The Comptroller's Comments on the Preliminary Budget for Fiscal Year 2005 and the Financial Plan for Fiscal Years 2005 – 2008

The City of New York
Office of the Comptroller
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I. Executive Summary

Two years ago, the City faced a $6.7 billion budget deficit. Fortunately, the City took the actions necessary to balance a budget battered by recession and the destruction of the World Trade Center. While the City's finances appear to have weathered the storm, our recovery is fragile. Economic indicators demonstrate that many New Yorkers are struggling. Prosperity may be returning to some sectors of the economy, most notably Wall Street and tourism; however, other sectors, including manufacturing and information, have not recovered. As such, many New Yorkers have not benefited from this upturn.

In fact, in 2003, the City's rate of unemployment was the highest of the 20 largest metropolitan areas in the nation. The City's unemployment rate in 2003 was 8.3 percent – 2.3 percentage points higher than the nation's – and the labor-force-participation rate was 57.6 percent, down from the high of 65.6 percent in July 2002. In the last three years, the City lost more than 230,000 jobs.

The cost of living in New York is accelerating rapidly. The New York City metro area's inflation rate rose by 24 percent in the last year, from 2.5 percent in 2002 to 3.1 percent in 2003. This rate is significantly higher than the U.S. inflation rate of 2.3 percent in 2003. New York City's high cost of living has been further exacerbated by landmark property tax increases passed to meet the City's financial needs. The City's rising property assessments also translate into higher tax burdens on homeowners.

The Comptroller's Office has determined that the Fiscal Year 2005 Preliminary Budget contains $939 million in risks. The City has assumed $400 million in additional aid from the state in its gap-closing program. The Comptroller's Office projects $200 million of that amount is at risk, mostly because of shortfalls in Medicaid savings and education aid assumptions contained in the Governor's Executive Budget. Until the State passes its budget, the City's assumptions of additional State assistance will remain an element of risk in its financial plan assumptions. Other risks include the assumption that the City will be relieved of $490 million in Municipal Assistance Corporation debt service. While there are currently two proposals with different mechanisms for providing MAC debt relief it is uncertain if either will materialize. Additionally, the City's assumption that the Metropolitan Transportation Authority will take over private bus operations, relieving the City of $145 million in subsidies, also remains in question.

Another risk in the preliminary budget is the absence of a provision for wage increases for City employees in Fiscal Years 2005 through 2008. In its collective bargaining negotiations with labor representatives, the City has maintained its position that any wage increases for employees be funded through productivity initiatives. Given that it will cost the City approximately $212 million annually for every one-percentage point wage increase granted to employees, this omission represents a risk.

The Comptroller's office further projects that the budget underestimates the amount the City will likely spend on overtime pay by $217 million. In fact, the City has acknowledged that overtime costs for FY 2005 may be at least $150 million more than budgeted. At the same time, the City has also adopted an aggressive effort in recent years to reduce the size of the City's workforce. Historically, overtime spending generally increases in periods of headcount reduction. In this context, the City must be careful that the savings it gains from headcount reductions are not negated by resultant increases in overtime spending. Sound management dictates that any headcount initiative must take into account the implications for overtime expenditures.

The challenge ahead is ensuring that this recovery will be long, sustained, and shared by all New Yorkers. It will require a delicate balance, one that can be achieved through efficient management, prudent allocation of available resources, realistic budgeting and assistance from our partners in Albany.

Table 1. FYs 2004-2008 Financial Plan

($ in millions)

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	Changes FY 2004-FY 2008 Dollar	Changes FY 2004-FY 2008 Percent
Revenues							
Taxes:							
General Property Tax	$11,472	$11,964	$12,436	$12,958	$13,510	$2,038	17.8%
Other Taxes	$14,881	$14,730	$15,159	$15,713	$16,579	$1,698	11.4%
Tax Audit Revenues	$545	$508	$508	$509	$509	($36)	(6.6%)
Miscellaneous Revenues	$4,371	$5,065	$4,241	$4,209	$4,250	($121)	(2.8%)
Unrestricted Intergovernmental Aid	$953	$585	$585	$585	$585	($368)	(38.6%)
Less: Intra-City Revenue	($1,186)	($1,096)	($1,094)	($1,094)	($1,094)	$92	(7.8%)
Disallowances Against Categorical Grants	($15)	($15)	($15)	($15)	($15)	$0	0.0%
Subtotal: City Funds	$31,021	$31,741	$31,820	$32,865	$34,324	$3,303	10.6%
Other Categorical Grants	$926	$801	$828	$843	$843	($83)	(9.0%)
Inter-Fund Revenues	$343	$330	$320	$316	$316	($27)	(7.9%)
Total City & Inter-Fund Revenues	$32,290	$32,872	$32,968	$34,024	$35,483	$3,193	9.9%
Federal Categorical Grants	$5,463	$5,089	$5,041	$5,029	$5,019	($444)	(8.1%)
State Categorical Grants	$8,393	$8,679	$8,653	$8,726	$8,786	$393	4.7%
Total Revenues	$46,146	$46,640	$46,662	$47,779	$49,288	$3,142	6.8%
Expenditures							
Personal Service							
Salaries and Wages	$16,851	$16,590	$16,650	$16,652	$16,661	($190)	(1.1%)
Pensions	$2,555	$3,165	$3,958	$4,335	$4,351	$1,796	70.3%
Fringe Benefits	$4,803	$5,086	$5,378	$5,676	$5,934	$1,131	23.5%
Subtotal-PS	$24,209	$24,841	$25,986	$26,663	$26,946	$2,737	11.3%
Other Than Personal Service							
Medical Assistance	$4,123	$4,541	$4,747	$4,944	$5,151	$1,028	24.9%
Public Assistance	$2,437	$2,247	$2,254	$2,255	$2,255	($182)	(7.5%)
Pay-As-You-Go Capital	$200	$200	$200	$200	$200	$0	0.0%
All Other	$12,174	$12,059	$12,282	$12,479	$12,669	$495	4.1%
Subtotal-OTPS	$18,934	$19,047	$19,483	$19,878	$20,275	$1,341	7.1%
Debt Service							
Principal	$1,450	$1,511	$1,572	$1,670	$1,725	$275	19.0%
Interest & Offsets	$1,104	$1,959	$2,147	$2,254	$2,387	$1,283	116.2%
Total	$2,554	$3,470	$3,719	$3,924	$4,112	$1,558	61.0%
Budget Stabilization	$1,390	$695	$0	$0	$0	($1,390)	(100.0%)
Prepayment [a]	($624)	($1,390)	($695)	$0	$0	$624	(100.0%)
NYCTFA							
Principal	$185	$346	$359	$374	$397	$212	114.6%
Interest & Offsets	$584	$627	$622	$609	$592	$8	1.4%
Total	$769	$973	$981	$983	$989	$220	28.6%
General Reserve	$100	$100	$300	$300	$300	$200	200.0%
	$47,332	$47,736	$49,774	$51,748	$52,622	$5,290	11.2%
Less: Intra-City Expenses	($1,186)	($1,096)	($1,094)	($1,094)	($1,094)	$92	(7.8%)
Total Expenditures	$46,146	$46,640	$48,680	$50,654	$51,528	$5,382	11.7%
Gap To Be Closed	**$0**	**$0**	**($2,018)**	**($2,875)**	**($2,240)**	**($2,240)**	

NOTE: Property Tax includes STAR, Other Taxes includes STAR and NYCTFA revenues.

[a] $624 million of FY 2004 NYCTFA debt was prepaid in FY 2003

Table 2. Plan to Plan Changes, November Modification vs. January Plan FY 2004

($ in millions)

	FY 2004	FY 2005	FY 2006	FY 2007
Revenues				
Taxes:				
General Property Tax	$66	$256	$305	$383
Other Taxes	$234	($69)	($104)	($87)
Tax Audit Revenues	$0	$2	$2	$3
Miscellaneous Revenues	$52	$196	$36	$36
Unrestricted Intergovernmental Aid	$122	$0	$0	$0
Less: Intra-City Revenue	($7)	$4	$5	$4
Disallowances Against Categorical Grants	$0	$0	$0	$0
Subtotal: City Funds	$467	$389	$244	$339
Other Categorical Grants	$25	$23	$30	$30
Inter-Fund Revenues	$1	$4	$1	$1
Total City & Inter-Fund Revenues	$493	$416	$275	$370
Federal Categorical Grants	$407	$576	$546	$523
State Categorical Grants	$65	$418	$408	$409
Total Revenues	$965	$1,410	$1,229	$1,302
Expenditures				
Personal Service				
Salaries and Wages	$248	$234	$298	$298
Pensions	$0	$0	$0	$0
Fringe Benefits	$2	$28	$30	$32
Subtotal-PS	$250	$262	$328	$330
Other Than Personal Service				
Medical Assistance	$0	$0	$0	$0
Public Assistance	$86	$1	$0	$0
Pay-As-You-Go Capital	$0	$0	$0	$0
All Other	($98)	$9	$26	$21
Subtotal-OTPS	($12)	$10	$26	$21
Debt Service				
Principal	$0	$0	$42	$113
Interest & Offsets	($28)	($15)	($49)	($154)
Total	($28)	($15)	($7)	($41)
Budget Stabilization & Prepayments	$977	$495	$0	$0
MAC Debt Service	$0	($977)	($495)	$0
NYCTFA				
Principal	$0	$10	$10	$11
Interest & Offsets	($15)	($25)	($10)	($11)
Total	($15)	($15)	$0	$0
General Reserve	($200)	($200)	$0	$0
	$972	($440)	($148)	$310
Less: Intra-City Expenses	($7)	$4	$5	$4
Total Expenditures	$965	($436)	($143)	$314
Gap To Be Closed	**$0**	**$1,846**	**$1,372**	**$988**

NOTE: Property Tax includes STAR, Other Taxes includes STAR and NYCTFA revenues.

Table 3. FYs 2004-2008 Financial Plan Risks and Offsets

($ in millions)

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
City Stated Gap	**$0**	**($0)**	**($2,018)**	**($2,875)**	**($2,240)**
Revenue Assumptions					
Property Tax	$0	$0	$50	$50	$50
Personal Income Tax	$36	$35	$3	$53	$53
Business Taxes	$11	($7)	$27	$24	$6
Sales Tax	$16	$56	$27	$39	$46
All Other Taxes	$37	$29	$24	$14	$15
Expenditure Projections					
Overtime	($25)	($217)	($150)	($150)	($150)
Private Bus Subsidy	$0	($145)	($148)	($153)	($153)
State Actions	$0	($200)	($200)	($200)	($200)
MAC debt service	($492)	($490)	($492)	($494)	($470)
Total Risk	**($417)**	**($939)**	**($859)**	**($817)**	**($803)**
Restated Gap	**($417)**	**($939)**	**($2,877)**	**($3,692)**	**($3,043)**

II. The State of the City's Economy

A. ECONOMIC OUTLOOK

The U.S. economy in 2003 completed its second full year of jobless growth. Despite strong gains in Gross Domestic Product (GDP), the economy continued to lose jobs. Two reasons for the weakness in the job market were outsourcing of jobs to overseas suppliers and the high productivity growth of U.S. workers.

The City's recession continued into the first half of 2003. Some signs of recovery emerged in the third and fourth quarters of 2003, aided by the low interest-rate environment and the rise in the Wall Street profits.

The economic forecasts for both the City and the nation are for continued growth. Both the Comptroller and the Mayor expect positive job gains in 2004 and in 2005 for the City and the nation. However, these gains will not fully offset the job losses that have occurred in the past three years.

B. THE CITY'S ECONOMIC ASSUMPTIONS

The City's economy showed some recovery in the second half of 2003. A small upward trend began in the third quarter, when the Gross City Product (GCP) grew 0.5 percent, turning positive for the first time after ten quarters of decline. This trend became more significant in the fourth quarter, when GCP grew 2.9 percent. Also, payroll jobs increased by 10,000 in the fourth quarter after 11 quarters of decline. Both the Comptroller and the Mayor believe that the City economy will post positive growth in 2004 and 2005. The Comptroller's forecast calls for a moderate growth of 2.6 percent in 2004, and 3.5 percent growth in 2005. The Mayor's forecast is a more optimistic growth of 4.6 percent in 2004 but a lower 2.7 percent in 2005. Both forecasts show weak job gains for the City, with the combined job growth for 2004 and 2005 adding up to less than half of the jobs lost between 2000 and 2003.

C. THE U.S. ECONOMY

The national economy, as measured by real GDP, grew 3.1 percent in 2003, better than the 2.2 percent growth in 2002. Gross private domestic investment grew 4.3 percent in 2003, the first positive growth in three years. Government expenditures in 2003 rose 3.4 percent and personal consumption expenditures rose 3.1 percent.

Despite strong GDP growth, the labor market continued to deteriorate in 2003. The nation lost 409,000 jobs in 2003 on top of year-over-year losses of 1,485,000 in 2002. From December 2000, when jobs were 132.4 million, through January 2004, the nation lost more than 2.2 million jobs.

Both the Mayor and the Comptroller forecast continued growth in the nation, as shown in Table 4. However, the Comptroller's forecast for job growth is less optimistic, because of such factors as the continuing impact of outsourcing, declines in manufacturing jobs and the tapering off of the mortgage refinancing boom. Another reason for the difference between the two forecasts is the different slopes of the yield curves. On the assumption that national inflationary pressures will remain muted in the first half of 2004, the Comptroller forecasts that the Federal Reserve will not raise the target Federal Funds rate until the fourth quarter of 2004 and then only by 25 basis points, followed by another 50 basis points in 2005.

Table 4. Selected U.S. Economic Indicators Annual Averages, Actual 2003 and Forecast 2004-2005

	2003	2004 Forecast		2005 Forecast	
	Actual	**Comptroller**	**Mayor**	**Comptroller**	**Mayor**
GDP Change (%)	3.1	4.3	4.7	3.7	3.8
Jobs Change (Millions)	-0.4	1.6	2.0	2.4	3.2
Inflation Rate (%)	2.3	2.1	1.7	2.2	1.6
Wage Rate (%)	2.5	4.0	3.0	N/A	3.6
Unemployment Rate (%)	6.0	6.0	5.7	5.8	5.4
Federal Funds Rate (%)	1.13	1.13	1.3	1.5	2.4
10-Year T-Notes (%)	4.01	4.8	4.8	5.1	5.6

SOURCE: Actual=preliminary U.S. data from NYS Department of Labor, Bureau of Labor Statistics, and Federal Reserve Board of Governors. Mayor=forecast by the NYC Office of Management and Budget in the January Plan. Comptroller=forecast by the NYC Comptroller's Office. na=not available.

D. THE NEW YORK CITY ECONOMY

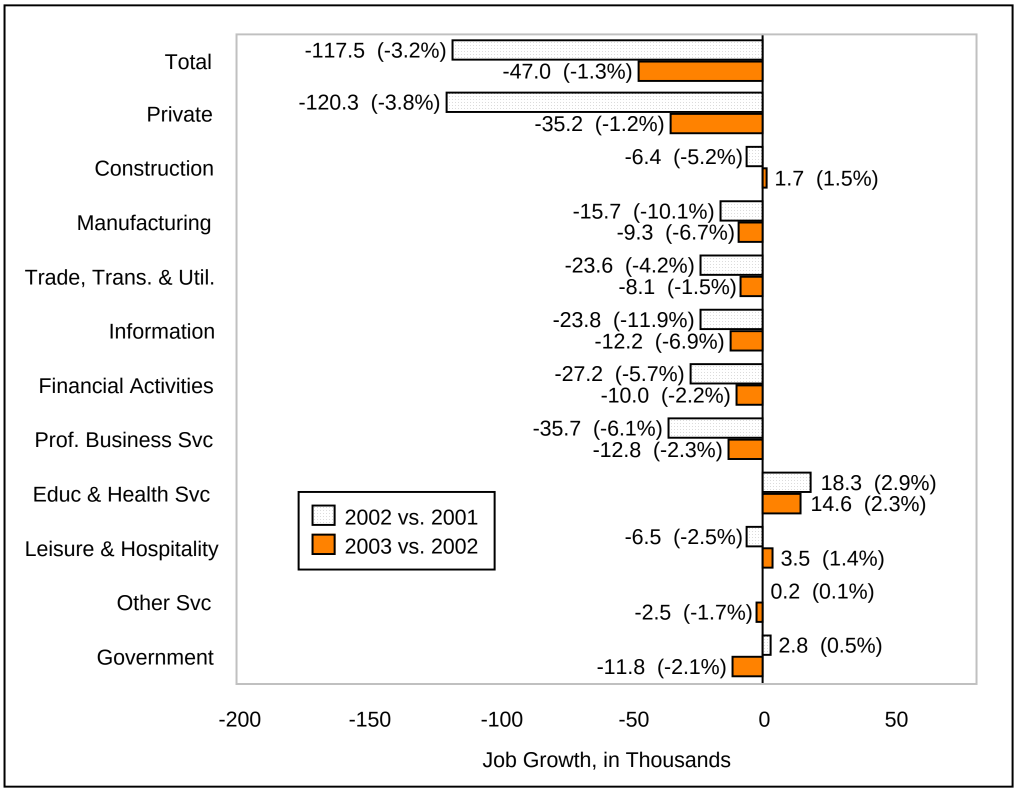
In the second half of 2003, the City's economy finally started to grow. The first half of the year showed a continued decline in GCP and negative job growth, but by the third quarter GCP growth was slightly positive. In the fourth quarter, both GCP and job growth were positive. After ten quarters of decline, GCP grew 0.5 percent in the third quarter and 2.9 percent in the fourth quarter of 2003. Seasonally adjusted total payroll jobs were up by 10,000 in the fourth quarter, posting a gain for the first time following 11 quarters of contraction. Also, the seasonally adjusted unemployment rate fell to 7.9 percent in the fourth quarter after being above eight percent for four quarters.

