005*, issued March 2001.

these savings through another source. The January Plan assumes that the parties will not restructure benefits and that the City will draw upon $200 million in assets in the Health Insurance Stabilization Fund, leaving about $150 million. The fund was established to relieve employees who were paying health insurance premiums for Group Health Insurance and Blue Cross coverage that were higher than the premiums charged by HIP. As part of the restructuring agreement, however, the City and Municipal Labor Committee agreed that the Health Insurance Stabilization Fund would fund an expansion in drug coverage. These expenses have been greater than planned and could deplete the fund in the near future. Consequently, the City could come under pressure from the unions to increase its annual contribution to the fund from the current level of $35 million.

In addition, the City had anticipated $500 million in savings in FY 2003 from negotiations with the municipal unions. The unions agreed to support State legislation that permitted the City to extend, over ten years, planned pension contributions to fund the cost of cost-of-living allowances for retirees. The extension reduced the City's costs by $277 million in FY 2003 and declining amounts in subsequent years. The January Plan, however, assumes that the remaining $223 million of anticipated savings will not be realized. The January Plan also assumes that the municipal labor unions will agree to actions that will reduce City costs by $600 million annually beginning in FY 2004, but such agreements have yet to be negotiated.

Collective Bargaining

The City has reached new labor agreements with nearly all of its employees. The January Plan, however, does not include any funding for wage increases after the current round of negotiations. The agreement with District Council 37 (DC 37), the largest union representing civilian employees, expired on June 30, 2002, and the agreements with the City's other large unions expire during FY 2003. In December 2002, DC 37 asked for a two-year agreement, protection from layoffs, and a "fair, reasonable, and responsible wage increase." The Mayor maintains that future collective bargaining agreements will not be retroactive and any wage increases must be funded entirely with productivity savings. Wage increases at the projected inflation rate would increase costs by $280 million in FY 2003, $775 million in FY 2004, $1.3 billion in FY 2005, $1.8 billion in FY 2006, and $2.3 billion in FY 2007. A recent agreement between the Metropolitan Transportation Authority (MTA) and the Transport Workers Union (TWU) provides a lump sum payment of $1,000 in 2003 and annual wage increases of 3 percent in 2004 and 2005. In addition, the MTA agreed to increase its health insurance contributions by about $400 million over a three-year period. In total, the TWU agreement provides for an average annual increase in wage and fringe benefit costs of about 4 percent. A similar agreement for City workers would increase costs by about $3.7 billion by FY 2007.

Police Overtime

Overtime costs in the Police Department have increased dramatically over the past several years and have exceeded planned levels by wide margins. The Department spent $353 million on overtime in FY 2002 (excluding costs related to the World Trade Center) and a similar amount in FY 2001. Although the Department is continuing to spend at levels consistent with the previous two fiscal years, the Plan assumes that overtime costs will decline to $264 million in FY 2003 and to $241 million in FY 2004. For example, the Department spent $34 million, more than half of the amount appropriated for the entire year, during the first quarter of FY 2003 covering events such as the opening session of the United Nations. In addition, the size of the police force has been declining in recent years, putting pressure on the Police Department to provide coverage through overtime. The police force is projected to decline by 2,016 officers between June 2002 and June 2004 due to a high attrition rate and budget cuts that have reduced planned hires. For these reasons, we believe the Police Department is likely to exceed its overtime budget by $75 million in FY 2003 and $100 million in subsequent years.

