New York City Independent Budget Office

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Analysis of the Mayor's Preliminary Budget for 2015

IBO's Reestimate Of the Mayor's Preliminary Budget for 2015 And Financial Plan Through 2018

IBO

New York City
Independent Budget Office
Ronnie Lowenstein, Director

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

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

Preface

As required by the New York City Charter, this report is IBO's review of the Mayor's Preliminary Budget for 2015 and Financial Plan Through 2018. The report presents IBO's most recent economic forecast and projections of city tax revenues and expenses based on the Mayor's budget plan as well as detailed examinations of some of the key proposals in that plan.

As IBO completed this report on the Mayor's Preliminary Budget for 2015, negotiations over the state budget were still underway. Our report reflects state issues affecting the city budget as presented in Mayor de Blasio's plan.

While this report appears the same as it has in recent years, there has been one significant change: most of the sections examining key budget issues such as the potential cost of settling the expired municipal labor contracts or state funding of the city's schools were released as standalone publications over the past few weeks. We did this in order to contribute to the public discussion of these topics in a timely manner and as relevant hearings were underway at the City Council.

There is one other notable change, not with this report but with the timing of IBO's *Budget Options for New York City*, a volume that has long been an annual companion to our report on the Preliminary Budget. In the recent past, the budget options report has been released a few weeks after the report on the Preliminary Budget. We have reversed this timing and the budget options volume now precedes this report. The latest version of the budget options report was issued in December 2013, with the next one planned for next December.

This report on the Mayor's budget plan could not have come together without the dedication and effort of IBO's staff. A list of IBO's analysts and economists who contributed to this report can be found on the last page. The report is produced under the direction of Deputy Directors George Sweeting and Frank Posillico along with Supervising Analysts Ana Champeny, Ray Domanico, Paul Lopatto, and Michael Jacobs. Tara Swanson coordinated production and distribution and Arao Ameny, Elizabeth Brown, and Doug Turetsky provided editorial assistance.

Ronnie Lowenstein

Director

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Overview

The de Blasio Administration presented its Preliminary Budget for Fiscal Year 2015 and Financial Plan Through 2018 six weeks after taking office. Given the relatively short time for preparation, the de Blasio plan uses as its foundation the last budget presented by the Bloomberg Administration. Still, there are a number of initiatives in the new plan that herald new policies and priorities. While the largest and most hotly debated is the proposal to implement a five-year personal income tax surcharge on city residents with incomes over $500,000 and use the revenue to offer full-day prekindergarten to all 4-year olds and increase the availability of after-school programs for middle school students, there are a number of smaller, less noted measures as well.

Mayor de Blasio's first budget is something of a down payment on the programs he plans to implement. As such, the Preliminary Budget for 2015 and financial plan do not include a large amount of new spending. But the Mayor has already announced one new initiative not accounted for in the current plan, Vision Zero, and also intends to lay out a major affordable housing construction and preservation program by May 1. Other plans are also under consideration.

One issue, though, could have a major effect on the current plan for city spending and the prospects for any new initiatives: the eventual cost of settling expired contracts with every municipal union. While there are many scenarios for settling the labor contracts, IBO has estimated the cost of six different variants, with the estimated effect on the 2014 budget ranging from $500 million to $7.1 billion (see page 43 for more details). The issue of labor settlements clouds the entire budget discussion and has the potential to darken what is otherwise an unusually bright fiscal outlook for the city based on IBO's latest economic forecast and projection of revenues and spending under the Mayor's financial plan.

IBO projects the city will end the current fiscal year with a surplus of $2.0 billion, $244 million more than the Mayor estimates. Assuming that the entire surplus is used to prepay some 2015 expenses, IBO expects that fiscal year 2015 will end with a surplus of $1.2 billion. In contrast, the Mayor's plan anticipates no surplus from 2015. And while the Mayor projects shortfalls for each of the succeeding years 2016 through 2018, IBO expects surpluses ranging from $131 million in 2016 to $1.5 billion in 2018.

These estimates of budget surpluses are based on IBO's latest economic forecast and tax revenue projections along with our review and reestimates of the Mayor's spending plans for 2015 through 2018.

Total Revenue and Expenditure Projections
Dollars in millions

	2014	2015	2016	2017	2018	Average Change
Total Revenue	**$74,093**	**$75,289**	**$78,290**	**$81,276**	**$83,733**	**3.1%**
Total Taxes	46,196	49,181	51,786	54,299	56,708	5.3%
Total Expenditures	**$74,093**	**$74,103**	**$78,159**	**$80,181**	**$82,242**	**2.6%**
IBO Surplus / (Gap) Projections	**$-**	**$1,186**	**$131**	**$1,095**	**$1,491**	
Adjusted for Prepayments:						
Total Expenditures	$74,924	$76,216	$78,262	$80,181	$82,242	2.4%
City-Funded Expenditures	$53,394	$56,062	$57,767	$59,231	$60,901	3.3%

NOTES: IBO projects a surplus of $2.0 billion for 2014, $244 million above the de Blasio Administration's forecast. The surplus is used to prepay some 2015 expenditures, leaving 2014 with a balanced budget. Total taxes include universal pre-K personal income tax proposal. Figures may not add due to rounding.

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Pricing Differences Between IBO and the de Blasio Administration
Items that affect the gap
Dollars in millions

	2014	2015	2016	2017	2018
Gaps as Estimated by the Mayor	**$-**	**$-**	**$(1,059)**	**$(530)**	**$(370)**
Revenue					
Taxes					
Property	$5	$106	$36	$258	$586
Personal Income	120	307	346	396	488
General Sales	24	135	135	179	194
General Corporation	95	101	219	265	298
Unincorporated Business	6	183	263	350	438
Banking Corporation	3	105	182	244	239
Real Property Transfer	25	2	39	51	33
Mortgage Recording	(18)	35	36	37	17
Utility	24	33	28	35	40
Hotel Occupancy	12	36	52	66	74
Commercial Rent	5	15	13	3	(11)
Cigarette	1	1	1	(1)	(2)
Subtotal	**$302**	**$1,058**	**$1,349**	**$1,884**	**$2,393**
STaR Reimbursement	$7	$11	$9	$9	$13
Universal Pre-K (PIT increase)	-	24	45	36	36
TOTAL REVENUE	**$309**	**$1,093**	**$1,403**	**$1,929**	**$2,443**
Expenditures					
Fringe Benefits:					
Health Insurance - Education	$14	$13	$34	$38	$15
Health Insurance - City University	(39)	(6)	(13)	(22)	(31)
Health Insurance - All Other Agencies	9	(12)	5	41	42
Education	(32)	(75)	(166)	(288)	(494)
Police	(25)	(25)	(25)	(25)	(25)
Board of Elections	-	(25)	(25)	(25)	(25)
Correction	-	(15)	(15)	(15)	(15)
Homeless Services	(5)	(10)	(10)	(10)	(10)
Public Assistance	3	5	5	5	5
Small Business Services	10	(2)	(4)	(4)	(4)
Campaign Finance Board	-	-	-	-	(40)
TOTAL EXPENDITURES	**$(65)**	**$(152)**	**$(214)**	**$(305)**	**$(582)**
TOTAL IBO PRICING DIFFERENCES	**$244**	**$941**	**$1,189**	**$1,624**	**$1,861**
IBO Prepayment Adjustment 2014/2015	(244)	244	-	-	-
IBO SURPLUS/(GAP) PROJECTIONS	**$-**	**$1,186**	**$131**	**$1,095**	**$1,491**

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

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Among our key findings:

- The city will add a projected 70,300 jobs this year and an average of 59,700 over the next four years.
- Many of the new jobs are expected to be in relatively low-paying industries, as has been the case for the past few years. In 2013, average inflation-adjusted wages and salaries in the city were $82,200, slightly below their average for 2010 and well below their prerecession peak.
- Tax revenues are projected to grow by an average of 4.5 percent a year from 2014 through 2018, not including the proposed personal income tax surcharge for high-income New Yorkers. This is a slower growth rate than the 5.8 percent annual average increase over the prior five-year period.
- IBO expects tax revenues will be $300 million higher than projected by the de Blasio Administration this year and more than $1 billion a year higher in 2015 and 2016.
- City funding for the Department of Education will comprise 48 percent of the agency's $20.5 billion budget in 2015—again exceeding the contribution from the state, which had typically provided a larger portion than the city prior to 2012.
- Providing shelter for homeless families is projected to cost $544 million in 2015, $24 million more than the Mayor budgeted.
- To continue to provide summer activities under the plan to expand after-school programs will cost about $50 million more than currently budgeted.

Economic & Tax Revenue Forecast

IBO's forecast for the city's economy over the next few years anticipates that job gains will continue, although not as strongly as in the past three years, when the city added an average of 85,500 jobs annually. IBO expects the city to add 70,300 jobs this year and an average of 59,700 new jobs over each of the next four years.

Despite strong local job growth over the past few years, data on compensation and hours worked are more mixed. After adjusting for inflation, average wages and salaries in New York City in 2013 were slightly below their average for 2010 and well below their prerecession peak. Moreover, growth in the number of jobs has been accompanied by a decline in the average hours worked in the city.

In past economic expansions, growth in New York City has been led by Wall Street, where high average wages—about $353,000 in 2013 compared with $70,000 in all other industries—has spurred growth elsewhere in the economy. But the composition of the city's workforce has shifted, and is expected to shift further, towards lower paying industries. As in the past several years, the industries driving the city's job growth are expected to be education and health care (28.0 percent of total employment growth from 2013 through 2018), professional and business services (25.6 percent), leisure and hospitality (14.8 percent), and wholesale and retail trade (12.7 percent). The securities sector is expected to account for only 3.3 percent of new jobs over the same period. (See pages 9-15 for more details on our economic forecast.)

Based on our economic forecast, IBO expects baseline city tax revenues (not including the proposed personal income tax surcharge) will grow at an average annual rate of 4.5 percent over fiscal years 2014 through 2018. This is slower growth than the average annual increase of 5.8 percent over the 2010-2014 period. Still, IBO's estimates of tax revenues are higher than those presented by the de Blasio Administration. Our forecast of tax revenues exceeds the Mayor's estimates by about $300 million for this year and more than $1 billion a year in 2015 and 2016.

Some of the largest differences are in our estimates for personal income and business income tax collections. IBO expects baseline personal income tax revenue to exceed the de Blasio Administration's estimates by $120 million this year and by more than $300 million in each of the next two years. The higher collections are largely driven by IBO's expectation of more local job growth. IBO anticipates that business tax collections—general corporation, unincorporated business, and banking corporation taxes—will exceed the Mayor's estimates by about $100 million this year, nearly $400 million in 2015, and more than $660 million in 2016. IBO's outlook for U.S. economic growth is stronger than that of the de Blasio Administration and as a result leads to our expectation of higher profits for many New York City-based firms and more business tax revenue for the city. (For more details on IBO's revenue forecast, see pages 17-24.)

Spending

Based on IBO's reestimate of the budget plan proposed by the Mayor, total city spending would rise at an average annual rate that is roughly half the rate of growth of tax revenues. Expenditures are expected to rise from $74.1 billion in 2014 to $82.2 billion in 2018 based on IBO's estimates. Looking just at city-funded spending and adjusting for the use of surpluses to make prepayments, IBO estimates spending will grow from $53.4 billion this year to $56.1 billion in 2015 and $60.9 billion in 2018. (For a more detailed look at spending on an operating basis, see sidebar on page 6.) These estimates of spending growth, however, are absent any costs related to a labor settlement that includes retroactive raises and assumes raises in 2014 and 2015 of no more than 1.25 percent as budgeted in the Mayor's plan. Spending could increase substantially when an accord is reached.

The budget plan largely follows the contours of the Bloomberg Administration's last financial plan presented in November and contains no Program to Eliminate the Gap, or PEGs. One marked difference from the previous plan is the decision to leave $1.0 billion in the Retiree Health Benefits Trust fund, a source of funds that previously had been targeted to help pay for retiree health costs this year so that an equivalent amount of money in the general fund could instead be used to meet other expenses. (See page 44 for more details on the $1.0 billion left in the retiree health benefits fund.) Mayor de Blasio also doubled the size of the general reserve in the budget to $600 million for 2015 and beyond. These two changes reflect the city's relative fiscal strength as well as the need to set aside funds in anticipation of an eventual settlement of the expired labor contracts.

The only large spending initiative is the expansion of full-day pre-K and after-school slots for middle school students, paid for under the Mayor's budget with a personal income tax surcharge on filers with incomes of $500,000 or more. As this report is being completed, the surcharge appears to have little chance of approval in Albany. (See page 23 for more details on the surcharge proposal.) But Albany leaders do appear committed to providing funds for the pre-K expansion—what is not clear is how much funding and how many new slots could be created with those funds. Less certain is the commitment to funding the after-school expansion for middle school students. There is also some uncertainty on the local level as well. While IBO believes that the de Blasio Administration has underestimated the number of eligible 4-year-olds, there is also the issue of the take up rate—how many families will actually decide to send their children to the new full-day pre-K program. Also unclear is where these programs will be located and how close the new pre-K seats will be to where large numbers of eligible children live. This, too, will have a considerable effect on how many families take advantage of the program.

Most of the other new spending measures proposed by the de Blasio Administration are relatively small in the scope of the city's budget. In 2015, for example, the measures range from $43 million to restore funding for 20 fire companies to $2.4 million for 76 additional shelter beds for runaway and homeless youth to $1.8 million for the enforcement of the new paid sick leave law. The Mayor has also reversed $8.7 million in planned reductions for the five Borough Presidents and $732,000 for the Public Advocate.

Some new spending is the result of other factors not controlled by City Hall. The budget adds $35 million this year to cover the cost of the extraordinary number of snow storms the city has weathered. Another $7.0 million is added to this year's budget to pay for 36,000 poll workers needed in June because there will be separate federal and state primaries.

Sources of Spending Growth. These factors, though, only have a modest effect on the city's spending growth. As presented in the financial plan, spending by most city agencies is projected to be flat over fiscal years 2014 through 2018 (again, without the potential costs of a labor settlement that will likely result in growth in agency spending). Just a few areas of the budget continue to drive spending growth.

In dollar terms, the largest spending increase is projected for the Department of Education. Education department spending is expected to grow by about $800 million next year and total $20.5 billion. IBO projects education department spending will reach nearly $22.4 billion in 2018, an increase of $2.7 billion from 2014 (average annual growth of 3.2 percent).

The increase in expected education department spending next year is centered in two parts of the department's budget. The budget for classroom instruction for general education and special education students is projected to rise by $316 million to $8.5 billion in 2015. Payments to charter schools and nonpublic schools (excluding schools providing special education pre-K) are expected to increase by $186 million next year and total $1.9 billion. The growth in these payments is driven almost exclusively by the increase in spending on charter schools, which IBO projects will amount to nearly $1.3 billion next year. The State Senate has proposed changes in the support of charter schools that would raise these costs substantially.

In terms of rate of growth, debt service on the money the city borrows for its capital projects and the cost of health insurance and other fringe benefits for city employees are the two key factors driving spending upwards. Under the Mayor's plan, IBO projects debt service will grow at an annual rate of 8.0 percent (after adjusting for the use of the surplus to prepay some of this cost) over the 2014 to 2018 financial plan period. Spending on debt service is expected to total $6.8 billion in 2015, $1.1 billion more than this year. By 2018, debt service spending is projected to reach $7.8 billion.

In recent years, the Mayor's budget office has overestimated debt service costs by assuming an interest rate considerably higher than the actual rate. This enabled the Bloomberg Administration to find millions of dollars in debt service savings over the course of a fiscal year. Although the assumed interest rate in the current budget plan remains high, interest rates have been inching up, so built-in savings will not likely be as large. (For more details on the city's capital budget and financing plan, see pages 47-52 of this report.)

The cost of health insurance and other fringe benefits for city employees is expected to rise at a pace similar to that of debt service, growing at an annual rate of 7.2 percent over the 2014-2018 period. Health and other fringe benefit costs are expected to grow by about $220 million next year and total nearly $5.3 billion (excluding costs for the education department and city university system). These costs are projected to total $6.6 billion in 2018, an increase of about $1.6 billion from 2014. Mayor de Blasio has targeted savings on health insurance costs as one of his goals in negotiating labor settlements, so if successful these costs could ease in future budget plans.

IBO anticipates that some of the other large and costly items in the city budget will grow far more modestly. The cost of the city's contribution to employee pension funds is projected to rise by less than $10 million next year when it will total $8.2 billion. By 2018, city pension costs are expected to reach $8.6 billion, an increase of about $400 million (an annual growth rate of 1.2 percent). Under current projections, growth in city Medicaid spending is even slower. After rising an expected $82 million next year to $6.6 billion, Medicaid expenditures are projected to then remain roughly at that level for the rest of the financial plan as the state moves towards absorbing all of the increase in local Medicaid costs.

Some Additional Cost Estimates. There are also a number of expenses that IBO estimates will be higher than budgeted by the Mayor, additional expenditures that grow from $152 million in 2015 to $582 million in 2018. The largest of these expenditure differences is within the budget for the Department of Education. The budget does not include funding for all the charter schools scheduled to open this fall, nor does it contain sufficient funds for the charter schools that are already open and expected to expand the grades they include in the coming years. IBO estimates a $75 million shortfall for these purposes next year and $166 million in 2016—an amount that grows to nearly $500 million in 2018. It has been the routine practice of the Mayor's budget office not to include the necessary funds for new and expanding charter schools until later in the budget process.

IBO also projects that spending on overtime for the police and correction departments will be a combined $40 million a year more than budgeted for 2015 and 2016 based on expenditures in prior years. Although both these agencies have overspent their overtime budgets by substantially more than the amount IBO is adding, the additional spending on overtime has largely been covered by savings in other parts of the police and correction budgets. As a result, the two agencies are expected to need less money added to their budgets than the amount of additional overtime would suggest. Past patterns also lead IBO to expect that spending by the Board of Elections will be $25 million a year more than budgeted given the board's recent overspending.

Although the de Blasio Administration has increased city funds for providing shelter for homeless families by $6.3 million for 2015 and beyond, IBO expects additional funds will be needed given recent trends in

City Spending on an Operating Basis

In a surviving legacy of the 1970s fiscal crises, the city is required by law, to maintain its budget using generally accepted accounting principles. This means the city's budget must be balanced with expenditures equaling revenues received during and at the end of the city's fiscal year. It also means that in general city expenditures in a given fiscal year must be matched to revenues generated in the same year.

Of course, the city often receives more in revenue than planned or spends less than budgeted, resulting in a surplus for the current year. To get around the constraint of not ending the year with a surplus the city has developed a mechanism to avoid losing the benefit of a budget surplus by prepaying some expenses for the upcoming year while still matching revenues with expenditures in the same year. Generally, this involves using surpluses to make early payments of obligations originally scheduled for the upcoming fiscal year that are not associated with agency operations. The most common are prepayments of future debt service and early payments of subsidies due to noncity entities such as the Metropolitan Transportation Authority and the library systems.

Prepaying expenditures has the effect of masking what the actual rate of growth in spending would have been. When reversing the effect of the prepayments and reporting expenditures on an "operating basis" by assigning expenditures to the year in which they were due, a clearer fiscal picture emerges.

Officially, revenues exceeded expenditures by $5 million for 2013 as reported in the Comptroller's Comprehensive Annual Financial Report. However, after adjusting for prepayments and the use of funding from the Retiree Health Benefits Trust, on an operating basis 2013 would show a deficit of $423 million.

Operating results for 2014 and 2015 would also be in deficit by $831 million and $927 million, respectively, using IBO's projections of revenues and expenditures. Operating deficits for 2014 and 2015 emerge because expenditures are growing at a faster pace than revenues; with 2014 expenditures growing by 4.4 percent compared with 3.7 percent for revenues. In 2015, expenditures grow by 5.0 percent, slightly faster than the 4.9 percent growth in revenues.

Starting in 2016, revenues begin to grow at a faster pace, 4.8 percent, or 1.8 percentage points over expenditure growth, resulting in a small operating surplus of $28 million. The trend in revenue growth exceeding expenditure growth continues in 2017 and 2018 and results in operating surpluses of $1.1 billion and $1.5 billion, respectively.