Overall, GCP grew 1.7 percent in the second half of 2003, compared with a contraction of 2.1 percent in the first half. Total payroll jobs increased by 700 in the second half, compared with a loss of 24,400 jobs in the first half.

However, the second-half increases were not sufficient to make the year-over-year gains positive. The City lost 47,000 jobs in 2003 overall, after losing 117,400 jobs in 2002 and 31,100 jobs in 2001. Since 2000, the City has lost 195,500 jobs year over year, of which 182,400 were in the private sector. On a monthly basis, from December 2000 to December 2003 the total City job loss was 232,400 and the private-sector job loss was 223,500.

Of the 47,000 jobs lost in 2003, 35,200 were in the private sector and 11,800 were in the public sector. All sectors (broadly defined) except education and health services, leisure and hospitality, and construction, lost jobs as shown in Chart 1.

***Chart 1*. NYC Job Growth, in Thousands, and Percent Change, 2002 over 2001 and 2003 over 2002**



SOURCE: NYS Department of Labor, release of January 22, 2004. Note: Jobs are based on annual averages of monthly data. Differences between years are shown in thousands and in parenthesis the percentage changes.

The City's labor force shrank by 62,200 in 2003, as the number of City residents with jobs fell by 71,300 and the number of non-working City residents looking for a job (i.e., the unemployed) rose by 9,200. As a result, the unemployment rate rose to 8.3 percent in 2003 compared with 7.9 percent in 2002; the labor-force-participation rate fell to 57.6 percent from 64.7 percent; and the employment-population ratio fell to 52.8 percent in 2003 from 59.6 percent in 2002. Finally, the NYC metro area inflation rate was 3.1 percent in 2003, 0.6 percentage points above the 2.5 percent rate in 2002.

The City had the largest unemployment rate and the second-highest inflation rate (after Boston's, 3.7 percent) among the 20 largest metro areas in 2003.

The 2003 surge in stock-market activity and Wall Street profits have boosted the City's economy. Wall Street profits were $12 billion for the first three quarters of 2003 and are expected to be about $15 billion for the entire year 2003. Economic recovery is expected to continue in 2004 and 2005, as shown in Table 5.

Table 5. Selected NYC Economic Indicators: Annual Averages Actual 2003 and Forecast 2004-2005

	2003	2004 Forecast		2005 Forecast	
	Actual	**Comptroller**	**Mayor**	**Comptroller**	**Mayor**
GCP Change (%)	-2.1	2.6	4.6	3.5	2.7
Jobs Change (thousands)	-47.0	35.2	39.9	58.4	51.3
Unemployment Rate (%)	8.3	7.9	na	7.5	na
Wage Rate (%)	2.5	5.7	4.5	4.5	3.9
Inflation Rate (%)	3.1	3.0	2.4	2.8	1.8

SOURCE: Actual=preliminary NYC data from NYS Department of Labor, Bureau of Labor Statistics. Mayor=forecast by the NYC Office of Management and Budget in the January 2004 Modification. Comptroller=forecast by the NYC Comptroller's Office. na=not available.

III. The FY 2004 Budget

The January Modification reflects the impact of the turnaround in the local economy, the rebound in Wall Street profits and a robust residential real-estate market. The City now expects revenue to be $493 million higher than forecasted in the November Modification. The bulk of the increase results from higher tax revenue as well as an additional $122 million in unrestricted intergovernmental aid in the form of FEMA reimbursement. At the same time, the City has reduced its general reserve by $200 million, and recognized savings of $300 million from prior-year-payables, while increasing the program to eliminate the gap (PEG) by $50 million.[1] As shown in Table 6, these expenditure actions together with the projected revenue increase enabled the City to increase its Budget Stabilization Account (BSA) by almost $1 billion, to $1.4 billion, as well as fund a modest increase of $67 million in agency spending.

Table 6. Changes to the FY 2004 Estimates

($ in millions)

Revenues		Expenditures	
Tax Revenue	$321	Prior Year Payable	($300)
Miscellaneous	22	General Reserve	(200)
IGA	122	PEG	(50)
Others	19	Agency Spending	67
PEG	9	BSA	976
Total	**$493**	**Total**	**$493**

A. TAX REVENUES

The recovering local economy as well as continuing improvement in the national economy combined with Wall Street's resurgence and a strong real estate market have boosted the City's tax revenues. Tax collections through December are above the City's November estimates by $1.01 billion, $854 million of which is the result of timing issues related to property tax collections. Non-property tax collections are higher than the November estimates by $158 million and, with the ongoing economic recovery, this trend will likely continue especially for the business taxes. Consequently, the City has raised its tax revenue projections by $321 million over the November Modification estimate, as shown in Table 6 above.

[1] As a result of an ongoing Comptroller's audit, $17 million on deposit in the "Urban Accounts Payments to Franchised Private Bus Operators" fiduciary account was transferred to the general fund and included as part of the Department of Transportation's PEG. This together with an expected $12 million in additional reimbursement under the Clean Water/Air Grant from the New York State Department of Environmental Conservation for past Dept. of Sanitation (DOS) expenditure account of $29 million of the $50 million in additional agency PEGS. Other savings include the Department of Correction (DOC) civilian accruals ($2 million), State Criminal Assistance Program reimbursement to DOC ($3 million), DOS civilian vacancies savings ($1.7 million), Other-Than-Personal-Services (OTPS) savings of $1.5 million, and initiatives of $1 million or less spread across various agencies.

Real Estate Transaction Tax Revenues re-estimate accounts for more than half the increase in the tax revenue forecast as shown in Table 7. Collections for real estate transaction taxes which comprise commercial rent tax (CRT), mortgage recording tax (MRT) and real property transfer tax (RPTT) are above the November Modification estimate by $67 million through December. Real estate market activity remains robust as buyers move to take advantage of still historically low mortgage rates. The City has raised its estimates of real estate transaction tax revenue by $134 million to $1.47 billion.

Business Tax Revenues are also showing strength. Collections through December are $85 million better than the November modification reflecting the recovery in the local economy as well as the rebound in Wall Street profits. As a result, the City has revised the business tax revenue forecast upward by $103 million to $2.58 billion. Projections for FY 2005 are raised for each of the three business taxes as the economic recovery sets in and higher refunds from overpayments taper off and return to norm.

Table 7. Tax Revenues Before Gap-Closing Tax Initiatives
January Modification Compared with November Modification

($ in millions)

	November	**January**	**Change**
Property Tax	$11,317	$11,334	$17
Real Estate Transaction Taxes	1,337	1,471	134
Business Tax	2,472	2,575	103
PIT	5,310	5,268	(42)
Sales Tax	3,912	3,912	0
Other Taxes	1,095	1,115	20
Subtotal	**$25,443**	**$25,675**	**$232**
STAR Aid	$653	$677	$24
Tax Audit Revenue	525	546	21
Absentee Landlord Surcharge Repeal	(44)	0	44
Total Tax Revenue	**$26,577**	**$26,898**	**$321**

Property Tax Revenues are expected to be $17 million more than the November Modification estimate. The modest increase reflects a revision to the refund forecast and lien sale estimates resulting in an increase of $46 million. This is offset by an increase of $29 million to the current year reserve and the STAR exemption.

Personal Income Tax Revenue (PIT) estimates, in contrast to the other tax revenue forecasts, have been lowered by $42 million. PIT revenues contracted severely in the recession and has been slow to recover reflecting in part the weakness in the job market. Collections through December were only one percent above the November Modification estimate compared with the business tax collections which were above plan by nine percent. Despite the rate increase, PIT collections through December are above FY 2003 collections by only $291 million or 13.7 percent.[2] The business taxes collections, on the other hand, were above FY 2003 collections through December by $227 million or 28 percent with no policy change.

After adjusting for tax policy changes, PIT is expected to increase by $252 million or 5.1 percent over FY 2003. This compares with the business taxes, which are expected to increase $251 million or 9.9 percent in FY 2004 after adjusting for tax policy changes. Although PIT collections are expected to benefit from higher bonuses derived from Wall Street recovery, estimated payments will gain mainly from the rate increase as capital losses from earlier years carry forward.

B. EXPENDITURES

The City has reduced its FY 2004 general reserve by $200 million in the January Modification. At the same time, it has recognized a prior-year-payable adjustment of $300 million. These actions combined with the higher revenue estimates allow the City to increase its FY 2004 BSA from $413 million to $1.4 billion. Half of the FY 2004 BSA will be used toward balancing the FY 2005 budget and the rest will be used to provide budget relief in FY 2006.

In addition to increasing the BSA, the City also raised agency spending by $67 million compared with the November Modification. Most of the increase is concentrated in two agencies, the Police Department and the Administration for Children's Services (ACS), whose budgets rose by $34 million and $25 million, respectively.[3] Almost $21 million of the increase in the Police Department is to fund the estimated cost of providing security for the Republican National Convention. Another $6.7 million will fund the City match portion of the addition of 730 police officers under the Community Oriented Policing Services (COPS) grant program. In ACS, most of the increase is due to a $16 million increase in funding for higher-than-planned room and board cost in institutional schools for children with special needs.

C. OUTLOOK FOR FY 2004

While the FY 2004 budget contains several optimistic assumptions, including relief for the City from MAC debt service and productivity savings to pay for any wage increases, it is likely that the City will end FY 2004 in balance. The $1.4 billion BSA together with the general reserve of $100 million provides a comfortable cushion against

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[2] The legislation that instituted the temporary PIT tax increase provides for the elimination of the tax increase beginning Calendar Year (CY) 2006. Similarly, the repeal of the sales tax exemption on clothing and footwear purchases under $110 and the sales tax increase are scheduled to sunset May 31, 2004 and May 31, 2005, respectively.

[3] Excludes PEG changes and a shift of $38 million for out of school time spending from the Department of Youth and Community Development to the ACS.

any shortfalls in the budget. However, any draw down on the BSA or general reserve will adversely affect the outyears to the extent that these accounts are depleted.

IV. The Preliminary FY 2005 Budget

The Preliminary FY 2005 Budget assumes $2.7 billion in additional resources over the November Modification estimates. A significant portion of the additional resources identified in the current modification results from the increase to the estimated FY 2004 surplus available to prepay FY 2005 expenditures. As Table 8 illustrates, the additional surplus is projected to provide $976 million in budgetary relief in FY 2005. In addition, continuing improvement in the economy is expected to add $647 million to the City's coffers. The City has also proposed additional gap closing initiatives including another $247 million in agency PEGs and $700 million in State and Federal actions. A reduction of $200 million in the general reserve further adds to the resources available for budget balance in FY 2005.

Table 8. Changes to the FY 2005 Estimates

($ in millions)

November Modification Gap	**($1,846)**
Additional Resources	
Roll in of FY 2004 surplus	$976
Revenue Increase	647
PEGS	247
Fed/State Action	700
General Reserve	200
Total	**$2,770**
Additional Obligations	
Agency Spending	(179)
Property Tax Rebate	(250)
BSA	(495)
Total	**($924)**
January Preliminary Budget Gap	**$0**

The City intends to use the additional resources to close the $1.8 billion gap projected in November as well as to fund a property tax roll-back rebate, additional agency spending and an increase in the FY 2005 BSA. The property tax roll-back is expected to cost the City $250 million in FY 2005. The increase in agency spending is mainly due to new needs including the City match portion of the salary of an additional 730 police officers to be hired in FY 2004 under the COPS program, spending related to the initiative to end social promotion for third graders and expenditures within ACS. The City is also increasing the FY 2005 BSA that will be used to prepay FY 2006 expenditure by $495 million to $695 million

A. REVENUE OUTLOOK

The structure of the FY 2005 revenue budget, after the gap-closing program and including PIT revenues retained for New York City Transitional Finance Authority's (NYCTFA) debt service, remains fairly similar to that for FY 2004. Tax and miscellaneous revenues are expected to account for 69.2 percent of total revenues in FY

2005 compared with 67.8 percent in FY 2004. This modest shift results from an increase in miscellaneous revenues due mainly to an expected one-time receipt of $690 million in airport back-rent payments from the Port Authority of New York and New Jersey.

Similar to FY 2004, tax revenues will fund 58.3 percent of FY 2005 expenses, with property tax revenues accounting for 25.3 percent and non-property tax revenues accounting for 33 percent. The FY 2005 relative shares for property and non-property tax revenues shift slightly in favor of property tax revenue partly because some of the FY 2004 tax increases begin to phase out. Tax revenues will also account for 86 percent of City-funded revenues, similar to FY 2004. The share for miscellaneous revenues increase from 9.5 percent in FY 2004 to 10.9 percent in FY 2005.

The relative share from State and Federal aid is expected to fall to 30.8 percent in FY 2005 from 32.2 percent in FY 2004. Federal categorical aid is projected to decrease from 11.8 percent to 10.9 percent, state categorical aid to increase slightly from 18.2 percent to 18.6 percent and the share from other forms of aid to decrease from 2.2 percent to 1.3 percent.

Tax Revenues

The City projects that tax revenues will total $26.2 billion in FY 2005.[4] Non-property tax revenues are expected to account for 55 percent of total tax revenues with property tax revenues accounting for the remainder. Compared with FY 2004, the relative share for non-property tax revenues is expected to fall by one-percentage point reflecting the phase-out of the PIT rate increase, the elimination of the sales tax on clothing and footwear purchases of under $110, and the slowdown of real-estate-related tax revenues.

The $26.2 billion in tax revenues for FY 2005 represents an increase of $554 million or 2.2 percent over FY 2004. Higher projections for property tax revenues account for $474 million, or 86 percent of this gain. Property tax revenues, though accounting for most of the increase in tax revenues for FY 2005, is projected to increase by only 4.2 percent over FY 2004 compared with an expected increase of 14 percent in FY 2004. However, the FY 2004 growth is distorted by the full-year impact of the FY 2003 mid-year property tax rate increase, which accounts for about nine percentage points of the 14 percent increase.

The FY 2005 non-property tax revenues are expected to increase modestly by $80 million or 0.6 percent. This compares with an increase of $1.6 billion or 12.7 percent in FY 2004, due mainly to rate increases. Increases from stronger economic growth in FY 2005 are partially offset by legislative reductions and repeal of some of the 2003 tax increases and an anticipated decline in the property-related tax revenues. The business taxes are expected to continue to show strength in FY 2005, increasing by $210 million

[4] The definition of tax revenues used in the rest of this section includes NYCTFA set aside from PIT and net lien sales of property. It excludes STAR, audits and any tax program not yet approved.

or 8.1 percent. PIT revenues are expected to increase by only $92 million or 1.7 percent compared with $808 million in FY 2004. FY 2005 collections from the rate increase will be for 12 months compared with 18 months in the FY 2004 collections.[5] Additionally, beginning in January 2004 the rate will fall from 4.25 percent to 4.175 percent for single incomes exceeding $100,000, and joint incomes exceeding $150,000. All incomes over $500,000 continue to be taxed at 4.25 percent. The City is also expecting a drop in NYSE member firms' profits, which affects bonus payments.[6] Sales tax revenues are projected to decline by $25 million for FY 2005. The growth in business taxes and PIT revenues in FY 2005 are partially offset by expected drop in revenues from property-related taxes and sales tax. Property-related tax revenues are expected to drop by $138 million while sales tax revenues are expected to decline by $25 million. The sales tax on clothing and footwear purchases of under $110 is schedule to expire after May 31, 2004.

The $26.2 billion in projected tax revenues for FY 2005 represent an increase of $353 million or 1.4 percent from the November modification forecast. Of this increase, $165 million or 47 percent is attributable to non-property tax revenues and $188 million or 53 percent is attributable to property tax revenues. Property tax projections are raised, mainly due to a higher estimated value for the FY 2005 levy as market value estimates came in stronger than expected for FY 2005.

Much of the increase in non-property tax revenues is a result of more optimistic economic outlook. Business tax projections are raised by $100 million as the business sector continues to do better than projected. Sales tax revenues are unchanged from the November forecasts. PIT projections for FY 2005 are lowered by $16 million.

The Financial Plan

The City has raised its projections for tax revenues over the entire financial plan from the November Modification as illustrated in the Table 9.

Tax revenues are expected to recover as the economic recovery gains momentum.[7] As illustrated in Table 9, common-rate-and-base non-property taxes are expected to grow by 5.2 percent in FY 2004 after declining in FYs 2002 and 2003. Growth continues over the financial plan by more than four percent per year. All the major components of non-property taxes are expected to recover over the financial plan period. PIT revenues, after declining 14.8 percent in FY 2002 and 7.3 percent in FY 2003, are projected to grow by more than five percent a year and to strengthen toward the end of the plan period. The business taxes, after declining 16.8 percent in FY 2002 and

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[5] The PIT rate increase enacted in FY 2003 was retroactive to January 2003, hence collections received in FY 2003 represented 18 months' activity.

[6] The City expects Wall Street profits in CY 2003 to total $15 billion. Profits for CY 2004 are expected to pull back to $12 billion.

[7] Please see the discussion of "The New York City Economy" beginning on page 5 for the Comptroller's assessment of the local economy.

4.7 percent in FY 2003, are expected to recover quickly and rapidly in the early part of the plan, with growth slowing in the outyears.

