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Testimony of the New York City Independent Budget Office
To the New York City Council Committee on Finance
Regarding the Mayor's Preliminary Budget for 2024 and Financial Plan through 2027
March 6, 2023

Good afternoon, Chair Brannan and members of the New York City Council Committee on Finance, I am Louisa Chafee, director of the New York City Independent Budget Office. I am pleased to be joining you on this, my fourth working day in the role. Before I turn it over to my colleagues who will be providing you with highlights from IBO's analysis of the Preliminary Budget and our latest tax and revenue forecast, I wanted to express my excitement for this new role and say that I look forward to working with all of you.

Good afternoon, Chair Brannan and members of the finance committee. I am Elizabeth Brown, communications director at the New York City Independent Budget Office. Thank you for the opportunity to testify. Joining me today are several of my colleagues, including Michael Jacobs, assistant director for economics, and Brian Cain, budget review analyst.

I will begin with a discussion of our bottom line—one that will likely be changing given recent events. A month ago, IBO released our analysis of the Preliminary Budget along with our latest revenue estimates. We projected that the city would end fiscal year 2023 with a $4.9 billion surplus, $2.8 billion more than the Mayor's Office of Management and Budget (OMB) estimated. (All years refer to fiscal years, unless otherwise noted.) Our projection was based upon IBO's higher tax revenue forecast and somewhat lower estimates of city spending in 2023 compared with the Mayor. Assuming that the surplus would be used to prepay 2024 expenses, we then projected a $2.6 billion surplus in 2024. After gaps of around $3 billion each year through 2027. We cautioned, however, that the greatest risk to these near-term surpluses was the cost of the city's unsettled labor contracts. Since the release of our report, the size of that risk has become somewhat clearer.

Estimated Cost of Labor Settlements. As you know, the Adams administration two weeks ago reached a tentative contract agreement with New York City-District Council 37 (DC 37), one of the city's largest municipal labor unions. The agreement includes 3 percent raises for each of the first four years of the new contract (retroactive to the contract start date in May 2021), a 3.25 percent raise in the fifth year, and a $3,000 one-time ratification bonus for members, among other terms, including a work from home pilot program. Assuming this agreement is ratified, and that it sets the pattern of wage increases for all municipal employees, IBO estimates that the cost to the city, above what is already included in the city's labor reserve, would be between $16 billion to $17 billion over the course of the financial plan through 2027, not materially different than the Administration's appraisal. Apart from the estimate of one-time bonuses, which is calculated using current headcount, IBO's estimate is based on 2022 city staffing, since the impact of this agreement on attrition, hiring, and retention is unclear.

When exactly these costs are incurred depends on when each of the city's municipal labor unions ratify their contracts, however. For example, if all unions were to settle for a similar pattern as DC 37's tentative agreement this fiscal year, IBO estimates the additional cost to the city would be approximately $2.4 billion in 2023 (including all backpay and one-time bonuses), $2.0 billion in 2024, and growing to $4.8 billion in 2027, above the funds already budgeted in the labor reserve. Assuming no other changes to the budget, this would sap all but $318 million of our 2023 projected surplus, and result in a budget shortfall of $1.9 billion for 2024. Outyear gaps would increase to $6.2 billion in 2025, $7.9 billion in 2026 and $7.6 billion in 2027. While it is very unlikely that all unions will sign new contracts this year, and there is no guarantee that all unions will follow the DC 37 pattern, the near-term impact of the biggest risk as of our February report is less opaque today.

Economics and Revenue Forecasts. Moving from the municipal workforce to the city's workforce writ large, I will provide some highlights from our latest economic forecast. IBO's economic forecast is premised on slowing growth in both the national and local economies over the next 12 months, although we do not anticipate negative growth for a sustained period. For calendar year 2022, we expect the New York City economy will have added about 212,300 jobs, based on preliminary numbers, which would bring the city's total employment to 97.6 percent of its pre-pandemic level. However, the expected slowdown in national economic growth, and the fact that most of the nearly 900,000 jobs lost during the height of the pandemic have already been regained, will substantially slow growth this year and beyond. For 2023 we forecast the addition of only 45,700 jobs, before bouncing back to 93,000 in 2024. We now project the city will recover all lost jobs by the third quarter of 2024.

The most prominent change to IBO's employment forecast is an improved outlook for the leisure and hospitality sector, the industry hit hardest by the pandemic. The recovery of the 295,000 jobs lost (almost two-thirds of its pre-Covid total) has been sluggish until recently. But the healthy return of tourism to the city has boosted employment in the sector, which we now project will regain all lost jobs by the second quarter of 2024.

Two other sectors in which our employment outlook has changed, although not as markedly as leisure and hospitality, are information and financial activities. Information, which had the quickest recovery of any sector from its initial pandemic losses, is projected to remain essentially flat in 2023. Financial activities, including the securities industry, is projected to decline this year, before minimal growth resumes. As these are the two sectors with the highest average wages in the city, these changes to their outlook—although not particularly large in terms of the number of jobs—are worth noting.

As for tax revenue, after double-digit growth in many of the city's main tax sources in fiscal year 2022, tax revenue growth is expected to slow in 2023—turning negative in some cases—with aggregate tax revenue growth of only 1.7 percent over 2022. The declines are particularly large in percentage terms for the income taxes and property transfer taxes. Sales tax and real property tax are the exceptions among the city's major tax sources for which we forecast moderate growth. The weakness continues into 2024, with total tax revenue expected to shrink by 1.3 percent. Growth is expected to remain weak for most tax revenue sources in 2025 through 2027.