IBO Projected Operating Surplus /(Deficit)
Dollars in millions

	2013	2014	2015	2016	2017	2018
Total City Revenue	**$50,710**	**$52,563**	**$55,135**	**$57,795**	**$60,326**	**$62,392**
Growth/(Decline)		**3.7%**	**4.9%**	**4.8%**	**4.4%**	**3.4%**
Total City Expenditures	**$50,705**	**$52,563**	**$53,949**	**$57,665**	**$59,231**	**$60,901**
Reverse Prepayments and Transfers:						
2012 Prepayment	2,431	31	-	-	-	-
2013 Prepayment	(2,807)	2,807	-	-	-	-
2014 Budget Stabilization Account	-	(1,770)	1,770	-	-	-
IBO 2014 Prepayment Adjustment	-	(244)	244	-	-	-
TFA Debt Defeasance Prepayment	(196)	7	99	103	-	-
Retiree Health Benefits Trust Funds	1,000	-	-	-	-	-
Total City Expenditures - Adjusted	**$51,133**	**$53,394**	**$56,062**	**$57,767**	**$59,231**	**$60,901**
Growth/(Decline)		**4.4%**	**5.0%**	**3.0%**	**2.5%**	**2.8%**
Operating Surplus/(Deficit)	**$(423)**	**$(831)**	**$(927)**	**$28**	**$1,095**	**$1,491**

SOURCES: 2013 Comprehensive Annual Financial Report of the Comptroller; February 2014 Financial Plan
NOTE: Figures may not add due to rounding.

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Although these projections in revenue and expenditure growth are promising, one major expenditure issue remains unresolved. Once labor settlements are reached, additional funds may be needed if the new labor costs exceed what is currently budgeted in the city's financial plan, which would drive up the rate of expenditure growth. This along with other revenue and expenditure adjustments that are typically made to the out-years of the city's financial plans may very well change growth rate projections and could have a big effect on projected surpluses and gaps.

IBO Expenditure Projections
Dollars in millions

	2014	2015	2016	2017	2018	Average Change
Health & Social Services						
Social Services						
Medicaid	$6,547	$6,629	$6,598	$6,598	$6,598	0.2%
All Other Social Services	3,039	2,917	2,909	2,910	2,910	-1.1%
HHC	263	81	81	81	81	-25.5%
Health	1,404	1,362	1,358	1,358	1,358	-0.8%
Children Services	2,793	2,828	2,828	2,828	2,828	0.3%
Homeless	1,054	1,018	1,018	1,018	1,018	-0.9%
Other Related Services	647	750	719	732	741	3.5%
Subtotal	**$15,747**	**$15,586**	**$15,510**	**$15,524**	**$15,533**	**-0.3%**
Education						
DOE (excluding labor reserve)	$19,693	$20,515	$21,122	$21,779	$22,352	3.2%
CUNY	880	852	846	837	845	-1.0%
Subtotal	**$20,573**	**$21,367**	**$21,969**	**$22,616**	**$23,197**	**3.0%**
Uniformed Services						
Police	$4,739	$4,657	$4,645	$4,638	$4,638	-0.5%
Fire	1,962	1,862	1,841	1,823	1,787	-2.3%
Correction	1,070	1,078	1,078	1,078	1,078	0.2%
Sanitation	1,418	1,477	1,484	1,463	1,464	0.8%
Subtotal	**$9,190**	**$9,074**	**$9,048**	**$9,002**	**$8,966**	**-0.6%**
All Other Agencies	**$9,294**	**$8,096**	**$8,193**	**$8,331**	**$8,490**	**-2.4%***
Other Expenditures						
Fringe Benefits	$5,038	$5,261	$5,674	$6,108	$6,644	7.2%**
Debt Service	4,977	4,719	7,294	7,624	7,825	8.0%*
Pensions	8,197	8,205	8,324	8,428	8,605	1.2%
Judgments and Claims	663	674	710	746	782	4.2%
General Reserve	150	600	600	600	600	n/a
Labor Reserve:						
Education	-	-	-	-	-	n/a
All Other Agencies	265	465	714	983	1,268	n/a
Expenditure Adjustments	-	56	123	219	333	n/a
TOTAL EXPENDITURES	**$74,093**	**$74,103**	**$78,159**	**$80,181**	**$82,242**	**2.6%**

NOTES: *Represents the annual average change after adjusting for prepayments. **Fringe benefits exclude DOE and CUNY expenditures, which are reported within DOE and CUNY budget amounts. Expenditure adjustments include energy, lease and nonlabor inflation adjustments. Figures may not add due to rounding.

the shelter census. IBO projects that city spending on family shelter will be $9.2 million more than budgeted for 2015 and $24 million higher when state and federal funds for homeless families are included. (For more details on homeless services spending see page 31.)

New Dance, New Initiatives? For at least two decades budget making has come to be dominated by a ritual of cuts proposed by the Mayor, followed by restorations championed by the City Council that came to be known as the budget dance. This dance has largely crowded out discussion of broader spending and revenue initiatives by the City Council as part of the negotiations with the Mayor on an adopted budget. A fairly standard set of programs—from after-school slots to health care services to library subsidies—would receive funding for one year and then need to be renewed at the Council's initiative as part of the deal for the next year's budget. Mayor Bloomberg largely ended the dance in November by adding funds for the affected programs in each year of his last financial plan.

While there are still some programs that were not restored such as support for anti-eviction legal services and funding for classroom supplies teachers would otherwise pay for themselves, the Council's focus during budget negotiations is no longer largely tied to preserving a long list of community services. What could emerge in the future is a new dance with new steps, one that involves negotiating with the Mayor over a broader range of spending or revenue measures.

New spending initiatives are likely to come from the Mayor's office as well. Mayor de Blasio announced a much publicized Vision Zero plan to improve pedestrian safety just days after presenting the Preliminary Budget. Costs for the new program have yet to be presented. The Mayor's plan for building and preserving affordable housing, scheduled to be presented in May, will likely come with new costs for the city budget

A number of other issues could also lead to more spending than anticipated in the Preliminary Budget. One source of new spending needs could be the city's public hospitals. While the federal Affordable Care Act has helped propel enrollment in the Health and Hospitals Corporation's health insurance plan and boost revenues, the hospital system continues to face ongoing fiscal challenges. The de Blasio Administration assumes that the public hospitals will receive $400 million a year in 2015 through 2018 from the $8.0 billion coming to the state due to the recently announced federal Medicaid waiver. But the process of leveraging those funds could wind up forcing the city to provide more support for the hospitals corporation. (For more details on the Medicaid waiver and the fiscal condition of the public hospitals, see pages 34-36.)

Assistance for the New York City Housing Authority also could drive new spending. The housing authority's budget struggles led the de Blasio Administration to provide $53 million in one-time aid this year. A backlog of apartment repairs and funding shortfalls still present significant challenges to the housing authority and could put pressure on the city to provide more aid.

Conversely, there are risks to IBO's economic forecast that could result in lower-than-expected tax revenues and undercut the Mayor's spending plans. Financial upheaval in Europe, China, or elsewhere could affect the U.S. economy and have a disproportionate impact on New York City given its role as a global financial center. The effects could reach beyond the city's financial services industry, impacting New York's tourism and retail sectors as well. The city's economy would also face a challenge if Wall Street profits are constrained more than IBO expects by increased capital requirements and other regulations and as the Federal Reserve increases interest rates.

A Mix of Sun and Clouds. In presenting his first budget for the city, Mayor de Blasio declared his intent to be "both fiscally responsible and economically progressive." The Mayor expressed the view that being fiscally responsible is what would allow him to undertake initiatives promoting better services and reducing inequality.

At a glance, IBO's revenue and spending projections under the Mayor's budget plan present a bright fiscal outlook: five years running of budget surpluses—seemingly an indication of fiscal responsibility. But a closer look reveals the large cloud darkening this outlook: labor contracts with every municipal union have expired.

As IBO has noted, there are many different paths to an eventual settlement of the labor contracts. These different paths also lead to widely divergent outcomes in terms of cost to the city budget. Until a labor settlement is reached, the city's fiscal picture will remain clouded, as will the Mayor's ability to achieve his twin goals of fiscal responsibility and progressive government.

Economic Outlook

Economic Overview. IBO's economic forecast has changed little since its Fiscal Outlook report was released in December. The drag on U.S. economic growth created by federal fiscal policy in 2013—the tax increases that took effect in January and the cuts to federal government spending under the sequester that took effect in March—is now abating. With the expectation of no new contractionary policies and the Federal Reserve's (Fed) maintenance of low interest rates in 2014, IBO forecasts an acceleration of economic growth—to 2.8 percent growth in real gross domestic product (GDP) in 2014 and 3.5 percent in 2015. (Unless otherwise noted, in this economic outlook section years refer to calendar years rather than fiscal years.) Even with this growth, the U.S. unemployment rate is not expected to fall below 6.0 percent until late in 2015.

With the addition of 83,100 new jobs in 2013 according to recently revised data, employment in New York City reached an all-time high. IBO forecasts somewhat less employment growth in the coming years—the addition of 70,300 jobs in 2014 and an average of 59,700 new jobs in each of the next four years. While moderate in comparison to the numbers of jobs added in the last three years, the projected employment growth is on par with job growth during previous expansions. However, increases in wages and earnings in the city have not kept pace with job growth. The composition of the city's work force has shifted, and is expected to shift further, towards lower paying industries.

U.S. Economy. Though revised data indicate that the U.S. economy grew a bit faster in 2013 than was previously estimated, IBO's macroeconomic forecast remains almost the same as it was in December. Contractionary fiscal policies that took effect at the beginning of 2013, compounded by the federal government shutdown in October, constrained growth of the nation's real gross domestic product (GDP) to 1.9 percent—far less than 2.8 percent growth in 2012. The fiscal drag attributable to last year's tax increases and spending cuts is now abating, and barring external shocks to the economy and further contractionary fiscal policies, IBO forecasts faster real GDP growth in the next two years: 2.8 percent in 2014 and 3.5 percent in 2015.

The U.S. economy's recovery from the Great Recession of 2008 and 2009 has been unusually slow, with modest job growth in the private sector coupled with declines in government employment. It has taken four years for the private sector to regain almost all (98.5 percent) of the 8.8 million jobs lost over 25 months of contraction. Over the last three years, private sector employment gains have been relatively steady—ranging from 2.3 million to 2.4 million each year—while job losses in government have tapered off to an average of less than 3,000 a month in 2013. All the job gains have resulted in only a gradual decline in the nation's unemployment rate, from 9.9 percent at the recession's trough (fourth quarter of 2009) to 7.0 percent in the last quarter of 2013—still well above the average 4.6 percent unemployment rate in 2007. Had the labor force participation rate of the 16-and-over population not fallen during this period as discouraged job seekers left the labor market entirely, there would have been even less of a decline in the unemployment rate.

The recovery's lackluster employment gains and GDP growth have continued even as conditions favorable to a more robust economic expansion have been in place for some time. The recession brought a prolonged period of deleveraging by businesses, banks, and households that has strengthened balance sheets. After-tax profit margins of the corporate sector have reached new highs in the last few years as businesses have reduced their operating costs, although to the extent this has resulted from slower hiring and wage growth, it has damped down consumer demand. Large banks are also better capitalized—the result of more stringent capital requirements in the wake of the financial crisis and the high profit margins that low interest rates have enabled. The household sector's

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

	2013	2014	2015	2016	2017	2018
National Economy						
Real GDP Growth						
IBO	1.9	2.8	3.5	3.2	2.7	2.4
OMB	1.9	2.5	3.1	3.3	3.2	3.0
Inflation Rate						
IBO	1.5	2.0	2.4	2.4	2.5	2.4
OMB	1.5	1.4	1.7	1.9	1.9	2.0
Personal Income Growth						
IBO	2.9	5.6	6.9	5.9	4.9	4.5
OMB	2.8	4.7	4.8	5.2	5.5	5.2
Unemployment Rate						
IBO	7.4	6.4	6.0	5.7	5.5	5.4
OMB	7.4	6.6	6.0	5.7	5.3	5.1
10-Year Treasury Bond Rate						
IBO	2.4	3.3	4.2	5.1	4.9	4.7
OMB	2.3	3.3	3.5	4.0	4.6	4.6
Federal Funds Rate						
IBO	0.1	0.1	0.3	2.3	3.6	4.1
OMB	0.1	0.1	0.4	2.2	3.8	4.0
New York City Economy						
Nonfarm New Jobs (thousands)						
IBO	83.1	70.3	67.5	66.4	55.7	49.2
OMB	77.0	57.0	52.0	56.0	54.0	54.0
Nonfarm Employment Growth						
IBO	2.1	1.8	1.7	1.6	1.3	1.2
OMB	2.0	1.4	1.3	1.4	1.3	1.3
Inflation Rate (CPI-U-NY)						
IBO	1.7	2.1	2.9	2.9	3.0	2.9
OMB	1.7	1.6	1.9	2.1	2.1	2.2
Personal Income ($ billions)						
IBO	487.1	515.3	547.6	579.6	606.6	634.3
OMB	481.8	503.1	522.9	546.9	574.8	602.3
Personal Income Growth						
IBO	3.7	5.8	6.3	5.8	4.7	4.6
OMB	2.0	4.4	3.9	4.6	5.1	4.8
Manhattan Office Rents ($/sq.ft)						
IBO	68.4	68.0	69.9	72.3	73.4	75.2
OMB	68.4	67.5	69.4	71.0	73.3	75.2

SOURCE: Mayor's Office of Management and Budget
NOTES: Rates reflect year-over-year percentage changes except for unemployment, 10-Year Treasury Bond Rate, Federal Funds Rate, and Manhattan office rents. The local price index for urban consumers (CPI-U-NY) covers the New York/Northern New Jersey region. Personal income is nominal. For 2013, New York City personal income and growth rates are estimated, pending Bureau of Economic Analysis release. IBO employment numbers reflect March 2014 benchmark.

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debt as a percentage of its disposable (after-tax) income is at the lowest level in the last 30 years, and the improved financial position of households coupled with considerable pent-up demand, has stimulated consumer spending, particularly for autos and other durable goods. Very low interest rates have increased access to mortgage financing, stimulated home sales, and reversed the long slide in home prices. The improving housing market and the strength in the stock market have created a wealth effect that has also boosted spending, especially by higher-income households.

The Federal Reserve's policy of low interest rates, keeping the federal funds rate on overnight loans between banks near zero and continuing to buy up financial assets to put downward pressure on long-term interest rates (quantitative easing), has been an essential ingredient of economic growth. Low rates have been vital to the turnaround of the housing market, which had been a major impediment to growth in the aftermath of the Great Recession. In contrast to monetary policy, last year's fiscal policies—the elimination of the payroll tax cut and the increase in marginal tax rates for high-income taxpayers as well as sequestration's across-the-board spending cuts—substantially reduced GDP growth in 2013. Further damage was done by the extended negotiations between Congress and the White House over the federal budget and debt ceiling, which led to the partial shutdown of the U.S. government in the first half of October. In addition to interrupting government operations and pruning federal contracts with businesses, the shutdown and the brinksmanship that led up to it undermined consumer and business confidence.

IBO's forecast for 2014 and beyond is premised on there being no external shocks to the economy, no unintended consequences of monetary policy, and no additional harm from fiscal policy. The Federal Reserve has indicated that it will continue its accommodative monetary policy until labor markets have substantially recovered from the recession or inflation appears to be taking hold.[1] Based on our employment forecast, this suggests that the Fed will maintain a near-zero federal funds rate through most of 2014. IBO assumes the Federal Reserve will continue to slowly wind down its asset purchases in a transparent and orderly fashion and succeed in avoiding sudden spikes in interest rates. The approval in Washington of a budget agreement at the end of 2013 removes the threat of a government shutdown or another round of sequestration cuts in 2014. It is consistent with our premise that the total dollar amount of deficit reduction in federal budgets will remain essentially unchanged in the foreseeable future.[2] Also consistent is the Congressional agreement to shelve political brinksmanship until the nation's debt ceiling needs to be increased next March.

The unusually harsh winter weather that battered much of the country has slowed employment growth in recent months. From December through February, job growth averaged only 129,000 per month, compared with 194,000 per month for all of 2013. But with no new contractionary fiscal policies, IBO expects economic growth to pick up in 2014, as the impact of the 2013 tax increases and spending cuts are now diminishing. IBO forecasts 2.8 percent real GDP growth in 2014 and 3.5 percent growth in 2015—the latter growth would be faster than in any year since 2004. Personal income growth will accelerate from a modest gain of 2.9 percent in 2013 to 5.6 percent and 6.9 percent in 2014 and 2015, respectively. Faster growth will bring significant reduction in the unemployment rate, to an average of 6.4 percent in 2014 and 6.0 percent in 2015. It also will put upward pressure on prices. As the unemployment picture improves, we expect the Fed to begin increasing the federal funds rate by the end of 2014 in order to contain potential inflation. IBO forecasts a rise in the inflation rate from 2.0 percent in 2014 to 2.4 percent or 2.5 percent in each year thereafter.

IBO expects growth of both personal income and output to moderate after 2015, with real GDP growth dipping to 3.2 percent in 2016, and then falling further to 2.7 percent and 2.4 percent in 2017 and 2018, respectively. Despite slower economic growth, we expect the unemployment rate to continue its gradual decline, falling below 6.0 percent for the first time since 2008 by the end of 2015.

Compared with IBO's macroeconomic forecast, the Mayor's Office of Management and Budget (OMB) projects slightly slower real GDP growth in 2014 (2.5 percent versus 2.8 percent for IBO) and 2015 (3.1 percent versus 3.5 percent). Despite OMB's expectation of slower growth, the two forecasts of unemployment rates are very similar. For 2014, OMB's forecast of unemployment is just slightly higher than

IBO's (6.6 percent versus 6.4 percent), and the two forecasts are identical for 2015 (6.0 percent) and 2016 (5.7 percent). With slower growth, OMB forecasts considerably lower inflation than IBO; OMB's inflation forecast is below IBO's by 0.6 percentage points for 2014 (1.4 percent versus 2.0 percent) and by 0.7 percentage points for 2015 (1.7 percent versus 2.4 percent). The starkest differences between the two forecasts occur towards the end of the period, when OMB expects GDP growth to gradually slow to 3.0 percent in 2018, while IBO projects that growth will fall more steeply to reach 2.4 percent in the final year of the forecast.

New York City Economy. New York City payroll employment has grown by an average of 85,500 (2.3 percent) per year over the last three years. Private-sector growth has been even stronger (90,300, or 2.8 percent per year)—the largest three year average gain since records began (1950).[3]

Looking beyond the city's payroll expansion, however, the story is more mixed. The growth in payrolls has been offset somewhat by a decline in average hours worked in New York City. Average weekly hours of private-sector employees fell sharply in the recession and slipped further in 2012 and 2013. We estimate that about four-fifths of this decline reflected shrinking work weeks within industries. The remainder was due to the change in the city's job mix—in particular, the falling share of employment in financial activities (where average work weeks are long) and rising shares of employment in education and health care and in leisure and hospitality (where average work weeks are relatively short). In all, while total private employment increased 5.6 percent from 2008 through 2013, aggregate hours worked increased only 2.5 percent.

The city has also lagged the nation in terms of reducing unemployment. Even while the city has far outpaced the rest of the United States in terms of recovery of jobs lost during the Great Recession, the city's annual average unemployment rate declined from 9.6 percent in 2010 only to 8.6 percent in 2013; over the same period the national unemployment rate fell from 9.6 percent to 7.3 percent. However, the U.S. unemployment rate would have been higher had there not been a decline in recent years in labor force participation of working-age Americans—a decline which by itself causes the unemployment rate to fall since those not looking for work are not counted among the unemployed. In contrast, though New York City's labor force participation rate has been lower than the nation's, it has not been trending down.

The expansion also looks less robust in terms of wages. There has been no growth in overall real average wages in New York City from 2010 through 2013—and real wages remain well below the prerecession peak. This is largely due to the decline in securities sector wages, which have fallen in five of the past six years but remain five times higher than the average for jobs in other industries.

Wall Street's reduced compensation and hiring is also reflected in the composition of the current expansion as compared with previous growth periods. Thus, in the 2003 through 2008 expansion that preceded the recession, the securities sector accounted for 9.1 percent of the growth in jobs and 56.3 percent of the growth in real aggregate wages in New York City. In contrast, securities contributed nothing to job growth from 2009 through 2013, and generated just 9.3 percent of the aggregate real wage growth. Professional and business services, education and health care services, leisure and hospitality, and trade have been the main sources of job growth in both the prerecession and post-recession expansions, and are now also accounting for greater shares of the aggregate wage growth. The growing weight of the information sector is also notable—information has actually generated more aggregate wage

Comparing Average Wages and Salaries

	Average Wages and Salaries			Percent Change		
	2007	2010	2013	2007-2010	2010-2013	2007-2013
All Jobs	$88,275	$82,536	$82,203	-6.5%	-0.4%	-6.9%
Securities Sector	$437,546	$376,549	$353,376	-13.9%	-6.2%	-19.2%
All Other	$70,005	$68,793	$70,426	-1.7%	2.4%	0.6%

NOTE: In real 2013 dollars.