Table 9. The City's Revenue Assumptions

($ in millions)

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Change (January vs. November)	$232	$353	$405	$477	
Percent Change	0.9%	1.4%	1.5%	1.7%	
Change (Year-Over-Year)	$3,008	$554	$903	$1,031	$1,385
Percent Change	13.3%	2.2%	3.4%	3.8%	4.9%
CRB – Property (Y/Y Growth %)	6.1%	4.3%	4.0%	4.5%	4.6%
CRB – Non-Property (Y/Y Growth %)	5.2%	3.9%	5.3%	5.8%	5.0%
CRB – PIT (Y/Y Growth %)	5.1%	5.3%	5.2%	7.3%	6.2%
CRB – Business (Y/Y Growth %)	9.9%	7.9%	7.5%	5.6%	4.8%
CRB – Sales (Y/Y Growth %)	3.3%	5.1%	5.2%	5.1%	4.9%

SOURCE: NYC Office of Management and Budget
CRB = Common-Rate-and-Base

On balance, the Comptroller's outlook on the City's economy is more optimistic than the Mayor's. As a result, the Comptroller sees some upside to the Mayor's revenue forecasts and expects revenue to be $113 million higher than the City's projection for FY 2005.

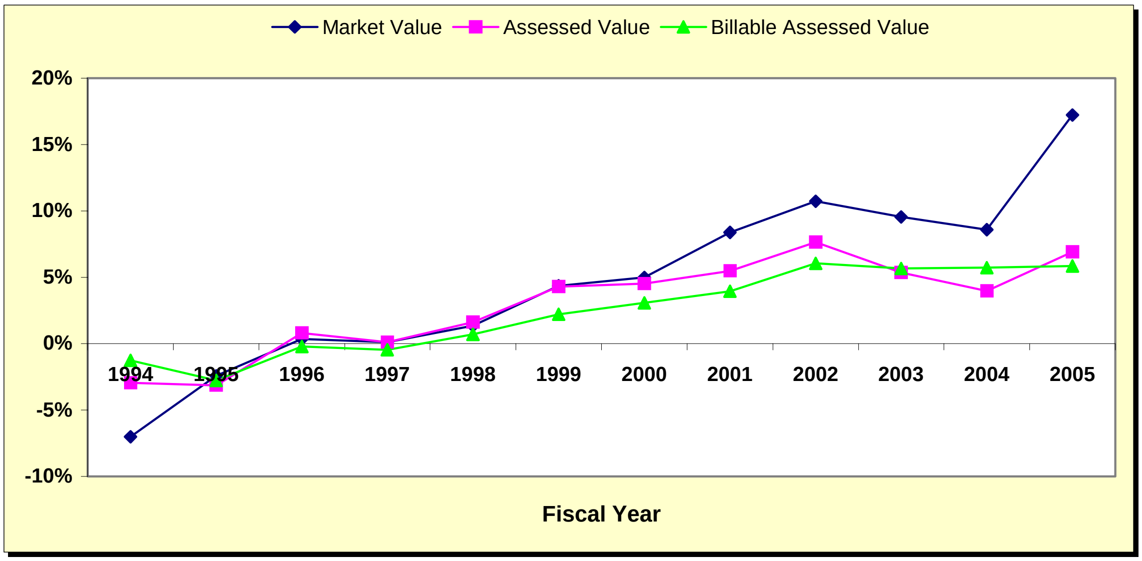
Real Estate

Overall Performance

The tentative assessment roll for FY 2005 property values shows surprising strength in estimated market value growth for FY 2005 as illustrated in Chart 2.[8] The Department of Finance estimates the market value of properties in the City for tax purposes to increase by 17.2 percent from $466.7 billion to $547.1 billion. This is the steepest increase in market values since the housing market began to recover from the 1990's decline. Market value growth slowed in FYs 2003 and 2004 and the trend was expected to continue with the prospect of a stock market rebound and rising interest rates. FY 2005 defied expectations by growth not only accelerating but also having its steepest ascent since 1994. The overall growth rate about doubles from 8.6 percent in FY 2004 to 17.2 percent in FY 2005.

[8] The Department of Finance determines its own estimate of market value of properties in the City for the upcoming fiscal year. This is necessary to set the tax rate on property before the beginning of the fiscal year. All FY 2005 market values discussion in this section refers to the recently released Department of Finance estimates.

***Chart 2*. Real Property, Growth of Market Value, Assessed Value and Billable Assessed Value, FYs 1994-2005**



SOURCE: NYC Department of Finance

As Table 10 shows, Brooklyn and Queens exhibit the strongest growth with market values appreciating by more than 20 percent. Market values in Manhattan and Bronx show a more moderate increase of 11.1 percent and 12.2 percent, respectively. The figure also shows that the main engines of growth in the property market are Class 1 and Class 2 properties which appreciate more than 21 percent.

***Table 10.* FY 2005 Market Value Growth by Class and Borough**

	Class 1	Class 2	Class 3	Class 4	Total
Manhattan	18.7%	14.0%	3.1%	8.8%	11.1%
Bronx	16.4%	9.8%	1.8%	4.1%	12.2%
Brooklyn	22.9%	51.8%	(0.3%)	4.1%	23.9%
Queen	22.8%	31.1%	8.0%	2.4%	21.0%
Staten Island	19.1%	48.4%	0.1%	(0.0%)	17.7%
Citywide	**21.7%**	**21.2%**	**3.3%**	**7.3%**	**17.2%**

SOURCE: NYC Department of Finance

Properties are not assessed at full market value but at a proportion of market value for tax purposes. Mirroring the growth trend of market value, assessed value growth also slowed in the past two years but will accelerate in FY 2005, increasing by 6.9 percent. The slower growth relative to that of market value growth is due to a lower assessment ratio for Class 1 properties[9]. The billable assessed value increases 5.85 percent because

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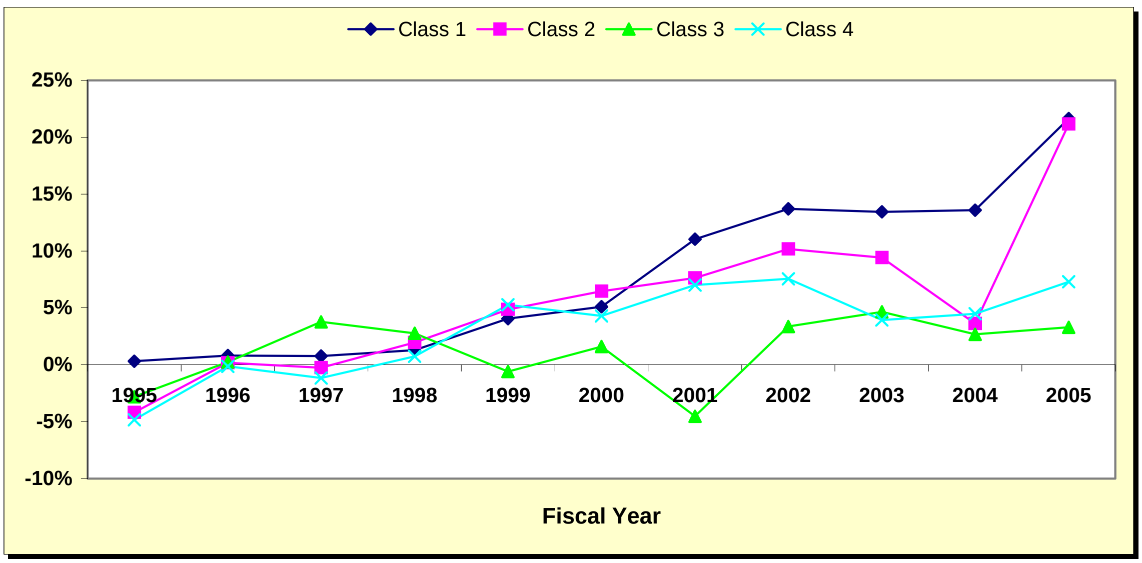
[9] Property is divided into four classes for tax purposes. Class 1 consists of one-, two- and three-family homes and small condominiums and co-ops. Class 2 consists of large residential rental units. Class 3 consists of utility properties and Class 4 is essentially commercial properties. Class 1 assessments may

of the restrictions on assessment increases in Class 1 properties and the five-year phase-in of assessed values for Class 4 and Class 2 properties.

Changes in Class 4 and Class 2 assessed values that are not phased in immediately are stored in an account referred to as the 'pipeline' which is used to offset the billable assessed value when it slows below the legal restrictions. This was the case for the past two years, allowing billable assessed value growth to surpass the growth in assessed value thus stabilizing the tax base. For FY 2005, the excessive growth in market value has added to the pipeline again as assessed value growth exceeds the billable assessed value growth.

Performance by Class

***Chart 3*. Real Property, Market Value Growth by Class, FYs 1995-2005**



SOURCE: NYC Department of Finance

Class 2 properties' market value, as estimated by the Department of Finance, shows remarkable growth in FY 2005. Since FY 2001, market value has been growing fastest among Class 1 properties as illustrated in Chart 3. Growth in Class 2 properties slowed the most in FY 2004, with growth rate contracting by almost six percentage points from 9.4 percent in FY 2003 to 3.6 percent in FY 2004. However, in FY 2005 Class 2 properties' market value growth rate increases the most, gaining 17 percentage points, to 21.2 percent. This is more than double the increase of eight percentage points for Class 1 properties, which moved from 13.6 percent in FY 2004 to 21.7 percent in FY

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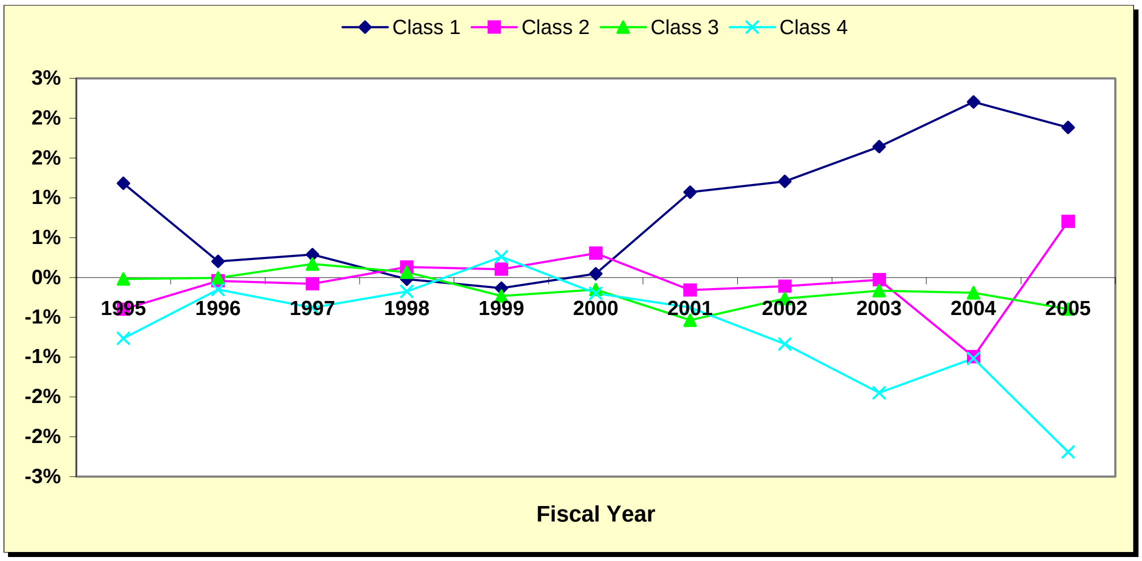
not increase by more than six percent annually or more than 20 percent over five years. Rental units with fewer than 11 units in Class 2 may not increase by more than eight percent annually or more than 30 percent in five years. There are no restrictions on Class 3 properties. Assessments are not limited for Class 4 properties and the remainder of Class 2 properties but the increases are phased-in over five years.

2005. Class 3 and Class 4 properties see more modest growth of 3.3 percent and 7.3 percent respectively.

Between FYs 2000 and 2004, the relative share of Class 1 properties market value increased while the relative share for each of the other classes declined. This is illustrated on Chart 4 where the percentage point change for Class 1 properties is positive and increasing while the percentage point change for the other classes are negative. In FY 2005, however, the relative share for Class 2 market value increases, reversing its previous relative decline. Class 1 share continues to increase but at a slower pace than FY 2004 while Class 3 and Class 4 relative contributions continue to decline.

***Chart 4*. Real Property, Percentage Point Change in Class Contribution to Market Value, FYs 1995-2005**



SOURCE: NYC Department of Finance

Non-Property Taxes

Our last March report compared the time the City is expected to take to recover lost revenues in this recession with the time it took to recover lost tax revenues in the 1989-1992 recession and the 1994-1995 recession.[10] With the recovery actually in progress and higher projections made in the last two budgets, we revisit some of the analysis.

[10] See "Non-Property Taxes" beginning on page 14 of *The Comptroller's Comments on the Preliminary Budget for Fiscal Year 2004 and the Financial Plan for Fiscal Years 2004-2007, March 2003 report.* This report is available on the Comptroller's website at www.Comptroller.nyc.gov

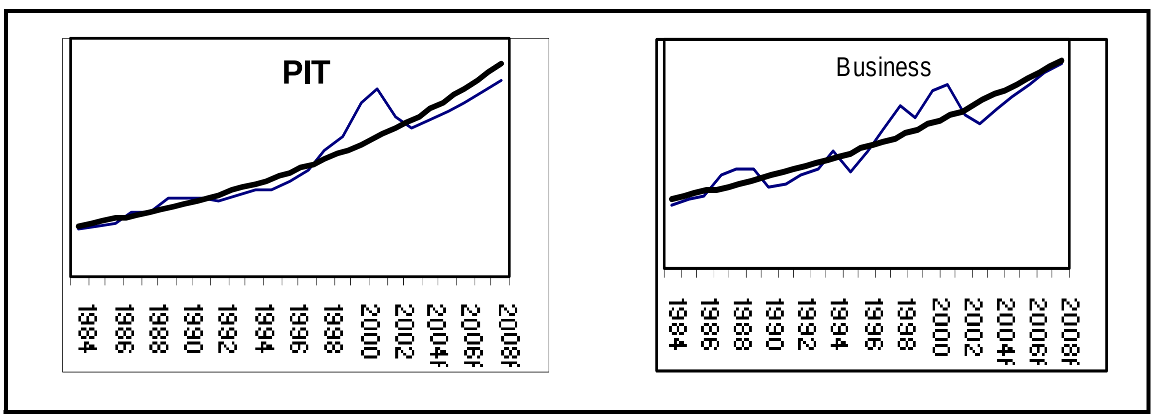
Table 11. Expected Time From 2001 to Recover Revenues Lost in This Recession, Common-Rate-and-Base Taxes

	Years to Recover, Forecast January 2003 and Expected Year of Recovery ( )		Years to Recover, Forecast January 2004, and Expected Year of Recovery ( )	
PIT	6	(FY 2007)	7	(FY 2008)
Sales	4	(FY 2005)	4	(FY 2005)
Business	5	(FY 2006)	5	(FY 2006)
Non-Property	5	(FY 2006)	5	(FY 2006)
Total	4	(FY 2005)	3	(FY 2004)

SOURCE: NYC Office of Management and Budget

FY 2001 was the last year before all tax revenues fell. As shown in Table 11, total tax revenues are now expected to recover lost ground in three years, by FY 2004, compared with the four years that was predicted in January 2003. The reduction in expected recovery time is driven by the strength of property and business tax revenue projections. Expected recovery time for non-property tax revenues and two of its components, business and sales tax revenues, remain unchanged from earlier projections. PIT revenues, on the other hand, is expected to take longer than was earlier projected. Instead of recovering in six years, by FY 2007, as was earlier predicted, it is now expected to recover in seven years, by FY 2008.

***Chart 5.* Common-Rate-and-Base: PIT and the Business Taxes**



SOURCE: NYC Office of Management and Budget

PIT stays below trend growth over the financial plan period as illustrated in Chart 5.[11] The business taxes recover to trend growth by the end of the plan period. As a result of the PIT, non-property taxes stay slightly below trend over the plan period.

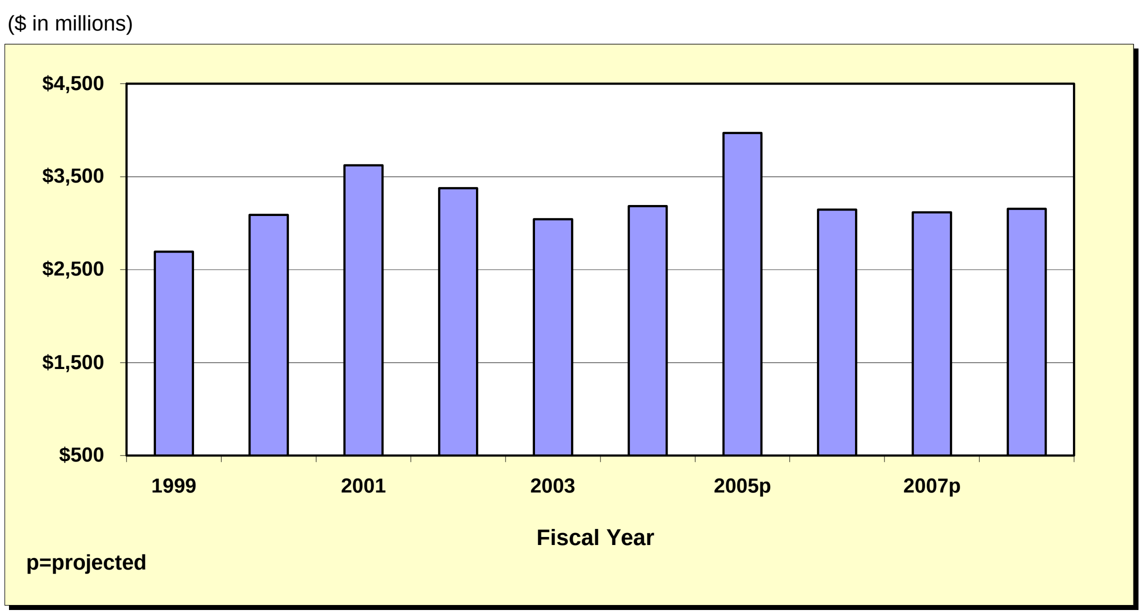
[11] The PIT trend is influenced by the higher than normal growth in FYs 2000-2001 but even when these years are removed from the analysis, PIT still remains below trend over the financial plan.

