THE STATE OF THE CITY'S ECONOMY AND FINANCES, 2002

The City of New York
Office of the Comptroller
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TABLE OF CONTENTS

EXECUTIVE SUMMARY ..... **iii**

A MIXED ECONOMIC OUTLOOK **3**

THE U.S. ECONOMY 3
THE NYC ECONOMY 5
Economic Performance in 2002 ..... *5*
Comptroller's NYC Forecast for 2003 ..... *5*
Comptroller's Forecast vs. City's Forecast *6*

THE CITY'S DAUNTING FISCAL OUTLOOK **7**

TAX REVENUES 8
MISCELLANEOUS REVENUES 12
INTERGOVERNMENTAL AID 13
EXPENDITURE ASSUMPTIONS 14
Headcount *15*
Overtime *17*
Pension Contributions *17*
Health Insurance *19*
Collective Bargaining *19*
Judgments and Claims *20*
Public Assistance *22*
Medicaid *23*
DEPARTMENT OF EDUCATION 23
HEALTH AND HOSPITALS CORPORATION 24
DEBT SERVICE 25
Capital Plan Assumptions *28*
Financing Plan *28*
Debt Burden *29*

ADDRESSING THE PROBLEM **31**

REVIEW OF RISK ANALYSIS 31
GAP CLOSING PROGRAM 32

APPENDIX I – STATE AND FEDERAL GAP CLOSING INITIATIVES **35**

APPENDIX II – REVENUE AND EXPENDITURE DETAILS **36**

APPENDIX III – ECONOMIC DATA **40**

GLOSSARY OF ACRONYMS **54**

LIST OF TABLES

Table 1. November Modification: Four Year Financial Plan Revenues and Expenditures Before Gap Closing Program *1*
Table 2. November Modification: Four Year Financial Plan Revenues and Expenditures After Gap Closing Program *2*
Table 3. Comptroller's Forecast of Five Key Indicators, NYC and U.S., 2003 .... *3*
Table 4. Eight U.S. Indicators, Actual 2001 and Comptroller's Projections, 2002 and 2003 .... *4*
Table 5. Percent Change in Real GDP, Inflation Rate, and Unemployment Rate, Projections, 2002 and 2003 .... *5*
Table 6. Selected City Indicators, Actual 2001 and Forecasts, 2002-2003 .... *6*
Table 7. Comparison of Forecasts of Real GCP, Employment, and Inflation, 2002-2003 .... *6*
Table 8. Changes to the City's FY 2003 Budget Projections November Modification Compared to Adopted Budget *7*
Table 9. Ten Highest Revenue Generating Initiatives and Annual Projections, FYs 2003 to 2006 .... *13*
Table 10. November Plan Expenditure *14*
Table 11. Changes in Pension Contributions to the Actuarial Pension Systems *18*
Table 12. WTC Related Claims Filed Against the City as of November 13, 2002 .... *21*
Table 13. G.O. Debt Service Reconciliation, June 2002 to November 2002 .... *26*
Table 14. FYs 2003-2006 Financing Program Comparisons Adopted Budget versus November Modification *29*
Table 15. Risks to FY 2003 Budget *32*
Table 16. The City's Gap Closing Program *33*
Table 17. PEG Initiatives Requiring Approval *33*

Table A1. State and Federal Gap Closing Initiatives *35*
Table A2. FY 2003 November Modification Revenue Detail *36*
Table A3. FY 2003 November Modification Expenditure Detail *38*

LIST OF CHARTS

Chart 1. City-Fund Revenue and Expenditure Growth and the Outyear Gaps *8*
Chart 2. City Funded Headcount *15*
Chart 3. Debt Service as a Percent of Tax Revenues, FYs 1982-2011 .... *30*

EXECUTIVE SUMMARY

Despite a projected gap of $1.1 billion in FY 2003, it appears that the City will end the current fiscal year in balance. FY 2003 gap-closing initiatives are expected not only to close the FY 2003 deficit but also to enable the City to establish a budget stabilization account (BSA) of $509 million as well as increase the general reserve to $300 million. The BSA and the general reserve, together with as yet unrealized prior-year adjustments, provide the City with a comfortable cushion against any shortfalls in the current year's budget.

The outlook for FY 2004 and the outyears of the financial plan presents a more daunting picture. Continuing softness in the economy, a lackluster stock market and the effects of the September 11th terrorist attacks continue to take their toll on the City's fiscal condition. The November Modification to the Financial Plan projected gaps of $6.4 billion beginning in FY 2004 and exceeding $7 billion by FY 2006.

Addressing budget gaps of this magnitude is a formidable task and will require the joint efforts of the City, other levels of government and the City's labor unions. The City has put together a comprehensive gap-closing program to balance the budget in FYs 2003 and 2004 and reduce the outyear gaps. The recent passage of an 18.49 percent rate increase in the property tax, while less than the 25 percent increase the City sought, is expected to generate revenues of $838 million in FY 2003 and more than $1.7 billion in each of FYs 2004-06.

The lower than expected property tax rate increase has reduced the City's expected FY 2003 surplus roll to $509 million from $804 million and decreased real property tax revenue projections by $608 million in FY 2004. The need to address the shortfall and the impact of a diminished surplus roll on FY 2004 budget balance cannot be minimized. Every dollar decrease in the FY 2003 surplus roll will widen the FY 2004 gap by a like amount. The City needs to address this shortfall when the Mayor releases the FY 2004 Preliminary Budget in January.

Unlike the seventies, when poor and inadequate accounting practices obscured the economic challenges confronting the City until it was in the middle of a fiscal crisis, the City now recognizes the magnitude and severity of its fiscal condition. The Mayor has presented a credible estimate of the budget deficits in the November Modification and has taken early actions to address the problems. The City Council's approval of the property tax increase and agency initiatives proposed by the Mayor have made significant inroads in reducing the outyear gaps.

The Federal government needs to support the City's effort to overcome its fiscal difficulty. The terrorist destruction of the World Trade Center was an attack on the nation and an act of war. New York City is still suffering from the aftermath of the attacks. New York City would have likely emerged from recession a year ago were it not for the attacks.[1] Even as the City develops solutions to its structural and economic

[1] This issue was discussed beginning on page 11 of the Comptroller's September 4, 2002 report "One Year Later —The Fiscal Impact of 9/11 on New York City." The report may be found on the Comptroller's website, www.comptroller.nyc.gov

deficits, the Federal government must give direct support to offset the losses resulting from September 11th.

Similarly, labor must work with the City to lower spending on personal services. The City expects its labor unions to identify productivity and fringe benefit cost containment initiatives that will produce savings of $223 million in FY 2003 and $600 million in each of FYs 2004-06.

Time is of the essence if the City is to avert a fiscal crisis. The City has taken an important first step by detailing a comprehensive plan and taking actions within its control to address its formidable budget gaps. It is crucial that early resolution be reached on the initiatives that require approval or agreement from other levels of government and the City's labor unions. This will ensure that these actions can be implemented in a timely manner to realize the full savings and that shortfalls can be identified at the earliest possible moment so that credible and viable alternatives can be crafted. In forging a solution to the current fiscal problems, the City must make every effort to balance the budget by ensuring that its growth in expenditures does not exceed its growth in revenues, placing the City on the road to structural balance.

Table 1. *November Modification:*
Four Year Financial Plan Revenues and Expenditures
Before Gap Closing Program

($ in millions)

	FY 2003	FY 2004	FY 2005	FY 2006
Revenues				
Taxes				
General Property Tax	$9,071	$9,340	$9,727	$10,135
Other Taxes[1]	13,306	13,913	14,879	15,858
Tax Audit Revenue	426	427	427	427
Miscellaneous Revenues	4,185	3,699	3,715	3,739
Transitional Finance Authority – 9/11	1,500	--	--	--
Unrestricted Intergovernmental Aid	790	580	555	555
Anticipated Intergovernmental Aid	230	--	--	--
Other Categorical Grants	678	411	407	414
Less: Intra-City Revenue	(1,108)	(1,045)	(1,045)	(1,044)
Disallowances Against Categorical Grants	(15)	(15)	(15)	(15)
Subtotal: City Funds	$29,063	$27,310	$28,650	$30,069
Inter-Fund Revenues	329	320	320	320
Total City Funds and Inter-Fund Revenues	$29,392	$27,630	$28,970	$30,389
Federal Categorical Grants	4,939	4,205	4,181	4,178
State Categorical Grants	8,333	8,316	8,402	8,469
Total Revenues	$42,664	$40,151	$41,553	$43,036
Expenditures				
Personal Services	$23,348	$24,333	$25,398	$26,576
Other Than Personal Services	18,469	18,408	18,759	19,118
Debt Service	2,028	3,261	3,447	3,687
MAC Debt Service	214	531	490	492
NYCTFA	586	823	1,040	1,027
General Reserve	200	200	200	200
Subtotal	$44,845	$47,556	$49,334	$51,100
Less: Intra-City Expenses	(1,108)	(1,045)	(1,045)	(1,044)
Total Expenditures	$43,737	$46,511	$48,289	$50,056
Gap To Be Closed	**($1,073)**	**($6,360)**	**($6,736)**	**($7,020)**
Gap-Closing Program	1,977	5,656	5,897	5,829
Increase General Reserve	(100)	(100)	(100)	(100)
Prepayments	(804)	804	--	--
Remaining Gap	**$--**	**$--**	**($939)**	**($1,291)**

1. Includes NYCTFA revenues

Table 2. *November Modification:*
Four Year Financial Plan Revenues and Expenditures
After Gap Closing Program

($ in millions)

	FY 2003	FY 2004	FY 2005	FY 2006
Revenues				
Taxes				
General Property Tax	$10,204	$11,675	$12,160	$12,670
Other Taxes[1]	13,306	14,926	15,563	16,097
Tax Audit Revenue	502	502	502	502
Miscellaneous Revenues	4,229	3,733	3,745	3,767
Transitional Finance Authority – 9/11	1,500	--	--	--
Unrestricted Intergovernmental Aid	790	580	555	555
Anticipated Intergovernmental Aid	230	--	--	--
Other Categorical Grants	716	447	430	431
Less: Intra-City Revenue	(1,104)	(1,037)	(1,034)	(1,033)
Disallowances Against Categorical Grants	(15)	(15)	(15)	(15)
Subtotal: City Funds	$30,358	$30,811	$31,906	$32,974
Inter-Fund Revenues	331	320	320	320
Total City Funds and Inter-Fund Revenues	$30,689	$31,131	$32,226	$33,294
Federal Categorical Grants	4,950	4,886	4,149	4,153
State Categorical Grants	8,296	8,547	8,637	8,706
Total Revenues	$43,935	$44,564	$45,012	$46,153
Expenditures				
Personal Services	$23,017	$23,158	$24,183	$25,367
Other Than Personal Services	18,154	18,373	17,600	17,754
Debt Service	1,964	2,947	3,372	3,537
Budget Stabilization Account & Prepayments	804	--	--	--
MAC Debt Service	214	--	490	492
NYCTFA	586	823	1,040	1,027
General Reserve	300	300	300	300
Subtotal	$45,039	$45,601	$46,985	$48,477
Less: Intra-City Expenses	(1,104)	(1,037)	(1,034)	(1,033)
Total Expenditures	$43,935	$44,564	$45,951	$47,444
Gap to Be Closed	**$--**	**$--**	**($939)**	**($1,291)**

1. Includes NYCTFA revenues

A MIXED ECONOMIC OUTLOOK

In 2002, the national economic record was mixed. The change in the real gross domestic product was positive during the first three quarters of 2002, but the National Bureau of Economic Research, the official arbiter of the turns in the business cycle, has not yet decided when the U.S. recession ended. Despite respectable GDP growth, job growth has been extremely weak, fueling negative sentiment among consumers and business investors. Corporate scandals, the soft stock market, and the possibility of war have also hurt consumer confidence.

In 2002, the City's economy not only suffered from the aftermath of the September 11th attacks, but was bombarded by the negative national economic and financial data. The City managed to clear the World Trade Center (WTC) site, but a hole remains in the heart of downtown Manhattan. A major transportation hub and at least 13 million square feet of class A space are still missing. The news of corporate scandals has hurt the stock market and created a liquidity crunch, which adversely impacted the securities industry, the City's most important economic engine.

In 2003, the national economy is expected to find more solid footing, as shown in Table 3. However, in case of a prolonged war with Iraq and pressures on the budget and prices, the Federal Reserve might raise the target Fed funds rate, which could create another recession.

Table 3. *Comptroller's Forecast of Five Key Indicators, NYC and U.S., 2003*

	Gross-Product Growth	Payroll-Job Growth	Wage-Rate Growth	Unemployment Rate	Inflation Rate
NYC	(GCP) –0.2%	-0.5%	1.2%	7.8%	2.8%
U.S.	(GDP) 2.6%	0.9%	3.3%	5.9%	2.1%

Source: NYC Comptroller's Office, based on data from the U.S. Depts. of Labor and Commerce.

In 2003, the City's economic slowdown is expected to continue, but at a much slower pace. Recovery is not expected until the second half of 2003. The City will be challenged by the need to rebuild lower Manhattan, restore confidence in Wall Street, and promote job growth while addressing a major budget gap.

THE U.S. ECONOMY

The key explanation for the behavior of the U.S. economy in 2002 is consumer caution, which has been keeping down the increase in consumer spending. Cautious investment sentiments are also keeping individuals from increasing their investment in the equity markets. Cautious corporate sentiment, which is based in part on corporate observation of consumer behavior, is keeping private investment low. One factor underlying consumer and corporate caution is the high level of debt and therefore illiquidity. Monetary policy has attempted to keep money easy and inexpensive, with record low interest rates, but lenders to consumers have kept the cost of consumer debt high and corporate lenders are cautious, putting a constraint on private investment.

Consumers are being rational in their cautiousness because jobs are not growing. National and local security is threatened and expectations of war are high, yet trust in government and business is weak. When consumer spending does not grow, it dampens corporate earnings and sentiment, which tends to lower corporate investment. A decline in corporate investment means fewer jobs, or even layoffs, which in a classic Keynesian cycle, in the next phase, reduces consumer spending.

The U.S. economy began 2002 on a strong note, with surprisingly strong first-quarter GDP growth. However, the biggest factors in GDP growth were higher government defense spending and changes in private inventories, while payroll jobs declined significantly. This jobless economic growth weakened consumer confidence.

The U.S. economy also grew in the second quarter, but at a much lower rate. Job losses continued. In addition, a sequence of disclosures destroyed the market values of Enron in March, of its accounting firm Arthur Andersen, and of other firms such as Global Crossing, Qwest, Adelphia, and WorldCom, the nation's second largest wireless company. The disclosures in many cases were swiftly followed by bankruptcy proceedings.

The stock markets responded with steep declines that meant great losses of personal wealth and wealth-related incomes. This in turn triggered a "negative wealth effect" as consumers' reduced wealth made them more cautious about spending. Lower consumer spending, which accounts for more than two-thirds of gross domestic product, affected businesses' willingness to invest.

Economic growth continued in the third quarter mostly because of consumer spending and government expenditure. Consumer spending was up predominantly because of strong auto sales, as consumer took advantage of low interest rates and manufacturing incentives. Finally, the target Fed funds rate was left alone until November, when the Federal Reserve cut it by 50 basis points.

Table 4. *Eight U.S. Indicators, Actual 2001 and Comptroller's Projections, 2002 and 2003*

	2001	2002	2003
1. GDP Growth, %	0.3	2.3	2.6
2. Jobs (millions), Change	0.2	-0.8	0.9
3. Inflation (CPI Change), %	2.8	1.6	2.1
4. Wage-Rate Growth, %	2.2	2.4	3.3
5. Unemployment Rate, %	4.8	5.8	5.9
6. Fed Funds Rate, %	3.9	1.7	1.5
7. 10-Yr T-Notes, %	5.0	4.6	4.6
8. 30-Yr T-Bonds, %	5.5	5.4	5.5

Source: NYC Comptroller's Office. Actual data are shown in 2001 column, and projections (averages for the year) are in the 2002 and 2003 columns.

Based on the above information, the Comptroller's Office predicts a slow economy during the fourth quarter of 2002 and the first quarter of 2003. However, starting in the second quarter of 2003, the economy is expected to rebound strongly. The risks to the national economy are the threat of an extended military action in Iraq and continued decline in financial markets.

Compared with forecasts for 2002 and 2003 by the Mayor and by the Federal Reserve Bank of Philadelphia's survey of professional forecasters, the Comptroller's outlook is less bullish, as shown on Table 5.

Table 5. *Percent Change in Real GDP, Inflation Rate, and Unemployment Rate, Projections, 2002 and 2003*

		GDP Growth		Change in CPI		Unemployment	
		2002	2003	2002	2003	2002	2003
1	Comptroller	2.3%	2.6%	1.6%	2.1%	5.8%	5.9%
2	Mayor	2.3%	3.0%	1.8%	3.1%	5.9%	5.9%
3	Federal Reserve Bank of Philadelphia	2.3%	3.0%	2.3%	2.3%	5.9%	5.7%

Source: Research Department, Federal Reserve Bank of Philadelphia, Survey of Professional Forecasters, third quarter 2002 (#3); and NYC Comptroller's Office (#1). CPI=Consumer Price Index.

THE NYC ECONOMY

The New York City economy, which the Comptroller's Office had expected to recover in the third or fourth quarter of 2002, remains mired in recession and may not fully recover until the second half of 2003.

Economic Performance in 2002

NYC is still struggling to recover from its recession, which began in the first quarter of 2001 and, as of the third quarter of 2002, has persisted for seven consecutive quarters. This is four quarters beyond what appears to have been the end of the national recession.

The devastating effects of the September 11th attacks have been compounded by shareholders' malaise resulting from the Enron, WorldCom and other corporate disasters. The City's recovery in the fourth quarter is not certain. The 11 cuts by the Federal Reserve in the target Federal funds rate in 2001 were expected to create a strong financial-market rebound and a rise in consumer spending. But financial markets have actually deteriorated because of the corporate scandals and because the threat of terrorism and possible military action in Iraq have dampened consumer spending.

The City managed to clean up the WTC site well ahead of schedule, but a large hole remains in the heart of downtown Manhattan, which is now missing a major transportation hub, more than 13 million square feet of Class A office space, and a thriving shopping and business center. Ten months into 2002, the City has realized only a fraction of expected compensation related to the September 11th attacks from insurance companies, charitable foundations, and Federal and state agencies.

Comptroller's NYC Forecast for 2003

NYC is still struggling to recover from the recession that began, like the nation's, in the first quarter of 2001. The destruction of the World Trade Center, followed by corporate accounting and disclosure scandals, prevented full recovery, and the City's economy is now not expected to show substantial growth until the second half of 2003.

The weakness in the City's economy stems from the low level of consumer and business sentiments. The Federal Reserve's cuts in the target interest rate to 1.25 percent have not yet succeeded in bringing NYC to recovery. NYC's economy is heavily dependent on the securities industry and depressed financial markets are a substantial drag on income growth. The City's problems could worsen as it addresses its budget gaps by raising taxes or laying off workers, with either alternative having negative economic effects. Finally, as shown in Table 6, the City's leading economic indicators are either weak or continued to deteriorate during the first ten months of 2002, a sign that the economic slowdown will persist.