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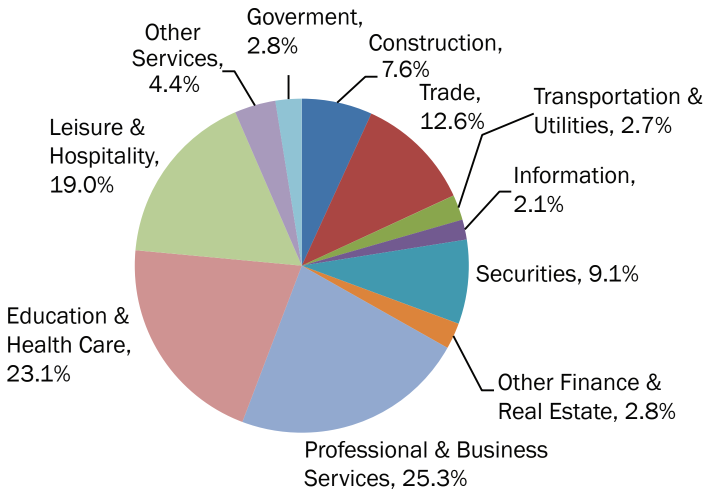
Prior Expansion

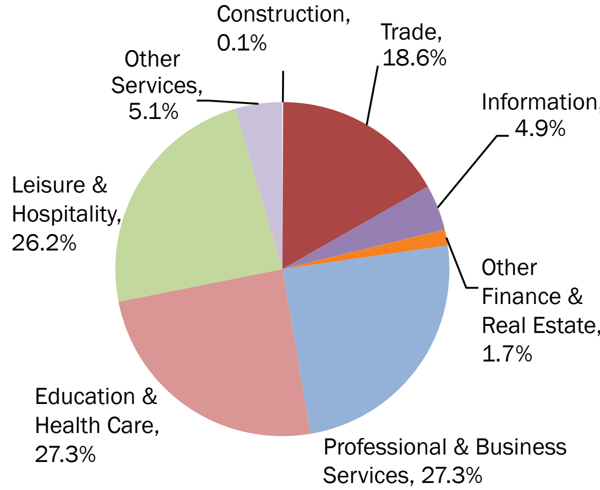
Current Expansion

Shares of New York City Employment Growth, 2003-2008



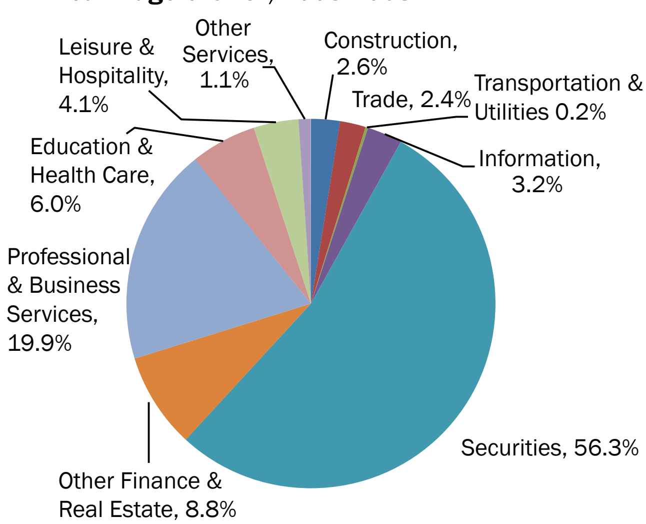
NOTES: Sums to >100%. Manufacturing contributed -11.8% to 2003-2008 NYC employment growth.

Shares of New York City Employment Growth, 2009-2013



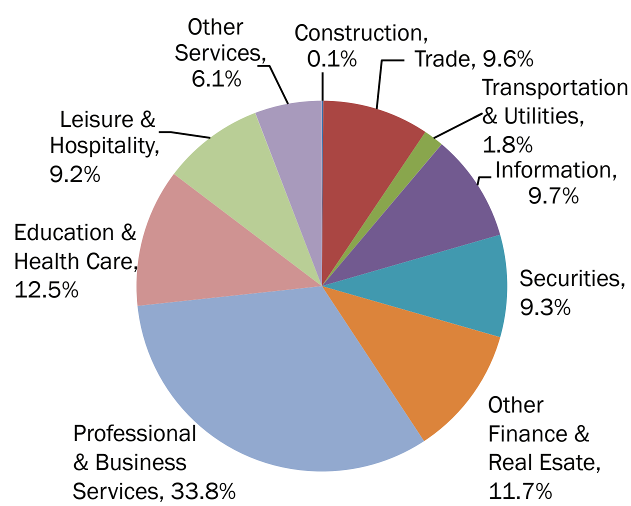
NOTES: Sums to >100%. Manufacturing contributed -2.0%, transportation & utilities -0.2%, securities -0.5%, and government -8.5% to 2009-2013 NYC employment growth.

Shares of New York City Aggregate Real Wage Growth, 2003-2008



NOTES: Sums to >100%. Manufacturing contributed -2.6% and government -2.0% to 2003-2008 NYC aggregate real wage growth.

Shares of New York City Aggregate Real Wage Growth, 2009-2013



NOTE: Sums to >100%. Manufacturing contributed -0.8% and government -3.0% to 2009-2013 NYC aggregate real wage growth.

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growth than securities in the current expansion.

The broker-dealer profits of New York Stock Exchange member firms were still a solid $16.7 billion in 2013, though down from $23.9 billion the previous year. But the difference between Wall Street before the recession and now is best seen in the comparison of firm revenues, which in 2013 were $162.4 billion—almost unchanged from 2012 but well under half of the 2007 peak ($352.0 billion). That broker-dealers still generate profits is largely by dint of the enormous decline in interest expenses. Interest costs fell to $14.4 billion in 2013—even in nominal terms, the lowest tally since 1987, though one has to go back to 1975 to find interest costs as low per dollar of revenue (8.8 cents per dollar). In 2007, interest costs were $249.8 billion (71 cents per dollar of revenue). The plunge in interest expenses reflects the near-zero funds rate policy of the

Federal Reserve since the recession, as well as a fall-off in borrowing.

IBO's economic forecast does not include any large shocks during the forecast period that would have a significant impact on the national or local economy, but a confluence of factors lead to a tapering of New York City job growth over the next five years. Total payroll job growth is projected to slow from about 70,300 in 2014 to 49,200 in 2018, averaging 61,800 (1.5 per percent) per year—moderate by recent standards, but still on par with "typical" expansions going back to 1950. Private-sector payrolls will grow by an average of 61,200 (1.7 percent) per year. IBO expects the deceleration in city job growth to become more pronounced after 2016, largely in line with the slowdown we project for the U.S. economy overall. Despite the tapering off of job growth, we are expecting the city's unemployment rate to fall throughout the plan period, hitting 5.3 percent in 2018.

The mix of industries IBO expects to add jobs over the next five years looks a lot like the mix adding jobs over the past four years. Again, most job growth will come from education and health care services (28.0 percent of total employment growth from 2013 through 2018), professional and business services (25.6 percent), leisure and hospitality (14.8 percent), and wholesale and retail trade (12.7 percent). The latter two sectors will continue to be substantially boosted by tourism. The securities sector is expected to pick up slightly, but will account for only 3.3 percent of projected city job growth—and just 13.0 percent of projected aggregate real wage growth, still a very far cry from expansions prior to the Great Recession.

With Wall Street adjusting to a new and still unfolding regulatory regime, IBO anticipates a moderate rise in New York Stock Exchange broker-dealer revenues, which are expected to finally surpass $200 billion again in 2018. But profits will remain fairly flat, averaging about $14.5 billion over the next five years. This is largely because rising revenues will be absorbed by growing interest costs. By 2018, interest expenses will offset about 18 cents of every dollar of broker-dealer revenues. This is still decidedly low by prerecession standards.

Property Values. Recent data shows that real estate markets, particularly for commercial properties, were even stronger in the last months of 2013 than IBO had estimated in our December forecast. The total value of commercial real estate sales recorded in 2013 was $53.8 billion, an increase of 43.0 percent over the 2012 total. There were 86 sales of large commercial buildings (those with a sales price of $100 million or higher) in 2013 compared with 70 in 2012.

Most residential markets continue to recover from their 2008-2009 nadir. Sales of coop and condo apartments have largely regained the prerecession levels, while sales of one-, two-, and three-family homes are still substantially below. The median sales price of Manhattan condos gained 8.9 percent in 2013. With several new condo buildings coming to market, the number of sales increased by 4.4 percent last year and was above the 2007 level. The median sales price for Manhattan coops grew only slightly (1.4 percent) and volume remains 15.7 percent below the prior peak in 2004. The median sales prices for both coops and condos in Manhattan are now essentially back to their 2008 levels.

Outside Manhattan, median apartment sales prices increased moderately in 2013—1.6 percent for condos and 3.2 percent for coops—and are now almost equal to their 2008 peaks. Volume for coop sales outside Manhattan was up by 29.5 percent in 2013 but is still only about two-thirds its prerecession level. The picture is different for condo sales where volume grew by 10.7 percent last year and was at the highest level since 1993.

The median sales price for houses in 2013 was up by 5.6 percent compared with 2012 but still remained 13.0 percent below the 2007 peak. There were 20,350 sales in 2013, an increase of 14.0 percent over 2012 but still barely half of the 39,400 that occurred in 2004.

IBO expects property markets to cool somewhat in 2014, with the total value of commercial property sold expected to decline by 14.3 percent, compared with a gain of 24.1 percent in 2013. Likewise, the residential sales total will grow by 6.1 percent, only a quarter of the increase that occurred in 2013. IBO projects that the total value of residential and commercial properties will together increase at an average rate of 7.2 percent annually in 2015 through 2018.

IBO projects a slight (-0.6 percent) decline in average Manhattan office rents in 2014, followed by modest growth (2.5 percent per year) through the rest of the plan period. This outlook reflects weakness in office-using employment sectors, particularly financial services, as well as the relatively large amount of office space expected to come on line at the World Trade Center beginning in 2015.

Risks to the Economic Forecast. IBO's outlook for the U.S. economy is premised on there being no external shocks to the economy, and on monetary and fiscal policies remaining conducive to growth. The risks to the nation's economy from unforeseen events or policies also extend to the city's economy, which has significant exposure to the national and global economy in its role as a world financial center and major tourist destination.

Risks to the U.S. Forecast. The execution of monetary policy poses a major risk to IBO's economic forecast, which anticipates a gradual and orderly rise in interest rates as the economy strengthens. Unwinding quantitative easing without generating sharp increases in long-term interest rates will be a challenge.

Recent agreements in Congress have reduced the possibility of contentious battles over the federal budget and debt ceiling this year, but after 2014 the risk of fiscal policy brinksmanship returns. Another showdown over the federal budget or debt ceiling would again undermine consumer and business confidence—essential ingredients to sustained economic growth—and potentially trigger another downgrade of U.S. debt.

A shock to the U.S. economy, whether from a large rise in oil prices or economic disruptions elsewhere in the global economy, could derail the economic growth IBO is projecting. Any sudden increase in the world price of oil could significantly harm growth here, particularly if it were to occur before the U.S. economy has gathered more momentum.

While potential geopolitical flash points such as the Middle East or, more recently, Eastern Europe, could bring collateral economic disruptions, the economic problems of China—the world's second largest economy—pose the greatest risk. China's growth has been spectacular, but it has been powered by an enormous accumulation of debt, large portions of which are off balance sheets and nonperforming in all but name. China's policymakers are now starting to confront the challenge of weaning the financial system and the economy at large off of unsustainable credit expansion, but it remains to be seen if this can be accomplished without major disturbances to international trade and finance.

The economic problems of the European Union have faded from the headlines in recent months as the region appears to have emerged from recession. But the current institutional underpinnings of the euro and economic differences among the countries using it may not be able to sustain the currency in the long run. European Union countries together constitute a major U.S. trading partner, and any worsening of their economies could have a major impact on global trade and financial markets, including those in the United States.

Risks to the New York City Forecast. Given New York City's role as a global financial center, shocks to the U.S. economy from financial crises in Europe, China, or elsewhere would have a disproportionate impact on New York City's economy. In addition to harming the city's financial services industries, the shock would also be transmitted to the city's tourism and retail sectors.

The city's economy would be challenged if the revenue and profitability of firms in the securities and banking sectors are constrained more than IBO has anticipated. Increased capital requirements and other regulations have already limited Wall Street revenues, and the eventual tightening of monetary policy will push up interest costs on the expense side. If that squeeze turns out to be tighter than we have forecast, a less profitable financial sector will spill over to the city economy at large.

Finally, by the end of the current financial plan in 2018, almost a decade will have passed since the Great Recession. That is a relatively long time to go without a cyclical downturn of one sort or another.

Endnotes

[1]In 2012, the Federal Reserve set a target unemployment rate of 6.5 percent to mark when it would begin to raise the federal funds rate. More recently, this month the new chair of the Federal Reserve has indicated that policymakers will use a broader set of criteria beyond the overall unemployment rate to identify when monetary tightening can begin, highlighting indicators such as the number of long-term unemployed.

[2]The failure of Congress to extend emergency unemployment benefits for the long-term insured, which expired December 28, 2013, could be considered a contractionary fiscal policy in most cases. But plans to continue the benefits have generally been premised on there being offsetting cuts to federal spending, which would make the extension revenue neutral.

[3]These numbers reflect the March 2014 benchmark revision; prior to the revision, overall employment averaged 2.1 percent annual growth over the past three years and total private employment 2.7 percent annual growth.

Tax Revenue Projections

Based on our updated economic forecast and current collections data, IBO estimates that tax revenues for 2014 will total $46.2 billion, an increase of 2.9 percent over 2013. (In this section and the balance of the report, years refer to city fiscal years unless otherwise noted.) Baseline revenue growth is projected to accelerate to 5.3 percent in 2015, bringing total tax revenues to $48.6 billion. IBO's tax forecast for 2014 is $508 million (1.1 percent) higher than in our December forecast with most of the increase coming from property transfer taxes and the personal income tax; in both cases collections last fall turned out to be better than we anticipated. For 2015, our forecast is up by $360 million (0.7 percent), largely due to stronger than anticipated property assessments on the tax roll that was released in January.

For the balance of the financial plan, baseline revenues are expected to grow at a healthy rate of 4.9 percent annually. Under IBO's forecast, tax revenues will total $56.1 billion by 2018. Over the five years, 2014 to 2018, projected tax revenue growth will average 4.5 percent annually which is slower than the growth for the five years 2010 through 2014 (the average was 5.8 percent annually) and far below the explosive tax revenue growth preceding the Great Recession.

IBO's baseline tax revenue forecast exceeds projections by the Mayor's Office of Management and budget (OMB) by $302 million (0.7 percent) in 2014 and $1.0 billion (1.6 percent) in 2015. The difference continues to grow, reaching $2.4 billion by 2018, although in percentage terms the difference is under 1.0 percent in each year from 2016 through 2018. The most significant differences in the forecasts are in the business and personal income taxes.

The figures above all pertain to baseline tax revenues that reflect current law. The Mayor's Preliminary Budget also includes a proposed increase in the personal income tax for high income households. If this increase were enacted, IBO estimates that there would be additional tax revenue of $554 million in 2015, $578 million in 2016, and $630 million by 2018. This proposal is discussed in more detail below.

In the individual tax sections that follow we focus on information that has changed since our December forecast was released. This is particularly the case for the real property tax where the new assessment roll was released in January.

Real Property Tax

IBO projects that property tax revenues will grow from $19.8 billion in 2014 to $20.9 billion in 2015, a 5.6 percent increase. Faster than projected growth on January's tentative assessment roll has led us to increase our 2015 forecast by $324 million compared with our previous forecast in December. We expect property tax revenue to grow at an average annual rate of 5.1 percent over the financial plan period.

The Tentative Assessment Roll for 2015. In January, the Department of Finance released the tentative 2015 assessment roll. After taxpayer challenges and other department adjustments are processed, assessments will be finalized in May and used for setting 2015 tax bills. IBO projects a larger than usual change from the tentative to the final roll this year, a decrease of 1.4 percent or $2.7 billion in assessed value for tax purposes.[1] About $982 million in assessed value for tax purposes was put back onto the tentative roll after a number of institutions—primarily not-for-profits—failed to submit information documenting their exempt status and therefore lost their full tax exemptions. IBO expects that many of these institutions will have their tax exemptions restored by the time the final roll is released, thereby lowering the total assessed value for tax purposes.

The final roll is expected to show assessed value for tax purposes of $182.7 billion. The restoration of exemptions for nonprofit institutions is expected to reduce assessed value for tax purposes in Class 4 by $737 million. The remaining reduction of $1.9 billion will result from routine tentative-to-final roll

IBO Revenue Projections
Dollars in millions

	2014	2015	2016	2017	2018	Average Change
Tax Revenue						
Property	$19,786	$20,887	$21,851	$22,961	$24,165	5.1%
Personal Income	8,783	9,458	9,989	10,451	10,856	5.4%
General Sales	6,448	6,765	7,050	7,349	7,616	4.2%
General Corporation	2,814	2,921	3,120	3,281	3,425	5.0%
Unincorporated Business	1,852	2,108	2,287	2,449	2,621	9.1%
Banking Corporation	1,220	1,273	1,365	1,434	1,465	4.7%
Real Property Transfer	1,458	1,323	1,469	1,566	1,629	2.8%
Mortgage Recording	932	889	998	1,057	1,092	4.0%
Utility	408	432	445	459	474	3.8%
Hotel Occupancy	541	575	612	643	675	5.7%
Commercial Rent	694	730	758	781	801	3.6%
Cigarette	58	56	54	51	49	-4.0%
Other Taxes, Audits, and PEGs	1,202	1,211	1,211	1,211	1,211	0.2%
Total Taxes Before Proposal	**$46,196**	**$48,627**	**$51,208**	**$53,694**	**$56,078**	**5.0%**
Tax Proposal						
Universal Pre-K (PIT increase)	$0	$554	$578	$605	$630	n/a
Total Taxes After Proposal	**$46,196**	**$49,181**	**$51,786**	**$54,299**	**$56,708**	**5.3%**
Other Revenue						
STaR Reimbursement	$844	$883	$886	$890	$894	1.4%
Miscellaneous Revenue	5,537	5,085	5,139	5,152	4,805	-3.5%
Unrestricted Intergovernmental Aid	-	-	-	-	-	n/a
Disallowances	(15)	(15)	(15)	(15)	(15)	n/a
Total Other Revenue	**$6,367**	**$5,954**	**$6,010**	**$6,027**	**$5,684**	**-2.8%**
TOTAL CITY-FUNDED REVENUE	**$52,563**	**$55,135**	**$57,795**	**$60,326**	**$62,392**	**4.4%**
State Categorical Grants	$11,708	$11,907	$12,277	$12,748	$13,144	2.9%
Federal Categorical Grants	8,400	6,846	6,835	6,824	6,823	-5.1%
Other Categorical Aid	876	881	869	865	861	-0.5%
Interfund Revenue	546	520	513	513	513	-1.5%
TOTAL REVENUE	**$74,093**	**$75,289**	**$78,290**	**$81,276**	**$83,733**	**3.1%**

NOTES: Figures may not add due to rounding.

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adjustments, such as Tax Commission appeals, corrections, adjustments for properties under construction, and general exemption processing. IBO projects overall reductions in assessed value for tax purposes of $79 million in Class 1, $1.0 billion in Class 2 and $2.1 billion in Class 4. These reductions will be partly offset by a $485 million increase in assessed value for utility property in Class 3 (in anticipation of state assessments expected in April).

Outlook for Market and Assessed Values in 2015. When the roll is finalized in May, IBO forecasts that market value in the city will total $910.9 billion, 5.7 percent greater than 2014. This growth rate is more than twice the average annual growth of 2.7 percent seen from 2011 through 2014. Even with our expectation of a larger than usual reduction from the tentative roll to the final roll, assessed value for tax purposes is projected to grow 6.4 percent over 2014.