Miscellaneous Revenues

The non-tax revenue portion of City funds is referred to as miscellaneous revenues. These receipts include a variety of non-tax revenues such as fees charged for licenses, franchises and permits, charges for municipal services, fines, rental income, interest income, water and sewer revenues and asset sales. These revenues have on average accounted for eight percent of total City income during the last decade and are forecast to remain stable throughout the financial plan period.

As Chart 6 shows, miscellaneous revenues grew from $2.7 billion in FY 1999 to $3.6 billion in FY 2001 before declining steadily to $3.1 billion in FY 2003. However, in FY 2003 even as miscellaneous revenues fell by ten percent relative to FY 2002, revenues from fines rose by nearly $65 million, or 13.5 percent, mainly as a result of an increase in parking violation fines. In FY 2004, miscellaneous revenues are projected to grow by less than four percent while revenues from fines are expected to rise by $143 million or 26 percent including $110 million in expected parking fine revenues.

***Chart 6*. Miscellaneous Revenues**



Miscellaneous revenues are projected to grow twenty-five percent in FY 2005 to nearly $4 billion and then decline to $3.1 billion in FY 2006, remaining at this level throughout the financial plan period. The growth surge in FY 2005 is largely the result of a shift to 2005 of the expected lump sum payments from the Port Authority for rental of the JFK and LaGuardia airports reflecting a new lease agreement the City reached with the Port Authority last October. The agreement on lease payments for the City owned airports extends the lease through 2050 and includes among other things a $500 million lump sum for past underpayments and a $93.5 million minimum annual rent payment. The City's financial plan anticipates the receipt of $783 million in FY 2005, $96 million in FY 2006 and $99 million in FYs 2007-2008 in airport rents.[12] Another one-time gain reflected in the FY 2005 miscellaneous budget includes $150 million that the City expects to receive from the Battery Park City Authority (BPCA) for the sale of City owned properties adjacent to the complex. BPCA has already received State legislative approval to increase its bond authorization by $150 million, which the Authority could use to complete the purchase.

The City's revenue program includes a number of small initiatives that the City anticipates will generate between $23 million and $25 million annually in miscellaneous revenues in fiscal years 2005 through 2008. Among other things, these proposals include establishment of a tax commission fee for review of applications for correction of assessments that the City projects will generate $2 million annually, an estimated $2.4 million annually in additional concession revenues from golf courses and an increase in collections of credit card convenience fee projected to raise an estimated $1.5 million annually.

Intergovernmental Aid

The January Modification shows an increase of $282 million in Federal and State grants for FY 2005. The bulk of this increase stems from the extension of higher Federal education funding reflected for FY 2004. The City has incorporated similar changes in the outyears, bringing Federal and State aid projections into a narrow range of between $13 billion and $13.1 billion in FYs 2005-2008 as shown in Table 12.

Federal and State actions represent key components in the City's FY 2005 gap-closing program. The City expects additional assistance from the Federal and State governments to constitute $700 million out of a total gap-closing program of $1.02 billion. The expected assistance includes $300 million in Federal actions and $400 million in State actions. To achieve these targets, the City has compiled an extensive list of potential Federal and State actions that could provide fiscal relief of up to $2.15 billion in FY 2005. Among the major proposed Federal actions is the permanent increase of Federal Medicaid funding match, estimated to provide savings of $242 million.[13] Other proposals include more equitable distribution of Homeland Security funds on a threat basis ($400 million) and appropriation of Federal education grants at authorized levels ($400 million). Under the proposed State actions, the City expects $495 million from Medicaid reform actions consisting of takeover of long term care ($116 million), takeover of Family Health Plus ($179 million), and cost containment actions ($200 million). The City is also seeking to reverse the shift of mandated costs from the State in

[12] The City's FY 2005 airport rent projection includes $690 million in past underpayments and retroactive rents for FY 2003 and FY 2004 as well as $93 million in FY 2005 rent.

[13] A temporary increase in Federal Medicaid funding share is currently in place, saving the City $232 million in Medicaid costs for FY 2004. However, unless the Federal government extends this measure, the benefit will expire on June 30, 2004.

recent years that could total $211 million, in addition to proposed mandate relief of $231 million that include tort reform and local finance law reforms.

Table 12. Federal and State Grants Projections in the January Modification

($ in millions)

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Baseline Grants					
Federal Categorical Grants	$5,415	$4,780	$4,742	$4,729	$4,720
State Categorical Grants	8,370	8,276	8,258	8,331	8,392
Total Federal and State Grants	**$13,785**	**$13,056**	**$13,000**	**$13,060**	**$13,112**
Changes Since the November Modification					
Education Grants	$211	$211	$211	$211	$271
Welfare Grants	131	19	18	17	17
All Other	59	52	31	9	1
Total Grant Changes	**$401**	**$282**	**$260**	**$237**	**$289**

SOURCE: NYC Office of Management and Budget.

Impact of the State Executive Budget

The recently released State Executive Budget has addressed some of these actions through proposals that include extensive Medicaid savings measures, takeover of Medicaid long term care, and tort reform savings, among others. Overall, State estimates indicate that the Governor's proposals could provide the City with up to $419 million in fiscal relief for FY 2005. The bulk of this assistance is contingent on the approval of sales tax increases and Medicaid cost containment actions.

The City contends that certain estimated revenue and savings are overly optimistic, primarily in the State's assumptions of education aid increase and Medicaid savings. The City's own analysis shows a benefit of $190 million from the Governor's proposed budget, excluding the impact on the financial plan of the Health and Hospitals Corporation. This represents a difference in benefit of $229 million compared to the State's estimate as shown in Table 13. The City's lower projections of education support and Medicaid cost relief constitute about $155 million of this difference. The remaining discrepancy of $74 million lies primarily in the City's lower estimates of health savings actions and public safety revenue initiatives. In particular, the State assumes a revenue increase of approximately $8 million to the City from changes in the reimbursement of indigent legal defense costs to localities. The City has disputed this assumption on the basis of a fundamental change in the reimbursement methodology and has instead estimated a cost of $25 million, representing a difference of $33 million compared to the State's estimate.

Table 13. Impact of State Executive Budget on the City's Budget in FY 2005

($ in millions)

	State Estimates	City Estimates	Difference
Medicaid Long Term Care Takeover	$32	$29	($3)
Net All Other Medicaid Cost Containment Savings	141	51	(90)
Subtotal Medicaid	$173	$80	($93)
General School Aid	56	(6)	(62)
Health	26	7	(19)
Social Services	(49)	(57)	(8)
Revenue and Tax Initiatives	155	161	6
Mandate Relief Savings	30	34	4
Public Safety and Miscellaneous Initiatives	28	(29)	(57)
Net Benefit to New York City	**$419**	**$190**	**($229)**

While the Governor's proposed budget is a meaningful starting point for the State's budget negotiation process, there will likely be significant changes before a State budget is adopted. Until the budget picture clears up at the State, the City's assumptions of additional State assistance will remain an element of risk to its financial plan assumptions.

Highlights of the Governor's Budget Proposals

Medicaid: Based on State estimates, the Governor's proposed budget contains about $173 million in Medicaid savings actions for the City as shown in Table 13. The proposed initiatives include the phased-in takeover of Medicaid long term care costs beginning in January 2005 that would provide a half-year savings of $32 million in FY 2005. The takeover would be phased in over the next ten years, with full implementation expected by 2015. The residual savings of $141 million mainly target the areas of pharmacy ($89 million), managed care ($34 million) and general services ($33 million). These savings are partially offset by increased graduate medical education costs ($25 million) and additional costs from the reinstatement of State home care savings target ($10 million). In contrast, the City indicates that the cost containment proposals will provide about $80 million in savings because of the State's overly aggressive assumptions in pharmacy and general Medicaid.[14]

Revenue and Mandate Relief Actions: The proposed State budget includes sales tax revenue initiatives that are expected to boost City revenues by a net value of $155 million. The majority of the revenues will come from continuing the re-imposition of sales tax on clothing and footwear under $110. The proposal would generate $152 million in sales tax revenue for the City in FY 2005. However, it would extend the tax

[14] See "Medical Assistance" beginning on page 34 for a further discussion on Medicaid savings proposals by the State.

burden that consumers currently face from a temporary clothing sales tax set to expire before June 2004. It also violates the proposition that the current clothing sales tax was only a temporary reinstatement. Under the State proposal, localities will be required to offer either four one-week exemptions on clothing sales tax or opt out of the exemption rules by offering none at all. The exemption threshold during the sales tax holidays will be raised to $500.

In addition, the Governor proposes mandate relief savings of $30 million from an assortment of actions that include tort reform, repeal of the Wicks' Law, and binding arbitration reform.[15] Similar actions were proposed in last year's State Executive Budget, but were not enacted. The City's estimates are generally in line with the State expectation regarding the benefit from sales tax revenue and mandate relief initiatives.

Education: Compared with the City's education aid assumptions, the Governor's proposed budget could provide $6 million less in school aid appropriations for FY 2005. In contrast, State budget estimates show a $56 million increase in education aid to the City. The difference between these two estimates arises from the omission of $62 million in fiscal stabilization grants from the Governor's proposal. The most meaningful increase in the proposed school aid allocations is the establishment of the Sound Basic Education grant for the City at $100 million. However, to receive this grant, the City will need to increase its own education funding by a corresponding amount due to a local funding match requirement.[16] The education aid proposals also includes a marginal net increase of about $6 million in formula-based aids. However, on the flip side, certain categorical grant allocations would fall by about $50 million, including a decline of $42 million in Teacher Support Aid.[17]

Social Services: Under the Governor's proposals, State funding for social services would decline by $49 million, mostly from lower Federal block grant funding for child welfare and reduced State support for summer youth programs. In comparison, the City has estimated a greater increase of $57 million in social services costs stemming from the Governor's budget proposals.

Health: The Governor has also proposed actions resulting in net budget savings of $26 million in this area, primarily by imposing co-payments and pre-approval procedures in early intervention programs for pre-kindergarten children. The City estimates that these actions will result in net budget savings in health of about $7 million, falling short of the State's target by about $19 million.

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[15] See "Judgments and Claims" beginning on page 32 for a discussion of the City's tort costs.

[16] The Governor also seeks to establish a $325 million reserve, to be funded by Video Lottery Terminal (VLT) revenues, that would provide further support for education spending in New York City and other high-need school districts. The breakdown of the $325 million reserve is not yet available.

[17] See "Department of Education" beginning on page 35 for a further discussion on the State education aid impact.

B. EXPENDITURE ANALYSIS

The City has reduced its FY 2005 City-funded spending estimate by $1.4 billion in the January Modification. As Table 14 shows, the largest reduction in FY 2005 spending stems from the increase in the FY 2004 surplus roll-in which helped reduce spending by an additional $976 million. In addition the City has reduced its FY 2005 general reserve by $200 million.

Table 14. January Modification Expenditure Adjustments

($ in millions)

	FY 2005
FY 2004 surplus roll-in	($976)
Fed/State Actions	(700)
PEG	(228)
General Reserve	(200)
BSA	495
Agency Spending	179
Total	**($1,430)**

Source: NYC Office of Management and Budget

November Modification PEGs ($ in millions)	
Police Department	$67.1
DOE	39.0
DOS	23.8
ACS	18.7
Subtotal	**$148.6**
All other agencies	79.2
Total	**$227.8**

The City has also incorporated additional gap closing initiatives which include $700 million in Federal and State actions and $228 million in agency reductions. The Federal and State actions are expected to have recurring savings in the outyears. However, of the $228 million in FY 2005 agency reduction programs only $101 million of savings, or approximately 44 percent, will recur in the outyears. As the figure to the right shows, the Police Department, Department of Education (DOE), the Department of Sanitation (DOS) and ACS account for more than half of the expenditure-related PEGs. Significant PEG initiatives in the January Modification are personal services savings of $67.1 million in the Police Department relating to higher than expected attrition of police officers ($37.1 million), civilian headcount reduction ($10.1 million) and overtime reduction initiative ($19.9 million); spending cuts of $39 million in the DOE relating to reduction of sabbatical expenses ($34 million) and summer school reprogramming ($5 million); expenditure reduction of $23.8 million in DOS from delays in Fresh Kill closure ($9.6 million), the receipt of a $6.8 million grant under the Clean Water/Clean Air Act, overtime reduction initiatives ($5.8 million) and civilian vacancies ($1.7 million); savings of $18.7 million in ACS due to foster care re-estimates ($9.6 million), TANF revenue increases ($4.8 million) and prior year claims ($4.3 million). The remaining agency PEGs are initiatives with savings ranging from $0.4 million to $5 million spread across various city agencies.

Offsetting some of the reductions are increases in other expenditure areas, the largest of which is the $495 million increase to the BSA, bringing the balance available to prepay FY 2006 expenditure to $695 million. The remaining offsets are due mainly to additional agency spending of $179 million. Spending on new needs in the Police Department, DOE, DOS and ACS account for $105 million of the spending increase.

Headcount

The FY 2005 Preliminary Budget projects the City's workforce will have 223,954 City-funded employees by June 30, 2005 as shown in Table 15. This represents a net increase of 5,734 positions from December 31, 2003 level. This increase results mainly from the reclassification of 2,800 full-time equivalents (FTEs) employees as full-time workers and the hiring of some 2,000 employees who were previously contract workers with the City. The FTEs' reclassification affects headcount in the Departments of Social Services, Homeless Services and Children Services.

City-Funded Full-Time Equivalents (Projected End of Fiscal Year)

	FY2004	FY2005	FY2006	FY2007	FY2008
Police civilian	5,380	5,326	5,326	5,614	5,614
DOE	14,411	14,411	14,411	14,411	14,411
All other	12,422	7,795	7,756	7,752	7,752
Total	32,213	27,532	27,493	27,777	27,777

The City now accounts for part-time employees as full time equivalents (FTEs). The City had 32,064 FTEs at the end of December 2003 and anticipates ending FY 2005 with 27,532 FTEs. This represents a decline of 4,681 from the expected level at the end of FY 2004, mainly in DSS, DHS and ACS. These positions are being converted to full-time positions beginning in FY 2005. The City's forecast of FTEs is then expected to decline slightly in FY 2006 before increasing to 27,777 in FY 2008 as shown in the figure above, mainly from an expected increase in FTEs at the Department of Health and Mental Hygiene.

Preliminary figures indicate that the City had a workforce of 218,220 employees as of December 31, 2003. This is 1,408 employees fewer than the City's planned year-end headcount of 219,628 for FY 2004. The Police Department is expected to hire 730 new officers before the end of the fiscal year. These officers will be hired under the COPS program, which is discussed below. The Police Department and the other uniformed agencies have been experiencing higher than usual attrition rate this fiscal year, which has had an adverse effect on overtime spending.

The City-funded work force is expected to remain relatively flat between FY 2005 and FY 2008, increasing by 703 employees to 224,657 in FY 2008 as illustrated in Table 15. The FY 2005 forecast reflects the elimination of vacant positions in agencies such as the Police Department where the headcount forecast reflects the elimination of 291 vacant positions in FY 2005. However, the outyears forecast for the civilian headcount does not reflect some of these reductions.

As illustrated in Table 15, the forecast for uniformed personnel, on the other hand, shows no change through FY 2008. Uniformed police peak headcount is expected to be 36,988 twice a year after new officers are hired and will allow the City to continue to receive Federal assistance under the COPS program. Under the COPS program, the Federal government provides 75 percent of entry-level salaries of the officers hired under the program for a three-year period. This is the fourth waiver the City has sought to maintain funding eligibility. The first waiver allowed the City to staff the Department with 39,110 uniformed officers, 2,330 lower than the required 41,440 officers. The second waiver affected the funding ratio for 500 officers hired in September 2000, which resulted in the Federal government funding close to 95 percent of the salaries for these officers. Additionally, the third waiver allowed the City to reduce the required number of officers in FY 2004 to 37,210. The current agreement allows the City to have a peak-headcount for police officers of 36,988 twice a year.