Table 6. *Selected City Indicators, Actual 2001 and Forecasts, 2002-2003*

	2001	2002	2003
Real GCP, (1996 $), % Change, SAAR	(0.3)	(2.1)	(0.2)
Payroll Jobs (Annual Change), '000s	(20.9)	89.0	17.0
Consumer Price Index (1982=100), % Change	2.5	2.5	2.8
Wage-Rate Growth, %	3.1	(0.4)	1.2
Unemployment Rate, %	6.1	7.6	7.8

Source: NYC Comptroller's Office. GCP=Gross City Product. SAAR=Seasonally Adjusted Annual Rate.

Comptroller's Forecast vs. City's Forecast

The Comptroller's Office forecast for the NYC economy is slightly more negative than the City's. The main reason for the difference is that the Comptroller's Office expects budget-balancing tax increases at both the State and City level, as well as a continuing slow rate of growth in the national economy, to retard economic recovery as shown in Table 7.[2]

Table 7. *Comparison of Forecasts of Real GCP, Employment, and Inflation, 2002-2003*

	GCP Growth		Payroll Jobs		Change in CPI	
	2002	2003	2002	2003	2002	2003
NYC Comptroller's Office	-2.0%	-0.2%	-89.0	-17.0	2.5	2.8
The City of NY (OMB)	-2.5%	-0.5%	-83.0	-13.3	2.4	3.2

Source: NYC, November 2001 Plan and NYC Comptroller's Office. OMB=Office of Management and Budget.

[2] The data underlying the Comptroller's economic analysis may be found in the Appendix to this report beginning on Page 40.

THE CITY'S DAUNTING FISCAL OUTLOOK

The City's fiscal outlook has not improved significantly since budget adoption in June. Continuing softness in the economy, a lackluster stock market and the continuing effects from the terrorist attacks on September 11 have eroded the City's tax base. Consequently, the City was compelled to lower its FY 2003 revenue projections by $773 million in the current modification. At the same time, the estimate of City-funded expenditures has risen by $300 million, which together with the drop in revenues have opened an FY 2003 gap of $1.073 billion.

The recent passage of the 18.49 percent property tax rate increase will generate additional property tax revenues of $838 million in FY 2003. As Table 8 shows, the rate increase together with other agency gap-closing initiatives will enable the City not only to achieve FY 2003 budgetary balance but also to establish a budget stabilization account (BSA) of $509 million to prepay FY 2004 expenditures.

Table 8. *Changes to the City's FY 2003 Budget Projections November Modification Compared to Adopted Budget*

($ in millions)

City-Fund Revenues		City-Fund Expenditures	
Property Tax	$73	PS	$154
Non-Property Tax	(763)	OTPS	146
Non-Tax Revenues	(83)	Subtotal	$300
Subtotal	($773)		
18.49% Property Tax		Gap-Closing Initiative	($720)
Increase	$838	BSA and Prepayment	509
Other Gap-Closing		General Reserve	100
Initiative	124		
Total	**$189**	**Total**	**$189**

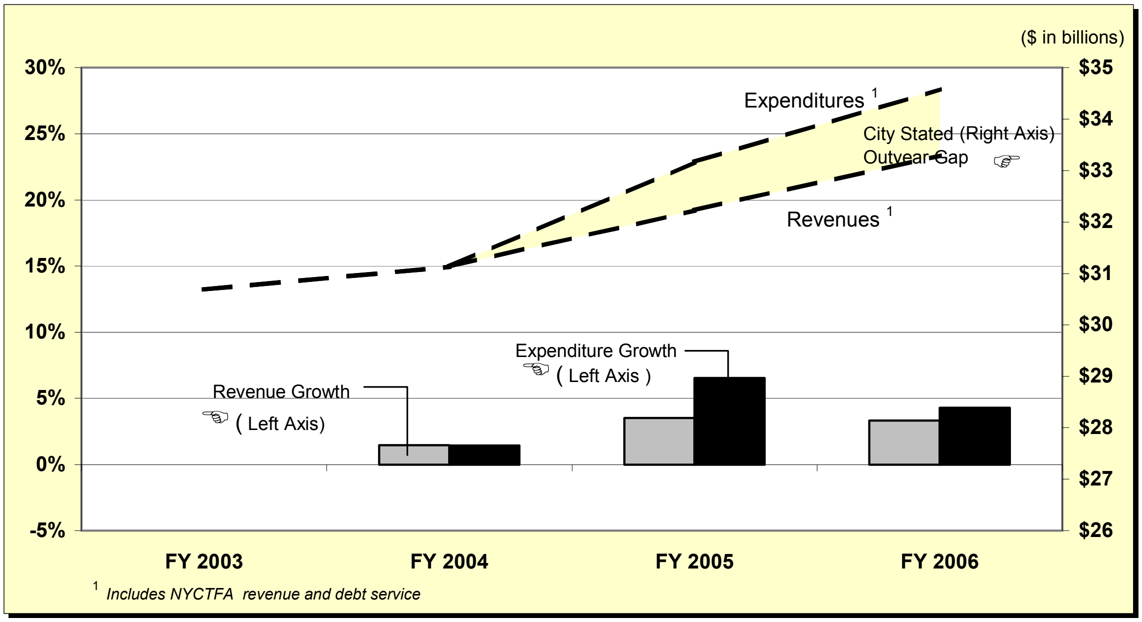
Includes NYCTFA revenue and debt service.

Next fiscal year's picture is even more challenging. With revenue estimates falling by $1.7 billion and expenditure projections rising by $927 million since budget adoption in June, the FY 2004 gap has widened by $2.63 billion to $6.36 billion. Similarly, declining revenues and escalating expenditures have expanded the outyear gaps to $6.74 billion and $7.02 billion in FYs 2005 and 2006.

Confronted with deficits of these magnitudes, the City has proposed a series of gap-closing initiatives beginning in FY 2003 to close the FY 2004 gap and substantially reduce the gaps in FYs 2005 through 2006. However, as shown in Chart 1, even if the City were to successfully implement the gap-closing program in its entirety, spending would continue to outpace revenues.[3]

[3] The large growth in FY 2005 expenditures shown on Chart 1 is due, in part, to a reduction in FY 2004 expenditures as a result of the anticipated prepayment, in FY 2003, of certain FY 2004 expenses.

Chart 1. City-Fund Revenue and Expenditure Growth and the Outyear Gaps



Tax Revenues

The City has lowered its economic assumptions since budget adoption in June with significant drops in the forecasts for Wall Street profits, GCP and jobs. As a result of the projected declines in Wall Street profits and capital gains, the City has reduced its forecasts for business taxes and personal income tax (PIT), bringing them in line with collection trends.

As the figure to the right shows, collection assumptions have been lowered by $693 million for FY 2003, $1.075 billion for FY 2004, $1.036 billion for FY 2005 and $892 million for FY 2006. The economically sensitive non-property taxes have been revised downward by $762 million in FY 2003, $1 billion in FY 2004 and FY 2005, and by $892 million in FY 2006.[4] PIT, business and sales taxes account for most of the lowered forecasts for non-property taxes. For FY 2003, some of this decline is offset by better

Changes in the City's Tax Revenue Forecasts
($ in millions)

Tax	FY 03	FY 04	FY 05	FY 06
Property	$69	$23	$4	$0
PIT	(336)	(585)	(607)	(630)
Business	(361)	(288)	(241)	(149)
Sales	(91)	(129)	(90)	(22)
Property-Related	64	(35)	(56)	(57)
Utility	(19)	(9)	(2)	5
Other	(19)	(52)	(44)	(39)
Total	**($693)**	**($1,075)**	**($1,036)**	**($892)**

4 Taxes net of refunds, audits and the School Tax Relief Program but including the portion of PIT set aside for New York City Transitional Finance Authority (NYCTFA). These figures exclude the revenue effect of the 18.49 percent increase in the property tax rate.

than expected performance from the real estate related mortgage recording (MRT), real property transfer (RPTT) and commercial rent (CRT) taxes as low interest rates continue to buoy the real estate market. The City expects interest rates to rise in the outyears and has lowered its forecast for these taxes to account for a slowdown in real estate activities resulting from the anticipated rate hikes.

The higher projections for property tax collections reflect lower forecasts for refunds and uncollectables and higher expected lien sales, rather than higher anticipated assessed values. The lower forecast for other taxes stems mainly from reduced cigarette and hotel-occupancy tax collections. Cigarette tax collections for FY 2003 have been coming in below plan as buyers seek alternate sources of cheaper cigarettes.

The City's lowered forecasts for tax-revenue collections in the November Modification reflect tax-collection trends. However, the Comptroller believes that the revised forecasts are too pessimistic overall. Thus, the Comptroller is expecting offsets ranging from $138 million in FY 2003 to $179 million in FY 2006, as shown in the figure to the right.

Risks and Offsets to the November Plan
($ in millions)

Tax	FY 2003	FY 2004	FY 2005	FY 2006
Property	$0	($169)	($149)	($98)
PIT	(118)	180	148	120
Business	218	161	180	168
Sales	4	(58)	(60)	(48)
Property-Related	45	41	45	47
Utility	11	11	12	12
Other	(22)	(22)	(23)	(24)
Total	**$138**	**$144**	**$153**	**$177**

Property Tax

The recent passage of an 18.49 percent increase in the property tax rate will yield increased collections of $838 million in FY 2003 and average $1.8 billion annually between FYs 2004 and 2006. It is likely that collections could fall further below the City's projections as the rate increase creates a higher incentive to challenge the tentative assessments that will be released in January. This is especially true for landlords and businesses whose assessments depend on income and expenses. Individuals may also be more diligent about seeking out exemptions and abatements that are available. The growth of property values has already begun to slow but the slowdown may accelerate if the tax increase affect jobs, business profits and assessed values. Manhattan's rental office market continues to be weak. Office vacancy rates continue to rise and asking rents continue to fall.[5]

Non-Property Tax

The Comptroller estimates that non-property tax revenues will be $138 million more in FY 2003 and an average of $300 million more in FYs 2004-06 than the City is projecting.

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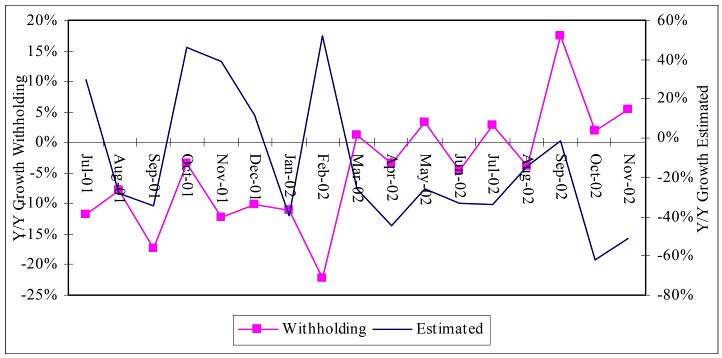
[5] NYC Comptroller's Office, "NYC Recession Persists into 7th Quarter," Third Quarter 2002 Economic Notes, November 2002.

Personal Income Tax (PIT)

Year-over-year comparisons of collections in the fourth quarter of 2002 have to be interpreted with caution because of extensions granted last year after the September 11th attacks. The two biggest components of PIT are withholding payments, which comes from wages and salaries, and estimated payments, which derives from capital gains. The withholding component of PIT was below the prior year's withholding for much of 2001. Towards the end of FY 2001, collections showed signs of recovery and hovered around the prior year's level until September when withholding surged to almost 20 percent over the prior year as shown in the figure to the right. Collections since September show a positive trend but this is likely the result of lower collections in 2001 because of extensions granted in the wake of September 11. In contrast, estimated payments in FY 2002 continue to fall below the prior year's level and are forecast to continue to deteriorate, as Wall Street's outlook remains bleak. Lackluster stock market performance will affect the bonus payment element of withholding. The City is projecting that PIT will grow 2.9 percent in FY 2003, 5.6 percent in FY 2004, and eight percent annually thereafter. The Comptroller is projecting flat growth for FY 2003, 12 percent growth for FY 2004 and seven percent growth annually thereafter based upon our assumptions of GCP growth.

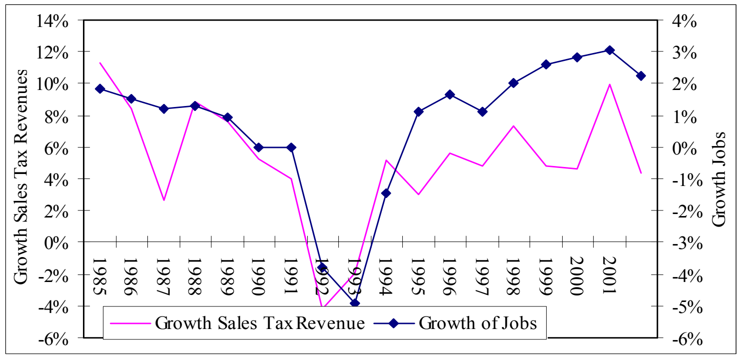


Business Taxes

As the performance of the corporate sector dims and outlook for Wall Street is scaled back, business taxes are contracting. Monthly collections as of October are $100 million below the June Financial Plan estimates. The general corporation tax (GCT) was 18 percent below plan, the banking corporation tax (BCT) was 32 percent below plan and the unincorporated business tax (UBT) was four percent below plan. As a result, the November Modification has reduced the anticipated annual collections for all years. Rising vacancy rates and falling asking rents affect even Midtown Manhattan, reflecting the mood of the corporate sector. The exposure of corporate accounting irregularities has forced many companies to restate their earnings and profitability. This impacts business tax revenues, investor confidence in these companies, and the companies' ability to raise capital for expansion. The corporate situation remains vulnerable even as the stock market shows weak signs of recovery. Investor confidence may still be fragile despite the passage of new laws governing corporate accountability. While the Comptroller has not lowered his forecasts for business tax revenues as much as the City, the City's more pessimistic projections are understandable.[6]

[6] The Comptroller's analysis is supported by the positive year-over-year growth in these taxes.

Sales Tax



As shown in the figure to the right, sales tax revenues are sensitive to jobs numbers and with the continued negative growth outlook for jobs into calendar 2003 sales tax revenues will remain weak into FY 2004. Early results from the Christmas shopping season indicated that sales are doing well.[7] However, auto sales, which were strong last year, show lackluster performance this holiday season. The Comptroller is expecting sales tax revenues to grow 3.8 percent in FY 2003 and stay flat in FY 2004 before growing by five percent in FYs 2005-06. The City forecasts growth of 3.7 percent in FY 2003, 2.6 percent in FY 2004, 5.3 percent in FY 2005 and 5.4 percent in FY 2006.

Real Estate Related Taxes

Bearish stock markets and low interest rates continue to buoy the real estate market and its related taxes. RPTT and MRT collections through October continue to do better than the City's expectations. RPTT is $75 million higher than expected and MRT is $50 million higher than projected. The CRT is $6 million above plan. The resiliency of these small taxes have been valuable in offsetting the drop in non-property tax revenues from the larger and economically sensitive PIT, business and sales taxes. As real estate activities begin to slow and interest rates are expected to rise, the City has lowered its forecasts for these taxes for FYs 2004-06. The City forecasts RPTT to grow 5.8 percent in FY 2003, decline 7.1 percent in FY 2004 and increase about seven percent annually thereafter. MRT is expected to decline by 13 percent in FY 2003 and 7.5 percent in FY 2004, and to grow thereafter. The Comptroller believes that these expectations are reasonable.

Other Taxes

The City reduced its forecast for this group mainly due to the cigarette and hotel-occupancy taxes. Cigarette tax collections are 16 percent below planned expectations through October. The City's cigarette tax base is probably contracting as consumers switch sales to out-of-state and Internet alternatives. This responsiveness or elasticity will likely increase with time.

[7] Wal-Mart reported record sales of $1.43 billion for the day after Thanksgiving. "Big Sales Draw Crowds, Not Big Gains for Retailer," *nytimes.com,* December 3, 2002.

The Tax Program

The Mayor has proposed two tax programs in the November Modification to help close the budget gap. One is raising the property tax rate and the other is to reform PIT. The Mayor proposed a 25 percent property tax rate increase effective January 2003. The City Council approved an 18.49 percent rate increase that moves the overall rate from 10.366 percent to 12.283 percent. This will yield the City additional revenues of $838 million in FY 2003, $1.7 billion in FY 2004, $1.8 billion in FY 2005 and $1.9 billion in FY 2006.

Miscellaneous Revenues

The City has lowered projections for miscellaneous revenues compared to the Adopted Budget assumptions by $134 million in FY 2003, $590 million in FY 2004, $286 million in FY 2005, and $18 million in FY 2006. These reductions are driven mainly by the elimination of various revenue initiatives whose outcomes were questionable. These include the proposed sale in FY 2004 of the Off-Track-Betting Corporation for $250 million and the expectation of higher rental income for JFK and LaGuardia airports of $170 million in FY 2003, $315 million in FY 2004, $280 million in FY 2005, and $35 million in FY 2006. The City expects to collect approximately $3.1 billion in miscellaneous revenues for FY 2003 from such sources as fees, fines, permits, and rents.

Miscellaneous revenues are projected to drop by more than $430 million in FY 2004 to just under $2.7 billion before recovering slightly and basically holding flat at slightly above $2.7 billion in FYs 2005 and 2006. More than half of the drop in FY 2004 can be traced to one-time revenue infusions of $297 million that do not occur beyond FY 2003. This includes $100 million from the potential sale of tax benefits and proceeds of $125 million from the State and TSASC as reimbursement for landfill closure cost. Additionally, residual tobacco settlement revenues are projected to decline by 64 percent, from $153 million to $56 million in FY 2004 and drop further in FYs 2005 and 2006 as a result of rising debt service costs.

Revenue expectations, except for the decline in revenues from the tobacco settlement, are in line with actual collections from past years. More than 60 percent of the revenues are attributable to the ten largest revenue generating initiatives, as Table 9 shows. Among these revenue sources are payment to the City from the Water Board for operations and maintenance and parking violation fines.

Table 9. *Ten Highest Revenue Generating Initiatives and Annual Projections, FYs 2003 to 2006*

($ in millions)

	FY 2003	FY 2004	FY 2005	FY 2006
Cable Television Franchises	$87	$87	$87	$87
CUNY Tuition & Fees	127	127	127	127
Parking Meters	79	85	88	88
Water Board Payment	775	742	741	740
Water Board Rental Income	111	127	148	166
Parking Violation Fines	428	448	447	447
Sale of Tax Benefits	100	0	0	0
Tobacco Settlement	153	56	29	32
Reimbursement of Landfill Cost	125	0	0	0
E-911 Surcharge	77	63	63	63
Total – Ten Highest Revenues	$2,062	$1,735	$1,730	$1,750
Total – Annual Projections	**$3,126**	**$2,695**	**$2,711**	**$2,733**

Intergovernmental Aid

The November Modification projects Federal and State categorical grants will reach $13.25 billion in FY 2003, showing an increase of about $530 million from the June Financial Plan estimate of $12.72 billion. The majority of the increase is attributable to a rollover of Federal funds from FY 2002 and the timing of certain WTC-related revenues.

