



Debt Affordability Study

December 2006

New York State
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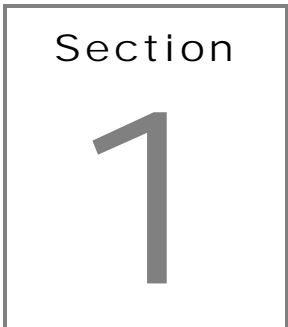
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Table of Contents

Executive Summary	3
Introduction	9
Review of Credit Ratings	13
New York City Transitional Finance Authority.....	17
State-Funded Debt Outstanding.....	21
State Debt Ratios.....	27
Comparison of State Debt Ratios to Selected Medians	29
Growth in State-Funded Debt Outstanding and Debt Service	33
Capital Program and Financing Plan	35
Debt Reform Act of 2000 - Statutory Debt Limits	43
Recommended Reductions in State-Funded Debt Outstanding	47
Recommendations	51



Executive Summary

The ability of New York State to issue debt has enhanced the quality of life for each New Yorker. The infrastructure we take for granted—roads and bridges, hospitals and universities, housing and mass transit—is made possible through the issuance of debt. What has proven detrimental to every New Yorker, however, is the lack of both a prudent debt management policy and an ongoing effort to assess the State’s capacity to borrow.

The 2006-07 Enacted Budget authorized \$16.5 billion in new State-Funded debt. In addition, this year’s budget continues the practice of circumventing the caps established in the Debt Reform Act of 2000. As a result of this considerable increase, State-Funded debt outstanding will reach nearly \$65 billion by the end of State Fiscal Year (SFY) 2010-11, representing a 32.5 percent increase in just five years. Debt service will increase to over \$7 billion—an increase of nearly 65 percent for the same time period.

New York welcomes a new administration on January 1, 2007. The new Governor has proposed a number of reform initiatives and has supported the Comptroller’s reform agenda, and we are hopeful that meaningful reform of the State’s debt practices will occur. Considering how much debt was authorized in the current fiscal year, it is imperative for the State to head in a more prudent direction by actively pursuing debt reform measures. The longer reforms are ignored, the more difficult it will be to achieve goals of restraint and reduction as debt mounts at such a rapid pace.

In 2006, the Legislature introduced the Comptroller’s constitutional and statutory reform legislation.¹ While the Comptroller is a proponent of

¹ See A.11515/S.8175 and A.11516/S.8176.

providing a comprehensive accounting of all the State's debt, with each new instrument that is introduced by the Legislature and Executive, there is an incentive to find artful ways to circumvent any type of reform, whether it be the current Debt Reform Act of 2000 or any future statutory or constitutional reforms. As with the Debt Reform Act of 2000, the moment any definition of debt is enacted, there is a chance that loopholes will be sought and possibly achieved. Leaders should avoid this temptation. The point of enacting reform is for all parties to adhere to such reform. While this has not been achieved with the Debt Reform Act of 2000, as we move forward to enact comprehensive debt reform, the Comptroller calls upon the State leaders to not only follow the letter of the law, but also the spirit to which the law was enacted.² The Comptroller calls on the Legislature to reintroduce and pass these reforms in the new session.

This second annual Debt Affordability Study is part of the initiative to increase awareness of debt levels, their impact on the State and the need to reform current practices. While the Comptroller continues to pursue a comprehensive reform agenda, in the absence of an established Debt Board as mandated by the proposals, the Comptroller continues to assume this responsibility. The first Debt Affordability Study was issued by the Office of the State Comptroller in December 2005.³ This second annual comprehensive Debt Affordability Study again evaluates resources and expected debt levels as a means of determining the reasonable level of State debt and considering ability to repay. This Study utilizes standard industry ratios as a basis of comparison to the national average and to peer states, allowing the State to better monitor debt levels. Realistic measurements of the State's debt burden introduced in the first Study and updated herein provide a roadmap to bring that burden down to an affordable level.

Chapter 59 of the Laws of 2000 established the Debt Reform Act of 2000 (Act). When enacted, the Act was considered by many to be the final word in stemming the use of debt. Peppered with loopholes, the legislation fell short of reform in that it lacked enforcement measures, mandates for transparency and provisions to actually reduce the State's debt burden. While designed to cap the levels of future debt, it did little to provide fiscal discipline or ensure that future debt is affordable. In fact, since its

² The Comptroller believes that the newly authorized New York City Transitional Finance Authority (TFA) Building Aid Revenue Bonds (BARBs) constitute a new form of State-funded obligation, and, to the extent that they are not covered by the existing definition of State-Funded debt in the Comptroller's debt reform proposals, the necessary technical amendments will be added to that definition to ensure that they are covered.

³ New York State Office of the State Comptroller. "Debt Affordability Study". December, 2005.

authorization, nearly every State debt indicator has moved in the wrong direction.

Over the past five years, State-Funded debt per capita has grown nearly 30 percent, from \$1,944 to \$2,517; total State-Funded debt increased by \$11.5 billion to \$48.5 billion during the past five years alone.⁴ Additionally, over the past several years, debt issuances traditionally used to finance capital improvements have been relied on more to finance non-capital asset spending as well. Debt continues to increase, and yet the State has failed to provide a comprehensive assessment of its ability to repay the debt.

Furthermore, changes in the Act were merely statutory and not constitutional. This lack of permanency is a fundamental flaw that has allowed the Legislature and the Executive to circumvent the law with artful legislative language. For instance, in response to the court decision on the Campaign for Fiscal Equity, the 2006-07 Enacted Budget provided \$9.4 billion in debt authorization for New York City school construction through Building Aid Revenue Bonds (BARBs) that allows the City to assign State building aid payments in support of the bonds.

This approach to finance the City's school construction is not captured under the definition of the 2000 reforms and, therefore, does not count toward the debt cap authorized in the Act. Although it is expected that the BARBs will be reported as a City, rather than a State, liability in accordance with Generally Accepted Accounting Principles (GAAP), in order to get a full accounting of State taxpayer debt burden and improve openness and transparency, it is imperative that these bonds also be counted as State-Funded debt, since the debt service is entirely dependent on future State Building Aid payments. The two measures are not mutually exclusive.⁵

Without constitutional changes, the 2000 reforms provide no guarantee of adherence to reform principles and as recently as this fiscal year, the Legislature and the Executive have sidestepped the restraints each time that debt could be used to solve their budgetary troubles. In fact, this

⁴ To provide a clearer and more comprehensive assessment of New York's indebtedness, in a reform measure initiated in 2005, the Comptroller introduced a specific measure of all debt funded by State resources termed "State-Funded debt." State-Funded debt includes all debt where principal and interest is paid either directly or indirectly by the State. Totalling \$48.5 billion at the beginning of State Fiscal Year (SFY) 2006-07, this measure includes General Obligation bonds, obligations associated with the State tobacco revenue stream, bonds issued to finance prior year school aid claims by the Municipal Bond Bank Agency on behalf of various school districts, obligations issued to refinance New York City's Municipal Assistance Corporation obligation and other State-Supported debt as defined in the State Finance Law.

⁵ The City is expected to recognize the BARBs as a debt in their Generally Accepted Accounting Principles (GAAP) based financial statements because the City accounts for all activities of the TFA, a blended component unit of the City; however, the debt is not a general obligation of the City and is exclusively dependent upon future State aid for repayment.

year's circumventing of the caps through the authorization of \$9.4 billion in BARBs is not unprecedented. Since its passage, the State has actually issued \$4.6 billion through the Tobacco Settlement Financing Corporation to finance deficits; \$511 million by the Municipal Bond Bank Agency to finance prior year school aid claims; and \$2.6 billion through the Sales Tax Asset Receivable Corporation to refinance (and extend) existing debt originally issued in 1976 to finance New York City's deficit by the Municipal Assistance Corporation. The combined effect of these authorizations and issuances total an additional \$17.1 billion outside of the Act's definition and, therefore, outside of the statutory limitation.

As a solution to the State's enormous and ever-growing debt burden, Comptroller Hevesi continues to call for the establishment of a Debt Management Board to develop a measure of affordability and annually assess the State's level of debt within the context of affordability. When the State's plan to issue debt exceeds the affordability threshold, the Board would play a role in prioritizing projects and determining acceptable debt issuances.

In reviewing the State's total debt position, this Debt Affordability Study evaluates three key debt ratios:

- Debt outstanding as a percentage of personal income,
- Debt outstanding per capita, and
- Debt service as a percentage of revenues.

This Study finds that New York has the highest debt service ratio of any state within the peer group (nearly one and one-half times higher than the peer median), the second highest debt per capita (nearly three times higher than the peer median) and the second highest debt to personal income ratio (over two and one-quarter times higher than the peer median). Only New Jersey has a higher per capita debt and higher debt to personal income ratio.