Table 15. NYC, Full-Time Year-End Headcount in City Funds

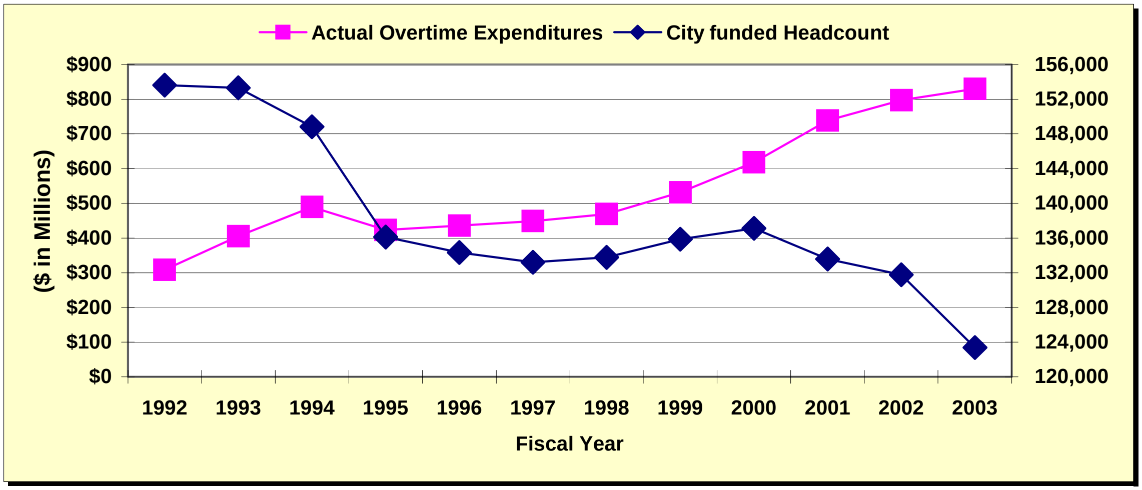
	FY 2005	FY 2006	FY 2007	FY 2008	Change FYs 2005 - 2008	Change As a percent FYs 2005 – 2008
Agency Uniformed:						
Police	34,774	34,774	34,774	34,774	0	0.0%
Fire	11,154	11,154	11,154	11,154	0	0.0%
Corrections	8,726	8,726	8,726	8,726	0	0.0%
Sanitation	7,117	7,117	7,117	7,117	0	0.0%
Sub-total	61,771	61,771	61,771	61,771	0	0.0%
Pedagogical:						
Dept. of Education	90,363	90,418	90,401	90,401	38	0.0%
City University	2,444	2,444	2,444	2,444	0	0.0%
Sub-total	92,807	92,862	92,845	92,845	38	0.0%
Civilian:						
Police	9,107	9,398	9,398	9,398	291	3.2%
Admin for Child Svcs.	6,275	6,275	6,275	6,275	0	0.0%
Dept. of Health	3,089	3,195	3,189	3,204	115	3.7%
Social Services	11,402	11,448	11,488	11,488	86	0.8%
All Other Civilians	39,503	39,716	39,676	39,676	173	0.4%
Sub-total	69,376	70,032	70,026	70,041	665	1.0%
Total	223,954	224,665	224,642	224,657	703	0.3%

SOURCE: Office of Management and Budget, January 2004.

Overtime

The City needs to ensure that even as it seeks to control headcount the savings from headcount reduction are not offset by resultant increases in overtime spending. While others factors such as unplanned events, quality of life and anti-crime initiatives, and negotiated wage play a major role in increasing overtime spending, Chart 7 shows that on balance there is an inverse relationship between overtime spending and staffing level. Overtime spending tend to increase in periods of headcount reduction. Thus, any headcount initiative needs to take into account overtime implication.

***Chart 7*. Overtime Expenditures vs. City-funded Headcount, excluding Pedagogicals, FYs 1992-2004**



The City's annual overtime spending, excluding WTC-related overtime, has increased significantly to $830 million in FY 2003 from $449 million in FY 1997. This growth in overtime spending was attributable to major unplanned events, wage increases and the expansion of overtime-funded anti-drug and quality-of-life initiatives in the Police Department. The pattern of rising overtime spending has continued through the first seven months of FY 2004. The City has paid $459 million in overtime from July 1, 2003 to January 31, 2004, which is nine percent or $41 million more than the same period in FY 2003. Approximately $18 million of the increase resulted from the August 14-15, 2003 blackout in New York City. Uniformed overtime spending alone was $346 million for the same period, or $38 million more than the $308 million for the first seven months of FY 2003. The higher than usual rate of attrition being currently experienced by these agencies partially contributed to this increase.

Uniformed overtime expenditure, which exceeded $500 million in FY 2001, has more than doubled between FY 1997 and FY 2003 as shown in Table 16. On a yearly basis, the City has consistently under-budgeted overtime projections, particularly for the uniformed services, in the beginning of the fiscal year in the hope of curbing overtime expenditures for the entire year. In the past, this has not been successful and the City has had to increase appropriations throughout the year to cover actual expenditures. The FY 2005 overtime appropriations for uniformed agencies was reduced by $41 million compared to the November Plan projections. The agencies have not yet developed any measures on how these reductions will be achieved. These reductions may be difficult to achieve if the agencies incur overtime expenditures at a similar rate as in recent fiscal years. Furthermore, the City is expected to incur additional overtime expenditure because of the upcoming Republican National Convention (RNC) this summer. The City has estimated that it will cost $30 million, mainly in overtime costs, for security for August 20 to September 2, 2004 RNC. The Federal Government has appropriated $25 million towards this cost. The City has acknowledged that overtime costs for FY 2005 may be at least $150 million more than budgeted.

Table 16. Actual Overtime Expenditures, FYs 1997-2003

($ in millions)

	FY 1997	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003
Uniformed Overtime	$304	$309	$353	$414	$509	$563	$613
Civilian Overtime	145	160	179	204	230	234	217
Total	**$449**	**$469**	**$532**	**$618**	**$739**	**$797**	**$830**
Percent Change		4.45%	13.43%	16.17%	19.58%	7.85%	4.14%

NOTE: Overtime costs for FY 2002 and FY 2003 exclude expenditures related to the World Trade Center disaster.
SOURCE: Comprehensive Annual Financial Report.

FY 2005

The under-budgeting of overtime in FY 2005 will add $217 million to the FY 2005 budget gap, as illustrated in Table 17. The Comptroller's projection assumes overtime costs in FY 2005 will be similar to the rate of spending experienced in the first seven months of FY 2004. This projection was adjusted for one-time occurrences such as the August 14-15, 2003 blackout in New York City and higher than usual attrition rates in the uniformed agencies. In addition, the hiring freeze in effect for selected City agencies will exert upward pressure on overtime spending.

Table 17. Projected Overtime Spending, FY 2005

($ in millions)

	Comptroller's Projection Overtime FY 2005	Planned Overtime FY 2005	FY 2005 Risk
Uniformed			
Police	$353	$196	$(157)
Fire	90	75	(15)
Corrections	55	40	(15)
Sanitation	71	71	(0)
Total Uniformed	$569	$382	$(187)
Others			
Police-Civilian	$31	$14	$(17)
Admin for Child Svcs	11	14	3
Environmental Protection	22	19	(3)
Transportation	29	29	(0)
All Other Agencies	103	90	(13)
Total Civilians	$196	$166	$(30)
Total City	**$765**	**$548**	**$(217)**

Pensions

The January Modification projections of the City's contributions to the five actuarial pension funds remain unchanged from the November Modification at $2.5 billion in FY 2004, $3.1 billion in FY 2005, $3.9 billion in FY 2006, $4.2 billion in FY 2007 and $4.2 billion in FY 2008.

However, these projections will change later this fiscal year when the City's Chief Actuary finalizes his calculations for the City's FY 2004 pension contributions. The changes could be significant if the Chief Actuary chooses to modify current actuarial assumptions, methods or policies.[18] Pension contribution projections beginning in FY 2005 will also be affected by FY 2004 investment returns.

Investment returns from July 1, 2003 through February 29, 2004 averaged around 16.5 percent for the five actuarial funds. Since the City's pension contribution projections are based on the assumption that actuarial assets will earn eight percent each fiscal year after FY 2003, future contributions will be reduced if FY 2004 earnings are above that threshold.

Health Insurance

The January Modification projects the City's health expenditures, including the Department of Education and the City University of New York, will total $2.4 billion in FY 2004, $2.7 billion in FY 2005, $2.9 billion in FY 2006, $3.2 billion in FY 2007 and $3.4 billion in FY 2008. These projections are all marginally higher than those in the November Modification and reflect rate increases of 10.43 percent in FY 2005 and eight percent per year thereafter.

In December, the City reached an agreement with the municipal unions that will save the City about $100 million annually. The savings will come from increased co-payments and deductibles as well as a new administrative fee.[19] It is expected that employees and retirees will pay a new administrative fee of $35 per year. Co-payments will increase for the psychotropic, injectable, chemotherapy and asthma (PICA) program and for doctors' office visits, diagnostic services, non-mandated in-vitro fertilization services, hospital stays and emergency room visits covered by the Group Health Incorporated health program.[20] The new fees and co-payments are scheduled to become effective beginning April 1, 2004.

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[18] For information on a recently concluded actuarial audit and its impact on the Chief Actuary's possible recommendations, please see the section on "Pensions" beginning on page 11 of "*The State of the City's Economy and Finances, 2003*" issued by the Comptroller on December 15, 2003.

[19] The $100 million figure was estimated by the City and its municipal unions.

[20] Approximately 60 percent of the City's employees and retirees elect to be covered under the Group Health Incorporated health program.

Overall, the December settlement's continuation of the PICA program, which cost about $140 million in FY 2003, and a $100 per member annual increase in the City's contributions to the union welfare funds, will cost the City approximately another $55 million annually.[21]

Labor

The Preliminary Budget for FY 2005 makes no provision for wage increases for City employees. As such, the City's projections of wages and salaries are projected to remain at approximately $16.6 billion annually between FYs 2005 and 2008. The City continues to hold on to its position that any wage increase for employees has to be funded through productivity initiatives. It will cost the City approximately $212 million annually for every one-percentage point wage increase granted to employees.[22]

With the projection of a relatively constant workforce and no proposed wage increases, the City's personal services expenditures are estimated to remain stable between FYs 2005 and 2008. Pension expenditures are expected to increase by 25 percent in FY 2006 and by nearly 10 percent in FY 2007 as shown in Table 18. However, only slight increases are projected annually for fringe benefits costs while wages and salaries remain constant between FYs 2005 and 2008.

Table 18. Personal Services Expenditures, FYs 2005-2008

($ in millions)

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Salaries and Wages	$16,851	$16,590	$16,650	$16,652	$16,661
Pensions	2,555	3,165	3,958	4,335	4,351
Fringe Benefits	4,803	5,088	5,308	5,678	5,936
Total	$24,209	$24,843	$25,916	$26,665	$26,948
Percentage of Budget	52.46%	53.27%	53.24%	52.64%	52.30%
Projected Growth:					
Salaries and Wages		(1.55%)	0.36%	0.01%	0.05%
Pensions		23.87%	25.06%	9.53%	0.37%
Fringe Benefits		5.93%	4.32%	6.97%	4.54%
Total		2.62%	4.32%	2.89%	1.06%

[21] Prior to this agreement, the PICA program was in danger of being discontinued as the Healthcare Stabilization Fund, from which it has thus far been financed, lacked sufficient funds. Under this settlement, the PICA program has been divided so that the chemotherapy and asthma components will be funded under the GHI program while the psychotropic and injectable components will remain funded from the Healthcare Stabilization Fund.

[22] It costs $272 million in all funds for every one-percentage point wage increase.

Judgments and Claims

The Preliminary Budget for FY 2005 projects Judgment and Claims (J&C) expenditures of $676 million, an increase of 5 percent from anticipated costs of $643 million in FY 2004. The City spent $627 million in FY 2003 for J&C settlements. Over the last several years, the City has implemented early settlement initiatives and aggressive investigative programs in an effort to curtail the growing costs for J&C. To further this effort, the City is currently targeting claims of $25,000 and over for early settlement and implementing more aggressive procedures in defending these claims. These claims account for about 17 percent of filings and results in about 80 percent of J&C annual costs.

Last year, the City Council enacted legislation, effective September 14, 2003, that relieved the City from personal and property injury liabilities caused by the failure of owners to maintain sidewalks abutting their properties in a reasonably safe condition. This law, which does not apply to sidewalks abutting one, two, and three family homes, is expected to eventually save the City approximately $40 million annually. Since this law was enacted, there has been a significant reduction in the filings of sidewalk claims. Between September 14, 2003 and January 27, 2004 approximately 356 claims were filed of which 171 were disallowed. The number of claims filed were 42 percent lower than the 611 claims filed between September 14, 2002 and January 27, 2003. The City has proposed tort reform in FY 2005 Preliminary Budget, which if enacted could result in savings of $50 million in FY 2005, $52 million in FY 2006, $54 million in FY 2007, and $56 million in FY 2008. Tort reform has been proposed for several fiscal years and includes:

- Implementing a cap of $250,000 for non-economic loss.
- Limiting the City's liability for economic losses to the same proportion as the City's responsibility for claimants' injuries.
- The shifting of claims against the City to the State's Court of Claims where judges, not juries, make award decision.

Tort reform proposals have to be approved by the State Legislature. There have been discussions on tort reform at the State level for several years and these discussions are continuing.[23] Given the growing cost of J&C the City needs to continue pursuing Legislative approval of its other tort reform initiatives to help control J&C costs.

Medical Assistance

The City's Medicaid spending projection remains unchanged in the January Modification. A funding shift of about $3 million, for additional Federal reimbursement

[23] The Governor has proposed mandate relief savings worth $30 million in FY 2005 from an assortment of actions that include tort reform.

covering services provided at Health and Hospitals Corporation (HHC) facilities, has lowered City-funded Medicaid expenditures by a corresponding amount each year beginning in FY 2005. This adjustment brings the projected City-funded Medicaid expenditures in the January Modification, excluding HHC, to $3.19 billion in FY 2004. Further adjusting for the temporary increase in the Federal Medicaid funding match, projected City-funded Medicaid spending in FY 2004 represents a growth of about eight percent from FY 2003 expenditures.[24] Moving forward, City-funded Medicaid spending is projected to grow to $3.63 billion in FY 2005 and then range between $3.81 billion and $4.22 billion in FYs 2006-2008. These assumptions reflect annual growth of about 5 percent or nearly $200 million on average. The main area of growth continues to be pharmaceuticals, which is expected to increase by over $300 million over the course of the January Modification from its FY 2004 base.

Medicaid cost containment forms the main thrust in both the City's and the State's budget savings proposals. The City, in its menu of actions seeking additional Federal and State assistance, has identified potential Federal and State actions that would reduce its share of Medicaid spending by over $700 million in FY 2005.[25] These proposed actions include the extension of the FMAP increase ($242 million), State takeover of Family Health Plus ($179 million) and long-term care ($116 million), and other State cost containment measures ($200 million).

The Governor has partly addressed the City's request for Medicaid cost relief in the State Executive Budget. According to State budget estimates, the Governor's proposals are expected to provide $173 million in Medicaid cost reduction for the City. The proposals include a phased-in takeover of long-term care that would provide savings of $32 million in FY 2005, though the proposed actions failed to include a State takeover of the Family Health Plus program. The other savings in the Governor's proposals, totaling about $141 million, mainly fall in the areas of pharmacy ($89 million), managed care ($34 million) and general Medicaid services ($33 million). This is not surprising since pharmaceuticals and managed care represent areas that have experienced rapid growth in recent years. These savings are partially offset by costs shifted to the City for graduate medical education ($25 million) and reinstatement of State home care savings target ($10 million). The nature of these initiatives mostly involves rolling back benefits in both fee-for-service settings and managed care, increasing co-payments for certain services, obtaining pharmacy vendor discounts, and reducing reimbursement rates for brand and generic drugs.

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[24] A temporary increase of the Federal Medical Assistance Percentage (FMAP) was enacted in May 2003, raising the Federal Medicaid funding share from 50 percent to 53 percent, for the period between April 1, 2003 and June 30, 2004. The higher Federal Medicaid funding match has provided the City an offset of $232 million to its share of Medicaid expenditures for FY 2004.

[25] In the January Plan, the City expects fiscal relief of $700 million from Federal and State initiatives to emanate from a list of potential actions totaling about $2.15 billion. See "Intergovernmental Aid" beginning on page 21 for a more detailed discussion.

The likelihood that such savings will materialize is uncertain. Further, the City's analysis of these actions shows a significantly lower savings of about $80 million for FY 2005. The City has discounted a significant portion of the State's aggressive savings assumptions. Given these prospects, it appears that the City's Medicaid cost burden will not be reduced significantly going forward unless the Federal government opts to extend the FMAP increase that is currently in place on a temporary basis through June 2004. However, the President's budget for Federal FYs 2004-2005 does not include a proposal to extend this measure.

Public Assistance

The City's public assistance caseload, through January 2004, has risen by a total of 10,992 recipients since the end of FY 2003. The January 2004 caseload of 432,538, as reported by the Department of Social Services, represents a 2.6 percent jump in the welfare rolls from the FY 2003 year-end caseload of 421,546. This continues the current rising trend in the welfare rolls since public assistance caseload bounced off a recent low of 418,770 in February 2003, the lowest level in about 39 years. However, compared with the historical peak of 1,160,593 reached in March 1995, the January 2004 caseload still represents a staggering decline of almost 63 percent. Over this same period, the City's share of monthly public assistance grant spending has fallen by about 52 percent, from $83 million in March 1995 to $40 million in January 2004. The steep decline in the welfare caseload and the corresponding reduction in expenditures since 1995 have reduced the City's commitment to public assistance spending by more than $400 million annually.

The recent rebound in the City's welfare rolls is mainly driven by a steady rise in the Safety Net Assistance (SNA) caseload. To date in FY 2004, the overall SNA caseload has grown by about 8,324 recipients. About two-thirds of this increase has occurred in the traditional SNA population, growing by 6.6 percent from 91,372 in June 2003 to 97,434 in January 2004. The remainder of the increase in the SNA caseload results from the ongoing transfer of former Family Assistance (FA) recipients into the SNA-Time Limit subcategory, increasing by nearly two percent to 132,317 in January 2004. As a result, monthly City-funded grant spending in the SNA program has risen by almost eight percent to a FY 2004 year-to-date average of $27.2 million, compared with the FY 2003 average of $25.2 million. Meanwhile, the City's share of average monthly grants for the FA program have remained basically the same between FY 2003 and FY 2004 at about $11.8 million, while the caseload has increased by 2,668 recipients or slightly more than one percent.