For FY 2004, Federal and State aid projections have increased by $997 million to $13.43 billion in the November Modification, based on two major revenue initiatives. The City currently seeks one-time revenue of $700 million from the Federal government for implementing security and safety measures against further terrorist attacks. The funds will be dedicated for security enhancements, technology updates, and facilities upgrades for public safety agencies. The City also expects the State to contribute $275 million, on a recurring basis beginning in FY 2004, to support ongoing teacher salary costs for the extended school day associated with the recent teachers' contract. These costs are funded in FY 2003 through the Municipal Bond Bank financing and other categorical revenues, but no funding source has been identified beyond the current year. The City has indicated that both of these revenue proposals will not provide fiscal relief because they represent funding for dedicated programs. However, if the City fails to receive State funding for the extended school day, the Department of Education could face a potential risk in its budget.

In addition, the City anticipates $200 million in FY 2004 from regional transportation initiatives that, based on preliminary indications, could include East River bridge tolls and the MTA takeover of private bus lines. The City has also developed a menu of Federal and State agendas totaling $1.2 billion in proposed Federal actions and $719 million in proposed State actions for FY 2004, which it anticipates will yield $200 million in additional Federal assistance and $200 million in additional State assistance. Major proposals for Federal assistance include more flexible use of Federal grants dedicated for disaster prevention ($250 million), higher Federal Medicaid match ($492 million), funding provisions for drug benefits in the Medicare program ($145 million), and reimbursement for protection of foreign dignitaries ($80 million). The State portion of the program includes initiatives, such as Medicaid cost containment ($250 million), establishment of an early intervention pool to offset non-Medicaid eligible costs ($150 million), tort reform ($100 million), debt finance reform ($80 million), and increased authorization for taxi medallions ($65 million). While the City may receive additional assistance from the Federal and State governments, it is unclear if the new revenues and savings will take form in many of these proposed actions.

The November Modification anticipates these proposals to generate significantly higher revenues and savings in FY 2005 and FY 2006. The value of regional transportation proposals is projected to rise sharply to $600 million in FY 2005 and $800 million in FY 2006. Expected assistance from the Federal agenda will rise by $50 million to $450 million for both FY 2005 and FY 2006.

Expenditure Assumptions

The November Modification projects that expenditures will grow from $43.5 billion in FY 2003 to $47.1 billion in FY 2006.[8] As Table 10 shows, spending on personal services (PS) is expected to grow by $2.4 billion between FY 2003 and FY 2006 while other than personal services (OTPS) expenditures are projected to rise by $1.3 billion over the same period. Most of the growth in PS spending is fueled by escalating pension costs driven mainly by pension investment losses. Spending on wages and salaries is held relatively flat over the financial plan period as the City has not funded any wage increases for the new round of collective bargaining, which has already begun.[9] Growth in OTPS expenditures are driven mainly by debt service spending and rising Medicaid costs while spending on public assistance is projected to remain flat.

Table 10. *November Plan Expenditures*

($ in millions)

	FY 2003	FY 2004	FY 2005	FY 2006
PS				
Salaries and Wages	$16,286	$16,009	$15,990	$16,011
Fringe Benefits	4,329	4,047	4,412	4,693
Pensions	1,801	2,570	3,250	4,132
Total PS	$22,416	$22,627	$23,652	$24,836
OTPS				
Public Assistance	$2,217	$2,056	$2,063	$2,063
Medicaid	3,915	4,233	4,375	4,515
Debt Service[a]	3,419	4,619	4,893	5,081
Other OTPS	11,503	11,558	10,640	10,654
Total OTPS	$21,053	$22,466	$21,971	$22,312
Total Expenditures[b]	**$43,469**	**$45,093**	**$45,622**	**$47,148**

a. Includes NYCTFA debt service and adjusted for the effects of pre-payments.
b. Net of intra-City expenditures.

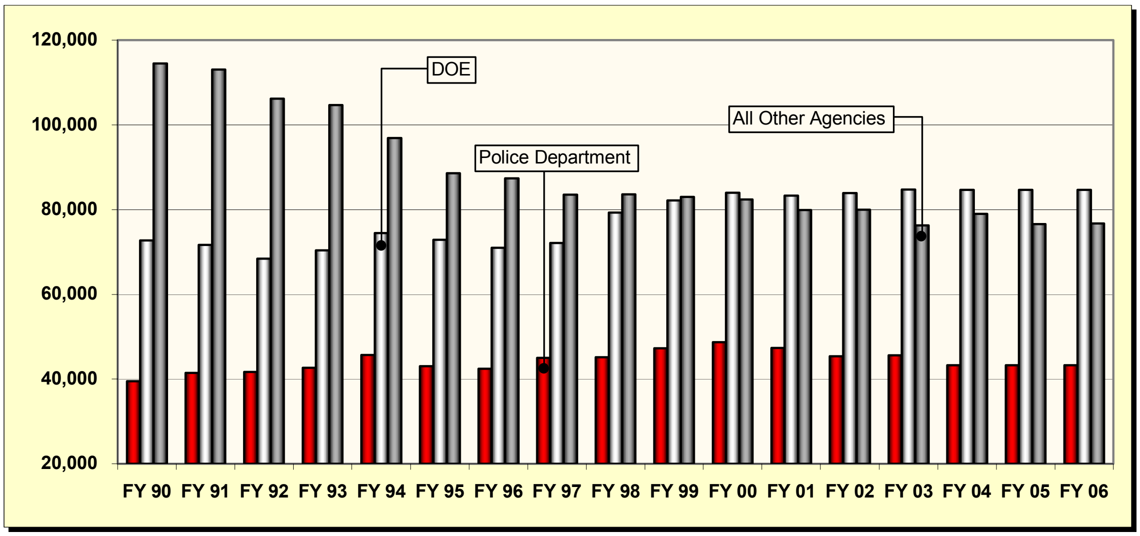
[8] Expenditures have been adjusted to include NYCTFA debt service and for the effect of the surplus roll.

[9] Almost all of the City's labor contracts expire in FY 2003. District Council 37, which represents the majority of the City's civilian workforce, has already begun negotiations with the City for a successor contract to the one which expired on June 30, 2002.

Headcount

As part of its effort to reduce the cost of personal services spending, the City implemented an early retirement program as well as a hiring freeze to reduce staffing levels. Compared to the Adopted Budget, the November Modification has reduced FY 2003 year-end City-funded full-time headcount by 5,615 employees, to 206,610. The City-funded headcount is expected to decline further in FY 2004 to 204,014.

Chart 2. City Funded Headcount



Source: Office of Management & Budget. FYs 2003-06 are projections assumed in the November Modification.

While the City has maintained that it has no immediate plans to lay off City employees, it nevertheless has not ruled out the potential for future layoffs if budget savings assumptions are not realized. However, as Chart 2 shows, City-funded headcount, excluding Police Department and Department of Education staff, has been significantly reduced over the past decade.

The last series of severance programs offered by the City in FY 1995 reduced the City-funded workforce by 11,654 employees. Excluding the Police Department and the Department of Education, staffing levels in all other agencies decreased by 8,965 employees. Following the severance program, the size of the City-funded workforce was held almost constant for two years, reaching a low of 200,664 in FY 1997.

However, as a closer examination of Chart 2 shows, all the growth in the workforce since FY 1997 can be attributed to additions in the Police Department and the Department of Education. Between FY 1997 and FY 2002, the full-time headcount in the Board of Education (now known as the Department of Education) and the Police Department grew by 11,800 and 386 employees, respectively. At the same time, the combined workforce of all other agencies shrank by 3,558 employees.[10]

[10] Total-funded headcount exhibited a similar trend. Excluding the Department of Education and the Police Department, total-fund headcount shrank by 2,795 between FYs 1997 and 2002.

It is evident that any workforce reduction program will necessarily entail some cuts in services. With staffing levels in all other agencies at an all time low, it will be difficult to achieve any substantial headcount reductions without personnel cuts in the Department of Education and the Police Department.

Early Retirement Program

The City's early retirement program, offered in August through October of this year, reduced the full-time headcount by about 4,000 employees. Consequently, total-funded headcount fell to 245,699 on October 31, 2002, while City-funded headcount dropped to 207,985 from 210,701 at the end of August. The Department of Social Services accounted for more than a quarter of the reduction, with 1,026 employees participating in the program. Of these, at least 33 percent (338 positions) were clerical titles, about 15 percent (153 positions) were caseworkers or welfare supervisory titles and 9 percent (97) were job opportunity specialists.

Early Retirement Program	
Agency	
DSS	1,026
Police (civilians)	415
ACS	355
DEP	277
Sanitation (civilians)	220
Transportation	199
HPD	149
Parks	142
Health/Mental Health	138
Fire (civilians)	122
DCAS	103
Homeless Services	99
Design/Construction	69
Probation	57

Uniformed Agencies

The City hired about 3,500 police officers between FYs 1997-2001 through the COPS Universal program.[11] Under the COPS program, the Federal government provided 75 percent of entry-level salaries for a three-year period. In return, the City was obligated to provide local funding for 25 percent of the salaries and for the entire salary amount for a year after the Federal funding ceased.[12] After the attacks on the WTC, however, the City sought and obtained three waivers. The first waiver allowed the City to staff the Department with 39,110 uniformed officers, significantly lower than the required 41,440 officers. This initiative saved the City $60 million in FY 2003. The second waiver affected the funding ratio for 500 officers hired in September 2000. The Federal government waived the 25 percent local funding requirement and now funds close to 95 percent of these officers' salaries. The third waiver the City expects to receive would reduce the required number of officers by another 1,900 officers for FY 2004, to 37,210. The two latter waivers are expected to save the City an estimated $74 million in FY 2004.

The hiring freeze and several personnel reduction initiatives, such as the delay in uniform recruitment classes for the Fire and Correction Departments, and the suspension

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[11] Under the Crime Bill of 1994, federal grants named Community Oriented Policing Services-COPS, became available to localities to hire officers and promote community policing. Localities failing to meet the requirements set forth in grants may be exposed to sanctions, including the suspension or revocation of current funding, rejection of pending grant applications, and exposure to other legal remedies.

[12] COPS-funded officers had to be maintained above the baseline level of officers. As a result, the City was required to maintain a peak level of officers for the duration of funding eligibility.

of the scheduled hiring of 466 civilians in the Police Department, is also assumed in the November Modification.

Overtime

As the City's workforce decreases, the City will have to ascertain whether some of the savings will be compromised by the need for additional overtime. The November Modification increased funding for FY 2003 overtime by $42 million, for a total of $610 million. The Fire Department increased its uniform overtime by $40 million and decreased its civilian-related overtime by $2.5 million. The Fire Department anticipates the need for more overtime expenditures from assessing current staffing levels, as well as from having cancelled 300 new recruits expected to start in FY 2003. The Police Department increased its uniform overtime by $20 million, mostly due to increases in salary base as a result of the recent collective bargainning settlement. The Department of Corrections (DOC) closed the Queens Detention Center in September and redeployed 182 positions. As a result of this, and other overtime cost initiatives, the DOC decreased its overtime projections by $14 million for FY 2003. The closing of the landfill in Staten Island provides an additional $1.5 million overtime savings for the Sanitation Department.

Given the unknown correlation between reduction in City personnel and the need for additional overtime, future overtime costs are difficult to predict. The City historically under-budgets overtime as a means to control spending, particularly in the uniformed agencies. If future labor negotiations require greater productivity from workers, the need for overtime may also diminish. As of December 20, 2002, the City had spent $328 million in actual non-WTC overtime in FY 2003. If current overtime spending patterns continue, actual overtime expenditure could be as high as $765 million, about $155 million more than the City's projection.

The City has accumulated almost $10 million of WTC related overtime for FY 2003. About 90 percent of this overtime was accrued by the Police Department for manning fixed posts created after the WTC attacks. The City anticipates to be reimbursed for this expenditure by the federal governement.

Pension Contributions

Projections of the costs of pension contributions have risen substantially since the Adopted Budget. The November 2002 Financial Plan anticipates that City-funded contributions to the five actuarial pension funds will more than double from $1.7 billion in FY 2003 to $4.1 billion in FY 2006. As Table 11 shows, most of the increases are due to greater investment losses in FY 2002 than anticipated at the time the FY 2003 Budget was adopted and a Court of Appeals decision which affirmed that teachers' "per session" earnings were pensionable. Also, with pension investments still suffering losses, the City expects FY 2003 pension investments to fall short of the actuarial interest rate assumption (AIRA) of eight percent. Accordingly, the City has added $475 million to pension contributions in FYs 2004 through 2006 to fund the expected shortfall.

Table 11. *Changes in Pension Contributions to the Actuarial Pension Systems*

($ in millions)

	FY 2003	FY 2004	FY 2005	FY 2006
Balance of FY 2002 Investment Losses	$4	$68	$176	$299
Teachers' "Per Session" Cost	100	100	100	100
Improved benefits & MISC	17	42	40	37
Early Retirement Cost	--	28	28	28
Savings From Headcount Reduction	--	(4)	(27)	(27)
FY 2003 Investment Return = Zero	--	50	150	275
Total	**$121**	**$284**	**$467**	**$712**

FY 2002 Pension Investment Losses

The City had made provision in the FY 2003 Adopted Budget for pension fund investment losses of three percent for FY 2002. Investments eventually lost approximately 8.3 percent during FY 2002 requiring further contributions beginning in FY 2003.[13] As shown on Table 11, the City has added a total of $547 million to the budget in FYs 2003 to 2006 to compensate for this greater loss.

Teachers' "Per Session" Earnings

The Court of Appeals of New York unanimously affirmed an order of the Appellate Division on October 22, 2002 making teachers' "per session earnings," from November 24, 1998 onwards, pensionable. While the City's liability is indisputable, some details have not been clarified yet. Also, since only the "per session pay" earned in the final year or the final three years prior to retirement would have an impact on pension benefits, the quantification of the liability will be based on actuarial assumptions.[14] Any quantification, however, is likely to be tentative because there is relatively little history of "per session" work, although it has increased rapidly in the last few years. However, it can be expected that teachers will now be more eager to do "per session" work in the years just before retirement to increase their pensions, so liabilities will be increased. Better estimates can be made in a few years when behavior patterns are established. For now, pending further estimates by the City's Chief Actuary, the City has increased its pension cost projections by $100 million in each year of the financial plan for this additional liability.

Following the active teachers' success in having "per session" earnings declared pensionable, Arnold H. Nager, a retired teacher, filed suit, individually and on behalf of retirees who left City service prior to November 24, 1998, against the Teachers' Retirement System and the City Comptroller to include "per session" earnings in computing their pension benefits.

[13] Please see Pages 12-13 of *The Comptroller's Comments on The Fiscal Year 2003 Adopted Budget* issued in July 2002 for more details.

[14] For Tier I members, pensions are based on the last year's earnings, whereas for other Tiers, generally, the average of the last three years' earnings or the highest three consecutive years' earnings are used. Therefore, only teachers who perform "per session" duties that are included in their final pension computation will benefit from this provision.

The City has not quantified any probable liability arising from this suit because the outcome of this suit is uncertain at this time. Moreover, the data on the retirees "per session earnings" are not readily available. The November Modification has not created any reserve for this purpose in its pension projections.

Early Retirement Cost

The City adopted an early retirement incentive program for non-pedagogical and non-uniformed employees. About 4,300 employees, including about 370 employees from the Department of Education, retired under the program between August and October, 2002. The City will have to pay the additional pension costs arising from the incentive over five years beginning in FY 2004. The City has included $28 million in each year, beginning in FY 2004, for this purpose.

FY 2003 Pension Investment Losses

The actuarial determination of pension contributions is based on pension investment returns from July 1 through June 30. Pension fund investments have lost about three percent from July 1, 2002 through the end of November, well short of the AIRA of eight percent. Since the City has to increase pension contributions to fund investment losses below the AIRA, the City has recognized that it will face additional pension costs from FY 2003 investment losses. As such, the City has added $475 million to pension contributions in FYs 2004 through 2006 in the November Modification based on the assumption that pension investments will realize zero percent return for FY 2003. This early action is prudent as it gives the City a headstart on funding potential pension investment losses.

Health Insurance

The City, excluding the Department of Education, has reduced its health insurance expense projections in the November Modification to $1.306 billion in FY 2003, $1.420 billion in FY 2004, $1.672 billion in FY 2005 and $1.842 billion in FY 2006.

The reductions of $15.4 million in FY 2003, $42 million in FY 2004, $44.1 million in FY 2005 and $45.6 million in FY 2006 reflect current and future headcount reductions and the correction of an overestimate made earlier on the number of retirees. The City's assumption in the FY 2003 Adopted Budget, that health insurance rates will increase eight percent annually after FY 2003, remains unchanged.

The November Modification's $42 million health insurance cost reduction in FY 2004 reflects coverage for approximately 7,550 fewer employees and retirees compared to the FY 2003 Adopted Budget projection.

Collective Bargaining

Since the FY 2003 Budget was adopted, the Patrolmen's Benevolent Association (PBA) and the Uniformed Firefighters Association (UFA) have reached contract agreements. The PBA's agreement is based on the decision made by the State Public Employment Relations Board (PERB). The UFA's agreement is patterned after the PBA's settlement and is currently awaiting ratification by its members. The twenty-four month agreement calls for a five percent wage increase on the first day of the contract, another five percent one year later, and an additional 1.5 percent for wage or benefit increases to be decided by the unions. Funding for these contracts, which will cost approximately $300 million annually, has been allocated in the labor reserve.

The vast majority of the City's labor contracts expire during this fiscal year. The November Modification contains no funding for any wage increases for employees beyond those negotiated in the last round of collective bargaining. The City has indicated that any wage increases will have to be funded through productivity initiatives. Every one percentage point increase will increase City-funded labor costs by about $200 million annually.

At the same time, the City is seeking $600 million in productivity savings beginning in FY 2004 to help close its budget gaps. While the City has begun preliminary discussions on the savings with the unions, no details on how the savings will be achieved have been laid out. The City has indicated that some options that may be considered are employee health insurance co-payments, pension cost containment, optimization of workforce deployment and extension of the work week. Because the City has projected full-year savings from this productivity initiative, a comprehensive plan to realize these savings must be developed and implemented by the start of FY 2004.

Judgments and Claims

Judgments and Claims (J&C) expenditures are expected to increase to $600 million in FY 2003, about 15 percent more than the amount spent in FY 2002. The FY 2002 spending was lower than anticipated because of the slow-down in claims processing following the WTC attacks. J&C expenditures are then projected to increase by ten percent to $658 million in FY 2004 and by five percent in each of FY 2005 and FY 2006 to $691 million and $728 million. These projections represent a net increase of $12 million in FY 2003 and $40 million each in FYs 2004 to 2006 since FY 2003 budget adoption. The funds were added to address higher costs than previously projected for resolving claims of $1 million or higher.

The City's projection of FY 2003 J&C expenditures seems reasonable at this time. Through October FY 2003, $152 million has been spent to resolve personal injury and property damage claims. This represents an average of $46,470 for resolving 3,279 claims compared with an average of $49,870 for the same period in FY 2002 to resolve 2,768 claims. In the last two fiscal years about 25 percent of the year's J&C costs were identified in the first four months. If the rate of claims being resolved in FY 2003 is similar, there should be little or no risk to the current projection of J&C expenditures for FY 2003.