The ratios have not changed significantly from the last Study, primarily due to State-Funded debt outstanding only increasing by \$300 million in SFY 2005-06.⁶ Furthermore, growth in personal income in New York State outpaced growth of outstanding debt over the course of the year, so the ratio of debt outstanding to personal income declined somewhat.

This Study illustrates that plans to issue an additional \$30.5 billion in State-Funded debt, while less than half this amount, or \$14.7 billion, was retired

⁶ Although the 2005-06 Enacted Budget authorized an additional \$13.2 billion in new debt, much of the debt authorized was scheduled to be issued in the later years of the Capital Plan.

over the next five years will serve to exacerbate the State's debt situation.⁷ The net result will be a 32.5 percent increase in the debt burden, raising outstanding debt by \$15.7 billion by 2011. This further increases the debt per capita from \$2,517 in SFY 2006 to \$3,297 by SFY 2011 and the debt service to revenues ratio from 4.4 percent to 5.6 percent during the same time period.

The implementation of recommended actions outlined in this Study, as originally presented in December 2005, will effectively curtail the growth of debt and provide a framework for structuring future debt issuances.⁸ The Debt Reform Act of 2000 set a cap on outstanding State-Supported debt at 4 percent of personal income. State-Funded outstanding debt burden is well above this cap, reaching 6.5 percent of personal income on March 31, 2006. Since State-Funded debt is currently above the statutory cap, the amount of debt will have to be reduced to a reasonable and affordable level. This Study recommends a method that would reduce State-Funded debt to 5 percent of personal income within eleven years by restricting State-Funded debt issuance to 95 percent of the previous year's level, achieving the capped level in SFY 2016-17.

These actions, combined with the establishment of a constitutional definition of State-Funded debt and a Debt Management Board, will provide New York State with the ability to effectively manage the State's burgeoning debt. The amount of new debt authorized in the 2006-07 Enacted Budget illustrates that the longer we wait for comprehensive reform, the more difficult it will be to achieve and sustain affordable debt levels.

If the State were to implement reform and limit the issuance of additional State-Funded debt to 95 percent of the prior year issuance level, this action would slow issuance of and growth in outstanding debt to \$61.0 billion in State-Funded debt outstanding by 2011—representing a reduction of \$3.2 billion from the current plan's projections. The State would issue \$4.1 billion less over the five-year period.

It is further recommended that the State increase its use of cash financing of capital projects in the years where there is a surplus, as well as dedicate

⁷ Between 1996-97 and 2003-04, the State issued approximately \$3 billion in new State-Supported debt annually. Beginning in 2003-04, the State began issuing debt that was not included in the Capital Plan, such as the \$4.6 billion by the Tobacco Settlement Financing Corporation. When the new debt authorized for the TFA is added to the 2006-07 Capital Program and Financing Plan projections, issuance in 2007-08 will exceed \$9 billion—a threefold increase from the historical average.

⁸ Office of the State Comptroller. "Debt Affordability Study." December, 2005.

EXECUTIVE SUMMARY

a portion of those funds to the early retirement of existing debt where appropriate.

Careful capital monitoring and planning, the establishment of realistic debt limits and a comprehensive review of additional borrowing proposals can reduce New York State's debt burden. More importantly, taking these steps would establish a framework for the State to control the growth of future debt and ensure the State's capacity to borrow and repay. The Comptroller continues to pursue debt reform and calls upon the new Governor and legislative leaders to enact these recommended reforms since they are essential to our State's long-term fiscal health.

Introduction

On December 20, 2005, the State Comptroller issued the first Annual Debt Affordability Study. The affordability concept was initially conceived in a report outlining the Comptroller's debt reform agenda entitled *New York's Debt Policy: A Need for Reform*, issued in February 2005. This report included a thorough analysis of the State's borrowing practices and a comprehensive package of recommended constitutional and statutory reforms to restore accountability, limit debt to an affordable level and provide more transparency. The seven-point reform proposal is comprised of the following provisions:

- Constitutionally define State-Funded debt,
- Limit State-Funded debt outstanding to 5 percent of personal income,
- Statutorily limit debt issuance to 95 percent of previous year issuance until the 5 percent of personal income threshold is achieved,
- Require voter approval for annual issuances exceeding \$1 billion, authorize multiple ballot initiatives and consolidate the issuance of State-Funded debt,
- Improve accountability and transparency with expanded oversight by the Public Authorities Control Board to over 200 public authorities,
- Mandate intergenerational equity and efficiency through the use of standards and guidelines, and
- Create a Debt Management Board and annually publish a realistic measure of debt affordability.

The Need for an Annual Debt Affordability Study

Recognizing that prudent debt management and capital planning should include a comprehensive annual assessment of debt affordability, the State

Comptroller, as part of the comprehensive debt reform package, called for the creation of a Debt Management Board to establish debt management policy and regularly monitor and report on the State's debt affordability level. During the 2006 legislative session, both the Assembly and the Senate introduced a constitutional and legislative reform package based on the Comptroller's proposals. The Comptroller continues to pursue his comprehensive reform agenda and, absent the existence of a Debt Management Board, is again taking the initiative to publish this Debt Affordability Study (the Study) so the State can effectively establish and implement a manageable and affordable long-term Capital Plan.

Debt affordability can be described as a measure of debt relative to the ability to repay. There are a number of measures that are useful in quantifying affordable debt levels. Popular measures of affordability include debt per capita, a comparison of outstanding debt to a measure of taxable revenue base (personal income or full value of taxable property) and a comparison of debt service to a measure of capacity or ability to pay (receipts). This Study uses three indicators to measure the State's ability to afford additional debt and as a basis for comparison to the national average and to a group of peer states, including:

- The ratio of State-Funded debt outstanding to personal income,
- State-Funded debt service to All Funds revenues, and
- State-Funded debt outstanding per capita.

Debt capacity is a limited resource that should be used only after careful analysis of all funding sources and spending needs. This Debt Affordability Study examines the State's ability to issue debt to finance critical infrastructure needs throughout the State and reinforces the prudent debt principles, including the immediate need to produce measures of debt affordability, as stipulated in the Comptroller's February 2005 report on New York's debt policies.

This Study will provide the necessary framework for the State to structure future debt issuances within current and projected resource constraints. The Study is premised on the concept that resources, as well as needs, should be considered in the development and implementation of State borrowing.

The methodology used in this Study follows an analytical approach, which measures the true State-Funded debt burden, rather than the statutory measures of State-Supported debt often used by the State.

A Debt Affordability Study can also provide a framework to evaluate the effect of the State's debt level on its credit standing. The Study, coupled

with other reforms articulated by the State Comptroller, can help the State improve its credit ratings and lower the costs of its debt.⁹ A Debt Affordability Study is generally viewed favorably by the rating agencies when evaluating issuers and assigning credit ratings. Standard and Poor's stated in a June 2002 report: "Capital planning and, more recently, debt affordability models or guidelines that evaluate capital requirement and funding sources and assess the future impact of current bond programs are strong management tools."¹⁰ Furthermore, according to a Fitch Ratings report, data affordability guidelines "are viewed as most valuable in Fitch's debt management analysis."¹¹

⁹ The State's General Obligation debt is currently rated AA/Aa3/AA- by Standard and Poor's Ratings Services, Moody's Investors Service and Fitch Ratings, respectively. Note that while General Obligation bonds are considered the "state" credit, various New York State revenue bond credits, including the Personal Income Tax Revenue bonds and bonds issued by the Local Government Assistance Corporation have been upgraded to AAA by Standard and Poor's, the highest rating available and above the State's General Obligation (GO) rating. In addition, Standard and Poor's also increased the rating on the Dedicated Highway and Bridge Trust Fund bonds issued by the Thruway Authority to AA from AA-. In these instances, Standard and Poor's primarily illustrated strong revenue growth and stability as a reason for an upgrade.

¹⁰ Standard and Poor's Ratings Services. "Stability and Resilience Led Six U.S. Counties to 'AAA' Status in Past Year." June, 2002.

¹¹ Fitch Ratings, Ltd. "12 Habits of Highly Successful Finance Officers." November, 2002.

Review of Credit Ratings

Credit ratings are rating agencies' assessment of the probability of a debt issuer's ability and willingness to repay debt on a timely basis. Credit ratings are a primary factor in determining the interest cost that debt issuers are required to pay when they go to market, as well as the on-going costs of liquidity support agreements associated with certain variable rate debt. Rating agencies have indicated that prudent debt management practices, including the use of debt affordability studies, are positive factors in assigning credit ratings.

There are several factors rating agencies analyze in assigning credit ratings. Significant weakness in any single category, including financial results and economic environment, level of reserves, debt portfolio, and fiscal administration and management, will hold ratings down. However, weakness in any one area may be offset by strength in another.