The public assistance budget in the January Modification contains the same caseload and grants assumptions as in the November Modification. The City still assumes caseload will reach 446,902 by June 2004 with expected baseline grant spending of $477 million in the current year. To date, the actual caseload has been running slightly below the City's projection on a monthly basis. Further, at the current average of about $39 million for monthly grant expenditures, it appears the City has provided adequate funding for public assistance in FY 2004. In the outyears, the City's June 2005 caseload projection remains unchanged at 458,902 and is expected to stay flat thereafter. The

January Modification still provides about $491 million for baseline grant expenditures in each of FYs 2005-2008. At this point, these projections appear to be reasonable estimates given that the caseload rebound is still a developing trend.

Department of Education

The January Modification has provided additional funding of $209 million to the Department of Education (DOE) in FY 2004. As a result, the DOE budget has increased from $12.47 billion in the November Modification to $12.68 billion in the current modification. The funding change mainly reflects increased Federal appropriations in various educational grants, most notably for Title II math and science programs ($137 million) and handicapped education grants ($48 million). The DOE recently released its first comprehensive fiscal analysis for FY 2004, showing a potential operating deficit of about $18 million in the current year. This budget deficit appears manageable at this point in the school year, and the Department has already indicated that it will take actions to bring spending in line with budget allocations.

The City has incorporated similar changes for FY 2005 and beyond in the January Modification, adding about $211 million annually in Federal funding for DOE. In addition, the City has provided $25 million annually beginning in FY 2005 for developing programs to end social promotions of under-performing third graders. Under this initiative, low-performing students will be offered more intensive remedial education, including enhanced instruction during the school year, summer instructional programs and additional tutoring. Among the determining factors in the DOE promotion policy for third graders is achieving a certain proficiency level in State and City standardized assessments and attaining an attendance rate of 90 percent or better. These funding increases are partially offset by a PEG savings target of $39 million assigned to the Department in the January Modification. The majority of the savings is expected from the reduction of sabbatical expenditures by pedagogues, saving about $34 million each year. The DOE has an agreement with the union to achieve similar savings in the current year; however, there is no agreement in place beyond FY 2004.[26] If the Department fails to reach an agreement with the union on a recurring basis, it will need to identify alternative savings to meet this PEG target. The Department expects to achieve the remaining $5 million in savings through reduced support for summer programs. Overall, the City projects the DOE budget to rise to $12.73 billion in FY 2005, reflecting an increase of $192 million from the November Modification estimate. In the outyears of the plan, total funding for the DOE is expected to range between $12.89 billion in FY 2006 and $13.11 billion in FY 2008.

[26] The City has taken the position that a provision of that agreement, the November 16, 2000 contract between the City and the United Federation of Teachers ("UFT"), permits the City to reduce the number of teachers on sabbatical. The UFT has disputed that position, and has filed a grievance before the New York State Public Employment Relations Board and a demand for arbitration. The contract expired by its terms on May 31, 2003, but the City and the UFT continue to be bound under the terms of that agreement.

The recently released State Executive Budget will likely have a marginal impact on State support for the DOE. While the Governor has acknowledged the need to revamp the State's education aid formulas, as a response to the Campaign for Fiscal Equity (CFE) court ruling, school aid appropriations in the State Executive Budget could leave the Department short by $6 million, compared with the City's FY 2005 education aid assumptions.[27] The Governor's school aid recommendations would increase formula-based aids (including general operating aid and building aid) by $106 million. This gain is more than offset by a net reduction of $50 million in categorical grants (including a $42 million decline in Teacher Support Aid) and the Governor's decision to discontinue the allocation of about $62 million in fiscal stabilization grants as discussed in "Highlights of the Governor's Executive Budget Proposals" beginning on page 23.

The Governor has advanced two proposals in his proposed budget to address the CFE decision. Within the formula-based aid allocations, the Governor has called for the establishment of a new Sound Basic Education grant that would provide $100 million to the City in FY 2005. However, a local funding match provision attached to the grant will require the City to increase its own support for DOE by the same amount. In addition, the Governor has proposed to establish an education funding reserve of $325 million, to be supported by Video Lottery Terminal (VLT) revenues. The reserve, separate from the normal school aid appropriations, will target high need districts such as New York City. However, the City's share of this reserve is not yet known.

Health and Hospitals Corporation

The January Modification projects that the Health and Hospitals Corporation (HHC) will complete FY 2004 with a closing cash balance of $121 million. While it appears that the Corporation will likely achieve a cash balance of this magnitude at the end of the current year, its financial condition has deteriorated since its last financial plan update in June 2004. The projected closing cash balance in the January Modification represents a decline of $108 million from the previous projection of $229 million when the FY 2004 budget was adopted.

This projected decline in the HHC cash balance results partly from an operating deficit that has risen by $52 million since June, chiefly due to a net decrease in normal Medicaid collections and timing of certain Federal Community Health Partnership (CHP) grants for managed care demonstration programs. The lower Medicaid revenue projection can be attributed to a reconfiguration of normal Medicaid collections between

[27] In the lawsuit CFE vs. New York State, the Court of Appeals ruled that the State has failed to provide New York City schoolchildren with the opportunity for a sound and basic education, citing inadequate financial support as a major reason for this failing. As part of the ruling, the Court has imposed a July 2004 deadline on the State to develop and implement reforms in its education aid formulas as a course of remedial action. A recent study by the CFE indicates that in order for the State to meet the requirements of the court ruling, it would need to provide an increase of $7 billion in education aid to schools statewide. The CFE estimates that a fair share of this funding increase for the City would be $3.6 billion.

fee-for-service and managed care, to better reflect actual collections to date, causing a net decrease of $38 million in revenue. The January Modification also shows a $131 million decline in CHP grants due to timing of funding flow, with part of this balance shifting into FY 2005 and beyond. The decreases in these two types of revenue, totaling $169 million, are partially offset by about a $99 million increase from a mix of other revenues (including indigent care pool revenue and Medicare) and expense reduction of about $18 million. In addition, the Corporation has scaled back its gap-closing program in the current year by a net of $54 million, which has also contributed significantly to the lower cash balance in the January Modification.

These changes have a direct impact on HHC's financial outlook in FY 2005. Most importantly, the Corporation will begin FY 2005 with a much lower expected cash balance of $121 million in the January Modification, due to the worsening financial condition in FY 2004. The timing of the CHP grants, which provides additional revenue of about $71 million in FY 2005, will help reduce the operating deficit and offset the impact of a lower opening cash balance. The Corporation's projected year-end cash balance, however, is still expected to decline further to $4 million from the June Plan projection of $23 million. To reach this projected cash balance, HHC will need to achieve gap-closing actions totaling $318 million in FY 2005. The gap-closing program is largely comprised of Federal and State actions of $178 million, productivity savings of $70 million, and other revenue enhancements of $50 million.

More importantly, the Corporation's revenue projection in the January Modification may be on the conservative end. Between FY 2004 and FY 2005, HHC projects that revenues will be down by $28 million, falling from $3.972 billion to $3.944 billion. Normal Medicaid collections, constituting about half of HHC's overall revenues, are projected to remain virtually flat at about $2.03 billion in these years and a main reason for the stagnant revenue projections for FY 2005. In contrast, HHC revenues rose by an average of 3.2 percent between FY 2001 and FY 2003. Therefore, there is a likely upside potential to HHC's revenue assumptions in the January Modification. However, the Corporation has indicated that the Governor's proposed budget could have a negative impact of $48 million on its revenue projection in FY 2005. The impact stems from various Medicaid savings measures targeting reduced reimbursement rates for hospitals and nursing homes.

In the outyears of the plan, the City projects that HHC will face operating deficits ranging from $624 million to $653 million in FYs 2006-2008. The Corporation has proposed gap-closing programs of similar values each year, relying heavily on Federal and State actions as a mean to maintain budget balance. Federal and State actions are expected to average more than $460 million, constituting about 73 percent of the value of gap-closing actions annually. The remainder of the actions are chiefly from productivity savings of $100 million and revenue enhancements of $50 million each year.

Debt Service

The January Modification assumes debt service costs will total $4.5 billion in FY 2005 growing to $5.2 billion by FY 2008. This is an increase of $666 million, or 14.7

percent. This also represents an annual growth rate of 4.7 percent. As shown in Table 19, major elements accounting for the increase are general obligation (GO) debt service in the amount of $581 million, DASNY and other conduit issuers in the amount of $61 million, NYCTFA debt service in the amount of $16 million, and TSASC debt service of $8 million.

Table 19. Annual Debt Service Cost

($ in millions)

	FY 2005	FY 2006	FY 2007	FY 2008	Changes FY 2005-2008
City GO Bonds	$3,267	3,465	$3,674	$3,848	$581
NYCTFA	973	982	982	989	16
TSASC	91	92	92	99	8
DASNY and Other Conduit Issuers	203	254	250	264	61
Total Debt Service	**$4,534**	**$4,793**	**$4,998**	**$5,200**	**$666**

SOURCE: Office of Management and Budget, January 2004.

As shown in Table 20, the $4.5 billion in FY 2005 debt service expenditures projected in the FY 2005 Preliminary Budget represents an increase of $638 million, or 16.4 percent from FY 2004. Estimated FY 2005 debt-service constitutes 16.5 percent of local tax revenues and 9.9 percent of total revenues and is estimated to grow to 16.9 percent of local tax revenues and to 10.8 percent of total revenues in FY 2008. The upward trend in debt service costs from FYs 2005 to 2008 is primarily from the anticipated sale of GO bonds, as a return to almost exclusive reliance on GO borrowing leads to a projected increase of $581 million in GO debt service costs. Debt service for NYCTFA and TSASC increase modestly for a combined total of $24 million, while debt service for DASNY and other conduit issuers are projected to increase by $61 million over the FYs 2005-2008 period.

Table 20. Changes in Annual Debt Service Costs, FY 2004 to FY 2005

($ in millions)

	FY 2004	FY 2005	Change
City General Obligation Bonds	$2,962	$3,332	$370
Transitional Finance Authority	809	973	164
TSASC	96	91	(5)
DASNY and Other Conduit Issuers	169	203	34
Total Effective Debt Service	**$4,036**	**$4,599**	**$563**
Refundings and Other Actions:			
GO Refunding Savings	($85)	($65)	20
NYCTFA Refunding Savings	(40)	-	40
Escrow Restructuring – GO Bonds	(15)	-	15
Subtotal	($140)	($65)	$75
Total Debt Service in Financial Plan	$3,896	$4,534	$638

SOURCE: Office of Management and Budget, January 2004.

General Obligation Bonds

GO debt service, as shown in Table 21, is the largest component of total debt service at $3.27 billion, or 72 percent in FY 2005 and increases slightly to 74 percent by FY 2008. Currently estimated at $3.27 billion in FY 2005, $3.08 billion, or 94 percent of the estimated debt service due in FY 2005, is from debt issued prior to January 31, 2004. The remaining balance of approximately $192 million is comprised of projected debt service of $111 million on debt yet to be issued and estimated short-term interest costs from projected note borrowing of $71 million. Other miscellaneous changes netting to an increase of about $10 million account for the balance.

Table 21. Components of Debt Service by Percent Share, FY 2005

	FY 2005
City General Obligation Bonds	72.0%
Transitional Finance Authority	21.5%
TSASC	2.0%
DASNY and Other Conduit Issuers	4.5%
Total Debt Service	**100.0%**

SOURCE: January 2004 Financial Plan, Office of Management and Budget

Over the financial plan period, there are planned GO bond issues of $13.1 billion that result in additional debt service costs of $911 million by FY 2008. Thus, of the $3.85 billion in estimated GO debt-service costs in FY 2008, approximately $2.89 billion is obligated to be paid from debt issued prior to January 31, 2004. The remaining estimated balance of $965 million is comprised of $911 million in debt service from debt to be issued after January 31, 2004 and $74.6 million for estimated interest cost on short-term notes offset by $21 million of projected interest earnings on invested GO bond proceeds.

Municipal Assistance Corporation

The January Modification still assumes no appropriation of sales tax for the payment of MAC debt service throughout the term of the financial plan period.[28]

The Governor's Executive Budget contains a new proposal to restructure and extend MAC debt. In lieu of the City's proposed use of the Sales Tax Asset Receivable Corporation (STAR) which utilizes an annual $170 million LGAC revenue stream to effectively extend $2.151 billion of MAC bonds for thirty years, the gubernatorial proposal will utilize a yet to be approved $250 million revenue stream which will extend

[28] For further discussion, refer to the Comptroller's Report on "*The State of the City's Economy and Finances*", December 2003, page 19.

the funding of MAC debt for 10 years to 2018. The latest gubernatorial proposal will provide the City, in FY 2004 and FY 2005, with $1 billion in budget relief through a series of MAC current and/or advance refundings or the issuance of MAC bonds to reimburse the City for payments made to MAC's debt service fund.

Both the City and gubernatorial proposals remedy the City's budgetary shortfall in FY 2004 and FY 2005 and provide for budget relief in subsequent years. If neither proposal is adopted, the remaining MAC debt-service payments sum to $2.5 billion through FY 2008 but create a significant budgetary problem for the City of about $500 million in FY 2004 and $495 million in FY 2005. If the gubernatorial proposal is accepted, total debt-service costs would increase to $3.2 billion through 2018, a change of $671 million, but the City's immediate budget shortfall would be financed. If the City's proposal to use the STAR Corporation is implemented, this would result in debt-service costs of approximately $4.4 billion through 2034, or an increase of over $1.9 billion, but the City's budgetary shortfall would be addressed as well.

Transitional Finance Authority

Estimated debt-service costs for NYCTFA are $973 million in FY 2005 growing to $989 million by FY 2008. Now that the NYCTFA has issued up to its currently authorized cap of $11.5 billion, the entire FY 2004 costs are from debt issued prior to January 31, 2004 and are obligated to be paid. Accounting for 21.5 percent of total debt service in FY 2005, NYCTFA's percentage declines to 19 percent by FY 2008 as a result of no further issues over the financial plan period.

At present, the City has three key legislative proposals related to the NYCTFA in Albany. One of the proposals seeks to change the $11.5 billion NYCTFA debt limit from "issued" to "outstanding." Thus, as the NYCTFA debt amortizes over time, additional capacity is generated through principal retirement.

The second proposal would permit the issuance of NYCTFA debt up to New York City's general debt limit as long as both the NYCTFA and GO bonds, combined, do not exceed the general debt limit.[29] If used properly, this would potentially save debt-service costs as interest costs on NYCTFA debt has been consistently lower than interest costs on GO bonds.

The third proposal would increase the capacity to incur variable rate debt to 25 percent of outstanding NYCTFA debt, excluding NYCTFA Recovery Bonds.

Tobacco Settlement Asset Securitization Corporation

Estimated debt-service costs for TSASC are $90.7 million in FY 2005 increasing to $99.3 million by FY 2008. All of the FY 2004 costs are from debt issued prior to

[29] The general debt limit is, with certain exceptions, 10 percent of the average full value of taxable real estate in the City for the most recent five years. In FY 2004, for example, it is $39.991 billion.

January 31, 2004 and are obligated to be paid. With total estimated tobacco revenue receipts in FY 2004 of $202.2 million, this leaves a residual of $106.1 million for use in the general fund after accounting for debt service. This residual will grow to $130.3 million by FY 2008.

The City has no plans to issue TSASC debt over the term of the financial plan period. Accounting for two percent of total debt service in FY 2005, this percentage declines to 1.9 percent by FY 2008. Of the estimated TSASC debt service in FY 2008, all costs are obligated to be paid from debt incurred prior to January 31, 2004.

Lease-Appropriation Debt Service

Estimated debt-service costs for bonds issued by the Dormitory Authority of the State of New York (DASNY) and other conduit issuers total $203 million in FY 2005, and comprise 4.5 percent of total debt service, growing to a projected $264 million, or 5.1 percent of total debt service by FY 2008. All of the FY 2005 costs are from debt issued prior to January 31, 2004 and are obligated to be paid. The City has recently made a policy decision to pay for the courts capital program through the use of GO bonds.