In its gap-closing program, the City has included savings from tort reform of $100 million beginning in FY 2004. This initiative requires enabling State legislation. Similar legislation in the past has failed to gain the required approval.

WTC Claims

The City's budget contains no provisions for additional expenditures that could arise from WTC-related claims. Through mid-November 2,157 WTC-related claims valued at $12.2 billion were filed against the City. This does not include about 1,000 claims filed against the Port Authority. Most of the WTC-related claims resulted from personal injuries and were filed by uniformed personnel as shown in Table 12. The potential liability of WTC-related claims far exceeds the City's total liability of $350 million as provided for in the Aviation and Transportation Security Act (the Act) enacted in November 2001. It is unclear at this time how the claims will eventually be resolved.

Table 12. *WTC Related Claims Filed Against the City as of November 13, 2002*

($ in milions)

	Value of Claims Filed[1]	Number of Claims Filed	Average per Claim ($ thousand)
Claims Resulting From Personal Injuries			
Department of Sanitation	$366	100	$3.7
Fire Department	4,611	1,569	2.9
Police Department	548	116	4.7
Other	918	118	7.8
Sub-total	$6,443	$1,903	$3.3
Claims Resulting From Deaths			
Fire Department & Police Department	$500	34	$14.7
Other	3,529	200	17.6
Sub-total	$4,029	$234	$17.2
Other Claims			
Police Action	$352	9	$39.1
AEGIS Insurance / 7 WTC	814	2	407.0
Other Property Damage Claims	520	9	57.8
Sub-total	$1,686	$20	$84.3
TOTAL	**$12,158**	**$2,157**	**$5.6**

1. Does not include value amount for 816 claims where amount was not specified.

Source: NYC Law Department

The Victim Compensation Fund of 2001 (the Fund) was created by the Act to enable families of those who died or suffered physical injury during the WTC attacks to receive compensation for victims' lost wages and for pain and suffering. It was assumed that families of the victims would choose to file claims with the Fund given the advantages the program offered. First, the Fund gave them an alternative to the significant risk, expense and delay inherent in civil litigation, by offering swift, inexpensive and predictable resolution of claims. Second, awards made through the fund are free from federal taxes. To obtain compensation under the Fund, however, families are required to waive their rights to file a civil action or to be a party to a civil action in any Federal or State court of law for damages sustained as a result of the WTC attacks.

Under the regulations issued by the Fund, payment of such claims may be received within 4 1/2 months after filing.[15] While the Fund's website does not include

15 The Fund must come up with a compensation amount within 120 days of the filing of a completed claim. Assuming the claimant accepts the amount and a hearing is not requested, a check should be issued within 20 days thereafter.

information about the number of actual payments made up-to-date, it indicates that as of December 16, 2002, there were 850 claims filed with the Fund, of which only 16 percent (or 135 claimants) had received a letter containing information about their compensation award.

The City may be subjected to the liability of many of the WTC-related claims which the Fund was created to address, including about 1,800 respiratory related claims filed by uniform personnel who assisted in the clean-up and rescue efforts. In addition to the potential cost of awards, the City is also assuming the costs of filing, processing, and litigating such claims. Discouraged by the lengthy claims processing time of the Fund, families have opted to file suit against the City. However, a recent agreement approved by the Manhattan Supreme Court allows the City to freeze these claims and give the claimants the opportunity to file against the Fund. Claimants would not have to give up their right to sue the City if they are turned down by the Fund and will be able to recommence their claims against the City between November 3, 2003 and December 22, 2003.[16]

Public Assistance

Since posting the lowest caseload in over 35 years in September 2002, the City's welfare caseload has reversed course slightly. According to data compiled by the City, public assistance caseload fell to 421,783 recipients in September, and rebounded to 425,387 by November. The November caseload represents about 37 percent of the peak of 1,160,593 from March 1995. Monthly grant spending has similarly fallen by 61 percent from $247.8 million to $96.6 million over the same span.

In December 2001, as mandated by Federal law, the City began transferring Family Assistance (FA) recipients who reached a five-year lifetime limit in the program into the Safety Net Assistance (SNA) program. The law has had a dramatic impact on the composition of the City's welfare caseload. Prior to imposing the time limit, FA recipients made up about 83 percent of the City's welfare roll. The transfers have shifted 126,931 recipients that still remain on the welfare rolls, into the SNA-5 year category. The October caseload shows that about half of the public assistance recipients now receive benefits through the SNA program.

In the November Modification, the City has not revised the caseload and grant assumptions in the public assistance budget. While the October caseload is significantly below the City's projected caseload of 452,442, grant expenditures have not fallen to the degree as expected in the City's budget assumptions. Monthly grant expenditures continue to hover slightly below $100 million, despite a 9.3 percent decline in caseload since November 2001. The City's share of these grants is approaching between $37 million and $38 million per month, compared to budgeted allocations of about $36 million each month. At this rate, the City could face a risk of $15 million in its public assistance budget in FY 2003. For FYs 2004-2006, the City could face risks of about $25 million each year for underestimation of public assistance grant expenditures.

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[16] "9/11 Rescue Worker Lawsuits Frozen," www.nydailynews.com, December 14, 2002.

Medicaid

The November Modification projects City-funded Medicaid spending of $3.04 billion for FY 2003, excluding HHC, reflecting a net increase of about $21 million from the Adopted Budget estimate of $3.02 billion. Among the changes, the City has added $28 million in the November Modification for expected enrollment increases in the Family Health Plus (FHP) program. This increase is offset by proposed savings totaling about $7 million from State pre-approval for AIDS pharmaceuticals and enhanced Medicaid reimbursement for certain skilled services.

For FY 2004, the City has increased its share of Medicaid funding by $67 million to $3.34 billion, mostly for FHP enrollment increases. The City now estimates that FHP enrollment will increase from the November 2002 enrollment of about 60,000 to 94,000 by the end of 2003. According to the City, the State has estimated that a maximum of 115,000 recipients will likely join the program in New York City, and the November Modification has accounted for a majority of this potential population.

City-funded Medicaid spending for FY 2004, projected at $3.34 billion, represents an increase of 9.8 percent, or $297 million, from FY 2003 estimates. This increase is largely driven by expected spending growth in pharmaceuticals ($176 million), acute care ($41 million), outpatient services ($27 million), and long-term care ($21 million).

The City could face a potential risk of $60 million in each year of the plan due to additional expenditures for recipients that enrolled in the Medicaid program through the Disaster Relief Medicaid (DRM) program in 2002. According to the City, these expenditures have not been separately accounted for other than against the City's baseline Medicaid projections.

Similar to previous projections, the November Modification funding for Medicaid expenditures in FY 2005 and FY 2006 still lags the growth reflected in the first half of the plan. The November Modification projects City-funded Medicaid expenditures to rise to $3.46 billion in FY 2005 and $3.59 billion in FY 2006, reflecting much slower growth rates of 3.8 percent and 3.5 percent, respectively. These lower growth rate projections could pose risks of $75 million in FY 2005 and $147 million in FY 2006 to the City's Medicaid budget.

Department of Education

In the November Modification, the Department of Education (DOE) absorbed reductions totaling about $200 million in City funds for FY 2003. Compared to the June 2002 Financial Plan, these cuts are equivalent to about a five percent reduction in City funds allocated to the DOE, while most agencies sustained cuts of about nine percent in their City-funded budgets. Incrementally, the November Modification reductions represent an increase of $100 million in budget cuts from those already announced by the

DOE in July.[17] The DOE has indicated that these reductions will not affect core instructional programs in districts and high schools.

The PEG program for the DOE comprises an array of actions that are expected to provide the same level of savings in FY 2004 and beyond, at $200 million annually. These actions include reduced per capita allocations to districts and high schools ($41 million), decreased funding for summer programs ($37 million), information technology and procurement savings ($35 million), central administration and pension savings ($37 million), and charter school register surplus ($16 million).

These savings are offset by various revenues and new needs totaling almost $46 million. Thus, the projected DOE spending of $12.1 billion in FY 2004 reflects a net reduction of $154 million in total funds. Chief among these offsets are $20 million in pension reimbursement, $18 million in Federal reading grant, and $7 million in collective bargaining transfer for school safety officers.

In addition, the City seeks additional State aid of $275 million beginning in FY 2004 to provide continued funding for an extended school day. Under the current teachers' contract, effective this school year, the regular school day has been extended by an additional 20 minutes of instruction. The State has provided funding for the corresponding increase in teacher salaries for FY 2003, on a one-year basis, through the Municipal Bond Bank borrowing and other revenues. If the State fails to provide the necessary funding, the City's position is that DOE will need to fund this cost internally.

Health and Hospitals Corporation

The Health and Hospitals Corporation (HHC) completed FY 2002 with a cash balance of $340 million, the third highest in the history of its operations, thus enabling the Corporation to carry forward an opening cash balance into FY 2003.[18] The November Modification also shows improvement in HHC's revenue projections for FY 2003, reducing its projected operating deficit by $89 million since the June Financial Plan. The City currently projects, after the inclusion of revenue and savings actions, a closing balance of $269 million for HHC in FY 2003, reflecting an increase of about $55 million from the June projection.

In the November Modification, revenue projections for HHC have increased by $192 million in FY 2003. The main components of the revenue increase are additional Federal grants of $152 million, mainly for hospital conversion into managed care, and greater indigent care pool revenues of $45 million from recognition of certain prior year revenues.[19] The Corporation also projects greater revenues from its managed care programs, thereby increasing HHC's revenue assumptions by about $33 million. This increase, however, is more than offset by a $42 million decline in HHC's Medicaid fee-

[17] For technical reasons, $20 million of this reduction is reflected in the City's pension agency budget and $180 million in the DOE budget.

[18] Includes $95 million in a designated fund for the Corporation's ongoing and future infrastructure improvements, equipment, and technological needs.

[19] The Corporation has changed the presentation of certain grant revenues in the November Modification that also increases disbursements by corresponding amounts in the form of reimbursable expenses. This change, however, does not have a net impact on the Corporation's revenue and expenditure projections.

for-service estimate. Meanwhile, the City expects HHC disbursements to rise by $103 million, largely reflecting certain reimbursable expenses and collective bargaining increases for nurses. Overall, the November Modification adjustments provide a net increase of $55 million to HHC's projected ending cash balance, after accounting for reduced savings of $35 million in its gap closing actions. Thus, it appears that HHC will likely remain in good financial shape through FY 2003.

The outlook for FY 2004 is less certain. The City now projects HHC will end FY 2004 with a cash balance of $316 million, an increase of $122 million from the June projection of $194 million. However, much of this increase comes from a higher opening cash balance ($55 million) and greater reliance on gap-closing actions ($50 million). To reach this target, HHC may need to rely on gap-closing actions totaling $275 million in FY 2004. Only a small portion of HHC's higher year-end cash balance for FY 2004 stems from improvement in its operating results. While the November Modification projects a $151 million increase in HHC revenues, projected disbursements are expected to rise by about $135 million. Thus, HHC still faces a projected operating deficit of $228 million, a small improvement of $16 million from the June projection of $244 million. HHC's gap-closing actions are largely unspecified at the present time.

Over the remainder of the financial plan period, the City projects that HHC will need to deal with operating deficits of $413 million in FY 2005 and $500 million in FY 2006. The widening gaps are a result of spending growth exceeding 7.3 percent over these two years, compared with revenue growth of only 1.1 percent. To achieve projected year-end cash balances of $253 million in FY 2005 and $127 million in FY 2006, the Corporation is counting heavily on gap-closing actions totaling $350 million and $375 million in these years, respectively. While HHC will likely face significant gaps in these years, the difference between spending and revenue growth is likely overstated because Medicaid revenues are basically held flat over this period in the November Modification.

Debt Service

The November Modification projects debt service costs, adjusted for current and prior-year prepayments, will total $3.53 billion in FY 2003, $4.74 billion in FY 2004, $5.10 billion in FY 2005, and $5.26 billion in FY 2006.[20] Compared with the June Financial Plan, these estimates represent decreases of $164 million in FY 2003, $44 million in FY 2004, $58 million in FY 2005, and $185 million in FY 2006.

General Obligation and Lease-Purchase Debt

As shown in Table 13, General Obligation (GO) and lease-purchase debt service are projected to total $2.63 billion in FY 2003, $3.22 billion in FY 2004, $3.37 billion in FY 2005, and $3.54 billion in FY 2006. Of these amounts lease-purchase debt service is estimated to be $171 million in FY 2003, $201 million in FY 2004, $215 million in FY 2005, and $268 million in FY 2006.

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[20] This number includes debt service for GO, NYCTFA, TSASC and MAC debt. It also includes interest on short-term notes and lease-purchase debt service, and excludes debt service of the Water Finance Authority.

Table 13. *G.O. Debt Service Reconciliation, June 2002 to November 2002*

($ in millions)

Description	FY 2003	FY 2004	FY 2005	FY 2006
Adopted Budget [1]	$2,744.6	$3,260.1	$3,439.1	$3,698.3
Increase / (Decrease)				
Baseline and Projected Debt Service[2]	($41.9)	$13.9	$38.3	$49.4
Interest Savings on Short-Term Debt (RAN's)	(53.1)	--	--	--
Savings from Future Refundings and Capital Budget Reductions [2]		(25.0)	(75.4)	(150.4)
Savings from Lease-Purchase Debt Service[2]	(3.0)	(10.3)	(35.6)	(71.3)
Savings from Lowered LOC Fees[2]	(12.2)	(10.0)	(11.1)	(12.3)
Changes in Variable Rate Assumptions[2]	(8.4)	(7.1)	16.5	24.8
Rounding and Other	0.8	(1.5)	0.0	(1.1)
Total Increase / (Decrease)	($117.8)	($40.0)	($67.3)	($160.9)
November Plan Net of Prepayments[1]	$2,626.8	$3,220.1	$3,371.8	$3,537.4

1. Net of prepayments
2. City estimates

Note: Positive Numbers are a cost, negative numbers are savings.

As depicted in Table 13, these projected debt-service expenditures represent decreases of $117.8 million in FY 2003, $40 million in FY 2004, $67.3 million in FY 2005, and $160.9 million in FY 2006 compared with the FY 2003 Adopted Budget and FYs 2003-2006 Financial Plan.

Changes in baseline debt-service and projected debt service are the result of three major factors:

1) $24 million in lower than expected savings in FY 2003 from G.O. refunding Series 2003 A & B
2) $64.1 million of actual unplanned savings from G.O. refunding Series 2003 C, D, & E reflected in the plan in FY 2003 along with $16 million in FY 2004
3) an increase in anticipated G.O. borrowing. The increase in borrowing of $200 million in the second-half of FY 2003, $360 million in FY 2004, and $220 million in FY 2006, all contribute to estimated debt-service increases of $30.5 million in FY 2004, $38.3 million in FY 2005, and $49.4 million in FY 2006.[21]

Significant savings of $53.1 million have been realized in FY 2003 from lower than anticipated Revenue Anticipation Note (RAN) interest costs of $11.9 million compared with the Adopted Budget amount of $65 million.

The November Modification contains estimated savings from future refundings and other actions of $25 million in FY 2004, $75 million in FY 2005, and $150 million in FY 2006. The City expects that these savings will come from either future refundings and/or reduced capital borrowing from current estimates.

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[21] The increase in borrowing reflects the use of the capital plan and related capital cash flow estimates as of the September 2002 Capital Commitment Plan. The capital plan reductions are scheduled to be implemented in the January 2003 Plan.

Estimated savings from lease-purchase debt sum to $3 million in FY 2003, growing to $10.3 million in FY 2004, $35.6 million in FY 2005, and $71.3 million in FY 2006. These decreases are primarily related to delays in the New York Stock Exchange project and DASNY courts projects.

The November Modification also includes savings from lowered letter of credit (LOC) and remarketing fees in the amount of $12.2 million in FY 2003, $10 million in FY 2004, $11.1 million in FY 2005, and $12.3 million in FY 2006. The City's reevaluation of its LOC and remarketing fee baseline led to these savings. Changes in variable rate assumptions from new and existing issues result in estimated savings of $8.4 million in FY 2003, $7.1 million in FY 2004, with increases of $16.5 million in FY 2005, and $24.8 million in FY 2006.

New York City Transitional Finance Authority

The New York City Transitional Finance Authority (NYCTFA) projects debt service costs of $586 million in FY 2003, $823.3 million in FY 2004, $1.04 billion in FY 2005, and $1.03 billion in FY 2006. These amounts represent an increase of $7.8 million in FY 2003, a decrease of $45.2 million in FY 2004, an increase of $9.1 million in FY 2005, and a decrease of $23.8 million in FY 2006 compared to the Adopted Budget and the FYs 2003-2006 Financial Plan.

The increase of $7.8 million in FY 2003 is comprised primarily of three decreases offset by one increase. These include:

1) $10 million in greater than anticipated refunding savings
2) $10.7 million in increased variable rate demand bonds (VRDB's) savings on existing VRDB debt outstanding
3) $5.6 million in lowered bond anticipation note (BAN) interest costs
4) a $33 million increase resulting from incorporating actual NYCTFA Recovery Bonds debt service into the plan.

The decrease of $45.2 million in FY 2004 is attributable to greater than anticipated refunding savings of $20 million, $10.2 million in increased VRDB savings, $8.9 million in savings from Recovery Bond debt-service re-estimates, and $6.2 million in lowered BAN interest costs.

The increase of $9.1 million in FY 2005 comes primarily from Recovery Bond debt-service re-estimates of $13.9 million offset by $4.6 million in VRDB savings. Similarly in FY 2006, the $23.8 million forecast decrease is from $19.7 million in savings from Recovery Bond debt-service re-estimates, and $4.6 million in VRDB savings.

TSASC

TSASC's debt is secured by tobacco-settlement revenues. The November Modification contains net debt-service costs of $104.5 million in FY 2003, $169.4 million in FY 2004, $198.9 million in FY 2005, and $200.1 million in FY 2006. This represents a decrease of $13.3 million in FY 2003, a slight increase of $355,000 in FY

2004, and negligible changes in FYs 2005 and 2006 from the FY 2003 Adopted Budget and FYs 2003-2006 Financial Plan estimates.

TSASC is the City's most expensive source of financing. Although secondary market rate information related to TSASC is scarce, a bond sale in July 2002 produced yields that were approximately 50 basis points higher than G.O. bonds with a twenty-year maturity.

Municipal Assistance Corporation

The November Modification assumes appropriations for Municipal Assistance Corporation (MAC) debt service to be $744.5 million in FY 2003, zero in FY 2004, $490.4 million in FY 2005, and $491.9 million in FY 2006. These estimates represents a net increase of $489.2 million in FY 2003, a net decrease of $489.2 million in FY 2004, and no changes in FYs 2005 and 2006 compared to the FY 2003 Adopted Budget and Financial Plan.

The receipt of a premium from the liquidation of debt-service reserves reduces MAC costs by $41.3 million in FY 2003 but increases MAC costs by a like amount in FY 2004. The use of the reserves provides a one-time benefit in FY 2003 but is assumed to be paid back in FY 2004. In addition to the debt service reserve action, there is a planned FY 2003 prepayment of FY 2004 debt service in the amount of $530.5 million which reduces MAC costs to zero in FY 2004. The Municipal Assistance Corporation (MAC) will pay off the last of its debt on July 1, 2008.