Class 1. The aggregate market value of Class 1 properties (one- to three-family houses) is expected to grow 4.2 percent in 2015. This would be the strongest growth since 2008 and far surpasses the

1.0 percent increase in aggregate market value seen in 2014. (Class 1 market value for 2014 was reduced by 1.7 percent between the tentative roll and final roll, presumably as the finance department recognized damage to homes as a result of Hurricane Sandy.)

IBO also projects strong growth in assessed value for tax purposes, an increase of 3.2 percent over 2014. In Class 1, the assessed value of a property moves toward a target of 6.0 percent of market value, with assessment increases capped at 6.0 percent a year or 20.0 percent over five years. If a parcel is assessed at less than 6.0 percent of market value, its assessed value grows until it hits the target ratio of 6.0 percent of market value or it reaches the cap on annual assessment increases—even if the market value stays flat or declines. When the housing market was strong, the median ratio for one-family homes outside Manhattan declined, from 5.4 percent in 2004 to a low of 3.7 percent in 2008, well below the 6.0 percent target. From 2009 through 2014, the median assessment ratio was increasing, from 4.0 in 2009 to 5.4 percent in 2014. The median assessment ratio remained 5.4 percent on the tentative 2015 roll.

Class 2 and Class 4. IBO projects that on the final roll for 2015, aggregate market value for all properties in Class 2 (multifamily property) will total $214.5 billion, 5.9 percent greater than in 2014. In Class 4 (commercial property), despite the larger than usual reduction from the tentative to final roll, market value is expected to total $253.6 billion, an 8.4 percent increase over 2014.

Aggregate assessed value for tax purposes is expected to be $62.6 billion for Class 2, 6.2 percent higher than 2014, and $90.7 billion for Class 4, a year-over-year increase of 7.5 percent. For both classes the projected annual growth exceeds the annual averages over the past eight years: 5.4 percent in Class 2 and 6.6 percent in Class 4.

This stronger growth in assessed value for tax purposes stems partly from the method for capturing changes in market value. Increases and, in many cases, decreases in parcels' market values are phased in over five years. The assessed value changes from the preceding four years that have yet to be recognized on the tax roll are called the pipeline. The pipeline had shrunk in the aftermath of the recent recession but strong growth in recent years, especially in Class 4, has replenished it. IBO projects that the pipeline will reach $18.1 billion in 2015, up sharply from $6.6 billion in 2011.

State STAR Exemption Registration. The state required all property owners receiving the School Tax Relief Program (STAR) property tax exemption to register with the state by December 31 of last year in order to continue receiving the exemption. While the deadline has passed, the state is still accepting late registrations. As of March 3, 2014, 80 percent of New York City residents currently receiving Basic STAR have registered (there is an Enhanced STAR benefit for property owners 65 years or older with income at or below $81,900, but they were not required to register with the state). The registration process will not have a fiscal impact on the city because the taxes will either be paid by property owners (if they do not register) or reimbursed by the state (if they register). However, over 100,000 city homeowners stand to lose their state tax benefit of about $300 each if they do not register.

Outlook for Market and Assessed Values, 2016-2018. For 2016, IBO forecasts an increase in aggregate market value of 5.1 percent. Growth in market value is projected at 3.7 percent in Class 1, 7.6 percent in Class 2, and 5.5 percent Class 4. In 2017 and 2018, annual market value growth is projected to average 4.7 percent for these three classes. Class 1 will be slower at 2.7 percent a year on average, while increases in Class 2 and Class 4 average 5.8 percent and 6.8 percent a year, respectively.

IBO projects growth of 4.9 percent in aggregate assessed value for tax purposes in 2016, slower than this year. Total assessed value for tax purposes in Class 1 is expected to grow an average of 2.8 percent a year from 2016 through 2018.

With the pipeline of assessed value increases in Class 2 and Class 4 replenished by the large increases in recent years, growth of assessed value for tax purposes is expected to remain strong through 2018, especially in Class 4. Growth of assessed value for tax purposes in Class 2 will average 4.2 percent a year through 2018. The Class 2 pipeline, estimated at $6.6 billion following the 2015 final roll, is expected to grow to $7.1 billion by 2018. With a larger pipeline in 2015, Class 4 has stronger growth, averaging 6.7 percent a year through 2018. IBO projects the total pipeline in Class 4 will be $11.4 billion after the 2015 roll is finalized, growing to $13.0 billion by 2018.

Revenue Outlook. After the Department of Finance completes the assessment roll, the actual property tax levy is determined by the City Council when it sets the tax rates for each class. IBO's baseline property tax revenue forecast, and the de Blasio Administration's, assume that the average tax rate during the forecast period will remain 12.28 percent, the rate set by the City Council in December 2008 when the Council enacted Mayor Bloomberg's proposal to rescind a short-lived 7.0 percent rate reduction.

The amount of property tax revenue in a fiscal year is determined not only by the levy, but also by the delinquency rate, abatements granted, refunds for disputed assessments, and collections from prior years. Taking these other factors into account, IBO projects that property tax revenue for 2014 will total $19.8 billion, 5.5 percent higher than in 2013. For 2015, IBO forecasts property tax revenue of $20.9 billion, an increase from our December 2013 forecast. From 2016 through 2018, revenue growth is projected to average 5.2 percent a year, reaching $24.2 billion by the last year of the forecast period. This projected revenue growth is slower than the 6.3 percent average annual growth seen from 2007 through 2013 when the pipeline of assessment gains from the boom years sustained assessments and revenues in the years when values were falling.

IBO's property tax revenue forecast is just $4.7 million above OMB's for 2014, stemming from small differences in estimates for components of the reserve. For 2015, our revenue forecast is $106 million above OMB's. This difference stems mainly from IBO assuming a slightly smaller reduction from the tentative roll to the final roll and from minor differences in estimates of the property tax reserve components, including the coop and condo abatement. In 2016, IBO's projected growth rate for the levy is slower than OMB's leaving our revenue forecast just $36 million higher than the de Blasio Administration's. In 2017 and 2018, IBO forecasts stronger growth than OMB and our revenue forecast is, respectively, $258 million and $586 million above OMB's.

Other Taxes

Transfer Taxes. Revenues from the real property transfer tax (RPTT) and the mortgage recording tax (MRT) have rebounded strongly since the last recession. IBO projects that receipts from these two taxes will reach $2.4 billion in 2014, almost 2.5 times the level of just four years ago when revenues hit bottom. Transfer tax collections are projected to dip around 7 percent in 2015, as commercial sales return to trend levels and higher interest rates decrease the volume of transactions. Growth is projected to resume in 2016, and by 2018 the combined revenue from the RPTT and MRT is projected to reach $2.7 billion.

The value of residential real estate transactions has grown steadily during the last two years, with seasonal peaks in each July-September quarter. The value of taxable residential sales reached $23.6 billion in the first six months of 2014 (July through December, 2013), a 35 percent increase over the same period last year.

Commercial sales have been more volatile, with peaks during the second quarter and third quarters of 2013 in response to impending changes in federal tax policy, a sharp decline in the April through June 2013 quarter, and a surge in the first half of 2014. Data from the city's Department of Finance show that 59 taxable commercial sales valued at over $100 million were recorded in the first half of this year, compared with 35 during the same period in 2013. The total value of taxable commercial sales during the first half of this year was $32.8 billion, an increase of 60 percent compared with the first half of last year.

IBO projects that total RPTT revenue for 2014 will reach $1.5 billion, an increase of 34 percent over 2013. Revenue is then expected to fall by about 9 percent in 2015, to $1.3 billion. RPTT growth resumes in 2016, and by 2018 revenue is forecast to reach $1.6 billion, just 5 percent below the 2007 peak.

IBO's forecast of MRT revenue in 2014 is $932 million, an increase of 26 percent over 2013. MRT collections are projected to decline by around 5 percent in 2015, to $889 million, in part due to higher interest rates. IBO expects moderate MRT growth beginning in 2016, with revenues reaching almost $1.1 billion in 2018. While this amount is three times the level of collections in 2010, it is still 30 percent below the 2007 peak of $1.6 billion. For the foreseeable future, lending standards will remain tighter than during the years leading up to the financial crisis. In addition, after years of historically low interest rates, it is likely that most mortgage holders who are both able to access credit and could benefit from refinancing have already done so.

IBO has raised its 2014 forecasts for the RPTT and MRT by around 14 percent each compared with the forecasts we published in December 2013. The RPTT forecast is $181 million higher, while the MRT forecast is $118 million higher. In both cases the revisions were made in response to updated collections data, which show significantly higher revenue in recent months than had been anticipated in early December. We have also raised our 2015 through 2017 transfer tax forecasts by an average of 3.4 percent a year in the case of RPTT and 6.2 percent a year in the case of MRT.

IBO's RPTT and MRT forecasts follow similar trends to those of OMB: strong growth in 2014 and a slight dip in 2015, followed by moderate growth through 2018. IBO's annual RPTT forecasts are mostly between 2.0 percent and 3.0 percent higher than OMB's. Our MRT forecast is 2 percent below OMB's for 2014, and between 2.0 percent and 4.0 percent higher than OMB in the out-years.

Personal Income Tax. Collections of the city's personal income tax (PIT) in recent months have been stronger than previously expected, leading IBO to increase its 2014 PIT forecast to $8.8 billion, $269 million more than we forecast in December. But the outlook for the city's economy has not changed appreciably, so only small changes have been made to our PIT forecasts for next year and beyond. IBO expects personal income growth to accelerate starting this calendar year, which will support strong PIT growth in fiscal year 2015, with revenues nearing $9.5 billion. Although PIT receipts are expected to continue to grow after 2015, the rate of increase is projected to slow.

IBO's personal income tax forecasts for subsequent years do not incorporate revenue increases that would result from enactment of the Preliminary Budget proposal to increase the top marginal PIT tax rate. That proposal and estimates of its revenue impacts are discussed below.

Even with the increase in the forecast, projected PIT receipts this year are still almost $400 million less than in 2013. The drop in revenue is a consequence of widely anticipated increases in federal income tax rates, especially rates on capital gains, at the start of calendar year 2013, which motivated many taxpayers to realize capital gains and take bonuses in calendar year 2012 instead. In turn, fiscal year 2013 PIT collections swelled, particularly from estimated payments that are typically made by taxpayers who are self-employed or anticipate realizing capital gains. Estimated payments so far in 2014 have been stronger than projected, and an increase in IBO's estimated payments forecast accounts for most of the upward revision in projected 2014 PIT revenue. Our withholding projection for this year has also been increased in response to unanticipated receipts in recent months.

IBO forecasts personal income growth of 5.9 percent and 6.3 percent in calendar years 2014 and 2015, respectively, which is expected to generate a 7.7 percent increase in PIT revenue in fiscal year 2015. PIT growth is projected to moderate after 2015, rising at an annual average rate of 4.7 percent to reach $10.9 billion in 2018; this slower growth in PIT receipts reflects our forecast of slower growth in income and employment.

IBO's personal income tax forecast exceeds OMB's by $120 million (1.4 percent) in 2014 and $307 million (3.2 percent) in 2015; the difference between the two forecasts increases over time. OMB substantially increased its PIT forecast between November and release of the Preliminary Budget, which has greatly reduced the current difference between the IBO and OMB forecasts.

Business Income Taxes. IBO forecasts business income tax revenue to be essentially flat this fiscal year at $5.9 billion, following 2013's faster pace, when combined revenue from the city's three business taxes grew 9.2 percent over the previous year. A 10.1 percent expected decline in banking corporation tax (BCT) collections will offset most of the projected growth in general corporation tax (GCT) and unincorporated business tax (UBT) revenues. Fueled by our expectation of faster U.S. and local economic growth in calendar years 2014 and 2015, IBO forecasts strong business tax revenue growth of 7.1 percent in fiscal year 2015 and 7.5 percent in 2016. After 2016, business tax revenue will continue to grow at a more moderate pace, and combined collections of the three taxes are projected to reach $7.5 billion in 2018.

The GCT generates the most revenue of the three taxes and is expected to grow 4.6 percent this year to yield $2.8 billion. The latest available data (through December 2013) on GCT payments over $1 million indicate that collections from corporations in the services and information sectors are lagging last year's levels. But payments by finance and insurance firms have been growing, spurred in part by a healthy (though not spectacular) $16.7 billion of profits earned by New York Stock Exchange member firms. In 2015, we expect strong growth in gross revenues to be accompanied by an increase in refunds—the first such increase in six years—to yield to $2.9 billion in net GCT collections—3.8 percent growth over 2014. The strong national and local economic growth is expected to manifest in 2016, with annual average growth of 6.8 percent. GCT revenue is particularly sensitive to U.S. economic growth given the abundance of large firms in New York City that serve national and global markets. As local and national economic growth slows down at the end of the forecast period, we expect GCT revenue growth to slow to average 4.8 percent a year in 2017 and 2018.

Based on collections through January, IBO has lowered its forecast of UBT revenue in the current year to $1.9 billion—growth of 2.4 percent. For every year beyond 2014, UBT revenue growth is expected to exceed that of the other two business taxes, due in large part to robust growth in the professional and business services industry, which is expected to add another 16,900 jobs in calendar year 2014. Combined with the momentum produced by the U.S. and local economies in the second half of this calendar year, those gains will strengthen UBT revenue growth starting in fiscal year 2015. For 2015, IBO forecasts $2.1 billion in UBT revenue, $256 million (13.8 percent) greater than 2014 collections. For the following three years, we project annual average growth of 7.5 percent, with UBT collections reaching $2.6 billion by 2018.

Current collections of the BCT are weak, and IBO projects a 10.1 percent drop in BCT revenue this year, to $1.2 billion in 2014. Data on BCT payments over $1 million show that this decline is a result of a decrease in payments from commercial banks. We expect moderate revenue growth to return in 2015, followed by faster growth in 2016, when BCT collections are expected to regain their 2013 level—nearly $1.4 billion. This pattern of decline followed by slow recovery of BCT revenue is consistent with our expectations of rising interest rates and the impact of instituting Dodd-Frank regulations, including the Volcker Rule. It is also consistent with the expectation that many of the recent settlements between large banks and the U.S. government over practices leading up to the 2008 crisis are likely to be tax deductible. After 2016, growth is expected to average 3.6 percent annually and BCT revenue will near $1.5 billion in 2018.

IBO's forecast of the combined business taxes is $104 million (1.8 percent) above OMB's in the current year and $389 million (6.6 percent) greater in 2015. For 2014, most of the difference is explained by IBO's forecast of GCT, which exceeds OMB's by $95 million. For 2015, IBO's stronger UBT forecast accounts for almost half the difference, and our higher GCT and BCT forecasts each account for just over a quarter. After 2015, the difference between the two forecasts grows each year, reflecting IBO's expectation of more rapid growth in local employment and output.

Sales Tax. IBO forecasts solid growth of sales tax revenue this year and next, averaging 5.0 percent a year to yield collections of $6.4 billion in 2014 and $6.8 billion in 2015. Collections from July through January have been strong—6.2 percent growth over the same period last year—in part the result of local income and employment growth enabling consumers to satisfy pent-up demand. But sales tax growth has gradually diminished month to month, and we expect this trend to continue in the coming months, 2015 revenue will be fueled by faster personal income growth in this calendar year and next along with rising consumer confidence resulting from more solid growth in the nation's economy.

The city is also expected to continue to benefit from record levels of tourism over the next few years. An estimated 54.3 million tourists visited the city in calendar year 2013, 3.0 percent more than in 2012. Over 11 million of these were foreign visitors, who are among the highest spending tourists, an increase of 4.6 percent from the previous year. The tourism boom has contributed to strong employment growth in retail, food service, and accommodations, which have added almost 87,000 jobs since 2010 as tourists eat at local restaurants, purchase goods from local retailers, and stay at local hotels. (Hotel bills are subject to sales tax, in addition to the separate tax on hotel occupancy.)

Beyond 2015, growth in sales tax collections is expected to moderate, averaging growth of 4.0 percent a year from 2016 through 2018. IBO expects slower personal income growth and less pent-up consumer demand to dampen sales tax collections. Weaker U.S. economic growth will also curb domestic tourism and spending per visitor.

IBO's sales tax forecast is approximately the same as OMB's in the current year and $135 million (2.0 percent) higher in 2015. The difference grows each year to reach $194 million in 2018 due to IBO's higher expectations for personal income growth.

Hotel Occupancy Tax. IBO forecasts 2014 hotel tax revenue will total $541 million, 7.1 percent more than 2013 collections, which were weakened by the impact of Hurricane Sandy. IBO's current hotel tax forecast is substantially higher than we projected in December because our earlier forecast was based on the assumption that the hotel tax rate would revert on December 1st to 5.0 percent as scheduled from the 5.875 percent rate that had been in effect since March 2009. Although the higher rate was not immediately extended, the city retained the authority to raise it up to 6 percent. Later in December, the City Council passed legislation to reinstate the prior higher rate of 5.875 percent; Mayor Bloomberg signed it shortly before leaving office. Hotel tax collections through January are up 4.0 percent, but IBO expects more rapid growth for the remainder of the year because an expected surge in both occupancy and room rates during the week leading up to the Super Bowl has not yet been reflected in collections data.

With a record-breaking 54.3 million visitors to the city in calendar year 2013, the number of hotel room nights sold set new records. Hotel occupancy rates and average daily room rates also increased, despite a substantial increase in the city's inventory of hotel rooms. The number and size of conventions also rose. We expect these trends to continue through fiscal year 2016—producing hotel tax revenue of $575 million in 2015 and $612 million in 2016 (average annual growth of 6.4 percent). IBO forecasts slower average growth of 5.0 percent a year in 2017 and 2018, as domestic tourism and tourist spending are projected to level off with slower U.S. economic growth.

IBO's hotel tax forecast exceeds OMB's every year: by $12 million for 2014 and $36 million for 2015. The difference grows throughout the forecast period because IBO forecasts faster economic growth nationally, particularly in the near-term, than does OMB.

Proposed Personal Income Tax Surcharge

The sole tax policy item in the Mayor's Preliminary Budget is the proposal to increase the city personal income tax (PIT) paid by high-income filers in order to fund pre-kindergarten and after-school programs. IBO estimates that the Mayor's proposal would generate $554 million in 2015 and $630 million by 2018, slightly higher than the de Blasio Administration projects.

The city PIT currently has five tax brackets, with marginal tax rates ranging from 2.907 percent to 3.876 percent. The top rate is levied on city residents' taxable income over $500,000, regardless of filing status.[2] The Mayor's proposal would raise the marginal rate in the top bracket by almost a seventh (13.8 percent), to 4.41 percent—a 0.534 percentage point increase. For example, a filer with taxable income of $750,000 would pay the higher rate on $250,000, the amount of income in the highest bracket. Rather than pay $9,690 in tax on the $250,000 of income in the highest bracket under the current rate ($250,000 x 0.03876), under the proposed new rate the tax would be $11,025 ($250,000 x 0.0441), an increase of $1,335.

PIT liability for filers with taxable incomes of $500,000 or less, the vast majority of all city resident filers, would not be affected. If the tax hike were enacted as proposed by the de Blasio Administration, IBO estimates that it would affect 53,373 filers in tax year 2014 and 59,200 filers in tax year 2015, 1.5 percent and 1.7 percent, respectively, of total filers in those years. PIT revenues are quite sensitive to the business cycle and the revenue from high-income taxpayers even more so. While IBO's estimate of the additional revenue under the proposal is premised on an economic forecast with moderate growth, a decline in taxpayers' earnings—and particularly of income from capital gains—could easily result in much less revenue than the de Blasio Administration is counting on.

Revenue Impact. If the proposal were enacted and made effective in the middle of this calendar year as the de Blasio Administration proposes, IBO projects a $554 million increase in 2015 PIT revenue. The additional fiscal year 2015 revenue would come from higher taxpayer liabilities for tax years 2014 and 2015. With total personal income expected to increase in the coming years, more city residents will have incomes above the $500,000 threshold. As a result, the amount of new revenue is projected to grow steadily, reaching $578 million in 2016, $605 million in 2017, and $630 million in 2018. Because IBO's forecasts of personal income growth and baseline PIT revenue are higher

Revenue Impacts of Proposed Increase in Top Marginal Personal Income Tax Rate
Dollars in millions

Fiscal Year	2015	2016	2017	2018
IBO	$554	$578	$605	$630
OMB	$530	$533	$569	$594

NOTE: Assumes the increase takes effect July 1, 2014.
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than OMB's, IBO's revenue estimate is $24 million greater than the de Blasio Administration's estimate for 2015 and an average of $39 million greater in each of the following three years.