For rating agencies, the level of available reserves a state has may indicate financial stability, flexibility and the capacity to meet financial obligations, including the payment of debt service during times of fiscal stress. In 1998, the State established the Debt Reduction Reserve Fund (DRRF) with the goal of supplementing pay-as-you-go (PAYGO) spending and paying debt service or paying down existing, outstanding debt.¹²

For State Fiscal Years (SFYs) 1999 through 2002, \$1.1 billion in revenues was deposited into the DRRF and was utilized for its intended purpose. In the 2006-07 Enacted Budget, the Legislature again made a deposit of \$250 million to the DRRF, bringing the total to \$1.3 billion over the last eight years.

¹² See Section 97-rrr of the State Finance Law.

While the State’s objective for the DRRF is commendable, the amount of funds dedicated to retire debt only minimally affected outstanding debt levels. In fact, between SFYs 1999-2006, the State issued \$36.3 billion in new debt, representing an increase of 44.1 percent. Putting aside the normal retirements the State experiences annually, the \$1.3 billion in DRRF retirements is a mere 3.6 percent as compared to growth in debt issued for that period. A key component to any debt reform package should include an ongoing, annual commitment to place a portion of surplus revenues in the DRRF to retire outstanding debt and/or to increase the use of PAYGO spending.

The State’s General Obligation bonds are rated AA- by Fitch Ratings (Fitch), Aa3 with a “stable” outlook by Moody’s Investors Service (Moody’s) and AA with a “stable” outlook by Standard and Poor’s Ratings Services (S&P). All three agencies base their General Obligation ratings on the State’s strong and diverse economic base, with its high debt levels, persistent out-year gaps and a politically charged budget process. Rating agencies place emphasis on consistently maintaining adequate reserves and overcoming fiscal challenges posed by local spending pressures.

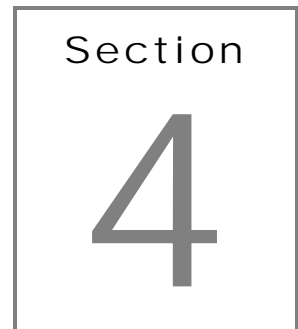
Figure 1

State of New York General Obligation Credit Ratings		
<i>(as of November 16, 2006)</i>		
	Rating	Outlook
Fitch Ratings	AA-	Stable
Moody’s Investors Service	Aa3	Stable
Standard and Poor’s Ratings Services	AA	Stable

Rating agencies also rate other New York credits, such as the Dedicated Highway and Bridge Trust Fund (DHBTF) bonds, Personal Income Tax (PIT) Revenue bonds, Local Government Assistance Corporation (LGAC) bonds, Sales Tax Asset Receivable Corporation (STARAC) and various appropriation backed credits issued by public authorities on behalf of the State. In the past, the State’s General Obligation credit garnered the highest rating among New York State credits because of the pledge of the State’s full faith and credit and the fact that the debt service did not require an appropriation to be paid. Most appropriation-backed bonds have been typically rated lower due to the required appropriation. However, Fitch and Moody’s currently rate PIT bonds the same as General Obligation bonds for two primary reasons. First, these bonds are backed by 25 percent, or \$6 billion, of the State personal income tax—the State’s largest revenue source. Second, while the State budget has been enacted late for 20 of the last 22 years, the annual debt service bill has been enacted on time for the last 12 years. This decision on the part of the Executive and the

REVIEW OF CREDIT RATINGS

Legislature has contributed to improved GO ratings because debt service payments are ensured to continue without uncertainty of payment or interruption. Standard and Poor's recently upgraded the ratings for PIT Bonds and bonds for LGAC and STARC to AAA, a full step above the State's General Obligation credit, primarily due to an improved economic environment and revenue flow.



New York City Transitional Finance Authority

Chapter 16 of the Laws of 1997 (Enabling Act) established the New York City Transitional Finance Authority (TFA, "Authority"). This Authority was created in order to allow the City of New York access to a financing mechanism for general City capital purposes since it was near its constitutional debt limit and needed a way to provide funds for its capital plan. The Authority was initially provided with the authorization to issue up to \$7.5 billion in bonds. The Act was amended in 2000 and 2006 to increase the amount of bonds the Authority could issue for general City capital purposes to a current total of \$13.5 billion. Debt service on the bonds is funded by revenues from the City personal income tax and, if necessary, sales tax revenues and also, in certain instances, State Building Aid.¹³

The Enabling Act was also amended in 2001 to authorize the Authority to have up to \$2.5 billion of bonds and notes outstanding to pay costs related to or arising from the September 11 attack on the World Trade Center (Chapter 297 of the Laws of 2001). The TFA can issue bonds without limitation secured solely by State and federal funding related to or arising from the September 2001 terrorist attacks. These bonds are not counted against the TFA debt cap for general City capital purposes.

The School Financing Act (Part A-3 of Chapter 58 of the Laws of 2006) included as part of the 2006-07 Enacted Budget authorized the Authority to

¹³ Page 2 of the Official Statement for the New York City Building Aid Revenue Bonds, Fiscal 2007 Series S-1, dated November 9, 2006 indicates that the City's portion of State Building Aid that was assigned to the New York City Transitional Finance Authority (TFA) will also be available to support debt service on the bonds issued for general City capital purposes prior to the first issuance of the TFA Building Aid Revenue Bonds (BARBs) in November 2006, as well as certain other TFA expenses, should the personal income and sales tax revenues be insufficient.

have an additional \$9.4 billion in bonds outstanding in order to finance a portion of New York City's five-year educational facilities capital plan, as well as all costs of issuance, debt service reserves, refunding bonds and any capitalized interest, which is expressly authorized without limitation. This new \$9.4 billion authorization is structured as a revolving cap on the amount of debt outstanding as opposed to a maximum cap on the amount of debt to be issued. Therefore, as the principal on these bonds is paid, additional debt can be issued by the TFA.

The School Financing Act also authorized the City, acting through the Mayor, to assign all or a portion of the City's State Building Aid (State aid payable to the City or its school district pursuant to subdivision 6 of section 3602 of the Education Law) to the Authority, at which point it becomes the property of the Authority. Pursuant to this authorization, the City assigned all of its State Building Aid to the TFA.

The TFA created a new category of subordinate debt secured solely by the assigned Building Aid, and issued the first \$650 million of Building Aid Revenue Bonds (BARBs) on November 16, 2006. The TFA has indicated that it does not expect to use other statutory revenues to secure these bonds in the future.¹⁴ Payment of State Building Aid is subject to annual appropriation by the State. Although these bonds do not fall within the statutory definition of State-Supported debt, in its review of these bonds, Moody's Investors Service "...views this as a state appropriation credit, due to the fact that the debt is secured by a strong state commitment to Building Aid payments to the city, which are subject to state appropriation."¹⁵ While Standard and Poor's does not specifically identify the credit as a State credit like Moody's, the credit summary and rating report offer similar analysis of the funding stream.¹⁶

¹⁴ See Page 3, Official Statement for the New York City Transitional Finance Authority, Future Tax Secured Bonds Fiscal 2007 Series A, \$500,000,000 Subseries A-1 Tax-Exempt Subordinate Bonds, \$200,000,000 Subseries A-2 Taxable Subordinate Bonds.

¹⁵ Moody's Investors Service. "Moody's Assigns A1 Rating to \$650 Million NYC Transitional Finance Authority Building Aid Revenue Bonds." October 27, 2006.

¹⁶ Standard and Poor's. "New York City Transitional Finance Authority's State Bldg Aid Revenue Bonds Rated AA-." October 31, 2006.

The City plans to issue approximately \$4.7 billion in BARBs through 2010 according to the following schedule:

(in millions)

FY 2007	FY 2008	FY 2009	FY 2010	Total
\$1,278	\$1,394	\$1,394	\$635	\$4,701

Source: Exhibit A-3, New York City Financial Plan, Four-Year Capital Plan Funding Sources, November 2006. This Study recognizes the TFA BARBs as State-Funded debt, and the tables throughout this Study include these bonds with other State-Funded obligations.

The School Financing Act is yet another example of the inadequacy of the Debt Reform Act of 2000. The bonds are not included in the statutory definition of State-Supported debt, but are exclusively dependent on State funding for repayment.

Additionally, the Act authorized the City to permanently assign its portion of State Building Aid to the TFA. There is also no limit on the ultimate amount of BARBs that can be issued by the TFA since the cap is on the outstanding amount and as bonds are repaid, additional bonds can be issued.