When compared with OMB, our forecast of total tax revenue is higher in every year of the financial plan period, by $1.8 billion this year, $924 million in 2024, $1.7 billion in 2025, and greater amounts in 2026 and 2027. In terms of specific taxes, our forecasts of business income, personal income, and real-estate related taxes are higher than OMB's in each year, while forecasts of sales tax revenue are lower in most years.

Spending Re-estimates. Turning to spending, we also have several notable differences in our estimates of city-funded costs compared with those projected by the Mayor. One area where we have estimated *lower* than budgeted costs is for personal services spending, excluding uniformed agencies, which I will discuss shortly. Using actual personal services costs from the first half of 2023, IBO estimated that spending on non-uniform agencies would be about $1.7 billion less than planned in the Preliminary Budget for this year, primarily due to the high number of municipal vacancies. The settlement of the city's labor contracts in this year, however, could erode this difference, as unused funds could help pay for the salary increases.

There are several other areas, however, where IBO projects *higher* than currently budgeted city-funded costs. The largest of these is for the Department of Education. IBO estimates DOE will require an additional $306 million in city funds in 2023 compared with the Preliminary Budget. The additional need increases to $905 million in 2024 and reaches $1.5 billion in 2026 and forward. More than half of the additional funding required in the latter years of the financial plan comes from the drop off in federal Covid-19 aid. IBO estimates the DOE will require $881 million in 2026 and forward to fund ongoing programs funded by these relief funds—programs that include Summer Rising, 3-K and Mental Health for All. IBO also anticipates Carter Case spending for students with disabilities and charter schools' costs will be above what the Mayor has budgeted in each year of the financial plan.

IBO also estimates additional city funding is necessary to cover the cost of providing services to asylum-seeking individuals and families who have arrived in New York City. The city has budgeted $1 billion in federal funding in 2023 to cover the cost of providing services to this population. However, the federal government has only authorized $800 million for asylum seeker expenses nationally and it is unclear how much will be allocated to New York City. The state Executive Budget, released after the Preliminary Budget, included some funding to help the city cover these costs, including a proposal to reimburse the city for 29 percent of shelter service costs, with maximum contribution of $1 billion in reimbursements over two years. Without specifics on the city's federal allocation, IBO assumes that the city and to a lesser extent state will cover these costs.

We estimate that the bulk of city spending on asylum seekers to be ongoing shelter costs. Based on the rate of recent asylum seeker arrivals, we project total shelter costs of at least $609 million in 2023 and $852 million in 2024. I should note these estimates do not include the costs of constructing

Humanitarian Emergency Relief and Response Centers (HERRCs), such as the cost of weatherizing the Brooklyn Cruise Terminal. Based on the state's proposal, IBO estimates that city spending on shelter for asylum seekers will total $432 million and $605 million for this year and next, respectively. An influx of asylum seekers beyond our current forecast of growth would increase this estimate, as would any reduction in proposed state funding. Federal aid would reduce the city cost.

IBO also projects higher than budgeted spending on overtime for the uniform agencies, with the largest difference in our estimate being for the police department. IBO estimates NYPD is on pace to spend $825 million on overtime in 2023, $369 million more than is currently budgeted. However, approximately $109 million of the additional overtime police funding needed will likely be offset by underspending in other areas of the NYPD personal services budget. This results in a need for $260 million in additional city funds for NYPD in 2023. Similar trends are seen in the other years of the plan.

Pressure from State Executive Budget. While the governor included some financial relief to the city in the Executive Budget with the proposal to help fund the shelter stays of asylum seekers, it also contained several provisions that would put increased pressure on the city budget.

Most notably is a proposal to increase the city's contribution to the Metropolitan Transportation Authority by approximately $500 million annually. With public transit ridership stalled at two-thirds of pre-pandemic levels, the MTA continues to face large annual operating deficits. The city's increased subsidy would consist of greater contributions to paratransit costs, contributions for MTA farecards for city students, and increased payroll tax offsets. The governor also proposed ending Affordable Care Act savings that the city has been receiving. Since 2015, these ACA Enhanced Federal Medicaid Assistance Percentage (eFMAP) payments have been flowing to localities, including New York City, which has historically passed these on to H+H, the city's public hospital corporation. The eFMAP payments change would eliminate city savings of $124 million in 2023 and $343 million in 2024 onward moving it to the state. This change could increase pressure for the city to support H+H.

To conclude, the settlement of the city's labor contracts will likely eclipse IBO's surplus projection based on the Preliminary Budget for 2024, and increase IBO's projected gaps going forward. While this does not come as a surprise, it does mean policymakers may be faced with tough choices, particularly in the outyears. The potential 2024 gap, when including an estimate of the cost of new labor contracts, is manageable relative to city-generated revenues and could be substantially offset with funds currently held as general reserves included in the city budget. However, possible outyear gaps well-exceed this cushion and proposals in the state budget, the difficult to predict nature of the asylum-seeker costs, and slowing economic growth increase the pressure on city coffers.

Thank you for your time and we are happy to answer any questions.