Impact on Taxpayers. Almost 59,200 filers are projected to have taxable incomes over $500,000 in tax year 2015, and if the proposal were adopted they would together incur $586 million in additional PIT liability, an average of almost $9,900 per filer. But this average is a misleading indicator of the additional tax owed by a typical filer affected by the tax increase because most would face much smaller tax increases, while a small number would face increases that are much larger.

A small number of filers with very large incomes and tax liabilities have a disproportionate effect on the average. Just over half of the total tax increase would be borne by the projected 1,709 filers (2.9 percent of affected filers) with incomes over $10 million. In contrast, over half of all affected filers are projected to have incomes between $500,000 and $1 million in 2015, but they would be responsible for only 5.4 percent of the additional liability.

Income Volatility. PIT revenue in general is quite volatile, but because of the greater importance of nonwage income for top bracket filers the amount of revenue to be gained from raising the top marginal tax rate is potentially even more volatile than PIT revenue as a whole. A relatively small number of filers with very high incomes would account for most of the additional revenue under the proposal, and a large share of the total income of these most affluent filers consists of income from realized capital gains. IBO projects that capital gains will account for 47.5 percent of total income for filers who will earn more than $10 million in tax year 2015 and 23.1 percent of income for filers with incomes from $5 million to $10 million. (These two groups of filers are expected to receive almost 75 percent of all capital gains realizations received by city residents in 2015.)

Capital gains is a relatively volatile form of income that is very sensitive to the business cycle and to changes in tax policy. In the wake of the last economic downturn, the capital gains income of city residents collapsed, plunging from $63.0 billion in 2007 to $15.5 billion in 2009. Capital gains partially rebounded in the two following years, to $25.5 billion in 2011—still only 40 percent of 2007 income. IBO's estimates of revenue gains from the proposal assume continued growth of capital gains from calendar year 2014 on. If there is an unexpected weakening or downturn of the economy, the decline in the revenue to be gained from the proposal will fall far more than would total PIT revenue.

Endnotes

[1]When IBO refers to market values and assessments, the reference includes only taxable property. The assessed value for tax purposes (also referred to as billable taxable value) reflects the required phase-in of assessment changes for apartment, commercial, and industrial buildings.
[2] The taxable income of a filer equals adjusted gross income less exemptions and deductions.

Impact of Proposed Tax Increases by Level of Income for Tax Year 2015
Dollars in millions

Taxable Income Group	Number of Filers	Total Tax Increase	Share of Total Tax Increase	Average Tax Increase	Average Increase in PIT Liability
$500,001-$750,000	22,107	$12.70	2.20%	$573	2.50%
$750,001-$1,000,000	9,742	$18.70	3.20%	$1,916	6.20%
$1,000,001-$2,000,000	15,109	$70.80	12.10%	$4,683	9.40%
$2,000,001-$5,000,000	8,232	$111.20	19.00%	$13,512	12.40%
$5,000,001-$10,000,000	2,282	$76.90	13.10%	$33,684	13.70%
Over $10,000,000	1,709	$295.30	50.40%	$172,786	13.80%
All Affected Filers	59,181	$585.50	100.00%	$9,893	7.00%

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Education

City Continues to Shoulder Largest Share of School Funding

The Mayor's Preliminary Budget assumes that city funding of the Department of Education (DOE) in 2015 will exceed state funding for the fourth year in a row. City funding is projected to increase by $548 million to reach 48 percent of the DOE's budget. State funding is expected to increase by $234 million, bringing state funds to 43 percent of the DOE total. Prior to 2012, the state traditionally contributed a larger share of the DOE's funding than did the city.

This reversal of roles would not have occurred if the state had fulfilled the commitments it made in 2007 to resolve the *Campaign for Fiscal Equity Inc. v. State of New York* case. However, state revenues plunged after the 2008 financial crisis and the promised aid was repeatedly postponed. Although state revenues have stabilized and begun to recover, education aid has not been restored to the levels promised in 2007. Because of this ongoing shortfall, New Yorkers for Students' Educational Rights (NYSER), a coalition of advocacy groups and parents, filed a complaint last month with the New York State Supreme Court against the State of New York.

Many of the members of NYSER had previously been part of the Campaign for Fiscal Equity, the organization that brought the earlier court case. The campaign brought suit against the state in 1993, challenging the adequacy of funding for New York City public schools. A 13-year legal battle ended in November 2006 when the state's highest court—the Court of Appeals—issued a final ruling in the case. In its decision, the court ruled that in order to provide a "sound, basic education" to New York City public school students, the operating funds provided to the Department of Education needed to increase by $1.9 billion, with the increase phased in over four years. This figure was provided as the basis from which the State Legislature would start in developing school finance legislation.

In response to the decision, the State Legislature enacted the Education and Budget Reform Act of 2007, which was signed into law on April 1, 2007 by then-Governor Eliot Spitzer. The act specified increases in state aid that were even larger than what was outlined in the decision and provided increases to local school districts across the state, not just New York City. Specifically, the state committed to increasing funds by $7.0 billion statewide, to be phased in over a four-year period. New York City's portion was expected to total $3.2 billion by the end of the 2010-2011 school year, of which $2.4 billion was expected to flow through Foundation Aid, a newly created formula-based aid.

Aid and Accountability. Foundation Aid was a centerpiece of the legislation, designed to replace numerous preexisting formula aids and distribute the new funding more equitably, based on student need, community income, and local property wealth. In all, 13 streams of state aid revenue were collapsed to form Foundation Aid.[1] During the 2007-2008 school year—the first year of the agreement—a district would receive Foundation Aid equal to the sum of prior year aids now considered Foundation Aid plus 20.0 percent of its promised total four-year increase. In year two, the 2008-2009 school year, 22.5 percent of the total promise of increased Foundation Aid would be phased in, with increases of 27.5 percent and 30.0 percent to follow in years three and four, respectively. After school year 2010-2011, when the Foundation Aid phase-in was complete, all districts would continue to see annual increases in Foundation Aid of at least 3.0 percent.

The other central component of the legislation was an accountability system known as the "Contracts for Excellence." Low-performing districts that received annual increases in Foundation Aid of either 10.0 percent or $15 million were required to specify how planned increases would be used and all districts were required to devote aid increases to initiatives proven to raise student achievement. State-approved initiatives included class size reduction, increased learning time, school restructuring, teacher and principal quality initiatives, and full-day kindergarten and pre-K.

The first two years of the Foundation Aid phase-in went according to plan, with a total increase to the city's schools in 2008-2009 of $1.1 billion above the 2006-2007 funding level. However, in the third year, as statewide economic conditions worsened, then-Governor David Paterson and the State Legislature deferred the planned increase, pushing the completion date back by three years. In addition, the Legislature introduced a deficit reduction measure to help balance the state budget. This measure was first used in the 2009-2010 state budget and came to be known as the Gap Elimination Adjustment (GEA).

Foundation Aid Declines. Due to these constraints, state Foundation Aid for New York City declined by $579 million in city fiscal year 2010 compared with the amount in the previous year. In spring of 2010, increases for what was originally scheduled to be the start of the fourth and final year phasing in the Foundation Aid expansion were pushed back yet again as the state continued to freeze Foundation Aid and again imposed the GEA. The state has continued to limit the growth of Foundation Aid and kept the GEA in place, thereby constraining increases in state aid for the city.

In January 2013 the city's state aid revenue was dealt a further blow when negotiations with the United Federation of Teachers regarding new teacher evaluations stalled, missing a state deadline. The impasse resulted in a loss of $250 million of the planned increase in Foundation Aid for the 2012-2013 school year. The city ultimately reached an agreement with the teachers, narrowly missing an additional penalty that would have threatened funding in subsequent years. With a further cut avoided, Foundation Aid bounced back somewhat in 2014 but it remains $2.2 billion below the amount projected for the city under the 2007 legislation.

Some Aid Growth Ahead. In the Mayor's Preliminary Budget, Foundation Aid revenue is projected to grow by 2.7 percent in 2015, from $5.9 billion to $6.1 billion and then by 3.9 percent to $6.2 billion for 2016. By 2018, the city expects to receive $6.9 billion in Foundation Aid, although this would still be below the $7.6 billion originally expected by 2012.

The deadline for adopting the state budget is April 1st. Foundation Aid and the continuation of the GEA are key issues in the budget negotiations now underway between the Governor, the Senate, and the Assembly. Although the NYSER case is unlikely to affect the outcome of the current negotiations, in the longer term the case may increase pressure to bring state aid levels closer to what was promised in 2007.

Spending Increases in New Five-Year Capital Plan for Schools Relies Heavily on Statewide Referendum

The School Construction Authority (SCA) released a $12.8 billion proposed spending plan for fiscal years 2015 through 2019 in early February. The plan now moves to the City Council for review and must be approved, with or without modifications, by the end of this fiscal year. Total funding for the five years of the proposed plan would be almost $1.0 billion, or 8.5 percent, higher than under the current plan covering 2010 through 2014.

Consistent with the prior plan, the proposed plan incorporates approximately equal shares of state and city funds, but also includes $800 million for the city from the Governor's $2.0 billion New York State Smart Schools bond proposal, which will be on the statewide ballot in November. The capital plan allocates $490 million of this anticipated funding to enhance technology in schools through infrastructure projects and software purchases; about $300 million is allocated to facility restructuring to expand capacity for pre-kindergarten classroom space, more than half of the funds devoted to such reconstruction work in the plan. If approved by voters, this additional funding would allow SCA to redirect $490 million of funding previously earmarked for technology towards building 4,900 more seats to reduce class size.

The SCA's proposed plan organizes projects into three categories: capacity, capital investment, and mandated programs. Mandated programs are required by local or state law and include: remediation, such as removal of lead paint and replacement of PCB-contaminated light fixtures; building code compliance; insurance; and boiler conversions to phase out two highly polluting forms of heating oil as called for in Mayor Bloomberg's PlaNYC. Compared with the current plan, the proposed plan increases spending on capital investment and mandated programs.

Despite the inclusion of $490 million that would be freed up by the Smart Schools bond proceeds, spending on capacity would decline slightly.

The change in mandated programs accounts for the largest increase over the 2010-2014 plan—almost $1.0 billion, or 40 percent. The mandated program items with the largest increases include boiler conversions and associated climate control ($523 million) and PCB-related lighting replacements ($203 million).

Spending on capital investment is set to increase by 16 percent, with increases in both the capital improvement program and school enhancement projects. Two categories account for the largest increases in capital improvements: removal of transportable classroom units and redevelopment of playgrounds ($405 million), and athletic field upgrades ($105 million). Among school enhancement projects, spending on technology would fall substantially (down $277 million, or 30 percent) while spending on facility restructuring (including accommodations for more pre-kindergarten seats) increased by $325 million.

There is a slight decrease in spending on capacity compared with the 2010-2014 plan but a significant shift in resources. Funding for charter school construction has been eliminated in the new plan. Under the previous program charters could combine public matching funds with privately raised money for buildings that would be city-owned but leased to charter schools on a long-term basis. This initiative was allocated $210 million in the current capital plan but zeroed out for 2015-2019. The SCA's facility replacement plan is also reduced by $290 million, though $400 million remains allocated to this program. These reductions are offset by increases to class-size reduction ($490 million) and pre-K capacity ($210 million). The class size reduction program is dependent on anticipated revenues from the Smart Schools bonds. Under the new plan, spending on capacity would total $3.3 billion over 2015-2019, a decline of $58 million (1.3 percent).

In total, the five-year plan would add 37,460 new seats: funding for 32,560 seats is categorized as new capacity, while funding for the 4,900 seats that depend on the November referendum is shown as class-size reduction. The $210 million for the pre-K initiative would provide even more seats either in newly constructed buildings or in leased space.

Timeline for Estimated Completion of New Capacity Seats

School Year	Number of Buildings	Number of Seats
2015-2016	1	113
2016-2017	2	1,349
2017-2018	12	5,983
2018-2019	13	6,875
2019-2020	11	5,752
2020-2021	11	6,714
2021-2022	6	4,211
2022-2023	1	757
2023-2024	1	806
TOTAL	**58**	**32,560**

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While the 4,900 seats for class-size reduction have not been allocated pending the outcome of the referendum, the plan does specify the proposed locations of the 32,560 new capacity seats that are not dependent on the state bonds. Queens is expected to get the biggest share—over 13,000 seats and 40 percent of seats categorized as new capacity. Almost 9,700 seats (30 percent) will be built in Brooklyn. The Bronx and Manhattan will receive 14 percent and 12 percent of seats, respectively; and 4 percent of seats will be built in Staten Island.

The SCA plans for seats based on anticipated need in specific neighborhoods within the 32 school districts. Three neighborhoods would each receive more than 5 percent of the anticipated 32,560 seats. The area encompassing Corona, Lefrak City, and Elmhurst in district 24 will collectively get almost 2,400 new seats, about 7 percent of total new seats citywide. Two other neighborhoods would each get almost 2,000 seats, or 6 percent of the total: Tribeca and Greenwich Village in district 2 (Manhattan) and Dyker Heights in district 20 (Brooklyn).

The majority of newly constructed seats will serve elementary and middle school students. Only 3,100 seats in the plan are dedicated to high schools, with most of those to be located in Queens. Although no sites have yet been identified for any of the high school seats, 2,800 would be in Queens and the remaining 300 in Staten Island.

The SCA plans to lease space for slightly more than

School Construction Authority Changes to the Five-Year Capital Plan: 2010-2014 Plan to Proposed 2015-2019 Plan
Dollars in millions

Category/Description	Fourth Amendment 2010-2014	Proposed Plan 2015-2019	Change
Capacity	**$4,458.5**	**$4,401.0**	**-$57.5**
New Capacity	3,559.0	3,301.0	-258.0
Charter and Partnership Schools	210.0	--	-210.0
Pre-Kindergarten Initiative	--	210.0	210.0
Class Size Reduction Program	--	490.0	490.0
Facility Replacement Program	689.5	400.0	-289.5
Capital Investment	**$4,277.8**	**$4,943.7**	**$665.9**
Capital Improvement Program	2,763.8	3,333.7	569.9
Exterior	1,721.9	1,775.9	54.0
Interior*	817.2	844.6	27.4
Other	120.9	99.9	-21.0
TCU Removal and Playground Redevelopment+	75.2	480.0	404.8
Athletic Field Upgrades+	28.6	133.3	104.7
School Enhancement Projects#	1,514.0	1,610.0	96.0
Technology	926.8	650.0	-276.8
Facility Enhancements	587.2	960.0	372.8
Facility Restructuring	200.0	525.0	325.0
Safety & Security	100.2	100.0	-0.2
Science Lab Upgrades	90.0	50.0	-40.0
Accessibility	75.0	100.0	25.0
Physical Fitness Upgrades+	59.3	48.5	-10.8
Swimming Pools	13.1	12.0	-1.1
Gymnasium Upgrades	46.2	36.5	-9.7
Library Upgrades	11.7	42.2	30.5
Auditorium Upgrades	51.0	44.3	-6.7
Bathroom Upgrades	--	50.0	50.0
Mandated Programs**	**$2,478.4**	**$3,455.2**	**$976.8**
Lighting Replacements*	276.7	480.0	203.3
Boiler Conversions and Associated Climate Control*	227.0	750.0	523.0
Asbestos Remediation	159.6	175.0	15.4
Lead Paint Removal	11.3	15.0	3.7
Emergency Lighting	14.6	50.0	35.4
Code Compliance	60.4	150.0	89.6
Building Condition Surveys	48.7	75.0	26.3
Wrap-up Insurance	514.9	650.0	135.1
Prior Plan Completion Cost	858.6	621.2	-237.4
Emergency, Unspecified, Misc.	306.6	489.0	182.4
Resolution A Projects (funded by elected officials)	**$620.0**	**--**	**-$620.0**
TOTAL	**$11,834.7**	**$12,799.9**	**$965.2**

SOURCE: IBO analysis of School Construction Authority Capital Plan documents
NOTES: IBO has reorganized some of the categories in the amended 2010-2014 plan to match the categories shown in the plan for 2015-2019. TCU stands for transportable classroom unit. *The total for interior improvements under the capital improvement program in the amended 2010-2014 plan excludes amounts dedicated to lighting replacements and boiler conversions and associated climate control, which are listed under mandated programs in the proposed new plan. +The total for physical fitness upgrades in the amended 2010-2014 plan excludes amounts dedicated to TCU removal and playground redevelopment and athletic field upgrades, which are listed under the capital improvement program in the proposed new plan. #School enhancement projects were labeled as Children First Initiatives under the 2010-2014 capital plan. **In the amended 2010-2014 plan, the amount dedicated to mandated programs was included under the capital investment category; it is now a separate category in the proposed new plan.

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a third of the projects in the plan and has already identified sites for seven projects. Leased space accounts for almost 9,800 seats—30 percent of the new seats that are not dependent on the bond issue. Design has already begun on three of the seven projects for which sites have been identified.

The proposed 2015-2019 plan lists a total of 58 capacity projects, five of which are carried over from the 2010-2014 plan and account for 2,947 seats. Two of the carry-overs are in Manhattan, two are in Brooklyn, and one is in Queens. The timeline for one of the Manhattan projects—an 806-seat project in district 2—has been pushed back five more years from the original timeline in the 2010-2014 plan. The project, for which a site has yet to be identified, was funded for design only (beginning in May 2014, just months before the current capital plan wraps up). In the proposed 2015-2019 plan, the project is again funded for the design portion only which would begin in May 2019, just before the next plan finishes.

The 32,560 new seats are expected to be ready during the course of the 2015-2016 through 2023-2024 school years, with more than 90 percent of seats expected in 2017-2018 through 2021-2022. More than 60 percent of the seats are expected to be completed by the end of the five-year capital plan.

Endnote

[1]These include the following: Net Support-Operating Aid, Special Reading, Improving Pupil Performance, Public Excess Cost Aid, Limited English Proficiency Aid, Magnet Schools, Teacher Support Aid, Ed Related Support Services Aid, Extraordinary Needs Aid, Minor Maintenance, Early Grade Class Size Reduction, Summer School, and Sound Basic Education

Housing, Health, & Community Services

Shelter Costs at Record Amounts, and Likely to Rise

The de Blasio Administration has budgeted record amounts to pay for the city's homeless shelter system, in part by abandoning several cost-saving programs that the Bloomberg Administration had proposed but failed to implement. It is likely, though, that still more funds will be necessary. The number of individuals and families in the city's shelter system continues to grow to all-time highs and since the end of its rental assistance program, the city has had limited options available to help them move into permanent housing. If shelter trends remain unchanged, the cost of emergency shelter for families may well exceed what the city has already planned.

Shelter Census, Length of Stay at Record Levels. The census in the city's homeless shelters, both those serving families and those serving single adults, continues to grow to record levels. During the first seven months of fiscal year 2014 there were, on average, 12,286 families in shelter each day—961 more families than during the same period last year. There was a similar increase in single adults in shelter over the same period. During the first seven months of fiscal year 2014, on average 9,956 individuals were in adult shelter each day–631 more than during the same period last year.

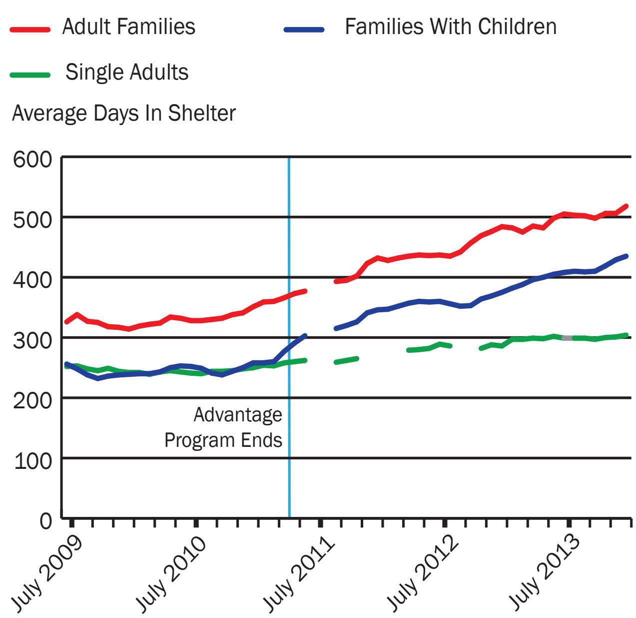
The main cause of these increases, particularly for families, is increased lengths of stay in shelter. In fact, the family shelter census grew this year even as the number of families applying for and entering shelter each month declined on average compared with last year. (According to city policies, families are required to apply for shelter, while single adults are not). Based on data from the first seven months of this fiscal year, 358 (about 12 percent) fewer families applied for shelter each month on average compared with the same period last year and an average of 71 (about 6 percent) fewer families entered shelter each month.[1]

Shelter stays have increased significantly, however. Based on data from the first seven months of the fiscal year, families with children spent an average of nearly 14 months (417 days) in shelter, 56 days more than during the same period last year. For families without children the average length of stay is even longer, nearly 17 months (505 days), 48 days more than during the same period last year. For single adults, the average length of stay is 300 days, 14 days longer than last year.