2. Debt Service

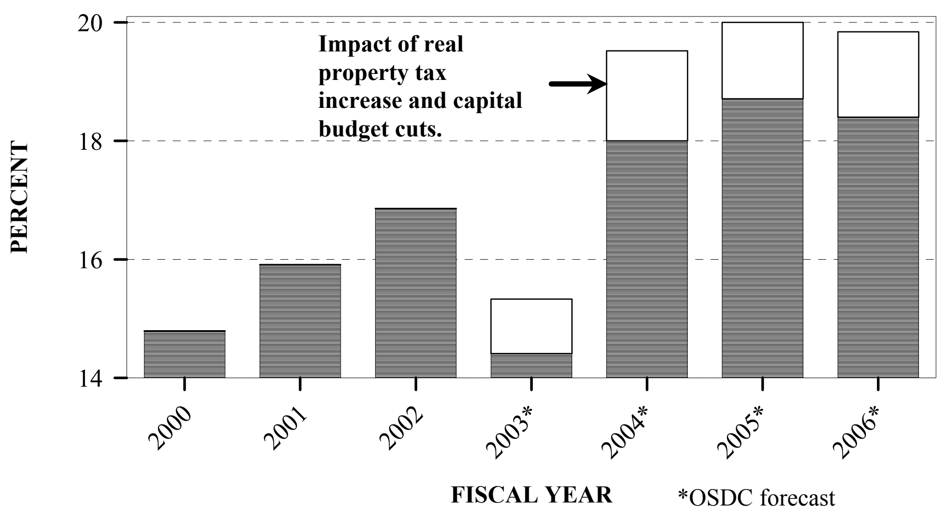
Debt service costs are projected to exceed $5.4 billion by FY 2007, which reflects an average annual increase of 12 percent during fiscal years 2003 through 2007. The rapid rate of growth in debt service costs will result in fewer resources for discretionary programs. The debt service burden (debt service as a percent of tax revenues, including amounts to support TFA and TSASC debt service) would peak in FY 2005 at 18.7 percent, and decrease to 18.3 percent by FY 2007. The City's projected debt service burden has been greatly reduced over the last eight months through bond refundings, cuts to the City-funded portion of the capital program, and an 18.5 percent increase in the property tax. Without these actions, the debt service burden would have reached 20 percent by FY 2005 (see Graph 11). The debt service burden would be reduced further if the Mayor's proposal to extend the City's personal income tax to nonresidents, or some alternative tax measure, were approved by Albany.

A series of six bond refundings—four general obligation (GO) and two TFA—lowered debt service costs by a total of $565 million in FY 2003 and $93 million in FY 2004. The first two GO refundings provided immediate budget relief of $368 million, but increased future costs by $480 million during fiscal years 2007 through 2019. Refundings that increase future costs make balancing the budgets in those years more difficult. A major contributing factor to the City's relatively high current debt burden are costs associated with refundings completed during fiscal years 1986 through 1995, which increased debt service expenses by $997 million during the current financial plan period. The past four refundings reduced costs by $197 million and did not increase future costs because they were structured in a more fiscally prudent manner.

The City took advantage of provisions in the federal economic stimulus package that were enacted in the aftermath of the attack on the World Trade Center, which permit New York City and certain other public entities in New York State to refinance tax-exempt bonds a second time to benefit from lower interest rates. Pursuant to the federal law, the City has refinanced $1.6 billion in bonds a second time and has until December 31, 2004, to identify another $2.9 billion in outstanding debt.

Graph 11

NEW YORK CITY DEBT SERVICE BURDEN



Source: NYC Office of Management and Budget; OSDC analysis

To help balance the operating budget, the City has scaled back the City-funded[15] portion of its capital program to reduce future debt service costs. Planned capital commitments as of April 2001 for fiscal years 2002 and 2003 have been reduced by $4 billion, or 25 percent. On January 28, 2003, the City released its Preliminary Ten-Year Capital Strategy for fiscal years 2004 through 2013. The strategy would allocate $40.3 billion for capital projects over the next ten years, about $14.1 billion less than the current ten-year strategy (see “Appendix B”). As a result, future capital commitments will average about $4 billion per year, about 36 percent

[15] City-funded capital projects are financed with general obligation, TFA, TSASC, and lease appropriation debt.