Although it is expected that the BARBs will be reported as a City rather than a State liability in accordance with Generally Accepted Accounting Principles (GAAP), in order to get a full accounting of State taxpayer debt burden and improve openness and transparency, it is imperative that these bonds also be counted as State-Funded debt, since the debt service is entirely dependent on future State Building Aid payments. The two measures are not mutually exclusive.¹⁷

While it may not be readily apparent, all State taxpayers will be responsible for financing a large portion of the City's school construction plan(s)—at least \$9.4 billion, plus interest in State resources will be necessary to pay off this City long-term capital plan spending.¹⁸ Further, it is important to point out that this debt will neither count toward the City's constitutional or State's statutory debt limits. While this debt does count toward TFA's statutory debt limit of \$9.4 billion, this cap is revolving, meaning as the debt is repaid, more can be issued.

¹⁷ The City is expected to recognize the BARBs as a debt in their Generally Accepted Accounting Principles (GAAP) based financial statements because the City accounts for all activities of the TFA, a blended component unit of the City; however, the debt is not a general obligation of the City and is exclusively dependent upon future State aid for repayment.

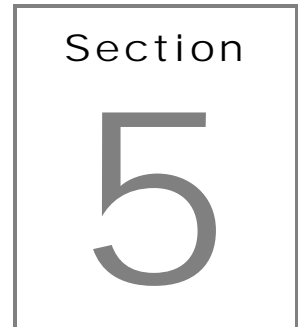
¹⁸ The City periodically updates the multi-year capital plan. The current plan relies upon issuances of \$4.7 billion in TFA BARBs over the next five-year period; however, future updates may include additional TFA BARBs.

Similar to certain other State-Funded obligations, such as the \$2.6 billion issued by the Sales Tax Asset Receivable Corporation (STARC), which pledged \$170 million in annual State sales tax revenue provided through the Local Government Assistance Corporation (also subject to annual appropriation), the State will not directly pay debt service for BARBs issued by TFA. Instead, the cost to the State will be a local assistance payment to the City or its assignee. Again, similar to STARC's annual \$170 million payment, the State Building Aid payments constitute 100 percent of the revenue available to support the debt service on the BARBs.

Debt Affordability

Authorizing localities or public benefit corporations to pledge future revenues to be received from the State establishes a State obligation that is one step removed from back-door borrowing where the State is contractually obligated to make payments to public benefit corporations and/or public authorities equal to the debt service payments made by the authority. In those cases, however, payments made to public authorities under these funding streams are accounted for as debt service and the State's debt caps (as established in sections 67-a and 67-b of the State Finance Law) recognize these obligations. In the case of TFA education bonds, the debt does not appear as a State obligation on its books, and there is no contractual obligation compelling payment.

The bonds issued by the TFA, STARC, the Tobacco Settlement Finance Corporation and the bonds issued by the Municipal Bond Bank Agency to finance prior school aid claims are NOT counted as debt under section 67-a of the State Finance Law. The payments from the State—in all cases the sole source of funding for these bonds—is not counted as debt service subject to the statutory caps. Instead, payments are either considered as local assistance or contingent obligations, thus providing an incomplete budgetary accounting of the State's true debt burden. The decision made by the Legislature and the Executive to structure the BARBs in this manner is, to date, the largest obligation not counted under the State's debt cap established in 2000. Any enacted reform must prohibit this type of debt or any future, similar obligation from circumventing the law.



State-Funded Debt Outstanding

New York's State-Funded debt portfolio utilizes a complex mix of dedicated, pledged or assigned resources in which many of the taxes and revenues previously reported in the General Fund have been moved to other funds for the repayment of debt. To provide a comprehensive approach to measure debt burden and capacity, the State Comptroller introduced the measure of State-Funded debt, which accounts for **all** debt exclusively supported by State resources.

State-Funded debt includes all debt where debt service (principal and interest) is paid, directly or indirectly, by the State.¹⁹ It includes General Obligation bonds and other State-Supported debt as defined by Section 67-a of the State Finance Law, as well as obligations associated with the financing of the State tobacco settlement revenue stream (bonds issued by the Tobacco Settlement Financing Corporation [TSFC]), debt issued by the Sales Tax Asset Receivable Corporation (STARC) to refinance New York City's Municipal Assistance Corporation (MAC) obligation from the 1975 fiscal crisis and amortized prior year school aid claims (bonds issued by the Municipal Bond Bank Agency [MBBA]). In the future, it will include Building Aid Revenue Bonds (BARBs) issued by New York City's Transitional Finance Authority (TFA).

The State makes payments for State-Funded debt, either directly for General Obligation bonds or indirectly to a public authority, bank trustee or, on past occasions, municipal issuers (lease-purchase or contractual obligation) to enable such issuer to make payments on its outstanding

¹⁹ This Study considers State-Funded debt as bonds, notes and other bonded long-term obligations, reported on a cash basis and defined in the proposed statutory and constitutional changes associated with the Comptroller's debt reform package. See "New York State Debt Policy: A Need for Reform." <<http://www.osc.state.ny.us/press/debtreport2005.pdf>.>

bonds. As of March 31, 2006, the State had approximately \$48.5 billion in State-Funded debt outstanding (see Figure 2).²⁰ Voter-approved, General Obligation debt issued by the State comprised only 7 percent of this State-Funded debt burden, or approximately \$3.5 billion. Total State-Funded debt outstanding, as of March 31, 2006, includes \$7.3 billion of debt not counted as State-Supported, as narrowly defined in Section 67-a of the State Finance Law.²¹ It does not yet include the \$16.5 billion in new debt authorized in the 2006-07 Enacted Budget since most of it has yet to be issued and may not be by State fiscal year-end.

Figure 2

State of New York State-Funded Debt Outstanding	
As of March 31, 2006	
(in millions)	
General Obligation Bonds	\$3,470
State-Supported Authority Debt	<u>37,707</u>
Total State-Supported Debt	<u>\$41,177</u>
TSFC - Tobacco Securitization	4,278
STARC - MAC Refinancing	2,505
MBBA - Prior Year School Aid Claims	504
State-Funded Debt	<u>\$48,464</u>

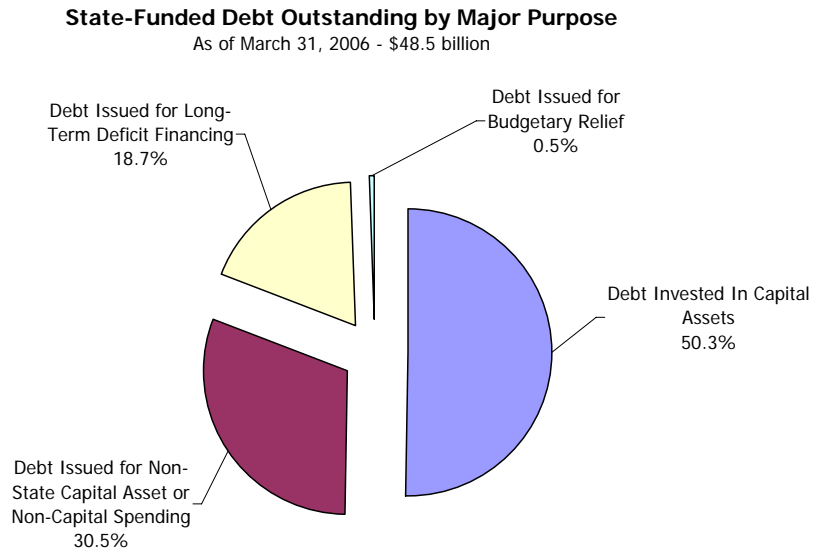
Source: New York State Office of the State Comptroller

²⁰ Debt figures throughout this Study, except where noted, are the original issue par amounts that remain outstanding and do not include adjustments for premiums, discounts, accretions, deferred losses or outstanding actions from the Debt Reduction Reserve Fund. This figure includes the Sales Tax Asset Receivable Corporation (STARC), which is a government created not-for-profit corporation and not a public authority.

²¹ Section 67-b of the State Finance Law states the following: "State-supported debt" shall mean any bonds or notes, including bonds or notes issued to fund reserve funds and costs of issuance, issued by the state or a state public corporation for which the state is constitutionally obligated to pay debt service or contractually obligated to pay debt service subject to an appropriation, except where the state has a contingent contractual obligation.

Figure 3 illustrates the State's outstanding debt itemized by major purpose as of March 31, 2006. In the State-Funded debt portfolio, of the \$48.5 billion outstanding, 50.3 percent, or \$24.4 billion, was issued to support or create State capital assets. Financing for primarily non-State capital asset or non-capital purposes was also provided equaling \$14.8 billion, or 30.5 percent. The remaining debt outstanding was used to finance annual and accumulated State deficits of \$9.1 billion, or 18.7 percent, and to refinance existing assets for budgetary relief of \$240 million. The use of debt for deficit financing or budgetary relief creates a long-term cost for future generations without creating an asset. Furthermore, it exacerbates structural imbalances because non-recurring resources are used for recurring expenses.