Capital Plan Assumptions

Although the November Modification includes assumed debt-service savings related to reductions in the Capital Plan, agency by agency capital program reductions have not been assigned. These savings have only been broadly incorporated in the debt service budget. We expect to see the details of the capital reduction program in the January Capital Plan.[22]

Financing Plan

The Financing Program in November Modification totals $24.9 billion between FYs 2003 and 2006 as shown in Table 14. This represents a net increase of $904 million compared to the Adopted Budget. About $11.8 billion of G.O. bonds are scheduled to be issued between FYs 2003-2006, followed by $7 billion in Water Finance Authority bonds, $2.66 billion in NYCTFA bonds, $1.91 billion in TSASC debt, and $1.4 billion in

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[22] In early December, $841 million in spending authority for capital funds was freed up from inactive City capital contracts. This could lead to the issuance of fewer G.O. bonds – about $580 million – over the next five years. The Comptroller required City agencies to perform an extensive review of encumbered capital expenses, an examination that detected nearly $1.2 billion in spending authority earmarked for construction and other capital projects which had been dormant for more than two years. More than two-thirds of the spending authority was found not to be needed for these projects. If future spending saved by this action is used to reduce the City's debt, the Comptroller projects savings of $2.7 million in FY 2003, $10.2 million in FY 2004, and $21 million in FY 2005. By FY 2008, the City can expect to save $49 million annually until FY 2020. The total savings of $1.24 billion will be spread out over 35 years.

Courts and HHC related DASNY debt. The relative shares have remained fairly constant since the April 2002 Modification.

Table 14. *FYs 2003-2006 Financing Program Comparisons Adopted Budget versus November Modification*

($ in millions)

	Adopted Budget	November Modification	Change	% of Nov. Plan
G.O. Bonds	$11,020	$11,800	$780	47.6%
Water Finance Authority Bonds[1]	7,014	7,040	26	28.4%
NYCTFA	2,655	2,655	--	10.7%
TSASC	1,913	1,913	--	7.7%
DASNY and Other Conduit Debt	1,300	1,398	98	5.6%
Total	$23,902	$24,806	$904	100.0%

[1] Water Finance Authority bonds are fully paid from non-City sources and thus do not directly impact the City's tax-levy funding sources.

Debt Burden

Debt service in the November Modification remains high. At $3.53 billion in FY 2003, it is projected to grow to $5.26 billion by FY 2006.[23] With a growth rate of 14.2 percent during the financial plan period, the rate of debt-service growth will outpace tax-revenue growth of 6.7 percent by an average of 7.5 percentage points per year.[24]

This disparity in growth rates is depicted in Chart 3 as debt service as a percent of tax revenues, estimated at 14.7 percent in FY 2003, grows to 17.8 percent by FY 2006.

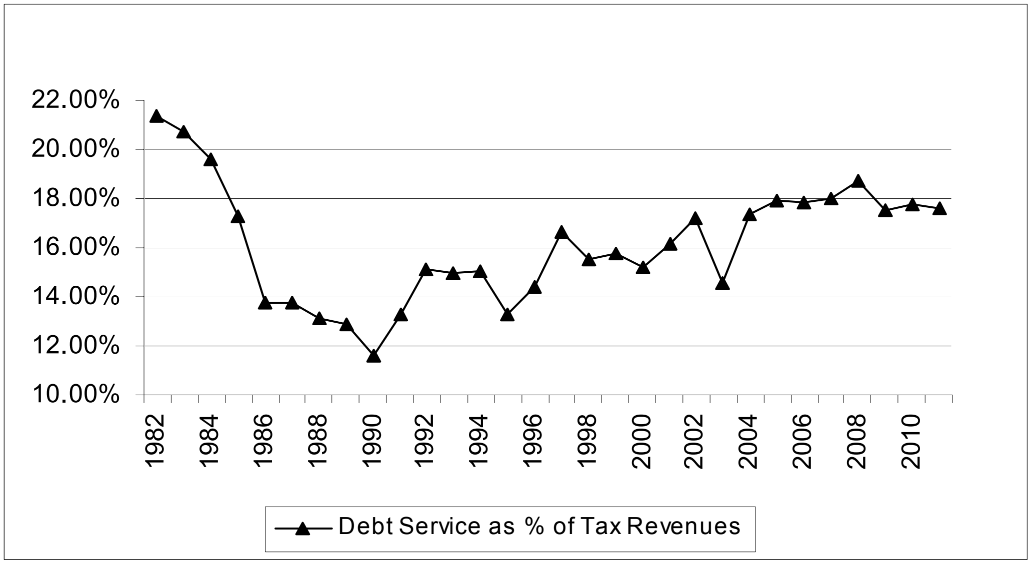
In the fiscal years beyond FY 2006, the percent stabilizes at about 18 percent assuming the new tax package takes effect through FY 2006 followed by an assumed annual tax revenue growth rate of four percent.

For a more detailed discussion of the City's debt burden, see the "*FY 2003 Annual Report of the Comptroller on Capital Debt and Obligations*" released on December 4, 2002, which may be found on the Comptroller's website, www.comptroller.nyc.gov

[23] Debt service includes GO, NYCTFA, TSASC, MAC, and Samurai bonds, along with lease-purchase debt service and interest on short-term notes.

[24] Tax revenues, as projected in the November Modification, including Tobacco revenues and NYCTFA PIT revenues.

Chart 3. Debt Service as a Percent of Tax Revenues, FYs 1982-2011



Source: Office of Management and Budget, *November Financial Plan*, November 2002 & New York City Office of Comptroller, *Comprehensive Annual Financial Reports*, 1982-2002

ADDRESSING THE PROBLEM

While there are some differences between the Comptroller's baseline revenue and expenditure estimates and the City's assumptions, overall, the City has done a credible job in its estimates of the budget gaps it must resolve. It has put together a comprehensive gap-closing program to address these gaps. As expected, given the magnitude of the gaps, the City has to count on the assistance and cooperation of other levels of government and the labor unions to address the fiscal crisis. The need for cooperation and assistance is reflected in the gap-closing programs where more than eighty percent of the fiscal relief in FY 2004 are found in initiatives that require the approval or cooperation of other levels of government and the City's labor unions.

Review of Risk Analysis

The Comptroller's Comments on the Fiscal Year 2003 Adopted Budget identified risks totaling $1.09 billion in FY 2003. Since the budget was adopted in June, the City has revised its revenue and spending assumption. The current modification recognizes a gap of $1.07 billion in FY 2003 relative to the Adopted Budget. While the City has addressed many of our concerns regarding its baseline revenue and expenditure assumptions, analysis of the current modification indicates that $545 million of risks still remain in the City's baseline estimates. Even so, it is likely that the City will end FY 2003 in balance as additional gap-closing initiatives in the November Modification have enabled the City to establish a BSA of $509 million as well as expand its general reserve to $300 million. These funds together with an as yet unrealized prior-year adjustment provide a comfortable cushion against shortfalls in the City's budget estimates. Table 15 shows the changes in the Comptroller's assessment.

The remaining risks stem mainly from the City's expenditure estimates. The Comptroller's risk assessment of the fringe benefit cost containment initiative has been reduced by $29 million to reflect the lower savings assumed by the City. At the same time, the risk assessment for PA has been reduced from $28 million to $15 million to reflect year-to-date spending. In addition, because the City has added funding to reflect both the full impact of FY 2002 investment losses and the pension cost of the teachers' "per session" earnings lawsuit, we have eliminated our risk for pension expenditures.[25] We have also increased our overtime risk assessment by $10 million as overtime spending trend indicates that overtime spending for the year may be $155 million above the City's estimate. Failure by the City to accurately account for additional expenditures for recipients enrolled in Disaster Relief Medicaid program in 2002 presents a new risk of $60 million.

In contrast, the Comptroller's risk assessment of the City's revenue estimates shows an offset of $138 million. As discussed in "Tax Revenues " beginning on page 8, the Comptroller believes that the City's tax revenue forecasts are too pessimistic. We have also eliminated our risk on airport rent and miscellaneous revenue as the City has

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[25] The teachers' "per session" issue is discussed beginning on Page 18.

removed its assumption of increased revenues from renegotiations of Port Authority and Metrotech leases.

Table 15. *Risks to FY 2003 Budget*

($ in millions)

	Adopted Budget	November Modification	Changes
Baseline Assessment			
Personal Income Tax	($43)	($118)	($75)
Other Taxes	($109)	$256	$365
Airport Rent	($175)	$0	$175
Other Miscellaneous Revenues	($35)	$0	$35
Overtime	($145)	($155)	($10)
Fringe Benefit Cost Containment	($252)	($223)	$29
Public Assistance	($28)	($15)	$13
Disaster Relief Medicaid	$0	($60)	($60)
Pension Cost	($73)	$0	$73
Subtotal	($860)	($315)	$545
State and Federal Aid			
Anticipated Federal Actions	($230)	($230)	$0
Subtotal	($230)	($230)	$0
Total Risk	**$(1,090)**	**($545)**	**$545**

The City, to its credit has presented a credible estimate of the budget gaps in its November Modification. The City has put together a comprehensive gap-closing program containing heavy reliance on the approval, cooperation and assistance of the State and Federal governments as well as the labor unions. The eventual implementation and realization of these gap-closing initiatives and their subsequent impact on the budget gaps hinge on the actions of these other levels of government and the City's labor unions. As such, risks assessment of these initiatives at this point is fraught with uncertainty as they must center around not only the decisions to approve the initiatives but also on the eventual form that the gap-closing actions will take as well as any alternative solutions. The City has taken an important first step in addressing the budget gaps early. The risk to the budget lies not so much in securing the approval for all these initiatives but in early resolution of the proposals so that shortfalls can be identified and alternative solutions crafted in a timely manner.

Gap Closing Program

Acknowledging a $1.1 billion FY 2003 gap and a $6.4 billion FY 2004 deficit, the City has taken the unprecedented measure of addressing next year's deficit in the November Modification. Coming on the heels of the $5 billion program to eliminate the gap (PEG) in the Adopted Budget, the City has put together another $1.682 billion in PEGs for FY 2003. This helps the City not only to achieve budgetary balance but also to get a head start on closing the $6.4 billion FY 2004 gap.

In an encouraging departure from its previous practice of heavy reliance on one-shots to close the budget gap, less than $100 million of the $1.7 billion FY 2003 gap-closing action in the November Modification are non-recurring actions. As Table 16 shows the remaining PEGs of almost $1.6 billion generate fiscal relief in excess of $2.5 billion in each of FYs 2004 through 2006. This enables the City to address the $6.4 billion FY 2004 gap with a $2.5 billion gap-closing program. The FY 2004 gap-closing initiatives, together with recurring gains of $2.6 billion from FY 2003 gap closing actions and an FY 2003 prepayment of $509 million prepayment have reduced the FY 2004 gap to $903 million.

Table 16. *The City's Gap-Closing Program*

($ in millions)

	FY 2003	FY 2004	FY 2005	FY 2006
Recurring Actions				
FY 2003 PEGS				
FY 2003 18.49 % Mid-Year Property Tax Increase	$838	$1,727	$1,799	$1,875
Agency Initiatives	752	847	775	772
Subtotal	$1,590	$2,574	$2,574	$2,647
FY 2004 PEGs				
Restructure PIT	$--	$1,013	$684	$239
Regional Transportation Initiatives	--	200	600	800
Other State Actions	--	200	200	200
Federal Actions	--	200	250	250
Labor Productivity	--	600	600	600
Agency Initiatives	--	243	355	433
Subtotal	$--	$2,456	$2,689	$2,522
Total Recurring Actions	**$1,590**	**$5,030**	**$5,263**	**$5,169**
Non-Recurring Actions				
FY 2003 Agency Initiatives	$92	$-	$-	$-
FY 2004 Agency Initiatives	-	18	-	-
Total Non-Recurring Actions	**$92**	**$18**	**$-**	**$-**
Total Gap-Closing Program	**$1,682**	**$5,048**	**$5,263**	**$5,169**

A significant portion of the FY 2004 gap-closing program relies on actions outside the Mayor's control. The largest gap-closing actions require the cooperation or approval of other levels of government and the City's labor unions. The outcomes of the PEGs rest upon the State, Federal and labor union actions as well as the support of the City Council. Table 17 shows the major initiatives in this category and the actions that are needed for the implementation of these initiatives.

Table 17. *PEG Initiatives Requiring Approval*

($ in millions)

PEG Initiative	**FY 2004 Relief**	Actions Needed
Restructure PIT	$1,013	State Legislature Approval
Regional Transportation Initiatives	$ 200	State Legislature Approval
Other State Actions	$ 200	State Legislature Approval
Federal Actions	$ 200	Federal Legislative Approval
Labor Productivity	$ 600	City/Union Negotiation and Agreement

A key element within the gap-closing program was the proposal for a mid-year 25 percent increase in the property tax rate that will generate budgetary relief of $1.1 billion in FY 2003 and more than $2.3 billion in each of FYs 2004 through 2006. The City Council recently approved a property tax rate increase of 18.49 percent, almost three-quarters of the rate hike the Mayor was seeking. However, the City is faced with a shortfall of $295 million in FY 2003 and $608 million in FY 2004 from this initiative. The loss of $295 million in FY 2003 prepayment coupled with the $608 million shortfall in expected revenue from the property tax rate increase has opened a $903 million gap in FY 2004.

Another major initiative is the proposal to restructure the PIT whereby the top rate of the PIT will be lowered to 2.75 percent and requiring non-City residents who work in the City to pay the same tax as City residents. This initiative is expected to net the City $1 billion in FY 2004 before declining to $239 million by FY 2006 as the top rate is ratcheted down to 2.25 percent.

The regional transportation initiatives are expected to generate revenues of $200 million beginning in FY 2004 and growing to $800 million by FY 2006. Among the proposals included in these initiatives are the proposal to toll the East River bridges and transferring the operational and financial responsibility of the City's private bus system to the MTA.

To achieve the $200 million in State as well as Federal actions, the City has assembled a menu of State and Federal initiatives totaling $719 million and $310 million respectively, as shown in Table A1 of the Appendix. These proposals will not result in any additional outlay by the State or Federal government. The City is also negotiating with the labor unions on productivity gains of $600 million.

In addition, the City has two major revenue initiatives yielding $975 million in FY 2004 and $275 million in the outyears in its PEGs. These two initiatives provide no fiscal relief as the revenues are to fund dedicated expenditures. The first initiative seeks State contribution of $275 million on a recurring basis to fund ongoing teacher's salary cost for the extended school day. It is expected that, should the City fail to realize this initiative, the Department of Education will make up the shortfall either through other funding sources or spending cuts. The second initiative seeks a one-time revenue grant of $700 million in FY 2004 from the Federal government to fund implementation of security and safety measures against future terrorist attacks.

The City Council's recent action underscores the importance of resolving expeditiously the gap-closing actions that are not in the Mayor's control so that any shortfalls can be identified at the earliest time possible. Because the shortfall from the property tax rate increase has been identified, the City has more than half a year to craft a credible and feasible solution to close the gap opened by the shortfall. In analyzing the FY 2004 PEGs in Table 16, it is evident that most of the gap-closing initiatives that require the cooperation of the State and Federal governments as well as the labor unions, will need to be approved before the start of FY 2004 to achieve the expected savings or revenues. Thus, early resolution is critical in these initiatives to ensure either timely implementation of these initiatives or timely development of viable alternatives.

APPENDIX I – STATE AND FEDERAL GAP CLOSING INITIATIVES

Table A1. *State and Federal Gap Closing Initiatives*

($ in millions)

	FY 2004	FY 2005	FY 2006
State Gap Closing Initiatives			
No Cost Proposals			
Medicaid Cost Containment*	$250	$214	$221
Establish an Early Intervention Pool (2.4% Assessment)[1]	150	150	150
Tort Reform	100	103	106
Debt Finance Reform/Refinance Community College Debt	80	30	30
Increase the Authorization for Taxi Medallions	65	65	65
Bond Act Funds for Municipal Recycling	30	0	0
Flexible Use of Child Care Funding	25	25	25
Nighttime Thoroughbred Racing at OTB	15	15	15
Increase the Authorization for Red Light Cameras	4	23	23
Total	**$719**	**$625**	**$635**
Federal Gap Closing Initiatives			
No Cost Proposals			
Flexibility in Hazard Mitigation Grant or First Responder Funding for Uniform Operating Funds	$250	$250	$250
Federal Welfare Spending Mandate Relief	40	10	10
Flexible Use of Community Development Block Grant	20	20	0
Total	**$310**	**$280**	**$260**

[1]Savings for both the City and State.