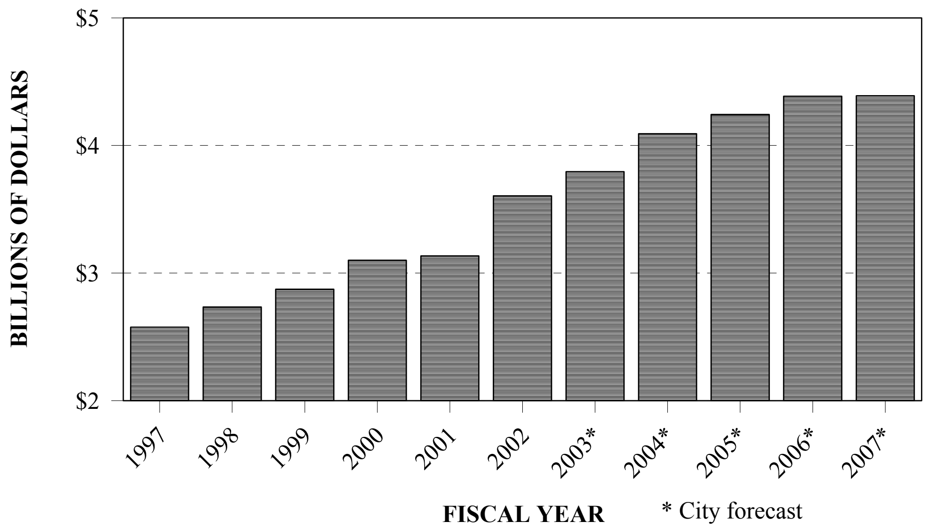
less than the average during fiscal years 2001 through 2003, but about the same level of the ten previous years. Nonetheless, the cuts could adversely affect plans to add capacity in overcrowded school districts, reconstruct bridges and highways, support mass transit, and create affordable housing.

3. Medical Assistance

Medicaid expenditures are projected to climb to over $4 billion in FY 2004 (see Graph 12), an increase of $297 million over the level projected for FY 2003. (The City's Medicaid estimates do not reflect the Governor's proposed Medicaid cost-containment initiatives.) City-funded Medicaid expenditures are projected to reach 14.4 percent of City-fund revenues by FY 2004, compared with an average of 11.9 percent during fiscal years 1997 through 2002. Since Medicaid costs are projected to grow faster than revenues, fewer resources would be available for other services. Moreover, our analysis indicates that Medicaid costs could be higher than projected by $50 million in FY 2004 and by $150 million in subsequent years.

Graph 12

CITY-FUNDED MEDICAID EXPENDITURES



Source: NYC Office of Management and Budget; OSDC analysis

The growth in Medicaid costs reflects the escalating cost of medical services and a 27.8 percent increase in enrollment. More than 2.1 million individuals were enrolled in Medicaid in November 2002—the highest level ever recorded in New York City. Enrollment growth is due to both the Disaster Relief Medicaid (DRM) initiative and outreach efforts to enroll children. About 340,000 individuals were enrolled in DRM since September 2001 through streamlined procedures. DRM expired in January 2002, and was subsequently replaced by the Family Health Plus (FHP) initiative, a program designed to combat the growing problem of the uninsured by covering the working poor who earn too much to qualify for Medicaid. Over 60,000 adults have enrolled in FHP since March 2002 and the January Plan assumes FHP enrollment will increase to 95,000 by December 31, 2003. The Governor, however, has proposed reducing FHP income eligibility to 133 percent from 150 percent of the federal poverty level. In addition, the New York State Coalition of Prepaid Health Services Plan recently provided testimony to the State Legislature that the City is experiencing a delay of three months or far longer processing applications for FHP because of administrative staff shortages at the City's Human Resource Administration.