Figure 3

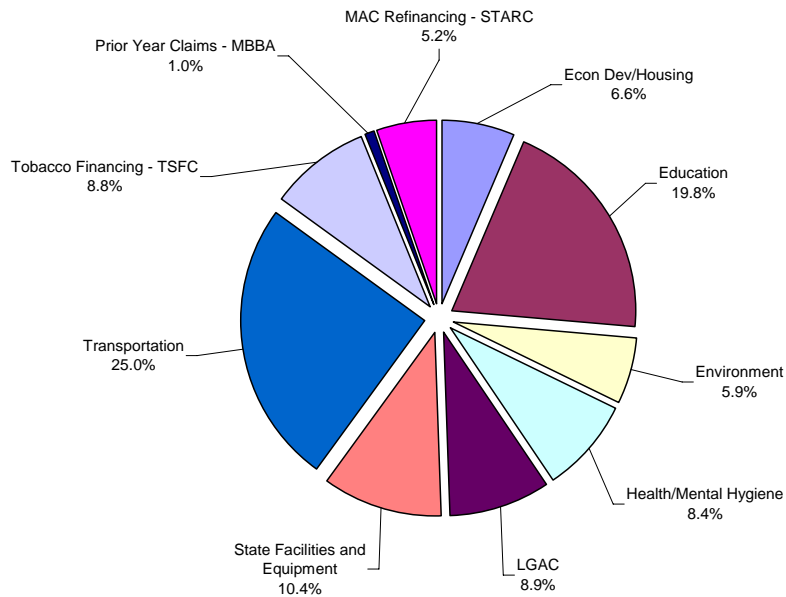


Source: New York State Office of the State Comptroller

Figure 4 illustrates State-Funded debt outstanding by major functional area invested for State-owned capital assets or other purposes as of March 31, 2006. Of the \$48.5 billion outstanding on March 31, 2006, transportation associated debt comprised the majority of debt outstanding (\$12.1 billion, or approximately 25 percent) with education, including higher education, holding the next highest share (\$9.6 billion, or 19.8 percent). Note that the \$7.7 billion (with \$7.3 billion outstanding as of March 31, 2006) in debt issued outside of the Debt Reform Act (TSFC, MAC refinancing – STARC and Prior Year School Aid Claims issued by the MBBA) makes up approximately 15 percent of total State-Funded debt outstanding.

Figure 4

Outstanding State-Funded Debt - 2005-06 Actual - \$48.5 Billion



Source: New York State Office of the State Comptroller

Rapidity of Repayment

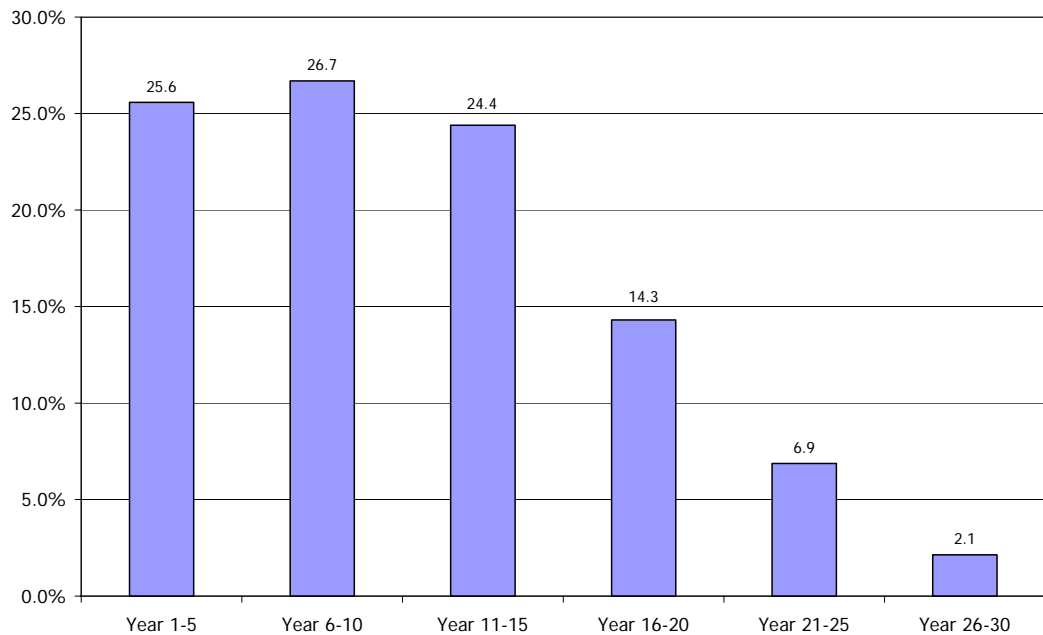
When issuing debt, the term of the debt should not exceed the useful or economic life of the underlying asset. The structure of payments and how that structure affects capacity and affordability are also important considerations. The rapidity of repayment or principal redemption measures how fast the State pays off its debt burden. According to Fitch, an issuer that pays off 65 percent of its debt within ten years is viewed

more favorably than one that pays off only 50 percent.²² Fitch considers it weak fiscal practice to pay off 35 percent or less in ten years.

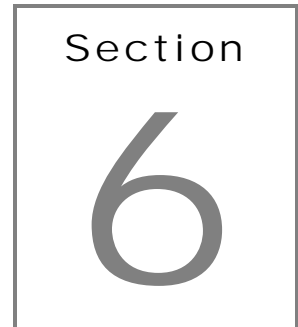
Currently, the State is scheduled to pay 52.3 percent of its State-Funded debt outstanding within ten years, which is below Fitch's criteria for favorable consideration of 65 percent; however, it is still well above the 35 percent indicator of weak fiscal practice. The payment structure of both new and existing debt directly affects this measure. Since 2003, the State has refunded and restructured over \$18 billion in outstanding debt. These refundings reconfigured portions of both the principal due in the current and near terms, as well as interest accrued on certain refunded debt. Many principal payments were restructured to eliminate or lower near term payments, thus increasing the future burden and adversely affecting future debt capacity.

Figure 5

Rapidity of Repayment - % Principal Redemption – State-Funded Debt Outstanding
as of March 31, 2006



²² Fitch Ratings Ltd. "The 12 Habits of Highly Successful Finance Officers." 2002.



State Debt Ratios

To facilitate peer group comparisons and better monitor affordability levels, it is useful to review debt ratios and analyze their change over time. This Study uses the following key ratios to assess the financial burden of outstanding debt: 1) debt outstanding as a percentage of personal income, 2) debt outstanding per capita, and 3) debt service as a percentage of revenues.

Debt to personal income indicates the burden a state's debt places on the income tax base, a primary source of revenue for New York State. Outside of federal funds, New York's personal income tax is the State's largest revenue source, comprising nearly 29 percent of All Funds receipts. The debt per capita measure allows the issuer to assess the actual and relative debt burden per taxpayer compared to other states. The level of debt service to All Funds revenues indicates the amount of flexibility that the issuer has in its budget.

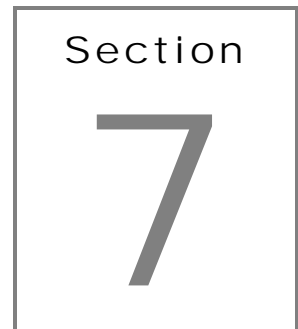
Figure 6 provides a presentation of the State's indebtedness and debt ratios as of March 31, 2006, compared to March 31, 2001 and March 31, 2005 when the first Debt Affordability Study was issued last year by the Comptroller. State-Funded debt outstanding increased by \$11.5 billion, or 31.1 percent, between 2001 and 2006. State-Funded debt outstanding to personal income increased from 6.0 percent to 6.5 percent, but decreased from 7 percent in 2005, primarily due to personal income growing faster than outstanding debt. State-Funded debt outstanding per capita increased by \$573, from \$1,944 in 2001 to \$2,517 in 2006—a slight increase from \$2,509 in 2005. The State-Funded debt service to All Funds revenue ratio declined from 5.4 percent to 4.4 percent from 2001, with a slight increase from 4.2 percent in 2005. The decline from 2001 is largely due to refundings over the last several years, including restructurings that temporarily lowered debt service costs.

Figure 6

State of New York				
State-Funded Debt Ratios at Year End 2001, 2005 and 2006				
	State-Funded Debt Outstanding (millions)	State-Funded Debt to Personal Income	State-Funded Debt Per Capita	Debt Service to All Funds Revenue
SFY 2001	\$36,958	5.96%	\$1,944	5.36%
SFY 2005	\$48,249	7.00%	\$2,509	4.20%
SFY 2006	\$48,464	6.54%	\$2,517	4.44%

To correspond to the limits established in the Debt Reform Act of 2000 and for comparison purposes, this report uses the ratio of State-Funded debt service as a percentage of All Funds receipts to measure annual debt burden. While it is reasonable to use All Funds receipts as a basis of comparison, included in this revenue is federal funding, much of which is earmarked for specific purposes and cannot be used for debt service needs. For a more thorough and comprehensive assessment of the State's debt service burden, the State may want to begin measuring debt service against State generated revenues.²³ This will more adequately measure the State's debt service burden compared to State generated revenues available for repayment. If the ratio of State-Funded debt service to State-generated receipts were used, the State would have a ratio of 6.0 percent, as compared to 4.4 percent of All Funds (as of March 31, 2006). If comparing State-Funded debt service with State generated receipts, the ratio would grow from 6.0 percent in 2005-06 to 8.2 percent in 2010-11.