APPENDIX II – REVENUE AND EXPENDITURE DETAILS

Table A2. *FY 2003 November Modification Revenue Detail*

($ in millions)

	FY 2003	FY 2004	FY 2005	FY 2006	Change FYs 2003-06 Percent	Change FYs 2003-06 Dollar
Taxes:						
Real Property	$9,182	$9,448	$9,835	$10,243	11.6%	$1,061
Personal Income Tax	$4,554	$4,583	$4,778	$5,249	15.3%	$695
General Corporation Tax	$1,304	$1,481	$1,600	$1,688	29.4%	$384
Banking Corporation Tax	$283	$355	$407	$464	64.0%	$181
Unincorporated Business Tax	$781	$840	$926	$1,013	29.7%	$232
Sale and Use	$3,485	$3,575	$3,763	$3,965	13.8%	$480
Commercial Rent	$380	$389	$404	$416	9.5%	$36
Real Property Transfer	$415	$384	$413	$436	5.1%	$21
Mortgage Recording Tax	$450	$418	$450	$480	6.7%	$30
Utility	$258	$269	$276	$278	7.8%	$20
All Other	$699	$688	$714	$735	5.2%	$36
Tax Audit Revenue	$427	$427	$427	$427	0.0%	$0
PEG(HPD Lien Sale)	$76	$75	$75	$75	(1.3%)	($1)
PEG Tax Initiative(PIT, Property)	$1,133	$3,348	$3,117	$2,774	144.8%	$1,641
Total Taxes	$23,427	$26,280	$27,185	$28,243	20.6%	$4,816
Miscellaneous Revenue:						
Licenses, Franchises, Etc.	$345	$347	$349	$343	(0.6%)	($2)
Interest Income	$43	$67	$95	$116	169.8%	$73
Charges for Services	$449	$454	$455	$456	1.6%	$7
Water and Sewer Charges	$887	$869	$889	$906	2.1%	$19
Rental Income	$103	$95	$91	$91	(11.7%)	($12)
Fines and Forfeitures	$551	$570	$569	$569	3.3%	$18
Miscellaneous	$747	$294	$263	$253	(66.1%)	($494)
Intra-City Revenue	$1,104	$1,037	$1,034	$1,033	(6.4%)	($71)
Total Miscellaneous	$4,229	$3,733	$3,745	$3,767	(10.9%)	($462)
Unrestricted Intergovernmental Aid:						
N.Y. State Per Capital Aid	$327	$327	$327	$327	0.0%	$0
Other Federal and State Aid	$463	$253	$228	$228	(50.8%)	($235)
Total Unrestricted Intergovernmental Aid	$790	$580	$555	$555	(29.7%)	($235)
Transitional Finance Authority 9/11	$1,500	$0	$0	$0	(100.0%)	($1,500)
Anticipated State and Federal Aid:						
Anticipated State Aid	$0	$0	$0	$0	N/A	$0
Anticipated Federal Aid	$230	$0	$0	$0	(100.0%)	($230)
Total Anticipated Aid	$230	$0	$0	$0	(100.0%)	($230)
Other Categorical Grants	$716	$447	$430	$431	(39.8%)	($285)
Inter-Fund Agreements	$331	$320	$320	$320	(3.3%)	($11)
Reserve for Disallowance of Categorical Grants	($15)	($15)	($15)	($15)	0.0%	$0
Less: Intra City Revenue	($1,104)	($1,037)	($1,034)	($1,033)	(6.4%)	$71
TOTAL CITY FUNDS	$30,104	$30,308	$31,186	$32,268	7.2%	$2,164

Table A2 (Con't). *FY 2003 November Modification Revenue Detail*

($ in millions)

	FY 2003	FY 2004	FY 2005	FY 2006	Change FYs 2003-06 Percent	Dollar
Federal Categorical Grants:						
Community Development	$298	$265	$257	$252	(15.4%)	($46)
Welfare	$2,385	$2,184	$2,178	$2,185	(8.4%)	($200)
Education	$1,271	$1,255	$1,237	$1,237	(2.7%)	($34)
Other	$996	$1,182	$477	$479	(51.9%)	($517)
Total Federal Grants	$4,950	$4,886	$4,149	$4,153	(16.1%)	($797)
State Categorical Grants						
Welfare	$1,556	$1,580	$1,587	$1,587	2.0%	$31
Education	$5,807	$5,801	$5,868	$5,933	2.2%	$126
Higher Education	$164	$164	$164	$164	0.0%	$0
Department of Public Health	$448	$460	$474	$485	8.3%	$37
Other	$320	$542	$544	$536	67.5%	$216
Total State Grants	$8,295	$8,547	$8,637	$8,705	4.9%	$410
TOTAL REVENUES	**$43,349**	**$43,741**	**$43,972**	**$45,126**	**4.1%**	**$1,777**

Table A3. *FY 2003 November Modification Expenditure Detail*

($ in millions)

	FY 2003	FY 2004	FY 2005	FY 2006	Change FYs 2003-06 Percent	Change FYs 2003-06 Dollar
Mayoralty	$105.801	$70.978	$70.978	$70.978	(32.9%)	($34.823)
Board of Elections	$49.701	$50.172	$50.172	$50.172	0.9%	$0.471
Campaign Finance Board	$9.697	$17.731	$17.731	$17.731	82.9%	$8.034
Office of the Actuary	$3.579	$3.735	$3.736	$3.736	4.4%	$0.157
President, Borough of Manhattan	$4.019	$3.543	$3.543	$3.536	(12.0%)	($0.483)
President, Borough of the Bronx	$5.404	$5.073	$5.073	$5.053	(6.5%)	($0.351)
President, Borough of Brooklyn	$5.387	$4.207	$4.207	$4.154	(22.9%)	($1.233)
President, Borough of Queens	$4.544	$4.115	$4.115	$4.015	(11.6%)	($0.529)
President, Borough of S.I.	$3.743	$3.574	$3.574	$3.574	(4.5%)	($0.169)
Office of the Comptroller	$56.829	$54.977	$54.977	$54.977	(3.3%)	($1.852)
Dept. of Emergency Management	$6.731	$3.528	$3.528	$3.528	(47.6%)	($3.203)
Tax Commission	$1.853	$1.885	$1.885	$1.885	1.7%	$0.032
Law Department	$102.061	$100.909	$100.338	$100.338	(1.7%)	($1.723)
Department of City Planning	$18.450	$17.438	$17.438	$17.438	(5.5%)	($1.012)
Department of Investigation	$18.665	$18.362	$18.362	$18.362	(1.6%)	($0.303)
NY Public Library-Research	$16.696	$16.611	$16.611	$16.611	(0.5%)	($0.085)
New York Public Library	$86.807	$86.950	$86.950	$86.950	0.2%	$0.143
Brooklyn Public Library	$63.559	$63.557	$63.557	$63.557	(0.0%)	($0.002)
Queens Borough Public Library	$60.677	$60.731	$60.731	$60.731	0.1%	$0.054
Department of Education	$12,237.394	$12,132.426	$12,236.655	$12,375.776	1.1%	$138.382
City University	$455.706	$450.372	$450.806	$450.442	(1.2%)	($5.264)
Civilian Complaint Review BD.	$10.217	$10.652	$10.506	$10.506	2.8%	$0.289
Police Department	$3,355.127	$3,234.958	$3,246.164	$3,243.625	(3.3%)	($111.502)
Fire Department	$1,105.301	$1,034.642	$1,032.709	$1,030.971	(6.7%)	($74.330)
Admin. For Children Services	$2,271.919	$2,252.004	$2,257.307	$2,257.308	(0.6%)	($14.611)
Department of Social Services	$5,823.540	$5,988.717	$6,120.619	$6,254.386	7.4%	$430.846
Dept. of Homeless Services	$632.235	$666.871	$667.267	$667.199	5.5%	$34.964
Department of Correction	$880.593	$855.609	$871.351	$865.305	(1.7%)	($15.288)
Board of Correction	$0.851	$0.913	$0.913	$0.913	7.3%	$0.062
Department of Employment	$182.696	$90.816	$90.816	$90.816	(50.3%)	($91.880)
Citywide Pension Contributions	$1,801.284	$2,570.492	$3,250.057	$4,132.219	129.4%	$2,330.935
Miscellaneous	$3,907.077	$3,741.917	$4,090.394	$4,363.298	11.7%	$456.221
Debt Service	$2,237.338	$2,946.868	$3,371.802	$3,537.386	58.1%	$1,300.048
M.A.C. Debt Service	$744.500	$0.000	$490.400	$491.900	(33.9%)	($252.600)
Public Advocate	$1.878	$1.837	$1.837	$1.837	(2.2%)	($0.041)
City Council	$47.294	$47.296	$47.296	$47.296	0.0%	$0.002
City Clerk	$2.467	$2.389	$2.389	$2.389	(3.2%)	($0.078)
Department for the Aging	$214.385	$194.063	$194.063	$194.063	(9.5%)	($20.322)
Department of Cultural Affairs	$119.384	$108.937	$108.937	$108.937	(8.8%)	($10.447)
Financial Info. Serv. Agency	$33.631	$36.231	$36.356	$36.246	7.8%	$2.615
Department of Juvenile Justice	$104.623	$100.910	$99.936	$103.936	(0.7%)	($0.687)
Office of Payroll Admin.	$8.107	$7.888	$8.018	$8.018	(1.1%)	($0.089)
Independent Budget Office	$2.511	$2.536	$2.536	$2.536	1.0%	$0.025
Equal Employment Practices Com	$0.481	$0.556	$0.556	$0.556	15.6%	$0.075
Civil Service Commission	$0.437	$0.540	$0.540	$0.540	23.6%	$0.103
Landmarks Preservation Comm.	$3.568	$3.188	$3.188	$3.188	(10.7%)	($0.380)
Districting Commission	$2.039	$0.000	$0.000	$0.000	(100.0%)	($2.039)
Taxi & Limousine Commission	$22.846	$23.155	$23.155	$23.155	1.4%	$0.309
Commission on Human Rights	$7.611	$7.154	$7.154	$7.154	(6.0%)	($0.457)
Youth & Community Development	$148.110	$122.146	$122.146	$122.146	(17.5%)	($25.964)

Table A3 (Con't). *FY 2003 November Modification Expenditure Detail*

($ in millions)

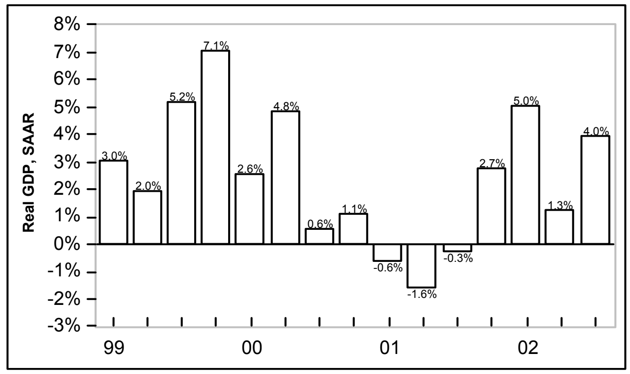
	FY 2003	FY 2004	FY 2005	FY 2006	Change FYs 2003-06 Percent	Change FYs 2003-06 Dollar
Conflicts of Interest Board	$1.605	$1.571	$1.571	$1.571	(2.1%)	($0.034)
Office of Collective Barg.	$1.557	$1.553	$1.553	$1.553	(0.3%)	($0.004)
Community Boards (All)	$11.968	$11.942	$11.942	$11.942	(0.2%)	($0.026)
Department of Probation	$79.753	$74.011	$73.901	$71.043	(10.9%)	($8.710)
Dept. of Business Services	$47.118	$29.122	$29.000	$29.375	(37.7%)	($17.743)
Housing Preservation & Dev.	$380.269	$356.075	$352.933	$367.633	(3.3%)	($12.636)
Department of Buildings	$57.949	$49.086	$49.086	$49.086	(15.3%)	($8.863)
Department of Public Health & Mental Hygiene	$1,343.260	$1,261.166	$1,298.450	$1,323.482	(1.5%)	($19.778)
Health and Hospitals Corp.	$843.439	$859.645	$877.749	$896.027	6.2%	$52.588
Dept. of Environmental Prot.	$801.517	$695.951	$694.726	$693.726	(13.4%)	($107.791)
Department of Sanitation	$963.746	$972.576	$963.028	$963.028	(0.1%)	($0.718)
Business Integrity Commission	$5.085	$5.054	$5.054	$5.054	(0.6%)	($0.031)
Department of Finance	$184.503	$183.978	$186.230	$186.230	0.9%	$1.727
Department of Transportation	$460.886	$428.607	$428.747	$428.075	(7.1%)	($32.811)
Dept. of Parks and Recreation	$183.166	$179.857	$182.580	$182.580	(0.3%)	($0.586)
Dept. of Design & Construction	$100.603	$86.007	$86.007	$86.007	(14.5%)	($14.596)
Dept. of Citywide Admin. Services	$251.201	$248.497	$252.938	$252.038	0.3%	$0.837
D.O.I.T.T.	$82.565	$88.403	$87.867	$90.932	10.1%	$8.367
Dept. of Records & Info. Serv.	$3.702	$3.214	$3.215	$3.215	(13.2%)	($0.487)
Department of Consumer Affairs	$12.368	$12.806	$12.806	$12.806	3.5%	$0.438
District Attorney - N.Y.	$74.643	$66.143	$66.143	$66.143	(11.4%)	($8.500)
District Attorney - Bronx	$41.419	$39.642	$39.642	$39.642	(4.3%)	($1.777)
District Attorney - Kings	$67.939	$65.494	$65.494	$65.494	(3.6%)	($2.445)
District Attorney - Queens	$36.236	$34.506	$34.506	$34.506	(4.8%)	($1.730)
District Attorney - Richmond	$6.093	$5.739	$5.739	$5.739	(5.8%)	($0.354)
Off. Of Prosec. & Spec. Narc.	$14.633	$14.334	$14.334	$14.334	(2.0%)	($0.299)
Public Administrator - N.Y.	$1.000	$1.042	$1.042	$1.042	4.2%	$0.042
Public Administrator - Bronx	$0.346	$0.357	$0.357	$0.357	3.2%	$0.011
Public Administrator - Brooklyn	$0.449	$0.480	$0.480	$0.480	6.9%	$0.031
Public Administrator - Queens	$0.364	$0.373	$0.373	$0.373	2.5%	$0.009
Public Administrator - Richmond	$0.249	$0.252	$0.252	$0.252	1.2%	$0.003
State and Federal Actions	$0.000	$375.000	($775.000)	($975.000)	--	($975.000)
General Reserve	$300.000	$300.000	$300.000	$300.000	0.0%	$0.000
Energy Adjustment	$0.000	$11.853	$20.741	$29.191	--	$29.191
Lease Adjustment	$0.000	$18.621	$34.805	$50.485	--	$50.485
OTPS Inflation Adjustment	$0.000	$33.764	$69.712	$106.702	--	$106.702
TOTAL EXPENDITURES	**$43,348.984**	**$43,740.880**	**$44,911.382**	**$46,416.516**	**7.1%**	**$3,067.532**

APPENDIX III – ECONOMIC DATA

Overall Performance: GDP, and Components

Real GDP grew at an average annualized rate of 3.4 percent since the fourth quarter of 2001. A strong growth despite the weak job market. (See Figure A-1.)

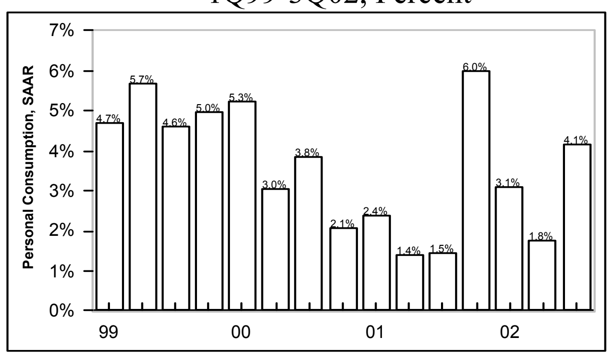
Figure A-1. Real GDP, Change, 1Q99-3Q02, Percent



Source: Quarterly data from U.S. Department of Commerce, with changes computed by the NYC Comptroller's Office. The percent change is in quarterly seasonally adjusted real (chain-weighted 1996) annualized dollars.

Consumption. Consumer spending continued to fuel the nation's economic growth. Consumption was the main driving force behind the rise in GDP. (See Figure A-2.)

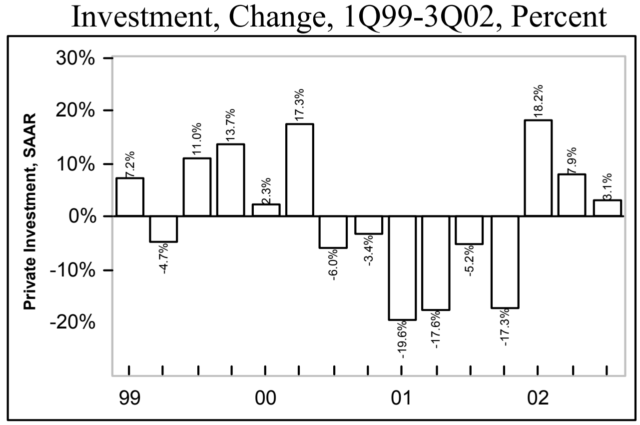
Figure A-2. Real Consumer Spending, Change, 1Q99-3Q02, Percent



Source: See Figure A-1.

Investment. Real private investment grew 3.1 percent in the third quarter, less than one third of the average annualized rate of 9.6 percent since the fourth quarter of 2001. (See Figure A-3.)

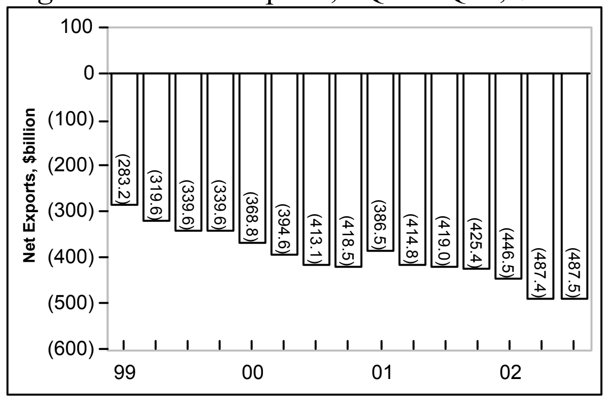
Figure A-3. Real Gross Private Domestic Investment, Change, 1Q99-3Q02, Percent



Source: See Figure A-1.

Exports-Imports. Both imports and exports continued to grow. However, imports grew more rapidly than exports, extending the trade deficit (net exports) at a record-high level. The third quarter trade deficit was a record $487.5 million, slightly above the previous peak in the second quarter. (See Figure A-4.)

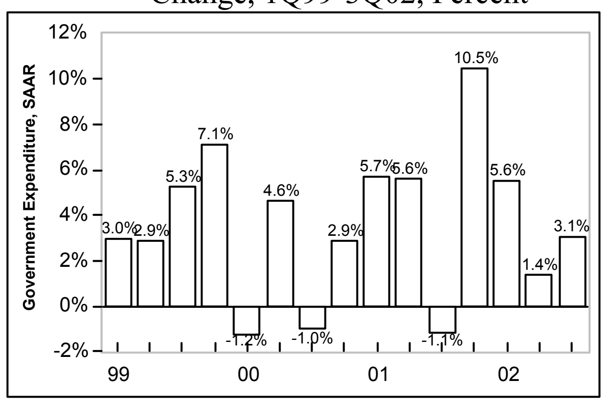
Figure A-4. Net Exports, 1Q99-3Q02, $ in billions



Source: See Figure A-1. Net exports=exports-imports.

Government. Real government expenditure was up because of a rise in national defense spending. This category of spending grew 11.6 percent in the first quarter of 2002, on a seasonally adjusted quarter-over-quarter annual rate. It grew 7.8 percent in the second quarter and 7.1 percent in the third quarter of 2002. (See Figure A-5.)

Figure A-5. Real Government Expenditure, Change, 1Q99-3Q02, Percent



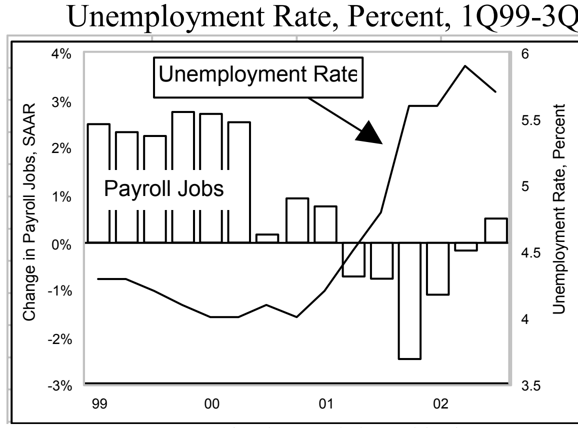
Source: See Figure A-1.

Labor-Market Indicators Improve

Jobs. Payroll jobs grew at an annualized rate of 0.4 percent in the third quarter of 2002 after five consecutive quarters of decline.

Unemployment. Civilian employment improved. The unemployment rate, which in the second quarter of 2002 reached 5.9 percent, its highest level in almost nine years, fell to 5.7 percent in the third quarter. (See Figure A-6.)