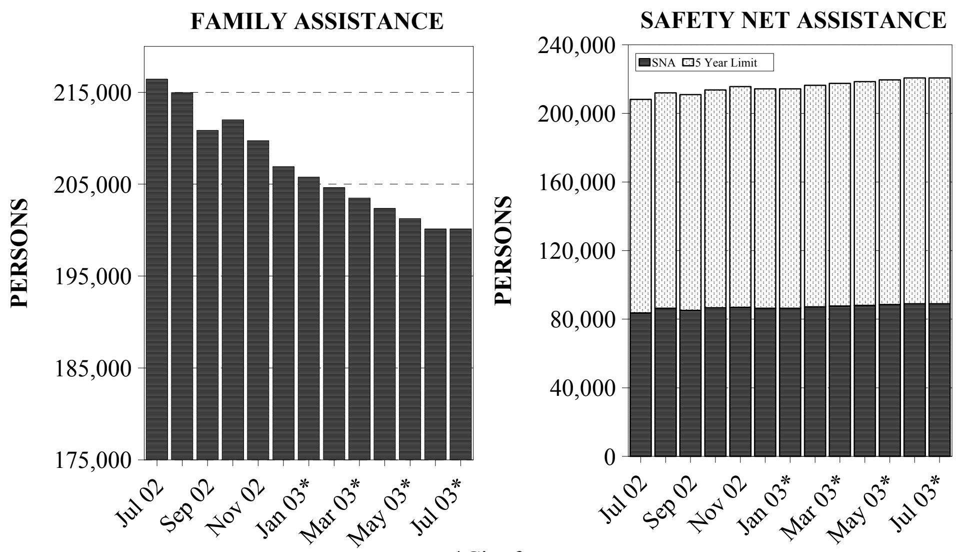
4. Public Assistance

Public assistance is essentially comprised of three programs. The largest is the Family Assistance program, which is administered by the State and assists families for a maximum of five years with federal funds from an annual block grant. The two other programs are components of the State's Safety Net Assistance program. One program primarily serves single adults and the other serves families who exhaust their federal benefits. Benefit levels for all three programs are the same, but the average grant per person can vary based on the needs of recipients for items such as rent. The State and City generally share equally in the cost of the two Safety Net Assistance programs.

Since FY 1995, New York City's public assistance caseload has declined by over 63 percent. During FY 2003 the monthly caseload averaged 424,284 through December 2002, the lowest level ever since the FY 1995 peak. Although the January Plan assumes that the total public assistance caseload will decline to 420,765 in June 2003, and remain at that level through FY 2004, the caseloads in the adult and family Safety Net Assistance programs will grow by 6,307 persons between December 2002 and June 2003 (see Graph 13). As a result of an increase in more costly public assistance cases, City-funded public assistance grants will total $386 million in FY 2003 and then grow by $23 million in FY 2004 and by smaller amounts in subsequent years.

Federal welfare legislation to replace the five-year law that expired in September 2002 has been stalled in Congress. Existing arrangements have been extended until a federal budget is adopted for this and other programs, but certain legislative proposals contain changes that could alter regulations and spending requirements. A consensus was reached, however, to retain the current level of block grant funding to states.

Graph 13
PUBLIC ASSISTANCE CASELOAD



*City forecast
Source: NYC Human Resources Administration; OSDC analysis

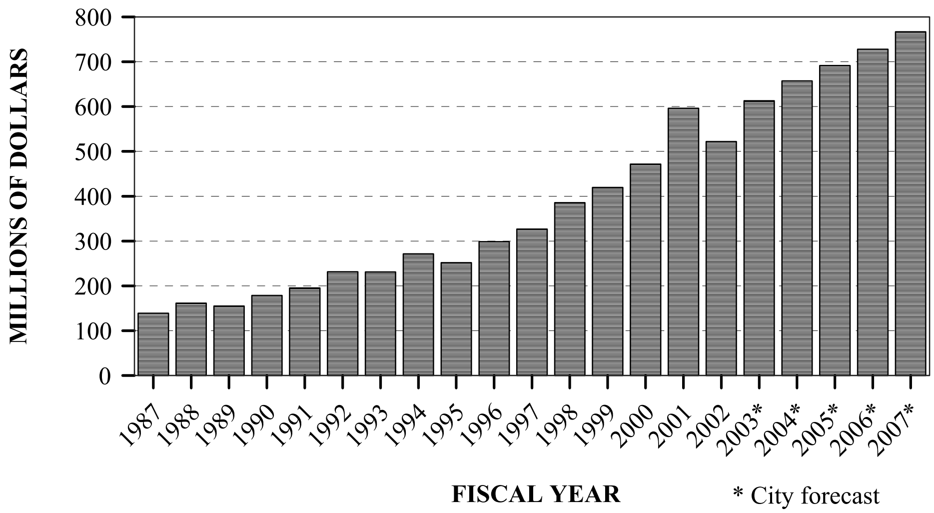
5. Judgments and Claims

The City spent $522 million on judgments and claims in FY 2002, significantly less than the prior year largely because of delays caused by the attack on the World Trade Center. Nevertheless, the amount spent in FY 2002 was more than twice the FY 1995 amount (see Graph 14). More than half of the growth results from an increase in the number and size of cases that cost $1 million or more. In FY 2002, these cases cost $228 million and have increased by nearly $105 million, or 85 percent, over the last five years. Medical malpractice cases, which have the highest average cost per case at about $600,000, constitute about one third of judgments and claims expenditures, and have increased by 52 percent since FY 1998.