Shelter stays have been increasing consistently since the city ended its rental assistance program, Advantage, in April 2011. (See IBO's Advantage blog post for details.) Absent a replacement program for Advantage or some other major change in policy, this trend is likely to continue.

Shelter Budget at All-Time High, And May go Higher. In order to meet the growing need for shelter beds, the city plans to spend a record $1.04 billion on Department of Homeless Services (DHS) programs in

Length of Stay in Shelter Increasing



SOURCE: Department of Homeless Services
NOTES: July and August 2011 data are not available for any group. Data on single adults are also unavailable for December 2011 through March 2012 as well as September and October 2012.
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fiscal year 2014, a $62 million increase over Mayor Bloomberg's last financial plan and $59 million more than the city spent last year. Slightly less ($982 million) is planned for total DHS spending in fiscal year 2015. This year's spending includes the addition of $3.8 million to add security and staffing at the city's Auburn and Catherine Street shelters and to begin transitioning these shelters from serving families with children to families without minor children. The Auburn shelter was widely criticized after poor conditions there were described in a recent *New York Times* series about a young resident named Dasani.

IBO estimates that family shelter costs, which make up the largest share of the DHS budget, will reach $541 million by the end of 2014, $13 million more than the city has budgeted. Of this total, IBO estimates $167 million will be city funds, $5.4 million more than what the Mayor's office currently has planned. (Family shelter funding also comes from the state and federal governments.) If shelter census trends remain unchanged, IBO estimates that family shelter will cost $544 million in 2015, $24 million more than the Mayor's current projection. IBO estimates $170 million of the family shelter spending in 2015 will be city funds, $9.2 million more than currently planned.

Adult shelter costs are also at an all-time high. The de Blasio Administration has budgeted $348 million for 2014, $21 million more than it spent last year. City funds make up $254 million of that total. (Unlike family shelter, the majority of adult shelter costs are paid for using city funds). The Mayor has budgeted slightly less for 2015: $339 million, of which $253 million are city funds. Given current shelter capacity for homeless single adults, these funding levels appear to be adequate, at least for this year.

IBO's Forecast of Family Shelter Costs Exceeds Mayor's
Dollars in millions

Family Shelter Costs	Mayor's		IBO		Difference	
	Total Cost	City Share	Total Cost	City Share	Total Cost	City Share
2013 (actual)	$490.6	$146.8	--	--	--	--
2014 (projected)	$527.7	$162.0	$541.1	$167.3	$13.4	$5.4
2015 (projected)	$519.9	$160.7	$544.2	$169.8	$24.3	$9.2

SOURCE: Mayor's Office of Management and Budget
NOTES: Family shelter includes shelter operations, shelter intake and placement, and shelter administration and support. Total costs include city, state and federal funds. Numbers may not add due to rounding.
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Past Cost-Saving Proposals Abandoned. The Preliminary Budget's increase in funding for family and adult shelters was driven in part by the de Blasio Administration's decision to abandon six failed cost-cutting plans proposed during the Bloomberg years. Nearly all of these programs—many of which were first proposed several years ago—were never implemented and never produced any savings. The Bloomberg Administration was forced to add funds each year to cover the failed programs, the de Blasio Administration's decision to permanently end the initiatives demonstrates some clear changes in policy. In total, the Preliminary Budget adds back $9.8 million ($8.2 million in city funds) in 2014 and $35 million ($19 million in city funds) in 2015 and beyond because the city no longer expects savings from the initiatives that are being dropped.

One of the programs that will no longer be pursued was a plan to house some homeless families in shared living spaces, which the Bloomberg Administration estimated would save $23 million ($9.1 million in city funds) a year. The policy change, first proposed in November 2010, was opposed by advocates for the homeless and the City Council, whose approval was necessary to implement the change. The de Blasio Administration has also chosen to drop the Bloomberg initiative that would have required adult shelter clients to prove that they have no other housing options before being placed in a shelter. This controversial plan, also announced in November 2010, was estimated to save the city $2.0 million (all in city funds) annually. The City Council sued the Bloomberg Administration to stop this change on a procedural issue and won in court.

The Mayor also added $4.4 million to the budget, equal to the savings expected from a subsidized employment program that placed public assistance-eligible adult shelter clients in jobs, with their public assistance grants paying for the employer subsidies for six months. The Bloomberg Administration originally expected that the program would lead 150 shelter clients to use the earnings from their subsidized jobs to move out of shelter early. While DHS said this program has helped some clients move into permanent housing—and that it will continue the program in the future—fewer have left shelter than originally projected.

Increased Federal Appropriations Benefit City Housing Programs, Yet Gaps Remain

While the federal government's most recent budget deal increased appropriations for many of its housing programs back to or slightly above presequestration levels, past federal cuts continue to impact the city's housing programs. The omnibus spending bill, passed in January, contained increases for many of the federal funding streams that the city relies on for its affordable housing programs, including Section 8 rental vouchers, public housing, and the HOME program. Although these increases will bring needed funds to the city's housing agencies, they do not reverse the effects of past budget cuts and chronic underfunding.

Section 8 Cost-Saving Changes Remain in Effect. One of the housing programs most seriously impacted by sequestration (the across the board federal funding cuts implemented last year) was the Section 8 Voucher Program, which is administered in New York City as two separate programs by the New York City Housing Authority (NYCHA) and the Department of Housing Preservation and Development (HPD). About 2,300 fewer New York City households are receiving rental assistance through the programs this year than last year after cuts forced NYCHA and HPD to stop issuing vouchers to new households—even as vouchers turned over from families leaving the programs—and undertake other measures to reduce program costs. Those actions were necessary to ensure that current voucher holders did not lose their housing assistance. Because funding for Section 8 is based on voucher costs and usage in the prior year, reductions to Section 8 appropriations are especially significant as they can negatively affect funding in future years.

This year's federal budget raised the appropriation for Section 8 vouchers renewal funding to $17.4 billion, slightly over $1 billion more than last year's sequester level. While increased funding this year may allow HPD to begin issuing new Section 8 vouchers again, it appears unlikely that NYCHA will be able to do so. For now, both NYCHA and HPD plan to continue other changes that were made to reduce voucher costs because of uncertainty about the adequacy of their agency-specific allocations for this year—which have not yet been released by the federal government—as well as about future appropriations. The number of households assisted through the two voucher programs fell from 130,129 during the first four months of city fiscal year 2013 to 127,901 in the first four months of this fiscal year after the agencies stopped issuing vouchers to new households. (Veterans, whose vouchers have a separate funding source, were exempt from this cut-off.)

Under sequestration, NYCHA, which administers the majority of the city's vouchers (about 91,000), faced a $78 million gap just to cover the costs of its existing rental vouchers in 2013. To address the deficit, NYCHA depleted its program reserves ($54 million) and received $21 million in shortfall funding from the federal government. NYCHA has applied for about $8 million more in shortfall funding, which it expects to receive this year. While a prior Section 8 funding shortage caused NYCHA to stop issuing new vouchers in December 2009, new families were able to enter the program with vouchers made available through attrition. After the more recent sequestration cuts, NYCHA was unable to issue vouchers to new families even as other households left the program. As a result, approximately 2,000 fewer families are receiving Section 8 vouchers from NYCHA this year compared with last. NYCHA has put other policies in place to reduce the cost of current vouchers, including reducing the utility allowance and restricting families from transferring the voucher from one apartment to another if the new rent is greater than their existing rent (unless there is an emergency situation).

Similarly, HPD, which administers about 37,000 of the city's housing vouchers, also stopped issuing Section 8 vouchers to new households after it faced a gap of $37 million under sequestration. As a result, about 300 fewer households are receiving rental assistance through HPD's Section 8 Program this year than last year. HPD also depleted its reserves ($24 million) and had to seek about $9 million in federal shortfall funding. The housing agency also made some significant changes to its program to lower the cost of existing vouchers to ensure that households currently holding vouchers did not lose their housing assistance.

HPD reduced its payment standard—the maximum monthly subsidy—from 110 percent of Fair Market Rent ($1,547 a month for a two-bedroom apartment) to 105 percent. The agency also began reevaluating the size of the vouchers held by current recipients, which is based on the number of people in the household. If a household's subsidy is higher than the maximum now allowed, the family must include the difference in their share of the rent, even if it exceeds 30 percent of their income, or move. (Exceptions can be granted for elderly or disabled residents.) While HPD plans to keep these savings measures in place, the agency expects to begin issuing new vouchers again this year given the increase in federal funds.

Despite Increase, Funding Still Low for Other Programs. In addition to Section 8, other housing assistance programs saw their federal appropriations increase this year. However, the increases come after years of deep funding cuts that continue to affect the city's programs.

For example, funding for the HOME Investment Partnership Program, a crucial source of capital funding for the city's supportive housing programs, was restored to presequestration levels. This means the city will likely receive a grant of about $60 million this year, about $2.5 million more than last year. While this is a welcome increase for HPD, due to repeated cuts in the recent past this year's grant is less than half the $125 million that the city received four years ago.

Because HOME funds can be spent over several years, cuts from previous years are just beginning to affect the city budget. As recently as 2012, HOME funds made up 36 percent of HPD's capital spending. According to HPD's current capital budget, HOME funds will make up about only 18 percent of planned commitments over the next several years. In addition to the capital funding, HPD can use 10 percent of its annual HOME grant for administrative purposes, which flows through the city's expense budget. This year, due to the past federal cutbacks, the city reduced the portion it uses for administration by $3.3 million.

Similarly, the federal public housing operating subsidy—one of the most important funding sources for NYCHA housing developments—has failed to cover necessary costs for several years. Congress has routinely appropriated insufficient funds to meet the actual costs of operating public housing. Therefore, NYCHA and other housing authorities have been funded at a percentage of their actual need, causing agencies to reduce staff and eliminate programs. Last year, NYCHA received federal operating support at about 82 percent of its $1.01 billion need. This year's federal budget raises the appropriation for the operating subsidy by 8.5 percent. While final funding levels for local housing agencies are still being determined, according to initial estimates from the federal Department of Housing and Urban Development, funding will cover about 89 percent of the actual cost of operating public housing nationwide—more than last year but still less than the full cost.

Medicaid Waiver Funds May Not Be a Great Deal for the City

New York State's amended waiver from some federal Medicaid regulations has been hailed as a savior for financially distressed hospitals throughout the state. The waiver amendment, informally agreed to by the federal government, would allow the state to retain $8.0 billion of federal savings from the state's Medicaid reform initiatives. But what the funds can actually be used for has not been well understood. Even less understood have been the impacts that the waiver may have on the Health and Hospitals Corporation (HHC) and the New York City budget. Especially in the latter case, these consequences may not be entirely positive.

New York State first submitted a proposal to the U.S. Centers for Medicare and Medicaid Services (CMS) to amend its existing Medicaid waiver in August 2012.[2] Specifically, the state sought to have the federal

Over Three-Quarters of HHC Operating Revenues from Medicaid and Medicare
Dollars in millions

	2012		2013	
	Amount	**Share**	**Amount**	**Share**
Medicaid Fee-for-Service & Managed Care	$2,309	40%	$2,105	37%
Disproportionate Share Hospital & Upper Payment Limit Payments	1,317	23%	1,402	25%
Medicare Fee-for-Service & Managed Care	986	17%	862	15%
Indigent Care and Other Pools	438	8%	446	8%
Other Patient Reimbursements	389	7%	360	6%
Grants, City Funds	245	4%	339	6%
All Other Revenue	65	1%	116	2%
Total Revenue	**$5,749**	**100%**	**$5,631**	**100%**

SOURCE: Health and Hospitals Corporation
NOTE: Amounts are on a cash and not accrual basis.
New York City Independent Budget Office

government allow the state to hold onto $10.0 billion in future federal Medicaid savings. The funding was to be reinvested into the state's health care system over the course of five years. New York had recently enacted a series of Medicaid reforms and state officials argued that they should be allowed to retain a portion of the approximately $17 billion in federal savings they expected from the changes. CMS rejected several aspects of New York's original proposal and the state submitted a revised application. Last month, the state and CMS reached an agreement in principle on $8.0 billion in federal reinvestment over five years. Specific details about how the money will be spent are unknown, as the state is still awaiting formal approval. Still, the revised application offers some clues.

The updated proposal includes three components, the largest of which is a Delivery System Reform Incentive Payment (DSRIP) plan worth $7.4 billion, or almost 75 percent of the $10.0 billion requested.[3] DSRIP is an existing mechanism to disburse Medicaid waiver dollars and foster quality improvements, which is currently being used in several other states. The primary goal of New York's DSRIP plan would be to reduce avoidable hospitalization statewide by a quarter over five years. The secondary goal would be to stabilize and transform the state's health care safety net. As proposed, the state's DSRIP plan would include 25 different programs, all of which require clearly defined outcome measures related to reducing avoidable hospitalizations. Some examples include: the implementation of care coordination and transitional care programs; the development of co-located primary care services in emergency departments; and the development of community-based strategies to improve cancer screening.

The state has proposed a four-step process to distribute DSRIP funds to specific providers. The first step would occur when New York formally receives its statewide funding allocation from CMS. The statewide allocation would then be split into two pools, one for public hospitals and the other for private, safety-net hospitals and other providers. Next would be the project allocation, with each project scored for elements such as avoidable hospitalization and quality objectives, potential cost savings, number of Medicaid members impacted, and the applicant's financial viability. Each project's overall score would determine the size of its allocation from either the public or private pool. The last step would be performance allocation, which would link payouts to project performance in terms of milestone attainment, reduction in preventable hospitalizations, financial sustainability, and other project-specific outcome metrics.

The state's revised application aims to allocate the first funds to approved planning projects in May. This was based, however, upon the state obtaining formal approval from CMS by March 3, which did not occur. More broadly, the state is planning on spreading project funding over five years.

The Mayor's Preliminary Budget assumes that HHC will receive $400 million in Medicaid waiver funding in each year from 2015 through 2018.[4] These projections are far from certain. One major concern is that federal

The Health and Hospitals Corporation's Financial Plan
Dollars in millions

Preliminary Budget - Projected	2014	2015	2016	2017	2018
Total Operating Revenues	$7,566.6	$7,717.4	$7,490.1	$7,399.3	$7,304.0
Total Operating Expenses	8,102.1	8,320.2	8,552.1	8,877.2	9,001.4
Total Interest Income and Expense	(104.0)	(105.0)	(106.0)	(105.0)	(104.0)
Profit/(Loss) Before Corrective Actions	(639.5)	(707.8)	(1,167.9)	(1,582.8)	(1,801.5)
Total Corrective Actions	92.6	689.9	785.9	833.0	883.0
Profit/(Loss) After Corrective Actions	(546.9)	(17.9)	(382.0)	(749.8)	(918.5)
Prior Year Cash Balance	323.1	734.9	1,004.5	901.8	526.3
Accrual to Cash Adjustment	958.6	287.6	279.3	374.4	403.9
Closing Cash Balance	$734.9	$1,004.5	$901.8	$526.3	$11.8

SOURCE: Health and Hospitals Corporation
NOTE: Amounts are on an accrual and not cash basis. All estimates come from Health and Hospitals Corporation, as approved by Mayor's Office of Management and Budget.

New York City Independent Budget Office

waiver funds, like all Medicaid funding, require a one-to-one match. The state's current plan to produce the match involves the use of both intergovernmental transfers and designated state health programs. These designated programs are state or local expenditures on existing public health services that CMS certifies as counting towards the state's match. Exactly which programs and how much spending will be eligible for this certification is unknown, but the designated programs will likely account for only a minority of the total state commitment. Rather, based on very preliminary estimates released in December, the state Department of Health (DOH) expects the lion's share of the match to come from intergovernmental transfers from public hospitals throughout the state. Specifically, DOH would assign each participating public hospital a transfer amount and then pool all these funds to draw down the federal match. DOH would then divide the combined funding into public and private pools, and from there distribute the money to individual projects.

This funding process could be problematic for HHC and the city several reasons. First, HHC's intergovernmental transfers would likely be significant given it is the largest public hospital system in the state. Second, hospitals are required to pay for their intergovernmental transfers with nonstate, nonfederal operating revenues—a very small pool of funds for HHC. In 2013, 77.6 percent of HHC's operating revenues came from Medicaid or Medicare—including supplemental funds from the Disproportionate Share Hospital and Upper Payment Limit programs—and as such would be ineligible for this purpose. Another 7.9 percent came from the indigent care and other pools, which are partially funded with Medicaid disproportionate share dollars. Given that much of HHC's remaining operating revenues are city funds, the city could end up paying for all or much of HHC's intergovernmental transfer obligation. This could occur using city funds already in the HHC budget or, considering HHC's challenging fiscal outlook, by the city increasing its subsidy so that HHC is able to draw down Medicaid waiver dollars.

Another concern is that if payments are performance-based, they become dependent on whatever outcome metrics the state uses. An example of how this could play out can be observed in two federal policies tying Medicare reimbursements to quality of care that took effect in October 2012. IBO's analysis of these two programs last spring found that HHC facilities fare worse than other hospitals in the city overall and specifically in terms of penalties and bonuses that were assessed based on adherence to clinical standards and patient surveys. HHC facilities do better than other hospitals in avoiding penalties for readmissions, however.

Lastly, while the state's application to CMS calls for waiver funds to be used for both public and private hospitals, the exact split between the two groups and the eligibility criteria for participating private providers is still being determined. HHC serves the most uninsured and Medicaid patients in New York, but there is intense pressure on state DOH to use waiver funds for other providers too. Upstate legislators are calling for the money to benefit hospitals outside of the city, which serve fewer needy patients, and downstate advocates are calling for funds to bail out struggling private providers in Brooklyn. The end result may be that HHC does not receive the equivalent of its entire intergovernmental payment plus a one-to-one federal match in Medicaid waiver funds. Were this to occur, HHC's payment, likely funded with city dollars, would be used in part to draw down federal dollars subsidizing other public or private hospitals throughout the state.

City's Public Hospitals Continue To Face Fiscal Struggles

The Mayor's Preliminary Budget projects that the Health and Hospitals Corporation's (HHC) expenses will continue to outstrip revenues in fiscal years 2014 through 2018, leading to growing operating deficits and dwindling cash reserves. The reasons for this ongoing trend have been well-documented in previous IBO publications and include repeated state and federal reimbursement cuts, decreased use of HHC facilities, a patient base weighted heavily towards Medicaid enrollees and the uninsured, and stubbornly high labor costs. In addition, two other issues are expected to factor into HHC's fiscal outlook in 2015 and beyond: new Medicaid waiver funding and a significant expansion in MetroPlus enrollment. The impact of the former is somewhat uncertain at this stage. The latter, however, is an unambiguously positive development for HHC and its bottom line.

A Growing Operating Deficit. HHC expects operating revenues to decrease by 3.5 percent by 2018, while operating expenses are on pace to increase by 11.1 percent. Adding in interest income and expense, which the corporation does not include when reporting operating revenue and costs, HHC projects an operating loss of $640 million in 2014 increasing to $1.8 billion in 2018. The corporation is only able to end each year with a positive cash balance by drawing down cash reserves from prior years and counting on a growing number of uncertain and unspecified "corrective actions" to provide relief.