Figure A-6. Payroll-Jobs Growth and Unemployment Rate, Percent, 1Q99-3Q02

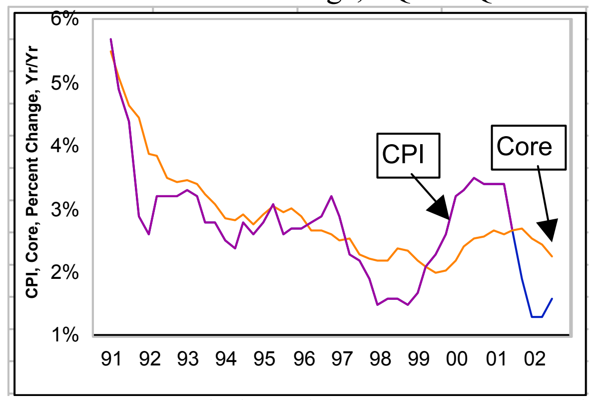


Source: U.S. Bureau of Labor Statistics, with changes computed by the NYC Comptroller's Office.

Inflation Higher but Tame

The U.S. inflation rate rose to 1.6 percent in the third quarter from 1.3 percent in the first and second quarters. The core inflation rate, which includes all items except food and energy, was 2.3 percent. Energy prices fell 4.3 percent after declining 14.1 percent in the first quarter and 10.6 percent in the second quarter. (See Figure A-7.)

Figure A-7. CPI and Core CPI, Year-over-Year Percent Change, 1Q91-3Q02

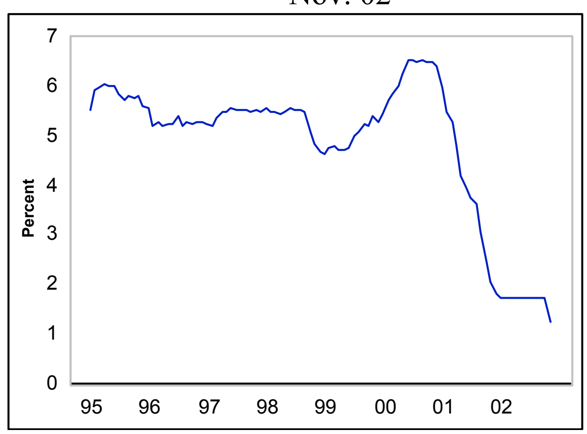


Source: U.S. Bureau of Labor Statistics. CPI=Consumer Price Index. "Core CPI" includes all items except food and energy.

Fed Funds Rate Cut

After lowering the target Federal funds rate 11 times in 2001, the Federal [Reserve] Open Market Committee lowered it only once in 2002. The Fed funds rate is 1.25 percent, the lowest in more then 40 years. (See Figure A-8.) The real Fed funds rate is –0.9 percent.

Figure A-8. Federal Funds Rate, Percent Jan. 95-Nov. 02

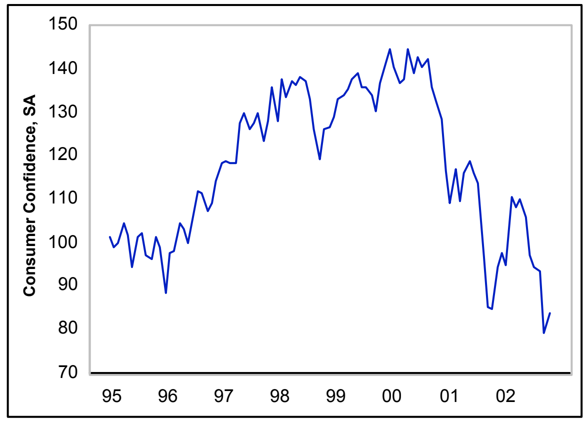


Source: Federal Reserve System, Board of Governors.

Consumer Confidence Low

After five months of consecutive declines, the Conference Board's consumer confidence index rose to 84.1 in November 2002. A low consumer confidence index is ordinarily interpreted as meaning that consumer spending will decline. (See Figure A-9.)

Figure A-9. Consumer Confidence Index, Jan. 95 – Nov. 02

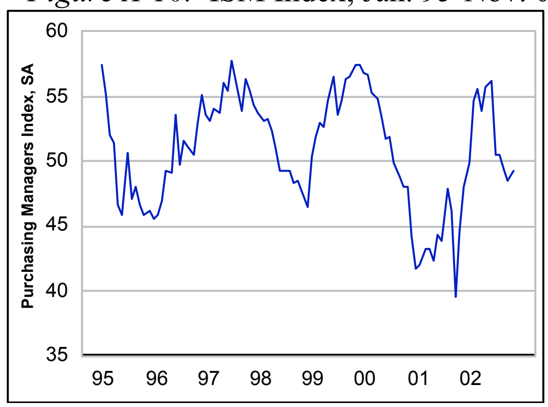


Source: The Conference Board. Index 1985=100.

Purchasing Managers' Index Low

The Institute for Supply Management's (ISM) Index shows that manufacturing activity improved slightly in November. After four months of falling or being flat, the ISM Index rose to 49.2. An ISM index below the critical 50 percent level signals slowing manufacturing activity. Manufacturing activity in 2003 will depend on consumer demand in the fourth quarter of 2002. (See Figure A-10.)

Figure A-10. ISM Index, Jan. 95-Nov. 02

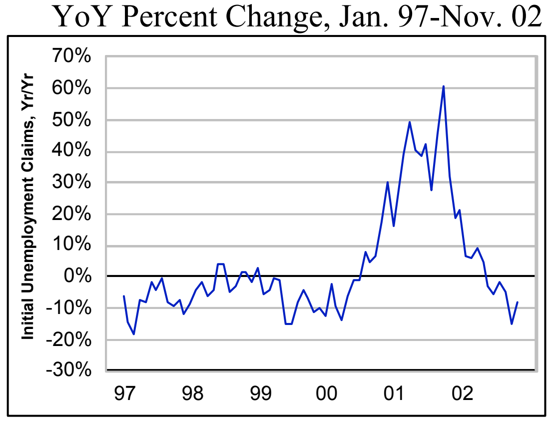


Source: Institute for Supply Management.

Initial Unemployment Claims Low

The number of new people filing for unemployment insurance (initial unemployment claims) is falling. This is ordinarily a good statistic, meaning that job losses have hit a low point, but a decline in initial claims does not tell us whether or not those without jobs are finding them. (See Figure A-11.)

Figure A-11. Initial Unemployment Claims, YoY Percent Change, Jan. 97-Nov. 02

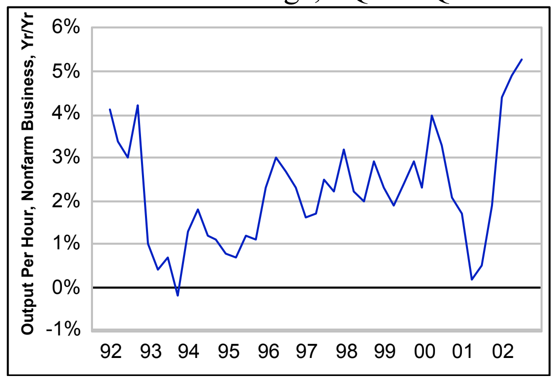


Source: The U.S. Bureau of Labor Statistics. YoY=Year over Year (each month compared with same month the previous year).

Productivity High

Non-farm business productivity, as measured by output per hour, posted an extraordinary annual productivity growth in the third quarter of 2002 of 5.3 percent. This is the highest growth rate since 5.3 percent growth in the third quarter of 1983. Higher productivity helps keep inflation low because it means lower production costs. Higher productivity is important for the United States in the face of competition from lower-cost overseas producers. (See Figure A-12.)

Figure A-12. Productivity, Year-over-Year Percent Change, 1Q92-3Q02

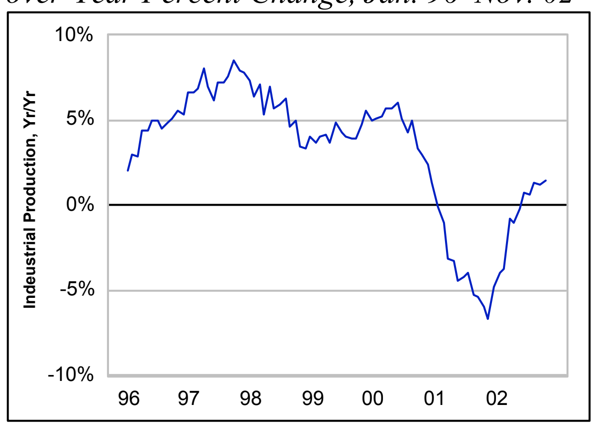


Source: The U.S. Bureau of Labor Statistics.

Industrial Production Higher

Industrial production is up, which is a sign that companies are increasing their capital spending. The level of spending is still well below the five-percent average of the 1997-2000 period, but is a marked improvement over 2001. Industrial production is sensitive to changes in consumer confidence. (See Figure A-13.)

Figure A-13. *Industrial Production, Year-over-Year Percent Change, Jan. 96–Nov. 02*

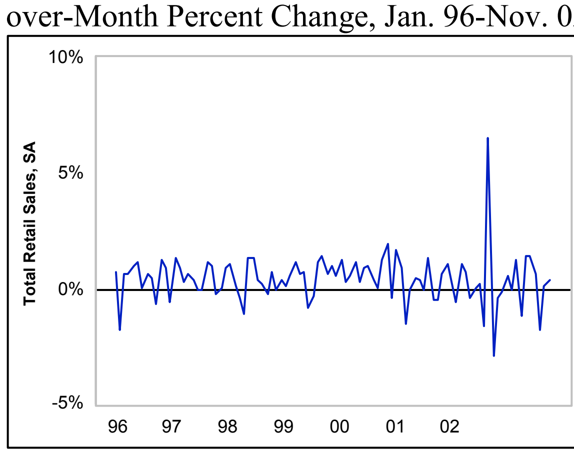


Source: U.S. Bureau of Labor Statistics.

Retail Sales Slightly Higher over 2001

A low level of consumer confidence ordinarily implies that retail sales will be weak. But in November, monthly seasonally adjusted retail sales were up by 0.4 percent over October. (See Figure A-14.)

Figure A-14. Total Retail Sales, Month-over-Month Percent Change, Jan. 96-Nov. 02



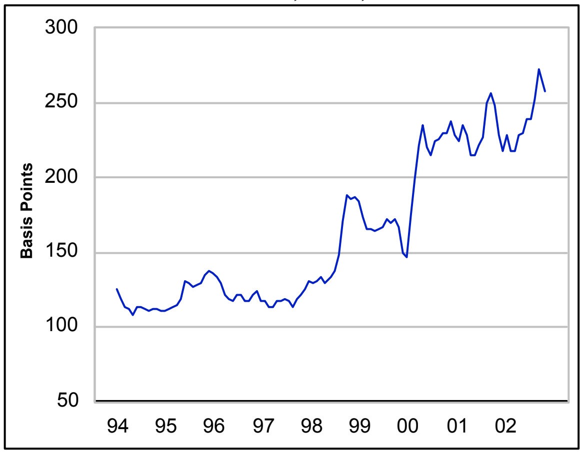
Source: U.S. Census Bureau.

Credit Availability Remains Tight

The quality yield spread, measured by the difference between monthly BAA corporate-bond yields and 20-year Treasury yields, was 258 basis points in November. This means that corporations without blue-chip status must pay a high and rising interest-rate risk premium. This is a barrier to renewed business investment. (See Figure A-15.)

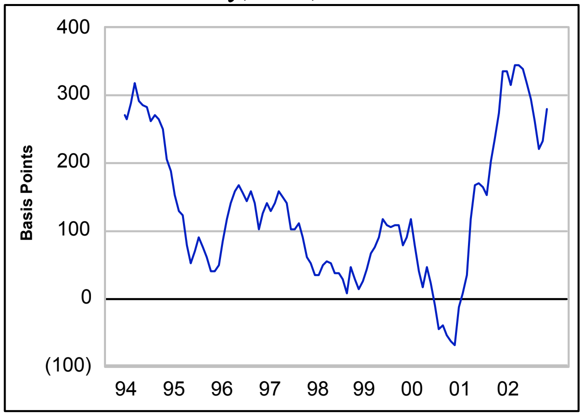
A crude measure of the yield curve is the spread between the monthly yield of ten-year Treasury bonds and three-month Treasury bills. As of November 2002, this spread remains positive (implying an upward-sloping yield curve in the three-month to ten-year range), although the difference in yields fell by about one-third, about 100 basis points, since the first quarter. A positive spread (i.e., an upward-sloping yield curve) is a positive sign for the future of the economy. (See Figure A-16.)

Figure A-15. Yield Spread, BAA Corporates Less 20-Yr Treasuries, BPs, Jan. 94-Nov. 02



Source: Federal Reserve System, Board of Governors. BPs= Basis Points. One percentage point = 100 basis points.

Figure A-16. Yield Spread, 10-Yr Treasury Less 3-m Treasury, BPs, Jan. 90-Nov. 02

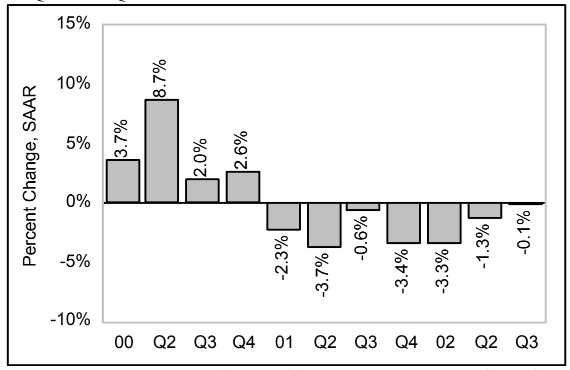


Source: Federal Reserve System, Board of Governors. The 10-year Treasury bond yield is subtracted from the 3-month T-bill yield. BPs=Basis Points. One percentage point = 100 basis points.

The Overall Economy: GCP

Real GCP fell at an annualized rate of 0.1 percent in the third quarter of 2002. The decline in GCP reflects losses in both jobs and income. The good news is that it is by far the smallest quarterly decline since the beginning of the recession. (See Figure B-1.)

Figure B-1. Real GCP, Percent Change, 1Q00-3Q02

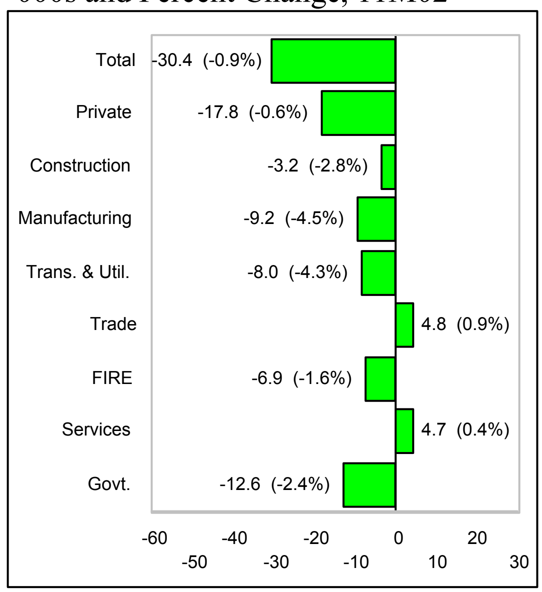


Source: NYC Comptroller's Office. SAAR= Seasonally Adjusted Annualized Rate

Payroll-Job Growth by Sector

Jobs Lost through November 2002. NYC lost 30,400 jobs in the first 11 months of 2002. The private sector lost 17,800 jobs and the public sector lost 12,600. Within the private sector, manufacturing lost 9,200 jobs, finance, insurance and real estate (FIRE) lost 6,900, transportation and public utilities lost 8,000, and construction lost 3,200. But services added 4,700 jobs and trade added 4,800. (See Figure B-2.)

Figure B-2. Payroll Job Growth, SAAR, '000s and Percent Change, 11M02



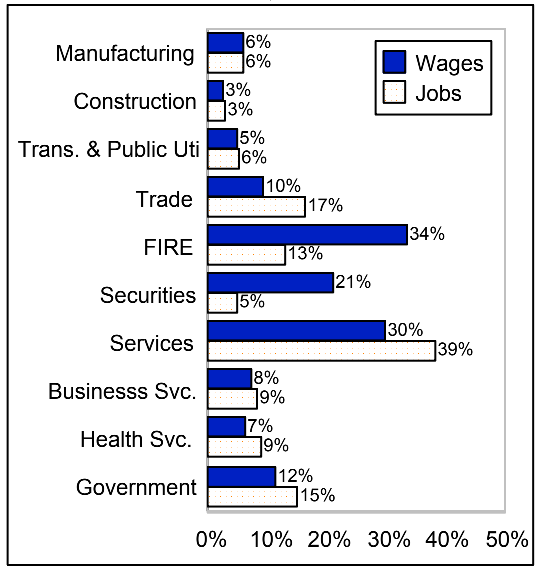
Source: Monthly data from NYS Dept. of Labor. Changes from the same period in 2001 computed by NYC Comptroller's Office. FIRE=Finance, insurance, and real estate. SAAR=Seasonally adjusted annual rate.

Since 9/11, from September through November 2002, NYC lost 112,900 jobs, 100,900 in the private sector and 12,000 in the public sector.

Jobs vs. Wages, 2001. Some jobs are worth more to the City than others. In particular, the FIRE sector in 2001 had 13 percent of the jobs but accounted for 34 percent of wages (including bonuses). Within the FIRE sector, the securities industry accounted for most of the FIRE sector wages but not even two-fifths of jobs. For all other sectors, the share of jobs equalled or exceeded the share of wages. (See Figure B-3.)

Implications. The only sectors showing growth of jobs in 2002 have been the lower-wage trade and services sectors. Losses have been heavy in the high-wage FIRE sector.

Figure B-3. Jobs, Wages and Employment as a Percent of Total, NYC, 2001

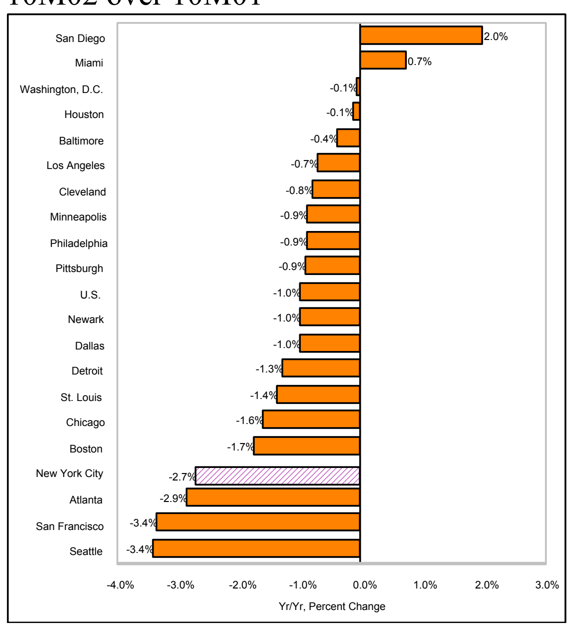


Source: NYS Dept. of Labor. Jobs = Payroll jobs covered by unemployment insurance. Percentages are computed by NYC Comptroller's Office. FIRE = Finance, insurance, and real estate.

Payroll-Job Growth, Metro/City Comparisons

On a year-over-year basis, NYC's rate of job losses during the first ten months of 2002 was the fourth-highest of 20 metro areas. Seattle, San Francisco, and Atlanta had greater job losses than the City. (See Figure B-4.)