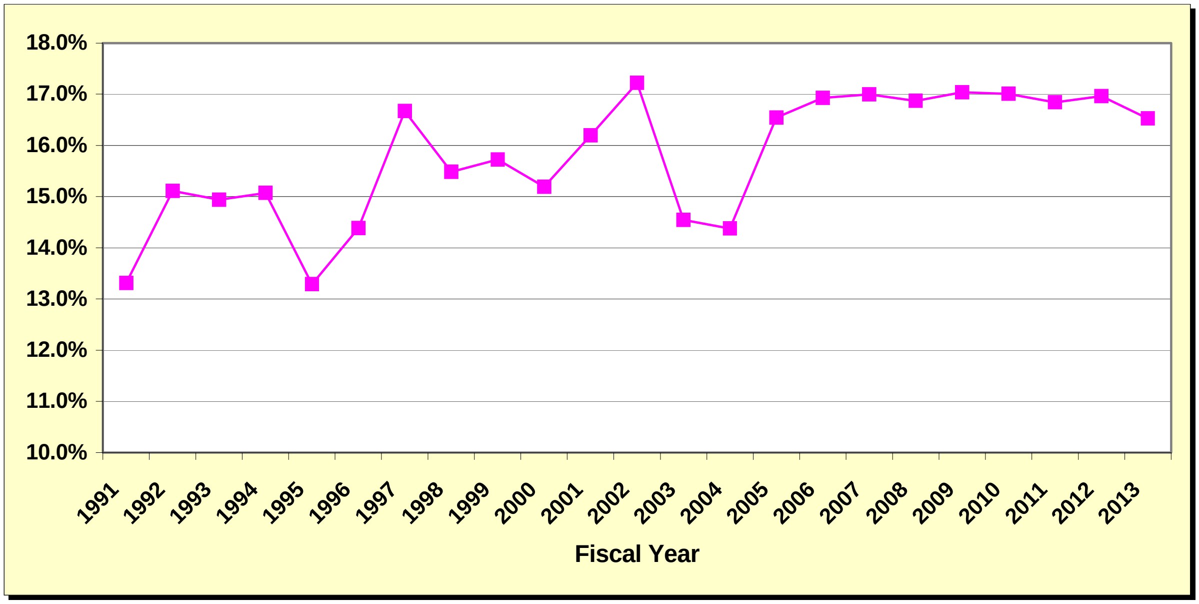
Approximately $254 million of the FY 2008 amount, or 96 percent of lease debt service costs, are from debt issued prior to January 31, 2004. The differential of approximately $11 million is from an anticipated Lincoln Center debt issue.

Debt Burden

Debt service, although improved from one year ago, continues to consume a significant percent of tax revenues as shown in Chart 8. The January Modification estimates debt service as a percent of local tax revenues to be 14.4 percent in FY 2004, growing to 16.5 percent in FY 2005, 16.9 percent in FY 2006, 17 percent in FY 2007, and 16.9 percent in FY 2008. In FYs 2009 through 2013, the ratio is projected to remain relatively stable, just slightly below 17 percent.

From FY 2005 to FY 2008, the average annual growth in debt service is projected to be 4.7 percent, compared with average annual local tax revenue growth of four percent.

***Chart 8.* Debt Service as a Percent of Tax Revenues, January 2004 Estimate**



SOURCE: FYs 1990-2003 Annual Financial Reports NYC Office of Comptroller, and January 2004 Financial Plan Modification, Office of Management and Budget, January 2004.

Capital Plan

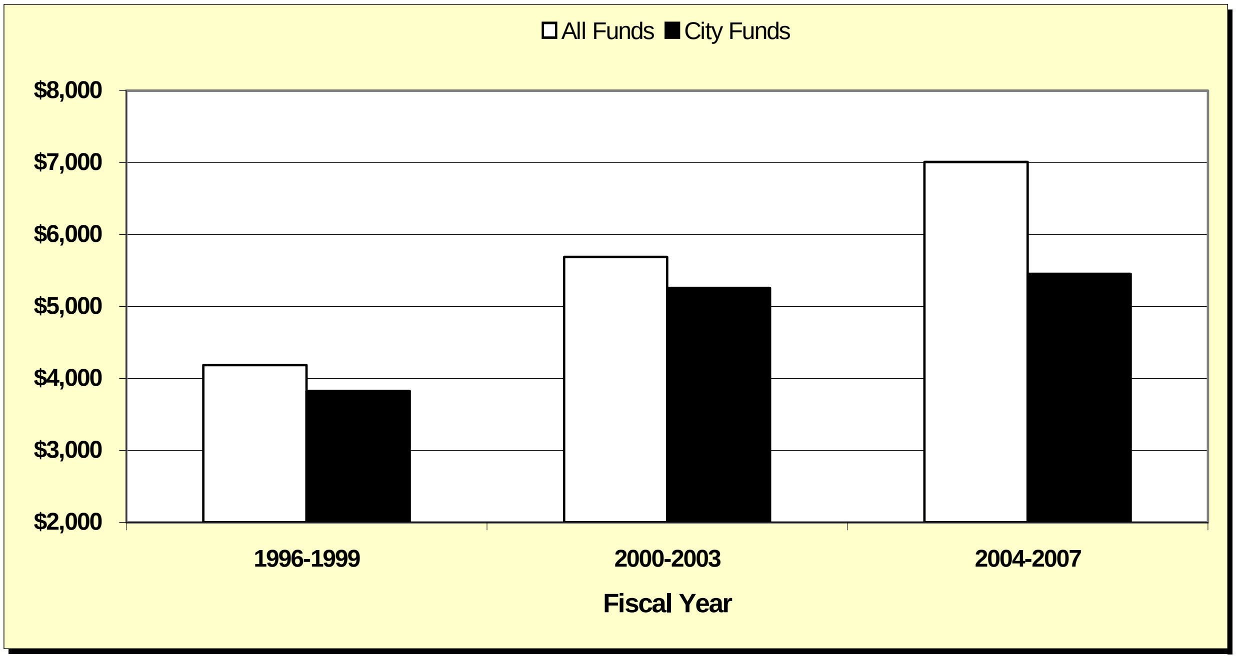
The January Capital Commitment Plan for FYs 2004-2007 sums to $30.7 billion over the four-year period, of which $24.5 billion is in City funds.

When factoring in $2.6 billion of adjustments for the reserve for unattained commitments, these figures decline to $28 billion in all funds and $21.8 billion in City funds.[30] This represents an increase of 22 percent in all funds and six percent in City funds from the September Capital Plan. The primary factor of the upward trend is the $5.5 billion all funds increase in Department of Education commitments over FYs 2004-2007. As a result, the average annual planned commitment levels remain high by historical comparisons at $7 billion. As shown in Chart 9 over a four-year period, actual commitments averaged $4.2 billion per year between FYs 1996-99, and $5.7 billion per year between FYs 2000-2003. Thus, all funds commitments for FYs 2004-2007 increase by 23.7 percent over FYs 2000-2003, but increase by a modest 3.7 percent in City funds. This occurs because the City projects new, but unconfirmed, State capital commitments for education of $3.9 billion over FYs 2005-2007.

[30] The reserve for unattained commitments is the estimated amount of contract registrations that are *not likely* to occur in a given fiscal year.

***Chart 9.* Capital Commitments Continue to Grow**

($ in millions)



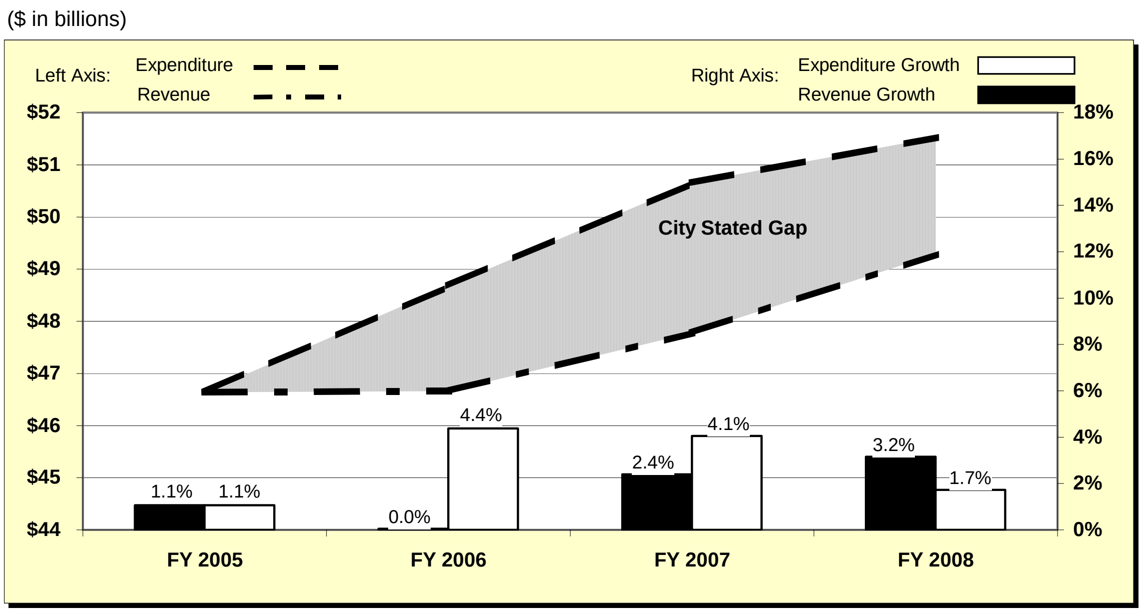
SOURCE: FY 2004 January Capital Commitment Plan, Office of Management and Budget, January 2004.

As in the past, three major program areas comprise just over 65 percent of all planned capital commitments during FYs 2004-2007. They are: 1) environmental protection; 2) education; 3) mass transit, highways, roads, and bridges. Other areas of significance are housing and economic development, courts, sanitation, parks and cultural affairs.

V. The FYs 2005-2008 Financial Plan

The January Modification projects a balanced budget for FY 2005. However, beginning in FY 2006 spending is expected to exceed revenue with the trend continuing into the outyears. As a result, the January Modification anticipates a deficit of $2 billion in FY 2006 growing to $2.9 billion in FY 2007 before narrowing to $2.2 billion by FY 2008 as shown in Chart 10.

***Chart 10*. The FYs 2005-2008 Financial Plan**



SOURCE: OMB
NOTE: Includes NYCTFA debt service

As Chart 10 illustrates, over the financial plan period expenditure growth is expected to peak at 4.4 percent in FY 2006 and slow down to 1.7 percent in FY 2008. In contrast, revenue growth is expected to be flat in FY 2006 and then grow steadily with gains of 2.4 percent and 3.2 percent in FYs 2007 and 2008 respectively.

A. GROWTH ASSUMPTIONS

Revenue Trends

Revenue is expected to grow 5.7 percent, from $46.6 billion in FY 2004 to $49.3 billion in FY 2008 as shown in Table 22. This growth is fueled solely by expected strength in tax revenues which are projected to grow at an average annual rate of four percent from $27.2 billion in FY 2004 to $30.6 billion in FY 2008. This growth in tax revenues is partly offset by a decline in non-tax revenues which is expected to drop by 3.8 percent between FY 2005 and FY 2008 from $19.4 billion to $18.7 billion.

The FY 2005 property tax revenue is projected to be two percent higher than the FY 2004 estimate. Between FY 2005 and FY 2008 property tax revenue is expected to average 4.2 percent annual growth, more than twice the FY 2005 growth. The relative slow pace of gain in property tax revenue in FY 2005 reflects the effect of the first year of the property tax rollback rebate. The City is proposing a property tax rollback rebate beginning in FY 2005 and will cost the City $250 million in foregone tax revenue in FY 2005 increasing to $267 million by FY 2008. Without the tax rebate, projected property tax revenue growth in FY 2005 would have been 4.2 percent, consistent with the average growth forecasted for the outyears of the plan.

Table 22. Projected Revenue Growth, FYs 2004-2008

($ in millions)

	FY 2005	FY 2006	FY 2007	FY 2008	FY 2005-08	FY 2008
Property Tax[1]	$11,559	4.0%	4.3%	4.4%	13.2%	$13,083
PIT	5,360	1.0%	0.9%	6.8%	8.9%	5,839
Other Non-Property Tax	10,283	3.8%	4.8%	4.5%	13.5%	11,676
Total Tax Revenues	**27,202**	**3.3%**	**3.8%**	**4.9%**	**12.5%**	**$30,598**
Miscellaneous Revenue	3,969	(20.7%)	(1.0%)	1.3%	(20.5%)	3,156
Others	1,116	1.5%	1.0%	0.0%	2.5%	1,144
Unrestricted IGA	585	0.0%	0.0%	0.0%	0.0%	585
Federal Categorical Grant	5,089	(0.9%)	(0.2%)	(0.2%)	(1.4%)	5,019
State Categorical Grant	8,679	(0.3%)	0.8%	0.7%	1.2%	8,786
Total Non-Tax Revenues	$19,438	**(4.5%)**	**0.2%**	**0.5%**	**(3.8%)**	**$18,690**
Total Revenue	**$46,640**	**0.0%**	**2.4%**	**3.2%**	**5.7%**	**$49,288**

[1] Includes the effect of the property tax rollback rebate.

PIT revenue is projected to grow by 8.9 percent from FY 2005 to FY 2008 with most of the growth coming in the last year of the financial plan period. The slow pace of PIT revenue recovery in the early part of the financial plan reflects in part the sluggish recovery in the job market and the write-off of capital gains from prior years. In addition, the phase-out of the PIT rate increase for CY 2003 serves to offset some of the gains from the economic improvement of the City. The PIT rate increase that was enacted for CY 2003 is scheduled to be phased out beginning CY 2004 and eliminated by CY 2006.

All other components of tax revenues are projected to exhibit a similar growth trend over the financial plan period. As the figure to the right shows, among the remaining components of tax revenues, business tax revenues, sales tax and real-estate-transaction tax revenues are projected to show the most rapid growth. The sales tax revenue projection reflects the sunset of the temporary sales tax rate increase, in May 2005.

Growth of Other Non-Property Tax Revenues

	FY 2006	FY 2007	FY 2008
Business Taxes	8.0%	6.3%	4.9%
Sales Tax	2.3%	5.0%	5.3%
Real Estate Transaction	4.1%	6.0%	5.0%
All Other	0.9%	1.7%	2.0%
Total	3.8%	4.8%	4.5%

Expenditure Growth

Expenditures are projected to grow by 10.5 percent between FY 2005 and FY 2008, a rate of almost twice the growth of revenues. However, as Table 23 shows, the misalignment in spending and revenue growth is driven by spending in pensions, health insurance, Medicaid, debt service and judgements and claims. The combined expenditures in these areas are projected to grow by more than 21 percent, more than three and one-half times the growth in revenue.

Table 23. Projected Expenditure Growth, FYs 2005-2008

($ in millions)

	FY 2005	FY 2006	FY 2007	FY 2008	FYs 2005-08	FY 2008
Pensions	$3,029	26.2%	9.9%	0.4%	39.2%	$4,215
Health Insurance	2,660	9.6%	8.8%	6.6%	27.2%	3,383
Medicaid	4,541	4.5%	4.2%	4.2%	13.5%	5,151
Debt Service	4,444	5.8%	4.4%	4.0%	14.8%	5,101
J & C	676	5.4%	5.4%	5.6%	17.4%	794
Subtotal	**$15,349**	**10.1%**	**6.4%**	**3.7%**	**21.5%**	**$18,644**
Other Fringe Benefits	$2,403	1.5%	1.7%	1.9%	5.2%	$2,528
Salaries and Wages	16,438	0.4%	0.0%	0.1%	0.4%	16,511
Public Assistance	2,247	0.3%	0.0%	0.0%	0.4%	2,255
Other OTPS	10,202	3.8%	8.0%	1.3%	13.6%	11,590
Subtotal	**$31,291**	**1.6%**	**2.8%**	**0.6%**	**5.1%**	**$32,884**
Total	**$46,640**	**4.4%**	**4.1%**	**1.7%**	**10.5%**	**$51,528**

While the City has proposed several initiatives to curb pension, health insurance, Medicaid, debt service and J&C cost, it has achieved only limited success. Because spending in these areas is dictated by contract terms, legislative requirements and federal and state mandates, controlling spending in these areas would require the cooperation of various parties including the state and federal governments as well as the labor unions.

Spending in all others areas is projected to increase by 5.1 percent, paralleling the revenue growth of 5.7 percent over the same period. However, this modest growth is based on the assumption that any wage increases to City employees will be funded through productivity savings. All labor contracts with City employees have expired and, with wages and salaries accounting for more than 30 percent of expenditures, any salary increase not offset by productivity gains will have a significant impact on the expenditure growth rate and the outyear gaps.

VI. Risks and Offsets

A. OUTYEAR RISKS

While the City has presented a reasonable projection of its revenues and expenditures these forecasts are based on several optimistic assumptions. These estimations, most of which rely on favorable actions on the part of other levels of government, exposes the City to significant budgetary risks. Table 3 on page 3 shows the City's forecast could be overstated by $417 million in FY 2004 with the gap exceeding $3 billion in FYs 2007 and 2008.

The largest risk to the FYs 2004-2008 Financial Plan Modification stems from the City's assumption of the removal of its MAC debt service obligations. There are currently two proposals to relieve the City of its MAC debt service payments. The first proposal assumes a State takeover of MAC debt service. As discussed in "Municipal Assistance Corporation" beginning on page 19 in "The State of the City's Economy and Finances, 2003" report issued on December 15, 2003, the constitutionality of the State legislation authorizing the State takeover is being challenged in the State Appellate Division by the Governor.[31] The second proposal, put forward by the Governor in his proposed budget, involves the restructuring and refinancing of MAC debt as discussed in Municipal Assistance Corporation" beginning on page 39. Both proposals carry significant risks. There is no certainty on whether the court will rule in favor of the City. At the same time, the revenue sources proposed by the Governor to fund the refinancing of the MAC debt require State legislative approval which is not certain at this time.

Other risks include the City's overtime assumptions. The City continues to underfund its overtime budget. As discussed in "Overtime" beginning on page 27, overtime spending fiscal year-to-date indicates that overtime spending will exceed the City's projection by $217 million in FY 2005 and $150 million annually in the outyears of the financial plan.

The remaining risks to the City's outyear forecasts arise from the assumption of State actions to provide budgetary relief as well as the anticipated elimination of private bus subsidies. While the City has assumed $400 million in budgetary relief from State actions it is likely that no more than $100 million of the savings will materialize. At the same time, the elimination of private bus subsidies is predicated on the takeover of private bus operations by the Metropolitan Transportation Authority (MTA). However, absent any strong indication that the MTA will agree to the takeover, the Comptroller is holding the assumed savings at risk.