There are a number of factors contributing to HHC's poor financial performance, including repeated cuts to Medicaid and Medicare reimbursement rates, losses associated with the months-long closures of several facilities in the wake of Hurricane Sandy, and a general trend of declining hospital use. Another potentially large threat to HHC's revenues looms in the form of nationwide reductions to Disproportionate Share Hospital (DSH) program funding that were included in the Affordable Care Act. Originally scheduled to go into effect in October 2013, the first of these cuts has since been delayed until October 2015 but has also doubled in size to $1.2 billion, or approximately 10 percent of total DSH funding nationwide. On the expense side, HHC is currently operating with a number of expired labor contracts and could face a sizable obligation for retroactive pay.[5]

MetroPlus. A wholly owned subsidiary corporation of HHC, MetroPlus is a managed care organization that was created in the 1980s, in part to increase the number of insured patients using HHC facilities. Until recently, MetroPlus only offered health insurance plans for HHC employees and for enrollees in government-sponsored insurance such as Medicaid and Medicare. This fall, however, MetroPlus entered the commercial market for the first time, rolling out a number of Qualified Health Plans (QHPs) and one Small Business Health Options Program (SHOP) plan available through NY State of Health, the Affordable Care Act health insurance marketplace for New York. MetroPlus also began listing their Medicaid and Child Health Plus plans on this site. NY State of Health launched in October 2013 with the first enrollees gaining coverage on January 1, 2014.

The results for MetroPlus and HHC have been very positive thus far. As of March 3, MetroPlus had enrolled just over 39,800 people into its various marketplace plans, including 27,700 applicants into QHPs (more than 70 percent of whom have already paid their premiums), 11,700 into Medicaid and Child Health Plus plans, and 400 into its SHOP plan. The 39,800 enrollees represent approximately 25 percent of total marketplace enrollment in New York City and about 8 percent of enrollment statewide. This level of success is likely due in large part to the fact that MetroPlus is offering the lowest cost premium option of any insurer at 3 out of the 5 coverage levels available in the individual market. MetroPlus also seems to be doing a good job attracting young people, generally the healthiest—and thus from the insurer's perspective, most desirable—group of enrollees. Specifically, about 49 percent of MetroPlus's total enrollment through NY State of Health is under age 35. In comparison, young adults age 18 to 34 made up only about 27 percent of total state and federal marketplace enrollment between October 1, 2013 and March 1, 2014.

On the other hand, enrollment in existing MetroPlus plans has fallen over the course of the past year, partly due to the phase out of Family Health Plus and a large number of MetroPlus members losing their Medicaid eligibility due to family income changes. Still, its net enrollment increase between December and February—reflecting the roll-out of the Affordable Care Act—was about 10,700 individuals, or 2.5 percent.[6]

This modest boost in MetroPlus enrollment should help HHC's bottom line in several ways. First, it will bring in additional premium revenue for the corporation. In the Preliminary Budget, HHC assumes that MetroPlus premium revenue will grow to $2.26 billion in 2015 and $2.32 billion in 2016 through 2018, an increase in 2015 of about 3 percent over 2013 actual revenue. If MetroPlus enrollment growth surpasses HHC projections, it could help fill in some of the corporation's sizable budget gaps. If enrollment growth falls short, however, it will increase the size of these gaps.

Second, more MetroPlus members should translate into more HHC patients, especially as the MetroPlus plans' network only includes a few private hospitals in addition to HHC's 11 acute care hospitals. This is especially important to HHC as use of its inpatient facilities has been declining for several years. Excluding Bellevue and Coney Island hospitals, which were closed for a significant portion of 2013 as they recovered from damage inflicted by Sandy, acute inpatient discharges for the first half of 2014 are down by almost 6 percent over discharges for the first half of 2013.[7] Compared with the equivalent period in 2010, 2014 discharges have declined by 11.0 percent systemwide.

Lastly, more patients with insurance—particularly commercial insurance—visiting HHC facilities should result in a more favorable payer mix for the corporation. Within the health care sector, reimbursement rates tend to be the highest for commercial insurance, followed by Medicare, and then Medicaid. HHC currently serves very few commercially insured patients. Individuals with commercial insurance represented just under 9 percent of HHC's total inpatient discharges in the first half of 2014, compared with over 59 percent for those with Medicaid, about 21 percent for those with Medicare, and roughly 9 percent for the uninsured.

If MetroPlus enrollment growth can shift significant numbers of HHC's patients from the uninsured category into the commercial category, or even into Medicaid, that would do much to improve the corporation's fiscal outlook. However, HHC believes that the majority of its uninsured patients may not be eligible for health care coverage through the exchanges, which do not cover undocumented immigrants. HHC pegs the undocumented at about 60 percent to 70 percent of its uninsured patients. If these estimates are accurate, it seems unlikely that this uninsured patient base will shrink dramatically anytime soon.

Reviewing the Changes in City Child Care Enrollment

The Mayor's Preliminary Budget includes $63 million a year in city child care funds that were added in the November 2013 Financial Plan. These newly baselined funds address some of the concerns over potential reductions in the number of children receiving subsidized care as a result of the transition of the city's child care system to EarlyLearn, a new service model designed to improve and standardize quality of care for preschoolers. This transition has been accompanied by a significant decrease in contracted enrollment, although some of the decrease would likely have occurred anyway.

Background. The Administration for Children's Services (ACS) administers the largest municipal child care system in the country, providing subsidies for 96,000 children as of January 2014. Subsidies are offered for three types of child care: informal care, family day care, and center-based care. The latter also includes those Head Start centers throughout the city that ACS administers as the recipient of a federal Head Start grant (other Head Start centers are operated by providers contracting directly with the federal government). These centers offer early childhood care and education programs to eligible children ages 3 and 4 from low-income working families. For many years the city-affiliated Head Start centers were administered separately from the child care program, but ACS recently blended them into one unified system.

Subsidy payments are made directly to providers under contract with ACS or through vouchers. Informal care is provided solely through vouchers, while family and center-based care is paid by a mix of contracts and vouchers.

Services are provided to two groups: public assistance families in work or training programs and low-income working families. Public assistance families are guaranteed vouchers to pay for care in their choice of center-based day care, family day care, or informal care. Eligible low-income working families receive vouchers or slots in ACS contracted child care facilities as space permits.

The Transition to EarlyLearn. In April 2010, ACS began the groundwork for a new initiative, called EarlyLearn NYC, encompassing all contracted center-based and family child care, as well as the city-affiliated Head Start programs. The primary goal was to improve and standardize quality of care while expanding services to communities with the greatest need. The new EarlyLearn contracts began in October 2012 with many providers new to ACS.

The implementation of EarlyLearn blended two early childhood programs: contracted child care and Head Start. By design, it has had no impact on the number of child care vouchers offered by ACS. In 2012, the last fiscal year prior to EarlyLearn, vouchers were used by about 60 percent of the children enrolled in ACS child care or Head Start.

Initially, the expected program capacity was 41,764, a decrease of more than 7,000 slots from the combined capacity of contracted child care and Head Start in 2012. While the number of slots was expected to drop, the spending per slot was expected to grow. Thus, the original plan was based on a tradeoff between increased quality and decreased quantity.

After complaints from advocates, parents, providers, and elected officials about the impending contraction, the Bloomberg Administration added funding for 4,147 slots and the City Council funded another 4,919 slots. Therefore, as of the 2013 Adopted Budget the expected number of contracted slots had risen to 50,830, an increase of 1,859 slots compared with the capacity in 2012.

There were important differences between the child care slots funded by the Council and those funded by the Bloomberg Administration, however. Unlike the EarlyLearn slots, these City Council child care slots were originally funded for just one year. Moreover, the contracts funded by the City Council were not issued under the terms of EarlyLearn, and ACS does not count them as part of its EarlyLearn system.

Impact on Enrollment. Although the long-term impact of EarlyLearn has yet to be determined, the initial phase has coincided with a significant decrease in contracted enrollment, although some of this decrease would have occurred without EarlyLearn; in particular, the shift of thousands of ACS Head Start slots previously administered by the city to independent providers.

In the years prior to the implementation of EarlyLearn, the city's subsidized child care system had shrunk considerably, as city funding cuts, a leveling off of federal funds and rising provider costs led ACS to cut back on capacity. Average child care enrollment decreased steadily from an all-time peak of 116,355 in fiscal year 2006 to 95,977 in 2012. Enrollment in Head Start, however, held relatively constant at around 18,000.

The new EarlyLearn contracts began to be implemented in October 2012. The rapid shift to a large number of new providers and new service locations created the potential for service disruptions for many families. Since it took some time for many of these providers to become fully integrated into the child care enrollment tracking system, reliable enrollment numbers are not yet available for the early months of the program. ACS is currently making an effort to pin down the enrollment numbers for fiscal year 2013. For now, reliable numbers are available for the first seven months of fiscal year 2014, and by comparing these to 2012 we can get a sense of the impact of the implementation of EarlyLearn on enrollment.

As expected, EarlyLearn has had no significant impact on the number of children receiving child care vouchers, which remains at about 69,000. While vouchers for low-income working families decreased by about 4,000 from 2012 to 2014, this was offset by an increase in the use of vouchers by families receiving public assistance.

On the other hand, there was a large decrease in contracted care enrollment. Total enrollment in ACS contracted center-based and family care decreased by 14,614 from 43,293 in 2012 to 28,679 in 2014. When City Council contracts are included, the enrollment decrease is less, but it still fell by 10,842, or about 25 percent.

Most of the decrease in contracted enrollment is a result of a decrease in capacity. At the time the 2013 budget was adopted, contracted capacity was expected to total 50,830, including 45,911 ACS slots and 4,919 City Council slots. Actual capacity for 2014 is just 40,886, however, including 36,695 ACS slots and 4,191 City Council slots.

Part of the decline is due to a shift in capacity from the city to independent providers of Head Start as a result of the federal decision to implement a new round of grant competition. Although these slots now fall outside of city control, they remain available to New York City families. The actual decline in enrollment in city-provided EarlyLearn Head Start was 5,019. In addition to the loss of city-provided Head Start slots, some providers rescinded seats due to difficulties in implementation. Finally, some funds had to be shifted from EarlyLearn to vouchers, as voucher families continued to shift away from informal to other care.

Beyond the decreases in capacity, some EarlyLearn providers appear to still be having difficulty achieving full enrollment, which is notable because under EarlyLearn reimbursement is based on enrollment rather than capacity. Over the last few months contracted enrollment has edged upward, however.

Funding. While public funding for subsidized child care has been tight for a number of years, in recent months funding has increased and there are signs of possible further easing in the future. The November plan baselined $63 million in city funds, most of it to fund the City Council's contracted slots which had previously been funded one year at a time. Discussions between

ACS and the City Council are ongoing about whether to incorporate these slots into EarlyLearn. In January, President Obama signed a federal spending bill which restores Head Start funds that had been scheduled for reduction under sequestration. In addition, the Governor's 2014-2015 Executive Budget proposes using state funds to provide a modest increase in the Child Care Block Grant subsidy allocations that help fund the city's child care system. Finally, the Mayor's plan to expand full-day prekindergarten could lead to a shift of significant numbers of 4-year olds from child care into pre-K, potentially freeing up child care funding for other age groups.

More Slots for More Hours, but No Summer Programs Under After-School Plan

There are currently more than 500 public middle schools in New York City serving over 224,000 students. Currently 56,369 middle school students participate in some form of after-school activity provided by either the Department of Education (DOE) or the Department of Youth and Community Development (DYCD). In September 2014 an additional 62,791 students would have access to after-school programs as part of Mayor de Blasio's plan to increase middle school after-school programs. This means that an estimated 119,160 students, or more than half of all middle school students, would have access to some form of after-school programming next school year. To accomplish this goal the Mayor's Preliminary Budget for 2015 includes $190 million in new city funds to expand and improve DYCD's Out- of-School Time program (OST).

Current Out-of-School Time Model. The Department of Youth and Community Development's OST program provides activities for school-age youth during after-school hours, on weekends, and during school vacations. OST programs are offered at no cost to participants and provide a mix of academic, recreational, and cultural programs for elementary, middle school, and high school students. OST service providers operate mostly in public school buildings, with a smaller number operating in facilities of the parks department and the New York City Housing Authority.

For 2013, DYCD revamped its OST program for elementary and middle school students to improve services and raised the per slot rate to cover the additional costs. This increased cost per slot, together with a scheduled decrease in funding, was expected to reduce the number of OST slots in 2013 by nearly half, from 52,600 in 2012 to 26,900. During negotiations to adopt the 2013 budget, however, the City Council added $51 million to restore nearly 30,000 slots for one year, although these were funded at the previous, lower cost per slot. As a result, the OST program was able to serve 65,957 students at all grade levels in 2013. (Since many students do not attend these programs every day, the number of students enrolled can exceed the number of slots.)

The City Council once again added $51 million to the 2014 Adopted Budget to maintain the 30,000 slots for an additional year. The additional funding has allowed OST to serve 65,023 students thus far in 2014, including 16,265 middle school students. In November 2013 the Bloomberg Administration baselined the $51 million that had been funded for one year at a time, allowing OST to maintain its current service levels in future years. It is in this context that Mayor de Blasio has introduced his plan to greatly expand the number of middle school students participating in OST.

Expanded Program Model. Earlier this month, the de Blasio Administration released a white paper detailing the changes to the city after-school system, specifically for middle school students. According to the white paper there are currently 45,095 slots for after-school activities citywide for middle school students. This number includes programs at the Department of Education and several of DYCD's after-school programs including OST, Beacons, and Cornerstone. The expanded program would create an additional 50,233 OST slots for a total of 95,328 after-school slots for middle school students. (The plan assumes that each slot can accommodate 1.25 students.)

The Mayor's budget anticipates that the $190 million to fund the expanded program will come from the proposed income tax surcharge on residents with incomes of $500,000 or more. Of the $190 million in funds, $159 million is slated for programming, while the remaining $31 million will go to DYCD and DOE for administrative costs associated with implementing the new program. DYCD anticipates that it will need to use some of its new administrative funding to hire additional program managers to help run the new contracts. The bulk of the $159 million in programming funds, $132 million, will go to fund

Middle School Expansion Funding *Dollars in millions*	
	2015
New Middle School Slots	$132
Enhancement of Current OST Middle School Slots	12
Nonpublic School Sites	8
District 75 School Programs	6
DYCD and DOE Administrative Costs	31
TOTAL	**$190**

SOURCES: Department of Youth and Community Development; After-School Programs for Middle School Students, Mayor's Office
New York City Independent Budget Office

the new middle school slots at public schools, which will be chosen through the RPF process. An additional $12 million will be used to enhance the current OST middle school slots, $8.0 million will go to new slots at nonpublic school facilities, and $6.0 million will be allocated for new OST slots at District 75 schools. The latter programs will be administered directly by DOE. District 75 schools provide educational, vocational, and behavioral programs for students with special needs who require services and supports that are not available in regular DOE schools.

The service model for the expanded program includes some critical changes that distinguish it from the current OST system. These include an increase in the annual cost per program slot, expansion of program hours to allow for higher quality programming, greater use of school resources, and the targeting of struggling students for additional academic intervention. The price per participant will increase from the current OST price of $2,100 to $3,000. This increase will allow each program to have a full-time director, as well as an education specialist to train other program staff and provide ongoing technical assistance. Teachers from the host schools will be encouraged to lead after-school activities.

The number of hours of service provided annually will increase from 413 hours in the current OST model to 540 hours. Of the 540 hours, 324 hours will be devoted to structured activities, meaning programming that is aligned with school-day instruction. This can include activities with a focus on the arts, literacy, STEM (science, technology, and math), leadership development skills, academic support, physical activity, and family engagement. Programs will be required to operate their structured activities nine hours per week for 36 weeks during the school year. The remaining 216 hours can be used for unstructured activities such as tutoring and recreation.

School principals will be required to make an in-kind contribution amounting to 10 percent to 15 percent of the total program funding received from DYCD for their schools' after-school program. Such contributions could include rearranging teacher's schedules to have a teacher available for a portion of the after-school program. These details will be outlined in the school partnership agreements between the nonprofit provider and the schools.

No Provision for Summer Programming. The revamped OST program introduced by DYCD in 2013 included funds to provide services during the summer months. Similarly, when the City Council began funding its own 30,000 slots, the Bloomberg Administration agreed to fund corresponding summer slots, but only through the summer of 2013. The $51 million that was added to DYCD's baseline budget in November 2013 to fund those 30,000 slots no longer covers summer services at those sites. Based on last year's cost, maintaining a summer component for the City Council slots would require roughly $20 million a year.

Similarly, there is no summer programming in the de Blasio Administration's plan to increase after-school services for middle school students. Based on current OST summer program costs, IBO estimates that an additional $28 million to $38 million would be needed in order to fund the summer portion of the new middle school expansion program, depending on what service model is adopted.

Endnotes

[1]Averages are based on available data. There are no data on applicants to shelter for October 2013 (fiscal year 2014). Data on shelter entrants were also missing for December 2012 and October 2013 (fiscal years 2013 and 2014, respectively).

[2]Under the 1115 waiver program—1115 refers to a specific section of the Social Security Act—states can apply to try out a new approach to delivering or financing Medicaid services. If approved, CMS may waive certain federal requirements and/or approve funding for populations and services not typically covered by Medicaid.

[3]The other two components of the state's revised proposal are Managed Care Contract Payments worth $2.1 billion and a State Plan Amendment worth $525 million.

[4]Unless otherwise indicated, all years refer to city fiscal years.

[5]As is the case with the city budget as a whole, HHC's financial plan does not include the cost of any retroactive pay to unions with expired contracts.

[6]Enrollees who signed up through the marketplace in fall 2013 did not actually receive coverage until January 1, 2014 and are not counted in December enrollment totals.

[7]This is the measure HHC most commonly uses to track hospital utilization. It excludes discharges from psychiatric and rehab inpatient units.

Labor Costs

The Big Unknown: How Much Could Union Settlements Cost?

The largest unknown in the Mayor's Preliminary Budget is how much collective bargaining agreements will cost given that contracts with all of the city's unionized labor force have expired, in some cases as long ago as 2007. The Mayor's budget includes a labor reserve that totals $1.4 billion for the years 2014-2016 ($265 million for 2014, $465 million for 2015, and $714 million for 2016) to cover the cost of two consecutive annual 1.25 percent raises following three years—and in some cases five years—of zero percent increases. This total will prove insufficient if the city and the unions ultimately settle for terms more generous than those assumed in the budget. Such a shortfall would have to be covered through some combination of savings elsewhere in the budget, drawing on reserves put away for other purposes, or additional revenues.

New York City municipal labor negotiations are traditionally structured in "rounds" with settlements in a given round typically adhering closely to a pattern of raises, with all contracts in a round spanning a similar number of years. Note that while the duration of the contracts in a given round is typically the same, the dates covered can vary significantly. For example, the city and many of its unions settled contracts for two consecutive 4 percent annual raises during the years from 2008 through 2010. District Council 37's contract in the 2008-2010 round expired in March 2010, while the teachers' last contract from the round *prior* to the 2008-2010 round expired only a few months earlier in October 2009.

A number of unions, including those representing the teachers and school principals, never reached agreements with the city during the 2008-2010 round. But even those unions that did reach agreements for that round have now reached the end of those contracts, in some cases three or more years ago.

Possible settlements of the over 150 expired contracts could involve many different combinations of retroactive pay, new raises, and one-time "bonus" payments, or no raises at all. To provide some context to the discussion of the magnitude of the possible costs the city faces in settling these contracts, IBO has estimated the costs of a handful of scenarios. In selecting these particular scenarios IBO is not suggesting that these are the only possible solutions, nor do we recommend any particular deal. We assume that the expense of settlements covering years up to and including 2014 would have to be paid with resources from this fiscal year, and recurring future costs funded in subsequent years.

Although the city's balance sheet includes a labor reserve for 2008 through 2013, it is our understanding that these funds have already been committed to accrued liabilities other than the expired contracts and therefore we assume that they will not be available to help pay for settling the expired contracts. The estimated annual costs in the following paragraphs *do* assume the use of the labor reserve money that has been set aside for 2014 through 2016 to offset some of the costs of settlements for those years.

These estimates cover all city workers—including non-union staff who traditionally receive raises that follow the union pattern. Employees of city-subsidized entities such as the public library systems and cultural institutions, the Health and Hospitals Corporation and the housing authority, who are not guaranteed contracts matching the pattern for city workers, are excluded. Our estimates also include projections for payroll taxes and the additional pension contributions necessitated by higher salaries. The estimates are for the city-funded costs, including expenses for Department of Environmental Protection workers who are paid via water charges rather than the city's general revenues.