Figure B-4. Job Growth, 20 Metro Areas and U.S. Average, Percent Change, 10M02 over 10M01



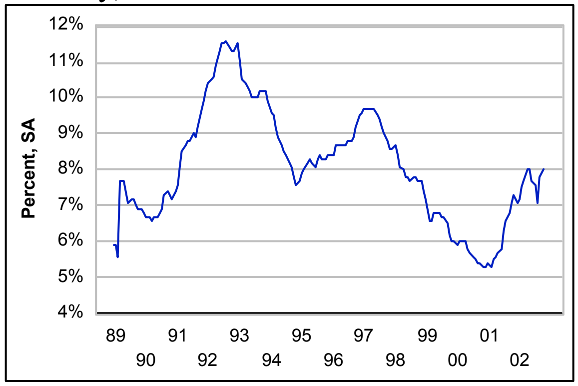
Source: Monthly data from NYS Department of Labor. Changes computed by the NYC Comptroller's Office. NYC's primary metro area data were not used because they would include not only NYC but also Putnam, Rockland, and Westchester counties. Based on the preliminary data for October 2002.

Unemployment Rate

The City's seasonally adjusted unemployment rate averaged 7.6 percent during the first 11 months of 2002, higher than the 5.9 percent average for the same period in 2001. But the rate was below the 11 plus percent peaks in 1993 at the end of the last recession in 1992. (See Figure B-5.)

During the first 11 months of 2002, the City's labor force rose by 63,100, as civilian employment (the number of New Yorkers working) increased by 35,300 and the number of unemployed increased by 27,800.

Figure B-5. NYC Unemployment Rate, Monthly, Jan. 89-Nov. 02



Source: NYS Department of Labor.

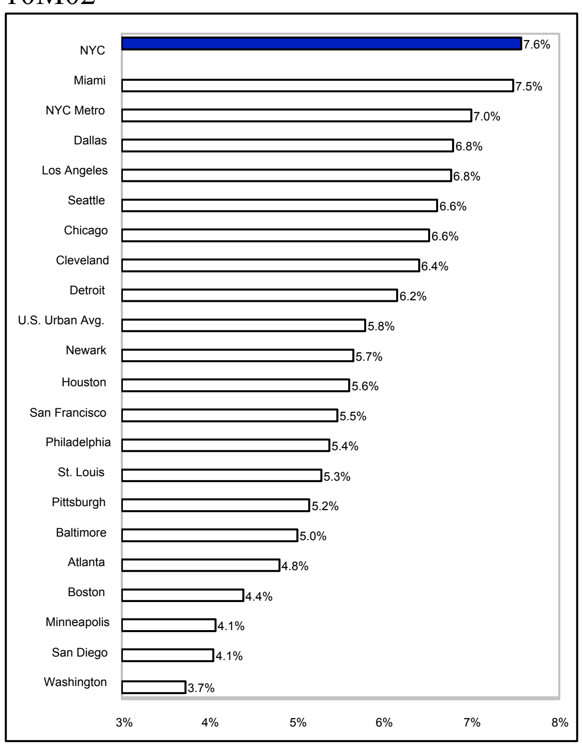
Unemployment-Rate Comparisons

NYC's average unemployment rate during the first ten months of 2002, 7.6 percent, was the highest of the 20 largest metro areas. (See Figure B-6.)

The metro areas with the next-highest rates were Miami, Dallas, Los Angeles, and Seattle.

The NYC primary metro area (which includes Putnam, Rockland, and Westchester counties) had an unemployment rate of 7.0 percent, ranking second highest after Miami.

Figure B-6. Unemployment Rate, 20 Largest Metro Areas and U.S. Urban Average, 10M02



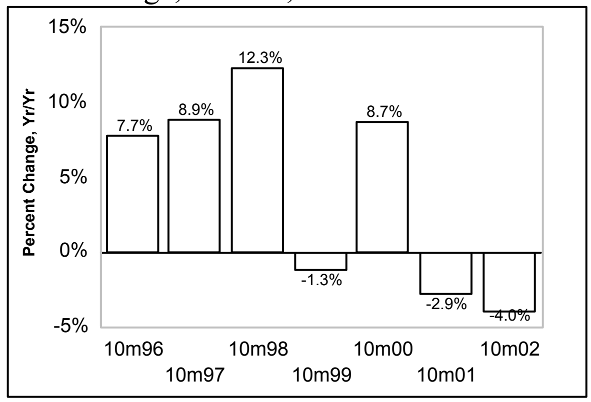
Source: Monthly data from NYS Department of Labor. Changes computed by the NYC Comptroller's Office.

Personal Incomes-Withholding Tax

Personal income data are published by the Department of Commerce with a lag of about two years. Therefore, two proxies for personal incomes are used. The first is the withholding component of the NYC personal income tax. The second is average hourly wages.

The withholding income tax is the amount of income tax withheld from wages. During the first ten months of 2002, revenues from the withholding income tax were down by four percent on a year-over-year basis. This indicates a weak job market. (See Figure B-7.)

Figure B-7. Withholding PIT, Year-over-Year Change, Percent, 10M96-10M02

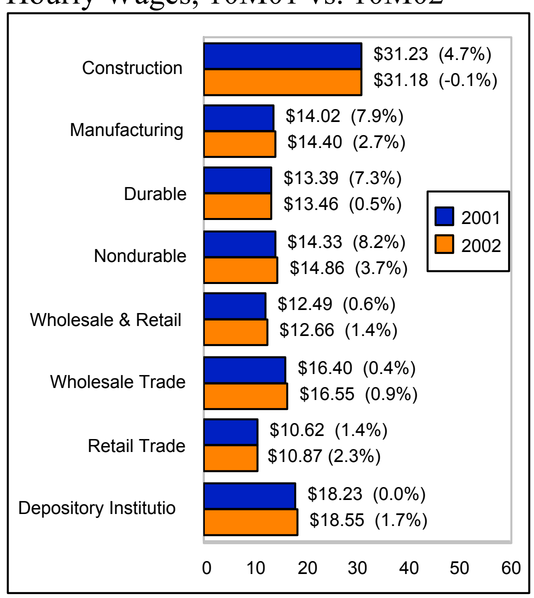


Source: NYS Department of Taxation and Finance. Cumulative 10-month data and year-over-year changes computed by NYC Comptroller's Office. In 1998 and 1999 some tax laws changed, on balance lowering tax rates. Therefore, the data prior to 1999 are incompatible with the data after 1999.

Average Hourly Wage

Average hourly wages, the other proxy for personal income, increased during the first ten months of 2002, except for construction, where the hourly wage fell by 5 cents to $31.18. Given the weak labor-market environment, the rise in average hourly wages primarily reflects cost-of-living adjustments rather than an increase in labor demand. (See Figure B-8.)

Figure B-8. Percent Change in Average Hourly Wages, 10M01 vs. 10M02



Source: Monthly data from NYS Department of Labor. Changes computed by the NYC Comptroller's Office.

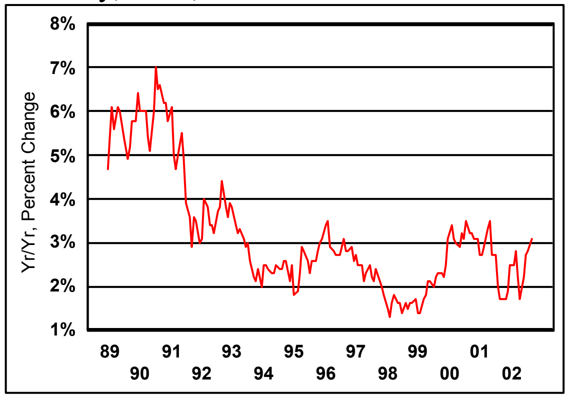
Inflation

The rate of inflation in the NYC metro area, measured by the percentage change in the regional Consumer Price Index (CPI), rose from 1.9 percent to 3.1 percent between January and October 2002. The average inflation rate for the first ten months of 2002 was 2.4 percent. (See Figure B-9.)

In the first ten months of 2002, the City's average core inflation rate, for all items except food and energy, increased to 3.7 percent. The City's low overall inflation rate resulted primarily from a 9.5 percent decline in energy prices. Apparel and upkeep prices also declined 1.7 percent and transportation prices declined 1.5 percent.

The biggest cause of inflation was the price of shelter, which rose 6.3 percent, followed by prices for medical care and services, which increased 4.3 percent.

Figure B-9. Inflation Rate (CPI), NYC Area, Monthly, YoY, Jan. 89-Oct. 2002

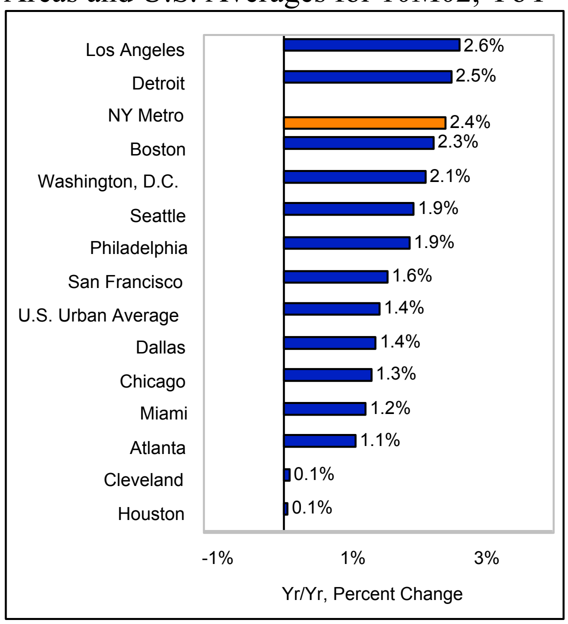


Source: U.S. Bureau of Labor Statistics. CPI= Consumer Price Index. YoY=Year over Year.

Inflation: NYC Metro vs. Other Metros

Of the 14 largest metro areas, the NYC metro area had the third-highest rate of inflation, 2.4 percent. Los Angeles had the highest rate, 2.6 percent, and Houston and Cleveland had the lowest, 0.1 percent. (See Figure B-10.)

Figure B-10. Inflation Rate (CPI), 14 Metro Areas and U.S. Averages for 10M02, YoY

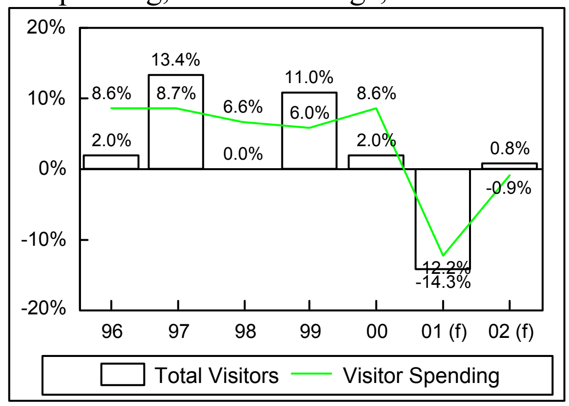


Source: Monthly CPI data series for each metro area from the U.S. Bureau of Labor Statistics. Areas selected and averages for the first ten months of 2001 are computed by the NYC Comptroller's Office. CPI=Consumer Price index. YoY=Year over Year.

Tourism

Based on NYC & Company projections, the number of visitors to NYC is expected to rise by 0.8 percent in 2002, but spending is expected to fall by 0.9 percent. These numbers mean that recovery in 2002 remains slow, because the number of 2001 visitors was down by 12.2 percent and their spending was down by 14.3 percent. (See Figure B-11.)

Figure B-11. Visitors, Number and Spending, Percent Change, 1996-2002

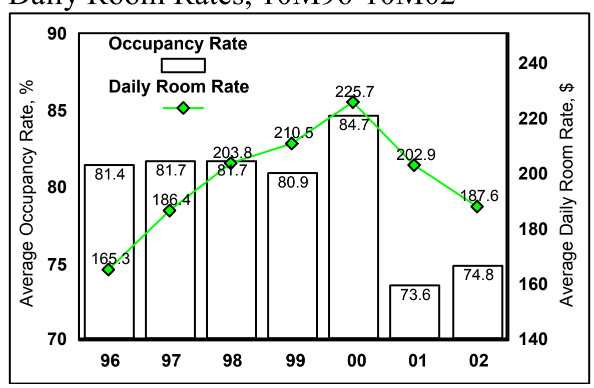


Source: NYC & Company, the NYC Convention and Visitors Bureau. Figures for 2001 and 2002 are NYC & Company projections.

The Hotel Industry

The average hotel occupancy rate slightly improved during the first ten months of 2002 compared with the first ten months of 2001. However, all the gains occurred because of the weak September 2001. Ignoring September, the average hotel occupancy rate was 74.8 percent during the first ten months of 2002, below the 74.9 percent during the first ten months of 2001. (See Figure B-12.)

Figure B-12. Hotel-Occupancy Rates and Daily Room Rates, 10M96-10M02



Source: PFK Consulting.

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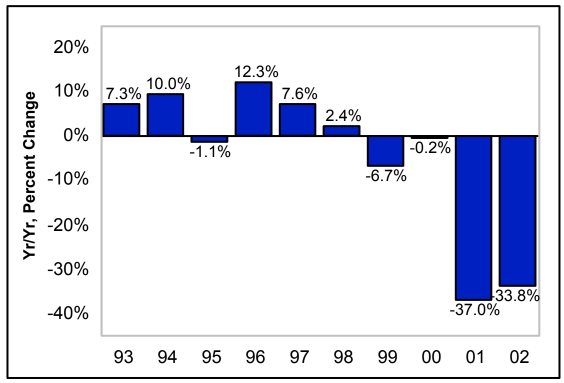
Leading Economic Indicators

The City's leading indicators on balance are very slightly negative. The help-wanted advertising index is down but may partly reflect a secular trend away from print media. Building permits are up through September, but when the unusual month of September is excluded (because of the exceptionally low number in September 2001), building permits through August were down only slightly. The business conditions index improved slightly in November.

Help-Wanted Advertising. On a year-over-year basis, the City's average help-wanted-advertising index during the first ten months of 2002 fell 33.8 percent. On a quarter-over-quarter basis, the average help-wanted-advertising index also showed signs of deterioration. The third-quarter ad index was the lowest, 20.3, below the second quarter index of 22.3, which was below the first-quarter index of 22.7. (See Figure B-13.) Three factors are at work in the deterioration of the help-wanted ad index. Two are cyclical and one is secular. The cyclical elements are fewer jobs to advertise and cuts in personnel advertising budgets (which result in more reliance on free or cheaper web site advertising). The secular trend is a move away from the print media toward advertising on the Internet. The precise mix of these shifts is hard to separate until the recovery cycle is completed.

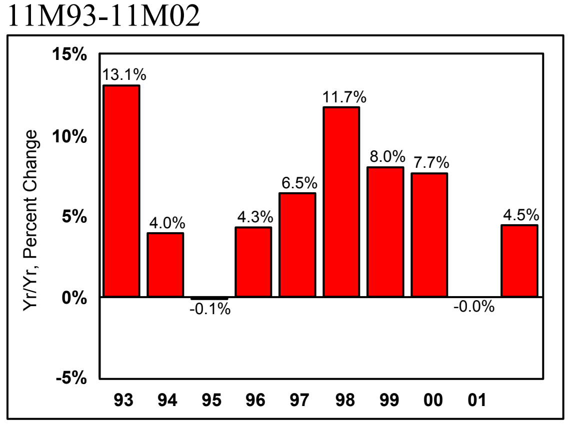
Building Permits. On a year-over-year basis, the total number of building permits issued in the first 11 months of 2002 increased 4.5 percent. However, ignoring the unusual month of September, the total number of building permits authorized increased only 0.1 percent year over year basis. (See Figure B-14.)

Figure B-13. Help-Wanted-Ads Index, Year-over-Year Change, Percent, 10M93-10M02



Source: The Conference Board. Change in annual averages computed by the NYC Comptroller's Office.

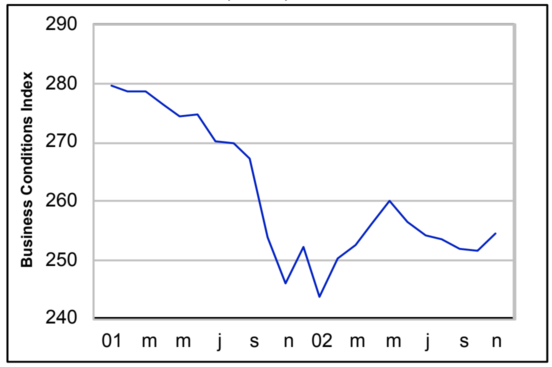
Figure B-14. Building Permits Authorized, Year-over-Year Change, Percent, 11M93-11M02



Source: NYS Department of Buildings. Change in annual averages is computed by the NYC Comptroller's Office.

Business Conditions. New York area purchasing managers report an improvement in business conditions. The business conditions index (BCI) is a measure of the current state of the economy and precedes or moves with local-area employment. It rose to 254.7 after five months of decline. Also, the BCI outlook improved by nearly one-fourth, to 56.3 in November 2002 from 45.8 in November 2001. (See Figure B-15.)

Figure B-15. New York Business Conditions Index, SA, Jan. 2001-Nov. 2002



Source: National Association of Purchasing Managers. SA=Seasonally Adjusted.

GLOSSARY OF ACRONYMS

ACS	Agency for Child Services
AIRA	Actuarial Interest Rate Assumption
BAN	Bond Anticipation Notes
BSA	Budget Stabilization Account
BCT	Banking Corporation Tax
BCI	Business Conditions Index
CPI	Consumer Price Index
COPS	Community Oriented Policing Services
CRT	Commercial Rent Tax
CUNY	City University of New York
DASNY	Dormitory Authority of the State of New York
DCAS	Department of Citywide Administrative Services
DEP	Department of Environmental Protection
DRM	Disaster Relief Medicaid
DOE	Department of Education
DOC	Department of Corrections
DSS	Department of Social Services
E-911	Emergency 911
FA	Family Assistance
FHP	Family Health Plus
FIRE	Finance, Insurance and Real Estate

FY	Fiscal Year
GCP	Gross City Product
GCT	General Corporation Tax
GDP	Gross Domestic Product
G.O. Debt	General Obligation Debt
HHC	Health and Hospitals Corporation
HPD	Housing Preservation Development
ISM	Institute for Supply Management
JFK	John F. Kennedy Airport
J&C	Judgments and Claims
LOC	Letter of Credit
MAC	Municipal Assistance Corporation
MTA	Metropolitan Transportation Authority
MRT	Mortgage Recording Tax
NYC	New York City
NYCTFA	New York City Transitional Finance Authority
OMB	Office of Management and Budget
OTPS	Other Than Personal Services
PA	Public Assistance
PBA	Patrolmen's Benevolent Association
PEG	Program to Eliminate the Gap (an action that is part of a gap-closing program)
PERB	Public Employment Relations Board
PI	Personal Injury

PIT	Personal Income Tax
PS	Personal Services
RAN	Revenue Anticipation Note
RPTT	Real Property Transfer Tax
SAAR	Seasonally Adjusted Annual Rate
SNA	Safety Net Assistance
STAR	School Tax Relief Program
TSASC	Tobacco Settlement Asset Securitization Corporation
UBT	Unincorporated Business Tax
UFA	Uniformed Firefighters Association
VRDB	Variable Rate Demand Bonds
WTC	World Trade Center