The January Plan assumes that costs for judgments and claims will increase from $613 million in FY 2003 to $767 million by FY 2007 at an annual growth rate of about 6 percent, a reasonable estimate. To limit the City's future liability, the Mayor has proposed legislation to the City Council that would make private property owners, and not the City, liable in court for most accidents stemming from improperly maintained sidewalks. A second bill requires notices of defects to be more detailed and gives the City additional time to repair sidewalk and roadway defects before it could be held liable for any damages. The City estimates that, if adopted, these proposals would reduce costs by more than $40 million annually. The City Council held a hearing but no further action has been scheduled at this time. Also, the City remains hopeful that the State Legislature will enact tort reforms that include imposing monetary caps on personal injury awards and moving cases to the Court of Claims from jury trials and other initiatives. The Governor supports the transfer to the Court of Claims, which could reduce the City's judgment and claims costs by $20 million annually. However, past efforts to enact tort reforms have failed to pass the State Legislature.

Graph 14

JUDGMENTS AND CLAIMS EXPENDITURES



Source: NYC Comptroller's Office; NYC Office of Management and Budget

The City's estimates, however, do not reflect its potential liability arising from the attack on the World Trade Center. The City has received 2,350 notices of claim related to the World Trade Center disaster with an aggregate value of nearly $13 billion; about 80 percent of this amount relates to claims filed by firefighters and other emergency workers. The ultimate outcome and fiscal impact on the City, if any, is not currently predictable.

VII. Covered Organizations

Covered organizations are semi-autonomous agencies subject to the Financial Emergency Act, which include but are not limited to the Board of Education,[16] the Health and Hospitals Corporation, and the New York City Transit Authority. The City has a financial relationship with these agencies and may be called upon to provide additional funding to help balance their budgets.

A. Department of Education

The Department of Education faces significant challenges in FY 2004 as it strives to reform school management, to direct more of its resources to classrooms, and to fulfill State and federal education mandates. The State has imposed higher standards for educational performance, graduation, and teacher certification, and the federal government has promulgated new standards for academic performance.

The Mayor's preliminary Executive Budget allocates $12.2 billion to education, excluding pension and debt service costs—$304 million less than budgeted for the current fiscal year. The City would contribute $5.1 billion, the State would contribute $5.8 billion, and the federal government would provide $1.3 billion (see Graph 15). The Mayor's budget, however, does not reflect the Governor's proposed budget, which would greatly reduce education aid to the City's public schools if enacted by the State Legislature.

The Mayor has cut City funding to the Department of Education by $579 million in FY 2003 and by $684 million in FY 2004, down from levels planned prior to September 2001.[17] Cuts to core classroom services, however, were spared for both years by shifting eligible expenditures to the State and federal governments or to the capital budget; by reorganizing central and district-level administrative functions including layoffs and attrition; by implementing a centralized purchasing system; and by recognizing additional savings from teacher turnover.

Last year, the State enacted a law that prohibits the City from reducing its funding for education (excluding pension and debt service) from one year to the next, unless City revenue declines. The City will meet this maintenance-of-effort requirement in FY 2004. City funding is anticipated to increase by $179 million, but