Some Scenarios. If the city and those unions that did not settle contracts during the 2008-2010 round when

Costs of Settling Expired Labor Contracts: Selected Scenarios
Dollars in millions

Settlement for Prior Round	Settlement for Current Round	2014	2015	2016
4%, 4%	Nothing	$3,336	$413	$62
4%, 4%	2%, 2%, 2%, 2%	$7,142	$2,412	$2,041
2%, 2%	1%, 1%, 1%, 1%	$3,391	$941	$631
4%, 4%	5% bonus in third year	$4,202	$563	$62
$5,000 bonus	Nothing	$500	n.a.	n.a.
Nothing	$5,000 bonus in third year	$736	$397	n.a.

NOTE: Amounts shown are net of labor reserve of $265 million in 2014, $465 million in 2015, and $714 million in 2016.
New York City Independent Budget Office

two consecutive 4 percent raises were the pattern—teachers and principals are the largest groups in this category—were given the pattern for that round and no raises were given to any workers for the subsequent round of contracts, the cost would be $3.3 billion in 2014. This figure includes retroactive pay from prior years plus the impact of those retroactive increases on current 2014 labor costs.

An alternative scenario uses the two 4 percent raises from the previous pattern followed by annual 2 percent raises for all workers in the subsequent round. This would cost $7.1 billion in 2014, $2.4 billion in 2015, and $2.0 billion in 2016. (The decline in cost in 2016 is attributable to the somewhat larger labor reserve in that year.) The cost of a less generous settlement with two consecutive 2 percent raises for those unions which did not settle in the 2008-2010 round and 1 percent raises for all workers in each year of the next round would be $3.4 billion in 2014, and $941 million in 2015 and $631 million 2016.

One-time cash payments or bonuses could also be part of a settlement either in combination with, or instead of, a recurring wage increase. One key distinction is that bonus payments are not included in the base wage for future contracts. Another is that they are not included as earnings when calculating pension benefits. A scenario that included the two 4 percent raises for those unions that missed the 2008-2010 round of settlements plus a bonus payment to all current workers equal to 5 percent of salary paid in the third year of the subsequent contract would require $4.2 billion for 2014 and then $563 million in 2015 and $62 million in 2016. For most city workers, the 5 percent payment would occur in 2014 or 2015.

Bonus payments could also be a specific dollar amount rather than a percentage of current salary. For example, if instead of retroactive pay raises for those unions that missed the 2008-2010 round, the city were to pay a bonus of $5,000 to current workers then on the payroll, the amount to be paid out of the 2014 budget would be $500 million. Alternatively, simply paying a $5,000 bonus to all workers in the current round without any accompanying wage increase would cost $735 million in 2014 and $397 million in 2015.

Obviously, the percentage or size of any bonus payment could be adjusted, not to mention the size of the annual wage increase, to help tailor a settlement with widely different budgetary costs. The estimated budget impact in 2014 for the handful of scenarios discussed here range from $500 million to $7.1 billion. Given that these estimates already include the use of the 2014 through 2016 labor reserve allocations, all of these scenarios would require finding significant amounts of additional resources in the budgets for 2014 and subsequent years to pay for a settlement that would take effect this year.

How It Works: Maintaining $1 Billion in The Retiree Health Benefits Trust

The Retiree Health Benefits Trust (RHBT) is a trust fund of assets maintained by the city and used to pay for benefits other than pensions for eligible retirees and their dependents. The Preliminary Budget reverses a previously scheduled withdrawal of $1.0 billion from the RHBT in 2014 that would have nearly exhausted the fund. Instead, the fund will end the fiscal year with a balance of at least $1.0 billion, and more likely several hundred million dollars more, depending on investment returns and other adjustments.

The city is obligated—either by law or by collective bargaining agreement—to pay a range of benefits to retirees, in addition to pension benefits. These are known as *other post-employment benefits* (OPEB) and include primary and secondary health insurance, Medicare Part B reimbursements, and city funding for retiree welfare fund benefits. The city's RHBT was formed in 2006 shortly after the Governmental

Accounting Standards Board established standards for reporting on future OPEB liabilities. According to the now-required disclosure in the city's latest annual financial report, the city's future OPEB liabilities were estimated to total $92.5 billion as of the end of the last fiscal year.

Although the accounting board did not require municipal governments to begin funding those liabilities on an actuarial basis—similar to what is required for pension liabilities—in 2006, the city indicated that it would use the trust fund to begin setting aside money that could be used to meet those future expenses. Even with the RHBT in place the city has continued to pay for retiree health expenses on a pay-as-you-go basis, although the payments now flow through the fund. Each year the city must appropriate sufficient funds to the RHBT to cover that year's OPEB obligations. Under the agreement establishing the trust fund, all RHBT assets must be used to pay for OPEB liabilities. As of June 30, 2013 the RHBT held assets of $1.4 billion in trust.

Withdrawals. When the RHBT was established, the city was running substantial current year surpluses which were the source of the funds originally deposited into the RHBT: $1.0 billion in 2006 and $1.5 billion in 2007.[1] Despite emphatic comments from the Bloomberg Administration at the time that the fund would not serve as a de facto rainy day account, it came to function in that way. When near-term budget deficits loomed following the financial crisis in 2008, the city was able to free up money to address budget gaps by "withdrawing" money from the RHBT. Instead of covering a fiscal year's full pay-as-you-go obligations by appropriating all of the necessary money from the general fund and routing it through the RHBT, the city allowed some of the assets of the fund to be used to cover the obligations due to current retirees. From 2010 through 2013, this arrangement allowed the city to free up $82 million, $395 million, $672 million, and $1.0 billion, respectively.

The Adopted Budget for 2014 assumed that the city would "withdraw" another $1.0 billion from the RHBT this year, which would have largely depleted the fund. However, the de Blasio Administration's Preliminary Budget for 2015 removes the scheduled withdrawal from the financial plan. Thus, money will flow into and out of the RHBT to pay 2014 OPEB expenses on a pay-as-you-go basis, leaving the RHBT's current balance essentially unchanged at about $1.4 billion. The final balance at the end of the fiscal year will depend on investment performance and other financial adjustments. This money could be used as a down payment on the city's OPEB obligations—including any additional liabilities that might result from future collective bargaining agreements—or alternatively, the city may once again resort to "withdrawals" to provide budget relief to free up funds for other purposes.

Endnote

[1]Budget surpluses also allowed the city to prepay $460 million in 2008 for 2009 OPEB liabilities and $225 million in 2009 for 2010 OPEB liabilities.

Capital Spending, Financing, & Debt Service

Four-Year Capital Commitment Plan

The February 2014 Capital Commitment Plan that was released with the Mayor's Preliminary Budget provides $38.6 billion for the city's capital program, covering the period 2014 through 2017. Total planned commitments are $904 million (2.4 percent) more than the capital funding in the adopted plan that was released in October 2013. Nearly 60 percent, $527 million, of the increase in planned spending is for parks and recreation facilities.

Over three-quarters of February's four-year capital plan—$29.8 billion—is city-financed. The $8.8 billion balance is expected to come from state, federal, and private grants. City funds make up an even larger share of the increase (93 percent) in capital funding between October and February.

The February 2014 plan includes a total of $2.4 billion for Hurricane Sandy capital projects, with $2.0 billion planned for 2014, $360 million for 2015, and about $2 million for 2016. Roughly $80 million was added for Sandy-related projects since the October plan, with over half of the increase—$47 million—allocated for the reconstruction of Rockaway Beach and about $14 million for citywide street reconstruction. The city expects to be fully reimbursed by the federal government for the storm-related projects.

Education, Environmental Protection, and Transportation. Capital commitments for the plan period 2014 through 2017 are largely concentrated in three areas: education, environmental protection, and transportation. Together these three categories total $22.3 billion, or nearly 60 percent of the overall capital plan.

Department of Education projects total $8.4 billion, which is the largest share (21.7 percent) of total planned commitments over the 2014 through 2017 period. The February 2014 plan increased funding by $25 million from the October level to rehabilitate components of school buildings (for additional information on school capital projects see page 26). The Department of Education's February 2014 capital plan includes $304 million to repair school buildings damaged due to flooding caused by Hurricane Sandy. This accounts for 12.7 percent of total storm-related funding in the plan.

Environmental protection projects account for the second largest share, $7.5 billion, or 19.5 percent, of total planned commitments from 2014 through 2017. There is no change in total capital funding for environmental protection projects from the October plan.

Transportation projects are the third largest share, $6.4 billion (16.5 percent), of total planned commitments. The February 2014 plan increased capital funding for transportation projects by a total of $61 million, including $45 million for road reconstruction in eastern Staten Island and $19 million for vehicle purchases to replace rental vehicles being used for road reconstruction. Conversely, funds for reconstruction of Worth Street in Manhattan were reduced by $26 million.

While there was only a small net reduction in total capital funding for bridge projects, there were notable changes to specific projects including an increase of $11.7 million for the rehabilitation of the Brooklyn Bridge and a reduction in funding of $11.5 million for work on the Manhattan Bridge.

The Department of Transportation's capital program includes $665 million for Hurricane Sandy-related projects, 27.7 percent of all storm-related funding. The capital plan includes over $400 million in street reconstruction (a net increase of $14 million from the October plan) and $37 million in street resurfacing, along with $69 million mostly for the replacement of signals and lights, $32 million for repairs to bridges citywide that were damaged during Sandy, and $40 million for the Battery Park City/West Street underpass.

Parks and Recreational Facilities. Capital funding for parks and recreation projects increased by $527 million (26.6 percent) since the October plan to reach

City Revises Four-Year Capital Commitment Plan
Authorized commitments, dollars in millions

	2014	2015	2016	2017	TOTAL
February 2014 Plan					
City Funds	$16,497	$5,808	$3,972	$3,502	$29,779
Noncity Funds	4,841	1,432	1,077	1,457	8,807
TOTAL	**$21,338**	**$7,240**	**$5,049**	**$4,959**	**$38,586**
October 2013 Plan					
City Funds	$16,185	$5,600	$3,812	$3,341	$28,938
Noncity Funds	4,676	1,534	1,077	1,457	8,744
TOTAL	**$20,861**	**$7,134**	**$4,889**	**$4,798**	**$37,682**
Change					
City Funds	$312	$208	$160	$161	$841
Noncity Funds	165	(102)	-	-	63
TOTAL	**$477**	**$106**	**$160**	**$161**	**$904**
Percent Change					
City Funds	1.9%	3.7%	4.2%	4.8%	2.9%
Noncity Funds	3.5%	-6.6%	0.0%	0.0%	0.7%
TOTAL	**2.3%**	**1.5%**	**3.3%**	**3.4%**	**2.4%**

NOTE: Plan figures exclude interfund agreements and contingency amounts.
New York City Independent Budget Office

$2.5 billion over the 2014 through 2017 period. Roughly half the increase, $230 million, is funding which has not been allocated to specific projects, including an increase of $82 million for neighborhood parks, $50 million for recreation centers, $23 million for comfort stations, and $18 million for citywide utility upgrades. There is also increased capital funding for specific parks or facilities improvements, including $40 million for Brooklyn Bridge Park, $33 million for the Staten Island Boardwalk, and $17 million for Pier 54 in Hudson River Park, and for specific acquisitions, such as $15 million for Goodhue Park.

The parks department capital program includes $457 million for Hurricane Sandy reconstruction, 19.1 percent of storm-related funding in the plan. A total of $60 million has been added since the October plan for Hurricane Sandy-related projects. Funding of $47 million for the reconstruction of Rockaway Beach was added for 2014 and another $114 million was shifted forward from next year to this year. Funding of $10 million for tree removal citywide was also added in 2014.

Hospitals. There was little change in capital funding for hospital projects from the October plan; a decrease of roughly $6 million, or 0.5 percent. Of the $1.2 billion in planned commitments for the Health and Hospitals Corporation), more than half, $658 million, is allocated for Hurricane Sandy reconstruction, which accounts for 27.4 percent of all storm-related funding in the February 2014 plan. The hospital corporation's capital program includes funding for the three most heavily storm-damaged facilities—$143 million for Bellevue Hospital Center, $113 million for Coney Island Hospital, and $79 million for Coler Memorial on Roosevelt Island. An additional $269 million for reconstruction throughout the public hospital system is also planned for 2014 but has not yet been committed to specific hospitals or projects.

Sanitation. Capital funding for sanitation department projects increased by $60 million (5.5 percent) from October to total $1.1 billion over the plan period. The February 2014 plan added $35 million for the construction of facilities related to the city's Solid Waste Management Plan and $17 million for the construction of a salt enclosure facility in Manhattan.

Fire. Capital funding for fire department projects increased by $60 million (21.7 percent) since October to $338 million over the plan period. The majority of the increase, $52 million, is for the renovation of firehouses across the city.

Paying for the Capital Plan

Borrowing. To finance the February 2014 Capital Commitment Plan, the city will borrow money by issuing three types of debt: general obligation (GO), Transitional Finance Authority (TFA), and Municipal Water Finance Authority (often referred to as New York Water or NYW). GO debt is backed primarily by the city's property tax. TFA debt is backed by the personal income tax. NYW debt is backed by fees and charges levied on users of the New York City water and sewer systems. The proceeds of water authority debt are pledged exclusively to capital improvements for the city's water and sewer system. GO and TFA debt proceeds fund the remainder of the city-funded capital program.

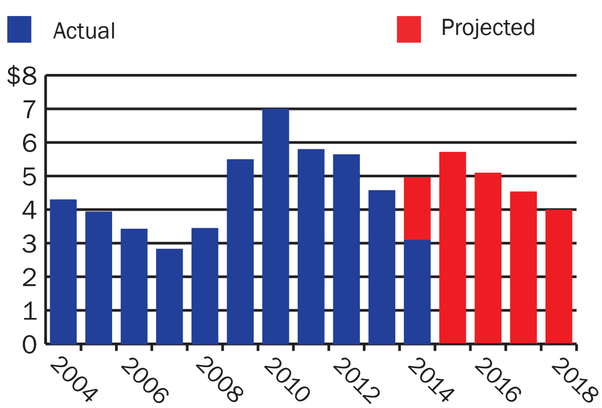
City Debt Issuance Trends. Annual borrowing is based on the city's cash needs for capital projects. Cash needs are roughly correlated with city capital expenditures in each year. There is a much weaker relationship between either cash needs or capital expenditures and capital commitments in a given year. This is because a capital commitment (when the city registers a contract for the project) in one year can result in capital expenditures in that year, in a later year, or spread out over a few years.

The Mayor's Office of Management and Budget (OMB) projects that the city will issue $4.9 billion in new debt in 2014, which would be an 8.4 percent increase over 2013. If this estimate holds, it would be the first year-over-year increase in borrowing since 2010. New bond issuance is projected to increase an additional 15.4 percent to $5.7 billion in 2015 before declining again in the succeeding years of the financial plan.

Growth in Debt Service. Debt service—the cost of repaying principal and/or interest on outstanding bonds—is a function of the amount of outstanding debt and the terms that were obtained when the debt was issued. Debt service in the city budget reflects GO and TFA borrowing, as well as several smaller obligations. Debt service for NYW borrowing is not an item in the city budget as it is paid directly by the water authority—a self-financing public benefit corporation.

Selected City Bond Issues

Dollars in billions



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

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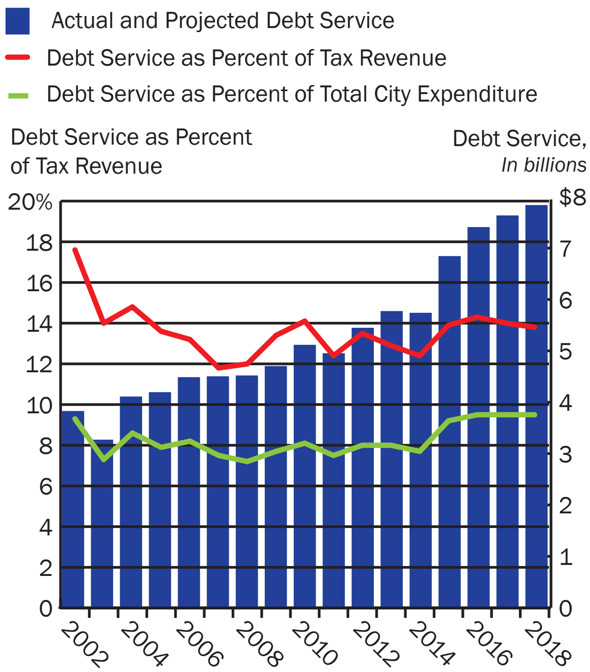
Debt service, adjusted for prepayments and defeasances—which involve the use of current surplus funds to prepay future interest and principal on existing debt—is expected to total $5.7 billion in 2014. That would represent a 0.3 percent decline from debt service in 2013.

This stability, however, may be short lived. The de Blasio Administration projects that debt service will grow by more than 19 percent from 2014 to 2015. Some of the increase is attributable to higher planned borrowing in 2015, but the de Blasio Administration's assumptions about financing conditions in 2015 through 2018 also overstate future debt service. OMB's assumptions about interest rates on new fixed-rate bonds and on variable-rate debt are generally very conservative, with actual rates typically below what had been forecast. Moreover, the city also assumes it will do short-term borrowing in 2015 through 2018 at an annual cost of $74 million, even though the city has not needed any short-term borrowing since 2004.

Some of the projected 2015 increase could be offset by interest rate savings if rates remain low. The city has kept debt service increases in check primarily by refinancing existing debt at lower interest rates and by selling new bonds at rates that are lower than its baseline budget estimates. In 2014, for example, the city has taken advantage of low rates to save more than $167 million in the current fiscal year and to lock in savings relative to their projections totaling $196 million in 2015 and $77 million in 2016. Additional refinancing later this year or next year could result in additional debt service savings for 2015 through 2018.

If interest rates remain low, the city could also see additional savings in 2014 and possibly 2015 on its variable rate debt. In the Preliminary Budget the city recognized $104 million in lower debt service expenses for 2014 by reducing the interest rate assumption for its outstanding tax-exempt, variable rate General Obligation debt from 3.02 percent to 1.46 percent. This comes on top of $84 million in savings for this year that OMB recognized in November from a similar change. If rates remain at their current level through June, the city could save an additional $80 million in variable rate debt service for this fiscal year. Since OMB has not materially changed its interest rate assumptions in the financial plan for 2015 through 2018, savings could be realized in these years,

Debt Service and Debt Service as Shares Of Tax Revenues and Expenditures



SOURCE: IBO, Mayor's Office of Management and Budget
NOTES: Fiscal years 2014 through 2018 are projected. Adjusted for prepayment of debt service. Projections based on IBO tax revenue and expenditure forecasts.

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depending on interest rate movements.

With rates projected to rise, the city will likely have fewer opportunities to secure savings by refunding debt in future years, so it is prudent to use conservative assumptions for the 2015 through 2018 debt service projection. In the short term, however, interest rates on municipal securities have remained stable. The Bloomberg and the Bond Buyer municipal bond indices are down slightly in recent months despite the Federal Reserve's announcement that it would rein in its expansionary monetary policies. Similarly, the Securities Industry and Financial Markets Association's Muni Swap Index, which measures the rates paid on high-grade, tax-exempt, variable rate municipal bonds, is lower than it was at this time last year.

Debt service as a percentage of IBO's forecasts of tax revenues and city expenditures is projected to increase in 2015, though the ratio is largely flat through the out-years of the financial plan as the projected growth in debt service is nearly matched by strong revenue growth. After adjusting debt service payments for prepayments, debt as a percentage of revenue is projected to increase from 12.4 percent in 2014 to 13.9 percent in 2015, and debt as a share of expenses would rise from 7.7 percent to 9.2 percent. While high, these estimates are within the range of what the city has paid in debt service relative to revenues and expenses in the past. Given the conservative nature of the city's debt service estimates in the financial plan, it is likely that these projections will settle closer to their long-run averages.

Contributors

David Belkin	Economic forecasting
Rachel Berkson	Parks, transportation, buildings
Justin Bland	Sanitation, environmental protection
Elizabeth Brown	Housing, public housing, homeless services
Sean Campion	Debt, debt service, economic development
Ana Champeny	Property tax
Martin Davis	Municipal labor
Christina Fiorentini	Health care, public hospitals
Julie Anna Golebiewski	Business, sales, and hotel taxes
Michael Jacobs	Personal income tax
Gretchen Johnson	Education
Paul Lopatto	Public assistance
Bernard O'Brien	Police, fire, elections board
Ana Maria Ventura	Capital plan
Nashla Rivas-Salas	Youth services, senior services, correction, information technology
Sarita Subramanian	Education, school construction
Alan Treffeisen	Property transfer and mortgage recording taxes

New York City

Independent Budget Office

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