²³ State generated revenues include all revenues generated within the State, including taxes, fees and tobacco settlement revenues used to pay debt service on Tobacco Settlement Financing Corporation bonds. It does not include federal funding.



Comparison of State Debt Ratios to Selected Medians

A comparison to national and peer group medians is useful to provide context to New York's debt position as compared to other states. The peer group in this Debt Affordability Study is represented by those states with the highest populations—California, Texas, Florida, Illinois, Pennsylvania, Ohio, Michigan, Georgia, New Jersey and North Carolina. In April 2006, Moody's published the *2006 State Debt Medians* report, which included its annual analysis of state debt medians. As shown in Figure 7, New York's State-Funded debt to personal income ratio, the State-Funded debt per capita ratio and the State-Funded debt service to All Funds revenues ratio are all significantly above the medians published in the Moody's report.

Figure 7 also details the peer group comparison for the three debt ratios evaluated. The debt to personal income and debt outstanding per capita ratios for peer states are taken from Moody's *2006 State Debt Medians* report, while the debt service to revenue ratio has been calculated using data from the most recent Comprehensive Annual Financial Report available for each state. Ratios for New York use the State Comptroller's measure of State-Funded debt, rather than Net Tax-Supported debt as presented in the Moody's report because State-Funded debt provides for a more accurate measure of New York's true debt burden.²⁴

As shown in Figure 7, New York has the highest debt service as a percentage of All Funds receipts in the peer group of large states at 4.4 percent, followed by Illinois at 4.2 percent. New York's ratio is 1.63 times higher than the peer

²⁴ Moody's measure of Net Tax-Supported debt includes State-Guaranteed Job Development Authority debt, Moral Obligation debt and debt associated with the State Secured Hospital Program. The Comptroller's State-Funded debt measure does not include these obligations because they are not directly supported with State resources. As a result, Moody's figure for Net Tax-Supported debt is approximately \$1.6 billion higher than the Comptroller's State-Funded measure.

COMPARISON OF STATE DEBT RATIOS TO
SELECTED MEDIANS

group and 1.26 times higher than the national average as last measured by Moody's Investor Services. New York's debt service as a percentage of All Funds revenue increased slightly between 2005 and 2006 from 4.2 percent to 4.4 percent.

In terms of debt per capita, New York's \$2,517 per capita debt burden is second only to New Jersey at \$3,276 within the peer group. New York's debt per capita is nearly three times the peer group of the ten largest states and more than three times the national median.

Within the peer group, New York's debt as a percentage of personal income of 6.5 percent is second to New Jersey at 7.9 percent. New York's debt as a percentage of personal income is more than two times the median, as compared to both the ten largest states and the nation.

Between 2005 and 2006, the comparison of ratios between New York and the nation and peer states improved in both debt per capita (3.01 times higher than peer states and 3.57 times higher than the nation, as compared to 2.93 and 3.34 times higher respectively in 2006) and debt as a percentage of personal income (2.44 times higher than peer states and 2.91 times higher than the nation as compared to 2.28 and 2.62 times higher respectively in 2006). However, the comparisons increased for debt service as a percentage of revenues (1.47 times higher than peer states and 1.2 times higher than the nation, as compared to 1.63 and 1.26 times higher, respectively, in 2006). The decline in outstanding debt ratios is primarily due to temporary slow growth in New York's debt outstanding, whereas debt service is increasing faster than normal largely due to changed payment structures as a result of refundings and restructurings over the last three years.

COMPARISON OF STATE DEBT RATIOS TO
SELECTED MEDIANS

Figure 7

Peer Group Comparisons					
	General Obligation Bond Rating (Fitch/S&P/Moody's)	2005 Debt (\$000)	2005 Debt Per Capita (\$)	2005 Debt as % of 2004 Personal Income	2005 Debt Service as % of All Funds Receipts *
California	A/A+/A2	57,697,000	1,596	4.6%	3.9%
Texas	AA+/AA/Aa1	7,017,682	307	1.0%	1.0%
Florida	AA+/AAA/Aa1	17,357,380	976	3.2%	2.8%
Illinois	AA/AA/Aa3	25,863,606	2,031	5.9%	4.2%
Pennsylvania	AA/AA/Aa2	9,476,910	762	2.3%	1.7%
Ohio	AA+/AA+/Aa1	10,490,319	915	2.9%	3.5%
Michigan	AA/AA/Aa2	6,909,000	683	2.1%	1.8%
Georgia	AAA/AAA/Aaa	7,110,040	784	2.7%	3.0%
New Jersey	AA-/AA/Aa3	28,562,000	3,276	7.9%	2.6%
North Carolina	AAA/AAA/Aa1	6,985,135	804	2.8%	1.7%
Peer Median		9,983,615	860	2.9%	2.7%
National Median		3,590,062	754	2.5%	3.5% **
New York - 2005-06	AA-/AA/Aa3	48,464,211	2,517	6.5%	4.4%
New York - 2004-05	AA-/AA/A1	48,248,981	2,509	7.0%	4.2%
NYS Ratio to Peer Median - March 31, 2006			2.93	2.28	1.63
NYS Ratio to National Median - March 31, 2006			3.34	2.62	1.26

* Note that Debt Service and All Funds Revenue are from each state's Statement of Revenues, Expenditures, and Changes in Fund Balances contained within the state's 2005 Comprehensive Annual Financial Reports. Consequently, reported debt service does not include payments reported in proprietary funds that are supported by proprietary fund resources. New York's debt service includes SUNY and CUNY obligations from proprietary funds that are not self-supporting.

** Last Published by Moody's in 1996.

Sources:

Comprehensive Annual Financial Reports from Fiscal Years Ending in 2005 for listed states

Moody's Investors Services, *2006 State Debt Medians*, May 2006

US Census Bureau

US Bureau of Economic Analysis

Global Insight

New York State Office of the State Comptroller, *New York State's Debt Policy - A Need For Reform*, February 2005

New York State Division of the Budget, *2006-07 Enacted Budget Capital Program and Financing Plan*, May 2006 - Updated October 2006

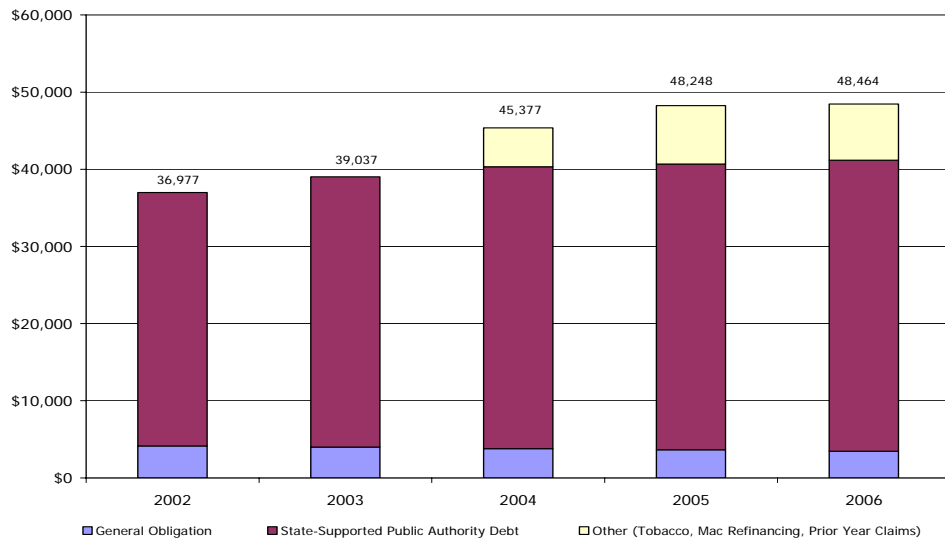
Section
8

Growth in State-Funded Debt Outstanding and Debt Service

It is necessary to review the rate at which debt has grown as part of the evaluation of the State's debt capacity and affordability. While the State has made substantial investments in infrastructure over time, it has also used debt to finance other non-capital spending. Total State-Funded debt grew by 31.1 percent, or \$11.5 billion, since SFY 2002, increasing from \$37.0 billion to \$48.5 billion at March 31, 2006. This represents an average annual growth rate of 7.8 percent. Figure 8 illustrates the total State-Funded debt outstanding at the end of SFYs 2002 through 2006.