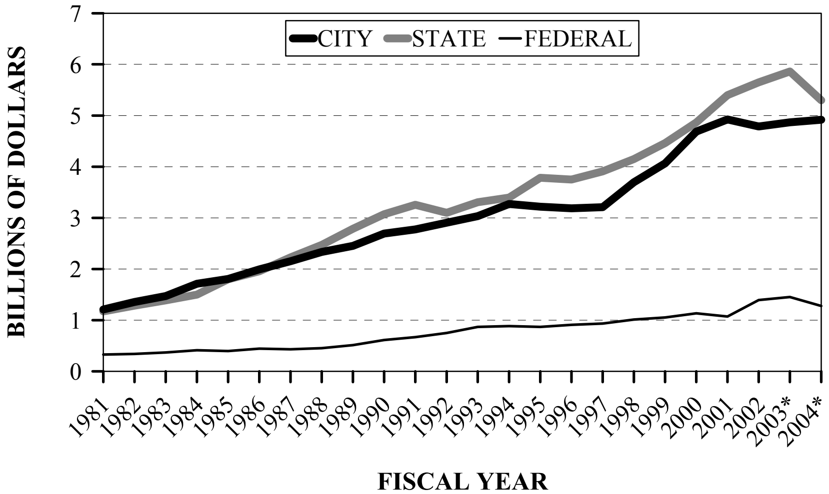
[16] The Board of Education has been renamed the Department of Education by the Mayor, although the legal name remains unchanged.

[17] City spending on pensions and debt service for education is projected to total $1.5 billion in FY 2004, an increase of 53 percent from FY 2003.

the resources fund only the incremental cost of the teachers' contract, leaving fewer City resources for other areas of the education budget.

Graph 15

EDUCATION FUNDING SOURCES



*City forecast
Note: Analysis excludes debt service and pensions.
Source: NYC Office of Management and Budget; OSDC analysis

The Governor's Executive Budget would cut education aid to New York City's public schools by $449 million. Operating aid would be reduced by 3 percent; State support for the universal prekindergarten (which serves 42,000 children), minor maintenance, and class-size reduction programs would be eliminated; and funding the teacher support program, which pays teachers' salaries, would be reduced by two thirds. In addition, the Governor would allocate $29 million in State education aid to help the City fund the debt service costs from borrowing $423 million from the New York State Municipal Bond Bank for State education aid owed from prior years, which would reduce the amount available for educational programs. Further, the Mayor's budget assumes that the State will continue funding the $275 million cost of extending the school day, which the State funded in FY 2003, but those resources were not included in the Governor's budget. Thus, the effective loss in State education aid would total $753 million. If the Governor's budget is enacted, the Mayor has stated that he would be compelled to lay off thousands of teachers and to increase class sizes.

For federal fiscal year 2004, the President proposes to increase federal education aid by far less than agreed on with Congress under the No Child Left Behind Act of 2001. Title I aid used to fund supplemental tutoring and school improvement plans, among many other services, was scheduled to increase by $7 billion nationwide. The President's budget allocates a $1 billion increase, of which New York City could receive $87 million. However, if the City were granted flexibility in spending the anticipated federal aid, this would mitigate the adverse impact of the State budget.

The President also proposes that more strict proof of income be required from parents whose children receive free or subsidized breakfasts and lunches during school. Tests of the proposed eligibility requirements in a national sample of school districts reduced program participation by 20 percent. About 82 percent of New York City's students receive free and reduced-price meals. Federal aid for certain other programs could be reduced as well because the amount of assistance is based, in part, on the number of children eligible for breakfast and lunch programs.

In June 2002, the State Legislature gave the Mayor more control over City schools, abolished community school boards, and created the State Task Force on Community School District Governance Reform to make recommendations to the State Legislature on replacing school boards by February 15, 2003. Despite achieving greater mayoral control of schools, the Mayor's ability to implement reforms continues to be subject to State and federal approval and to negotiations with unions. The State Legislature retained control to determine the nature and extent of parental participation in education. Any replacement for community school boards that is accepted by the State Legislature must also be approved by the federal Justice Department to ensure compliance with the 1965 Voting Rights Act.

In January 2003, the Mayor proposed a comprehensive reorganization of community school district management. The Mayor's reform suggests a replacement for community school boards and promises an integral role for parents in school governance. Under the Mayor's plan, community school district boundaries would be retained, but community school boards would be replaced with parent engagement boards. Election to the new boards would be limited to parents who previously served in some leadership capacity in a district school, such as on a school leadership team, and whose children attend a district school. The plan also offers new resources and structures to build parent participation, including a parent-involvement training and resource academy, Citywide parent information and support offices, and full-time parent coordinators to serve as ombudsmen for parents in every school. The proposal to limit school board candidacy to parents requires a change in State law, and State legislators have expressed strong concerns about other features in the Mayor's plan, including a move to block the plan in court. At the City's request, the State passed a bill to extend existing community school boards until June 30, 2004, which would allow more time for review and debate.