The Comptroller's more optimistic economic outlook and revenue projections help mitigate some of the expenditure risks. The Comptroller expects FY 2004 revenues to come in at $100 million above the City's estimates. For FYs 2005-2008, the

[31] The report is available on the Comptroller's website at www.comptroller.nyc.gov

Comptroller expects revenues to exceed the City's forecast by $113 million, $131 million, $180 million and $170 million respectively.

In addition to the risks and offsets identified above, the City faces potential exposure to the cost of collective bargaining. As discussed in "Labor" beginning on page 31, the City's contracts with all of its labor unions have expired. The City has not included any funding for wage increases for FY 2004 and beyond. Every one-percent increase in wages and salaries would cost the City $212 million.

Appendix – Revenue and Expenditure Details

Table A1. FY 2005 Preliminary Budget Revenue Detail

($ in millions)

	FY 2004	FY 2005	FY 2006	FY 2007	FY2008	Change FYs 2004-08 Percent	Dollar
Taxes:							
Real Property	$11,472	$11,964	$12,436	$12,958	$13,510	17.8%	$2,038
Personal Income Tax	$5,808	$5,920	$5,979	$6,077	$6,485	11.7%	$677
General Corporation Tax	$1,454	$1,567	$1,683	$1,786	$1,881	29.4%	$427
Banking Corporation Tax	$241	$291	$358	$403	$427	77.2%	$186
Unincorporated Business Tax	$880	$926	$966	$1,006	$1,044	18.6%	$164
Sale and Use	$3,912	$3,887	$3,976	$4,174	$4,396	12.4%	$484
Commercial Rent	$420	$430	$441	$456	$470	11.9%	$50
Real Property Transfer	$479	$444	$468	$503	$535	11.7%	$56
Mortgage Recording Tax	$572	$459	$478	$511	$538	(5.9%)	($34)
Utility	$294	$278	$278	$284	$284	(3.4%)	($10)
All Other	$821	$778	$791	$776	$786	(4.3%)	($35)
Tax Audit Revenue	$545	$508	$508	$509	$509	(6.6%)	($36)
Tax Initiatives Program	$0	($250)	($259)	($263)	($267)	0.0%	($267)
Total Taxes	**$26,898**	**$27,202**	**$28,103**	**$29,180**	**$30,598**	**13.8%**	**$3,700**
Miscellaneous Revenue:							
Licenses, Franchises, Etc.	$350	$359	$355	$353	$353	0.9%	$3
Interest Income	$14	$35	$56	$61	$74	428.6%	$60
Charges for Services	$533	$523	$524	$518	$518	(2.8%)	($15)
Water and Sewer Charges	$901	$907	$924	$944	$974	8.1%	$73
Rental Income	$93	$861	$173	$176	$176	89.2%	$83
Fines and Forfeitures	$691	$704	$703	$703	$702	1.6%	$11
Miscellaneous	$603	$580	$412	$360	$359	(40.5%)	($244)
Intra-City Revenue	$1,186	$1,096	$1,094	$1,094	$1,094	(7.8%)	($92)
Total Miscellaneous	**$4,371**	**$5,065**	**$4,241**	**$4,209**	**$4,250**	**(2.8%)**	**($121)**
Unrestricted Intergovernmental Aid:							
N.Y. State Per Capital Aid	$327	$327	$327	$327	$327	0.0%	$0
Other Federal and State Aid	$626	$258	$258	$258	$258	(58.8%)	($368)
Total Unrestricted Intergovernmental Aid	**$953**	**$585**	**$585**	**$585**	**$585**	**(38.6%)**	**($368)**
Other Categorical Grants	$926	$801	$828	$843	$843	(9.0%)	($83)
Inter Fund Agreements	$343	$330	$320	$316	$316	(7.9%)	($27)
Reserve for Disallowance of Categorical Grants	($15)	($15)	($15)	($15)	($15)	0.0%	$0
Less: Intra-City Revenue	($1,186)	($1,096)	($1,094)	($1,094)	($1,094)	(7.8%)	$92
TOTAL CITY FUNDS	**$32,290**	**$32,872**	**$32,968**	**$34,024**	**$35,483**	**9.9%**	**$3,193**

Table A1 (Con't). FY 2005 Preliminary Budget Revenue Detail

($ in millions)

	FY 2004	FY 2005	FY 2006	FY 2007	FY2008	Change FYs 2004-08 Percent	Dollar
Federal Categorical Grants:							
Community Development	$308	$258	$241	$241	$241	(21.8%)	($67)
Welfare	$2,464	$2,204	$2,197	$2,205	$2,204	(10.6%)	($260)
Education	$1,777	$1,737	$1,737	$1,737	$1,737	(2.3%)	($40)
Other	$914	$890	$866	$846	$837	(8.4%)	($77)
Total Federal Grants	**$5,463**	**$5,089**	**$5,041**	**$5,029**	**$5,019**	**(8.1%)**	**($444)**
State Categorical Grants							
Welfare	$1,659	$1,608	$1,611	$1,608	$1,608	(3.1%)	($51)
Education	$5,752	$5,759	$5,763	$5,828	$5,888	2.4%	$136
Higher Education	$164	$167	$168	$168	$168	2.4%	$4
Department of Health and Mental Hygiene	$471	$466	$471	$480	$480	1.9%	$9
Other	$347	$679	$640	$642	$642	85.0%	$295
Total State Grants	**$8,393**	**$8,679**	**$8,653**	**$8,726**	**$8,786**	**4.7%**	**$393**
TOTAL REVENUE	**$46,146**	**$46,640**	**$46,662**	**$47,779**	**$49,288**	**6.8%**	**$3,142**

Table A2. FY 2005 Preliminary Budget Expenditure Detail

($ in thousands)

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	Change FYs 2004-2008 Percent	Change FYs 2004-2008 Dollar
Mayoralty	$75,340	$69,174	$69,119	$69,119	$69,119	(8.3%)	($6,221)
Board of Elections	$87,212	$67,966	$68,101	$68,101	$68,101	(21.9%)	($19,111)
Campaign Finance Board	$18,577	$17,731	$17,731	$17,731	$17,731	(4.6%)	($846)
Office of the Actuary	$4,093	$4,055	$4,055	$4,055	$4,055	(0.9%)	($38)
President, Borough of Manhattan	$3,983	$3,011	$3,003	$3,003	$3,003	(24.6%)	($980)
President, Borough of the Bronx	$5,412	$4,353	$4,289	$4,289	$4,289	(20.8%)	($1,123)
President, Borough of Brooklyn	$4,983	$3,911	$3,858	$3,858	$3,858	(22.6%)	($1,125)
President, Borough of Queens	$4,780	$3,744	$3,564	$3,564	$3,564	(25.4%)	($1,216)
President, Borough of S.I.	$3,776	$3,035	$3,035	$3,035	$3,035	(19.6%)	($741)
Office of the Comptroller	$53,126	$51,424	$51,424	$51,424	$51,424	(3.2%)	($1,702)
Dept. of Emergency Management	$13,914	$3,691	$3,691	$3,691	$3,691	(73.5%)	($10,223)
Tax Commission	$1,922	$2,272	$2,272	$2,272	$2,272	18.2%	$350
Law Department	$103,983	$101,998	$101,515	$99,669	$99,669	(4.1%)	($4,314)
Department of City Planning	$20,233	$17,240	$17,190	$17,190	$17,190	(15.0%)	($3,043)
Department of Investigation	$16,317	$15,863	$15,655	$15,655	$15,655	(4.1%)	($662)
NY Public Library-Research	$8,998	$15,686	$15,686	$15,686	$15,686	74.3%	$6,688
New York Public Library	$46,789	$83,196	$83,196	$83,196	$83,196	77.8%	$36,407
Brooklyn Public Library	$34,588	$61,368	$61,368	$61,368	$61,368	77.4%	$26,780
Queens Borough Public Library	$32,947	$58,387	$58,387	$58,387	$58,387	77.2%	$25,440
Department of Education	$12,666,674	$12,726,166	$12,886,293	$13,031,875	$13,105,648	3.5%	$438,974
City University	$501,526	$495,157	$492,225	$490,030	$490,080	(2.3%)	($11,446)
Civilian Complaint Review Bd.	$10,208	$9,326	$9,326	$9,326	$9,326	(8.6%)	($882)
Police Department	$3,450,737	$3,327,843	$3,364,168	$3,365,898	$3,367,527	(2.4%)	($83,210)
Fire Department	$1,198,370	$1,118,217	$1,126,371	$1,125,620	$1,125,354	(6.1%)	($73,016)
Admin. for Children Services	$2,238,685	$2,079,516	$2,078,876	$2,081,265	$2,081,265	(7.0%)	($157,420)
Department of Social Services	$6,317,094	$6,562,822	$6,768,977	$6,977,928	$7,185,051	13.7%	$867,957
Dept. of Homeless Services	$639,567	$628,252	$627,138	$627,637	$627,637	(1.9%)	($11,930)
Department of Correction	$844,473	$821,969	$827,415	$825,482	$825,482	(2.2%)	($18,991)
Board of Correction	$843	$791	$791	$791	$791	(6.2%)	($52)
Department of Employment	$1,000	$0	$0	$0	$0	(100.0%)	($1,000)
Citywide Pension Contributions	$2,419,209	$3,028,866	$3,821,675	$4,198,849	$4,215,144	74.2%	$1,795,935
Miscellaneous	$4,334,773	$4,616,801	$4,885,145	$5,153,513	$5,473,856	26.3%	$1,139,083
Debt Service	$3,944,001	$2,775,456	$3,024,215	$3,924,014	$4,112,135	4.3%	$168,134
M.A.C. Debt Service	$0	$0	$0	$0	$0	0.0%	$0
NYCTFA Debt Service	$144,991	$973,153	$981,445	$982,779	$988,661	581.9%	$843,670
Public Advocate	$2,434	$1,523	$1,523	$1,523	$1,523	(37.4%)	($911)
City Council	$47,054	$45,831	$45,831	$45,831	$45,831	(2.6%)	($1,223)
City Clerk	$3,024	$2,856	$2,856	$2,856	$2,856	(5.6%)	($168)
Department for the Aging	$224,451	$198,804	$198,804	$198,804	$198,804	(11.4%)	($25,647)
Department of Cultural Affairs	$119,477	$98,752	$98,752	$98,752	$98,752	(17.3%)	($20,725)
Financial Info. Serv. Agency	$35,102	$37,210	$37,099	$37,099	$37,099	5.7%	$1,997
Department of Juvenile Justice	$99,783	$97,702	$101,977	$101,977	$101,977	2.2%	$2,194
Office of Payroll Admin.	$9,886	$11,356	$10,297	$10,250	$10,250	3.7%	$364
Independent Budget Office	$2,667	$2,667	$2,667	$2,667	$2,667	0.0%	$0

Table A2 (Con't). FY 2005 Preliminary Budget Expenditure Detail

($ in thousands)

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	Change FY 2004-08 Percent	Change FY 2004-08 Dollar
Equal Employment Practices Commission	$507	$503	$503	$503	$503	(0.8%)	($4)
Civil Service Commission	$540	$540	$540	$540	$540	0.0%	$0
Landmarks Preservation Comm.	$3,568	$3,191	$3,191	$3,191	$3,191	(10.6%)	($377)
Districting Commission	$0	$0	$0	$0	$0	0.0%	$0
Taxi & Limousine Commission	$24,082	$23,379	$23,379	$23,061	$23,061	(4.2%)	($1,021)
Commission on Human Rights	$7,296	$6,759	$6,759	$6,759	$6,759	(7.4%)	($537)
Youth & Community Development	$234,410	$184,833	$184,645	$184,645	$184,645	(21.2%)	($49,765)
Conflicts of Interest Board	$1,455	$1,357	$1,357	$1,357	$1,357	(6.7%)	($98)
Office of Collective Barg.	$1,553	$1,553	$1,553	$1,553	$1,553	0.0%	$0
Community Boards (All)	$12,077	$12,039	$12,039	$12,039	$12,039	(0.3%)	($38)
Department of Probation	$76,761	$74,039	$71,155	$71,155	$71,155	(7.3%)	($5,606)
Dept. of Small Business Services	$116,837	$85,880	$87,749	$83,645	$83,645	(28.4%)	($33,192)
Housing Preservation & Dev.	$413,695	$386,057	$390,470	$387,958	$387,958	(6.2%)	($25,737)
Department of Buildings	$58,038	$53,100	$52,035	$50,575	$50,575	(12.9%)	($7,463)
Department of Public Health & Mental Hygiene	$1,439,104	$1,346,509	$1,372,269	$1,400,053	$1,400,922	(2.7%)	($38,182)
Health and Hospitals Corp.	$843,320	$857,906	$876,184	$876,184	$876,184	3.9%	$32,864
Dept. of Environmental Prot.	$727,337	$717,381	$710,876	$710,876	$710,876	(2.3%)	($16,461)
Department of Sanitation	$1,000,779	$1,036,036	$1,052,029	$1,052,088	$1,052,088	5.1%	$51,309
Business Integrity Commission	$5,077	$5,227	$5,227	$5,227	$5,227	3.0%	$150
Department of Finance	$204,116	$183,771	$184,947	$186,197	$186,122	(8.8%)	($17,994)
Department of Transportation	$483,246	$431,790	$429,885	$429,956	$429,956	(11.0%)	($53,290)
Dept. of Parks and Recreation	$211,272	$193,424	$193,424	$193,424	$193,424	(8.4%)	($17,848)
Dept. of Design & Construction	$102,466	$86,098	$86,098	$86,098	$86,098	(16.0%)	($16,368)
Dept. of Citywide Admin. Services	$239,373	$244,505	$241,476	$241,476	$241,587	0.9%	$2,214
D.O.I.T.T.	$96,012	$106,233	$103,226	$100,152	$100,593	4.8%	$4,581
Dept. of Records & Info. Serv.	$3,791	$3,436	$3,436	$3,436	$3,436	(9.4%)	($355)
Department of Consumer Affairs	$12,966	$13,456	$13,204	$13,316	$13,344	2.9%	$378
District Attorney - N.Y.	$72,303	$61,660	$61,265	$61,265	$61,265	(15.3%)	($11,038)
District Attorney - Bronx	$39,193	$36,578	$36,243	$36,243	$36,243	(7.5%)	($2,950)
District Attorney - Kings	$65,136	$62,940	$62,565	$62,565	$62,565	(3.9%)	($2,571)
District Attorney - Queens	$34,382	$32,558	$32,248	$32,248	$32,248	(6.2%)	($2,134)
District Attorney - Richmond	$5,816	$5,492	$5,231	$5,231	$5,231	(10.1%)	($585)
Off. Of Prosec. & Spec. Narc.	$14,467	$13,071	$13,071	$13,071	$13,071	(9.6%)	($1,396)
Public Administrator - N.Y.	$988	$988	$988	$988	$988	0.0%	$0
Public Administrator - Bronx	$329	$329	$329	$329	$329	0.0%	$0
Public Administrator - Brooklyn	$454	$454	$454	$454	$454	0.0%	$0
Public Administrator - Queens	$353	$353	$353	$353	$353	0.0%	$0
Public Administrator - Richmond	$252	$252	$252	$252	$252	0.0%	$0
Prior Payable Adjustment	($300,000)	$0	$0	$0	$0	(100.0%)	$300,000
General Reserve	$100,000	$100,000	$300,000	$300,000	$300,000	200.0%	$200,000
Energy Adjustment	($4,846)	($2,904)	$5,644	$7,526	$15,108	(411.8%)	$19,954
Lease Adjustment	$0	$20,303	$36,324	$52,760	$69,299	0.0%	$69,299
OTPS Inflation Adjustment	$0	$0	$36,990	$75,022	$110,970	0.0%	$110,970
City-Wide Totals	**$46,145,507**	**$46,640,217**	**$48,680,618**	**$50,653,830**	**$51,528,223**	**11.7%**	**$5,382,716**

Glossary of Acronyms

ACS	Administration for Children's Services
BSA	Budget Stabilization Account
BPCA	Battery Park City Authority
CFE	Campaign for Fiscal Equity
CHP	Community Health Partnership
COPS	Community Oriented Policing Services
CRT	Commercial Rent Tax
DASNY	Dormitory Authority of the State of New York
DOE	Department of Education
DOS	Department of Sanitation
FA	Family Assistance
FMAP	Federal Medicaid Assistance Percentage
FTE	Full-Time Equivalent
FY	Fiscal Year
GCP	Gross City Product
GDP	Gross Domestic Product

GO Debt General Obligation Debt

HHC Health and Hospitals Corporation

JFK John F. Kennedy

J&C Judgments and Claims

MAC Municipal Assistance Corporation

MTA Metropolitan Transportation Authority

MRT Mortgage Recording Tax

NYC New York City

NYCTFA New York City Transitional Finance Authority

NYS New York State

OMB Office of Management and Budget

OTPS Other Than Personal Services

PA Public Assistance

PICA Psychotropic, Injectable, Chemotherapy and Asthma Drugs

PIT Personal Income Tax

PEG Program to Eliminate the Gap (an action that is part of a gap-closing program)

PILOT	Payment-in-lieu-of Taxes
RNC	Republican National Convention
RPTT	Real Property Transfer Tax
SNA	Safety Net Assistance
STAR	Sales Tax Asset Receivable
TANF	Temporary Assistance to Needy Family