Figure 8

State Funded Debt Outstanding
SFY 2001-02 to SFY 2005-06
(in millions)



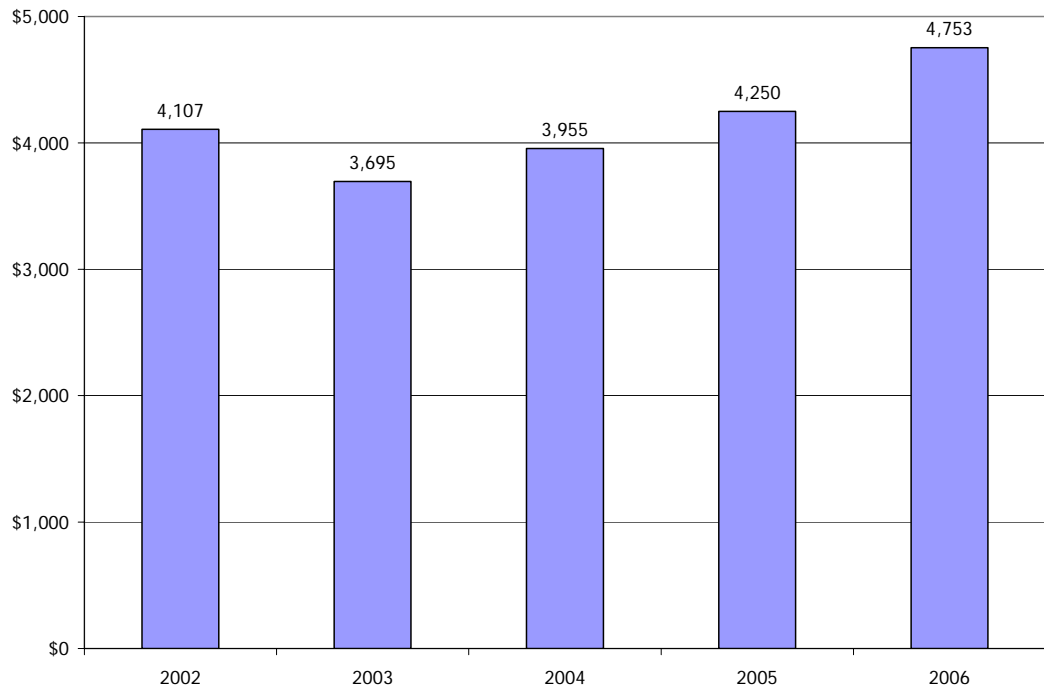
Source: New York State Office of the State Comptroller

GROWTH IN STATE-FUNDED DEBT
OUTSTANDING AND DEBT SERVICE

State-Funded debt service remains relatively unchanged when comparing SFY 2001-02 to SFY 2005-06, despite significant growth in State-Funded debt outstanding (see Figure 9). The slower growth in State-Funded debt service during this period of increasing State-Funded debt outstanding is primarily attributable to: the restructuring of debt through refundings to defer some principal payments to future years, the increased use of variable rate debt and interest rate exchange agreements, and lower interest rates.

Figure 9

State-Funded Debt Service
SFY 2001-02 to SFY 2005-06
(in millions)



Source: New York State Office of the State Comptroller

Section
9

Capital Program and Financing Plan

The Executive is statutorily required to annually submit to the Legislature a five-year Capital Program and Financing Plan with the proposed State budget. The Plan is required to include a comprehensive assessment of the capital assets and program needs of all State agencies, as well as a review and analysis of how such needs would be financed. The statute also requires an analysis of the affordability of State-Supported debt and an analysis of all costs related to financing the plan.²⁵

The Capital Program and Financing Plan is financed by four major sources of funds: current resources of the State (often referred to as pay-as-you-go), federal funds, General Obligation bonds and bonds issued by public authorities on behalf of the State. Until the release of the 2006-07 Capital Program and Financing Plan in January, the assumptions and information in the Capital Program and Financing Plan related only to State-Supported debt. However, starting in 2006-07, the Capital Program and Financing Plan was broadened to also account for the financing supported by future tobacco settlement revenues by the Tobacco Settlement Financing Corporation (TSFC) and the financing of prior year school-aid claims by the Municipal Bond Bank Agency (MBBA). This most recent Capital Program and Financing Plan includes retirement, debt levels and debt service information for TSFC and MBBA obligations, as well as moral obligations, contingent contractual obligations and State-Guaranteed debt.²⁶ Still absent

²⁵ Section 22-c of the State Finance Law.

²⁶ These other categories, along with State-Supported debt, are termed "State-Related Debt" by the Executive. Note that this measure does not include obligations issued by the Sales Tax Asset Receivable Corporation or the State-Funded portion of debt issued by the Transitional Finance Authority. The State has not been called upon to make payments for moral obligation debt since 1987. The State has never been called upon to make payments on contingent contractual obligations or State-Guaranteed debt.

from the Capital Program and Financing Plan is the inclusion of debt related to the Municipal Assistance Corporation for New York City (MAC) refinancing by the Sales Tax Asset Receivable Corporation (STARC).

To provide a comprehensive illustration of the State's true debt burden, obligations from STARC and the State's share of Transitional Finance Authority's Building Aid Revenue Bonds (BARBs) are included in this study.²⁷

Projected State-Funded Debt Issuance

Figure 10 represents the projected State-Funded debt issuance over the next five years pursuant to the Capital Program and Financing Plan updated October 30, 2006.²⁸ The table represents all planned State-Funded debt issuance associated with current and past Capital Plans.

Figure 10

State of New York Projected State-Funded Debt Issuances 2006-07 through 2010-11 (in thousands of dollars)						
	SFY 2007	SFY 2008	SFY 2009	SFY 2010	SFY 2011	Total 2007-2011
General Obligation	226,800	403,000	545,300	628,300	588,300	2,391,700
Other State-Supported Public Authority	4,331,789	7,396,140	4,336,964	3,728,323	3,580,309	23,373,525
State-Share TFA	1,278,000	1,394,000	1,394,000	635,000	-	4,701,000
State-Funded Total Issuances	5,836,589	9,193,140	6,276,264	4,991,623	4,168,609	30,466,225

Source: New York State Division of the Budget, *2006-07 Enacted Budget Capital Program and Financing Plan*, the *New York City Financing Program* and New York State Office of the State Comptroller. Note that education bonds issued by TFA are scheduled to be issued in City Fiscal Years (July 1 to June 30). As such, issuance amounts may not match SFY (April 1- March 31) as listed above and in other tables throughout this Study.

Projected State-Funded Debt Retirement

The State can generate the capacity for additional debt through the retirement of outstanding debt. Figure 11 illustrates projected State-Supported debt retirements pursuant to the Capital Program and Financing Plan, scheduled retirements for the TFSC, the MBBA (as it relates to Prior Year School Aid Claims) and the Sales Tax Asset Receivable Corporation, as

²⁷ As the State will probably never be called to make payments on the little amount remaining of moral obligation, contingent contractual obligation or State Guaranteed debt, they are not included in this analysis.

²⁸ The annual issuance of Building Aid Revenue Bonds issued by New York City's Transitional Finance Authority (TFA) are from the New York City Financing Program updated in November 2006.

of March 31, 2006. Figure 11 also includes projected retirements for Building Aid Revenue Bonds issued by the New York City Transitional Finance Authority (TFA BARBs).

Figure 11

State of New York Projected State-Funded Debt Retirements 2006-07 through 2010-11 (in thousands of dollars)						
	SFY 2007	SFY 2008	SFY 2009	SFY 2010	SFY 2011	Total 2007-2011
General Obligation	352,072	351,599	356,200	366,982	380,288	1,807,141
Other State-Supported Public Authority	1,994,595	1,945,803	2,087,484	2,417,957	2,488,135	10,933,974
State-Supported Total Retirements	2,346,667	2,297,402	2,443,684	2,784,939	2,868,423	12,741,115
TSFC	228,350	244,350	318,370	342,905	368,370	1,502,345
State Share TFA			18,492	39,350	60,988	118,830
STARC	48,145	49,730	51,520	53,525	55,740	258,660
MBBA	20,025	20,770	21,620	22,590	23,700	108,705
State-Funded Total Retirements	2,643,187	2,612,252	2,853,686	3,243,309	3,377,221	14,729,655

Source: New York State Office of the State Comptroller, New York State Division of the Budget and New York City Office of Management and Budget

Projected State-Funded Debt Outstanding

According to issuance and retirement assumptions in the Capital Program and Financing Plan, as well as scheduled retirements for the TSFC, the Sales Tax Asset Receivable Corporation, and the MBBA (Prior Year School Aid Claims) and projected retirements for TFA BARBs, the State will directly or indirectly issue \$15.7 billion more than it will retire over the next five years (see Figure 12). Consequently, the State is projected to end the SFY 2010-11 with \$64.2 billion in outstanding State-Funded debt—representing an increase of 32.5 percent, or \$15.7 billion, from the \$48.5 billion outstanding at the start of SFY 2006-07.