Other changes in the Mayor's plan will likely be subject to collective bargaining, such as the proposal to evaluate principals based on the level of parent engagement, the reassignment of certain administrators and some superintendents, and the proposal to employ full-time parent coordinators in every school.

Campaign for Fiscal Equity v. State of New York charges that New York State's system of education finance denies children their right to a sound basic education, in violation of the State constitution. In January 2001, Supreme Court Justice Leland DeGrasse ruled in favor of the Campaign for Fiscal Equity (CFE), ordering the State to reform its education funding mechanism by September 2001. New York State appealed the ruling. In June 2002, the State Appellate Division ruled that the State was not obligated to provide any more than an eighth grade education. Subsequently, the Governor and the plaintiffs entered into settlement negotiations, but were unable to reach an agreement. CFE submitted an appeal brief to the Court of Appeals, the State's highest court. New York State has until April 9, 2003, to submit its brief, and the Court of Appeals will hear arguments on May 8, 2003. New York City submitted a friend of the court brief in support of the CFE claim on February 25, 2003.

B. Health and Hospitals Corporation

The Health and Hospitals Corporation (HHC) ended FY 2002 with a cash balance of $340 million. Since HHC's expenses are projected to exceed revenues in FY 2003, the cash balance would be reduced to $221 million, but this would still be sufficient to close a projected budget gap of $192 million for FY 2004. HHC is facing projected budget gaps of $408 million in FY 2005 and about $500 million in each of fiscal years 2006 and 2007. To close these gaps, the HHC plan assumes additional resources of $175 million from State and federal actions in FY 2004, rising to $300 million by FY 2007. With the State and City each facing a budget crisis and the federal government curtailing discretionary spending, these amounts are unlikely to materialize, which will force HHC to increasingly depend on internal actions to close its budget gaps.

Moreover, HHC's projected budget gaps do not reflect the impact of the Governor's Executive Budget, which would adversely affect HHC's finances beginning in FY 2004. The Governor's Executive Budget would reduce Medicaid revenues to HHC in FY 2004 by an estimated $150 million to $200 million. According to HHC officials, cuts of this magnitude would require reductions in service levels to balance the FY 2004 budget. Such cuts also would exacerbate an already serious situation for fiscal years 2005 through 2007, which could put pressure on the City to provide additional funding to HHC to maintain service levels and access to care.

Appendix A
Nonrecurring Resources

The budget for fiscal years 2003 and 2004 includes $4.2 billion and $1.6 billion, respectively, from nonrecurring and other short-term actions (see Table 12). These actions will help the City balance the budget in those years, but will provide no long-term benefit. Borrowing in one form or another will free $3.8 billion for use in the operating budget during the course of fiscal years 2003 though 2007, with 81 percent of the proceeds dedicated to fiscal years 2003 and 2004. Future taxpayers will have to repay these "loans" at a cost of $5.9 billion and will receive no services in return.

Table 12
Nonrecurring and Other Extraordinary Actions
In Fiscal Year 2003 and 2004
(in millions)

	FY 2003	FY 2004
Deficit Financing	$ 1,500	$ - - -
Federal Aid	799	- - -
Debt Refundings	565	93
Phase-In Pension Costs	277	229
MAC Reserves	276	- - -
Municipal Bond Bank Loan	206	- - -
Education Resources	190	
Net Surplus Roll	57	621
TSASC	120	- - -
Health Insurance Savings	100	100
Sale of Tax Benefits	100	- - -
Port Authority Payment	- - -	600
Total	**$ 4,190**	**$ 1,643**

Source: OSDC analysis

Our estimate of nonrecurring resources includes:

- $1.5 billion in TFA bond proceeds in FY 2003 to reimburse the operating budget for revenue losses associated with the attack on the World Trade Center.
- $799 million in federal assistance to reimburse costs related to the attack on the World Trade Center, including $149 million to fund capital expenses.
- $565 million and $93 million from debt refundings in fiscal years 2003 and 2004, respectively, which generated one-time savings but at the expense of higher costs in the future.

- $277 million and $229 million in fiscal years 2003 and 2004, respectively, and declining amounts in subsequent years from phasing in certain pension costs over a ten-year period, which will be repaid with 8 percent interest.
- $276 million in FY 2003 from the Municipal Assistance Corporation by accelerating the receipt of reserve funds, which was established with bond proceeds.
- $206 million in FY 2003 from the New York Municipal Bond Bank, which the City intends to borrow against State education aid owed to the City from prior years. These funds will be repaid over a ten-year period at 5 percent interest.
- $190 million in FY 2003 for educational programs, including nonrecurring State education aid and resources set aside in a trust account to settle a lawsuit but no longer needed.
- $120 million in FY 2003 in bond proceeds from TSASC (tobacco bonds) to fund the operating budget of closing the Fresh Kills landfill. Accounting principles prevent the City from using TFA or general obligation bonds to capitalize the cost of eliminating an asset, but a State law enacted last year allows TSASC to fund these costs with bond proceeds.
- $100 million in each of fiscal years 2003 and 2004 from drawing down assets of the Health Stabilization Fund, pursuant to a January 2001 agreement with the municipal unions.
- $100 million in FY 2003, representing the net proceeds from the sale of tax benefits by conveying to a private entity the ability to depreciate, for federal income purposes, certain City assets. The proceeds represent the present value of the federal tax benefits to the private entity over the asset's depreciable life.
- $57 million and $621 million in fiscal years 2003 and 2004, respectively, representing surplus resources from prior years.
- $600 million in FY 2004 from the Port Authority of New York and New Jersey as a retroactive airport lease payment.

Appendix B
Comparison of Final FY 2002 and Preliminary Ten-Year Capital Strategies

(Total Funds in millions)

Project Type	Final FY 2002	Preliminary	*Increase/(Decrease)* Amount	Percent
Education	$ 13,343	$ 9,748	$ (3,595)	-26.9%
Bridges	5,958	4,468	(1,490)	-25.0%
Housing	4,998	3,662	(1,335)	-26.7%
Water Pollution Control	4,525	3,524	(1,001)	-22.1%
Highways	3,606	2,795	(811)	-22.5%
Water Mains	2,220	2,442	222	10.0%
Sanitation	2,876	2,270	(606)	-21.1%
Corrections	1,834	1,417	(417)	-22.7%
Courts	1,381	1,201	(180)	-13.0%
Sewers	1,172	1,005	(167)	-14.3%
Public Buildings	1,322	947	(375)	-28.4%
Transit	1,406	748	(658)	-46.8%
Water Supply	862	661	(200)	-23.2%
Economic Development	1,283	638	(645)	-50.3%
Parks and Recreation	1,025	601	(424)	-41.4%
Traffic	479	502	23	4.8%
Fire	683	443	(240)	-35.1%
Police	824	439	(385)	-46.7%
Cultural Affairs	599	416	(183)	-30.6%
Data Processing Equipment	643	350	(293)	-45.6%
DEP Equipment	507	343	(164)	-32.4%
Franchise Transportation	242	262	20	8.3%
Hospitals	728	217	(511)	-70.2%
Homeless Services	322	209	(113)	-35.1%
Human Resources	222	172	(50)	-22.5%
Admin. for Children's Services	238	144	(94)	-39.5%
Housing Authority	142	111	(31)	-21.8%
Health	170	99	(71)	-41.8%
Libraries	132	98	(34)	-25.8%
CUNY	114	96	(18)	-15.8%
Ferries	222	74	(148)	-66.7%
Transportation Equipment	114	67	(47)	-41.4%
Real Estate	83	47	(36)	-43.4%
Aging	44	29	(15)	-34.1%
Juvenile Justice	87	14	(73)	-84.0%
Total	**$54,405**	**$40,259**	**$(14,147)**	**-26.0%**

Source: NYC Office of Management and Budget