Figure 12

State of New York Projected State-Funded Debt Outstanding 2006-07 through 2010-11 (in thousands of dollars)						
	SFY 2007	SFY 2008	SFY 2009	SFY 2010	SFY 2011	\$ Increase (Decrease) 2007 Beginning - 2011 End
Debt at Beginning of Period	48,464,211	51,657,613	58,238,501	61,661,079	63,409,393	
Issuance	5,836,589	9,193,140	6,276,264	4,991,623	4,168,609	30,466,225
Retirement	(2,643,187)	(2,612,252)	(2,853,686)	(3,243,309)	(3,377,221)	(14,729,655)
Projected Debt at End of Period	51,657,613	58,238,501	61,661,079	63,409,393	64,200,781	15,736,570

Source: New York State Office of the State Comptroller, New York State Division of the Budget, and New York City Office of Management and Budget

Projected State-Funded Debt Service

Annual State-Funded debt service is estimated to grow to \$7.1 billion by SFY 2011 assuming projected bond issuances of \$30.5 billion. Figure 13 shows projected debt service each year over the next five years, including debt service on currently outstanding debt and projected new debt issuances. By SFY 2010-11, State-Funded debt service is projected to be 5.6 percent of All Funds revenues, up from 4.4 percent in 2006. This increase is primarily due to the \$30.5 billion in new issuances over the next five years, but also reflects the effects of \$18 billion in debt refinanced or restructured between 2003 and 2006 in which certain principal payments were deferred to later years and are beginning to come due during this period.

Figure 13

State of New York Projected State-Funded Debt Service 2005-06 through 2010-11 (in thousands of dollars)								
	SFY 2006	SFY 2007	SFY 2008	SFY 2009	SFY 2010	SFY 2011	Total % Change 2006-2011	Total \$ Change 2006-2011
General Obligation	486,760	495,539	493,830	503,949	529,127	562,488	15.56%	75,728
Public Authority	3,217,596	3,815,653	4,057,875	4,656,024	5,041,891	5,513,718	71.36%	2,296,122
2006-07 Capital Plan (State-Supported)	3,704,356	4,311,192	4,551,705	5,159,973	5,571,018	6,076,206	64.03%	2,371,850
State-Funded TFA			72,079	158,699	246,383	290,866	100.00%	290,866
TSFC	430,842	437,581	443,989	503,296	510,539	517,063	20.01%	86,221
STARC	170,000	170,000	170,000	170,000	170,000	170,000	0.00%	-
MBBA	28,363	45,189	45,186	45,184	45,182	45,189	59.32%	16,826
Total Other	629,205	652,770	731,254	877,179	972,104	1,023,118	62.60%	393,913
Projected Debt Service (State-Funded)	4,333,561	4,963,962	5,282,959	6,037,152	6,543,122	7,099,324	63.82%	2,765,763

Source: New York State Office of the State Comptroller and New York State Division of the Budget

Effect of New Debt on Ratios

The planned issuance of \$30.5 billion in new debt will have an effect on the State's debt ratios over the next five years. Analyzing projected available resources and assumptions in the current Capital Plan, Figure 14 illustrates projected debt ratios from SFY 2007 to SFY 2011 (2006 figures are also included for comparison purposes). The ratio of State-Funded debt outstanding to personal income is projected to increase from 6.7 percent in SFY 2007 to 7.1 percent in 2008 and 2009, then decline to 7.0 percent and finally to 6.7 percent by SFY 2011. The ratio of State-Funded debt per capita is projected to rise from \$2,680 in SFY 2007 to \$3,297 by SFY 2011. The debt service to All Funds revenues ratio is projected to increase from 4.4 percent in SFY 2007 to 5.6 percent by SFY 2011, representing a more than 25 percent increase over this time period.²⁹

Figure 14

State of New York Effect of Projected New Debt Issuances on Debt Ratios						
	SFY 2006	SFY 2007	SFY 2008	SFY 2009	SFY 2010	SFY 2011
Personal Income (prior year - \$ millions)	\$741,275	\$771,568	\$824,544	\$865,452	\$908,861	\$957,197
State-Funded Debt to Personal Income	6.5%	6.7%	7.1%	7.1%	7.0%	6.7%
Population (millions)	19,255	19,273	19,323	19,372	19,421	19,470
State-Funded Debt Per Capita	\$2,517	\$2,680	\$3,014	\$3,183	\$3,265	\$3,297
All Funds Revenues (\$ millions)	\$107,339	\$112,517	\$115,895	\$120,840	\$124,367	\$127,726
State-Funded Debt Service to All Funds Revenues	4.4%	4.4%	4.6%	5.0%	5.3%	5.6%

Current State Resources – Pay-as-You-Go

The use of current State resources to support a portion of the State's Capital Plan is critical to achieving a balanced approach to meeting the State's capital needs. During the second half of the 1980s, the State used pay-as-you-go (PAYGO) financing for an average of 55 percent, and as much as 75 percent of its State-Funded Capital Plan. During the first half of the 1990s in which the first three years were in recession, the amount of PAYGO declined to an average of 30 percent, with a low of 13.5 percent in 1991, indicating the need for current resources in other budget areas. The use of current resources for State-Funded capital spending did increase somewhat during the latter half of the 1990s and into the next decade. But even though the State experienced the largest economic expansion in

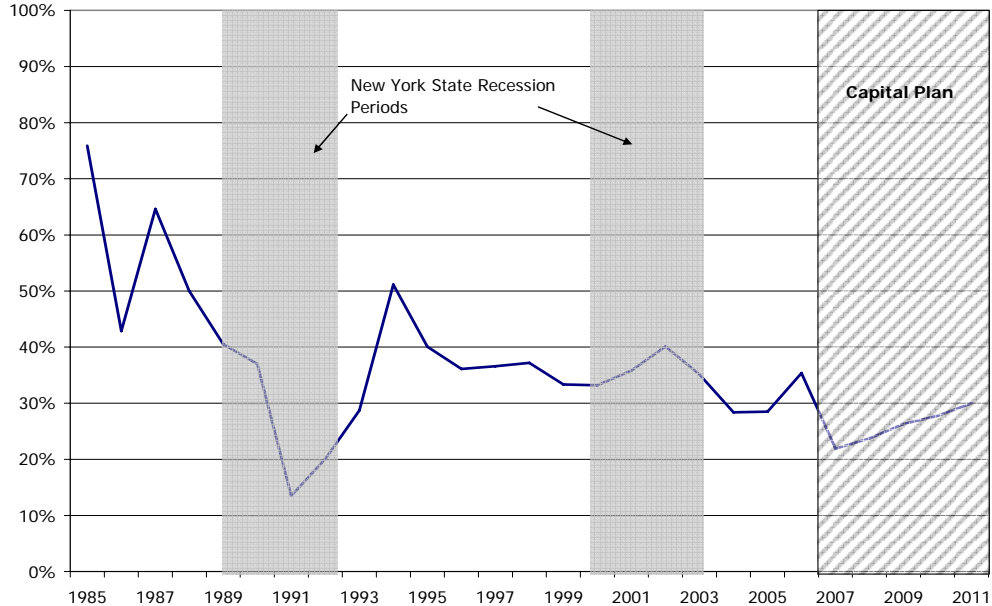
²⁹ Projections for personal income and population are provided by Global Insight Inc. Over the life of the plan, New York State personal income is projected to increase 22.1 percent, and population is projected to increase slightly over 1 percent. All Funds receipts projections are explained on Section 9 of this Study.

history and a number of multi-billion surplus years, the average annual use of PAYGO did not increase above 36.7 percent. If historical levels of PAYGO financing were used during the late 1990s expansion, the State's debt outstanding would be lower today.

Although the use of State cash increases steadily throughout the life of the 2006-07 Capital Program and Financing plan, the annual average is only 26 percent of total non-federal capital spending, significantly lower than the average annual PAYGO amount from 1985 to 2006 of 38.4 percent.³⁰ Utilizing current revenues for capital projects reduces the need to issue debt, thereby reducing future debt service, and is viewed positively by rating agencies. Increasing the use of PAYGO conserves debt capacity and reduces the burden passed to future generations. Furthermore, the increased capacity that results from increased use of PAYGO creates a buffer for those years when spending capacity is limited due to a downturn in the economy or other constraining circumstances. Figure 15 illustrates New York's continuing downward trend in the use of PAYGO as a percentage of non-federal capital spending.

Figure 15

PAYGO as a Percentage of Non-Federal Capital Spending



³⁰ Between 2006-07 and 2010-11, the amount of pay-as-you-go (PAYGO) increases from a low of 21.9 percent in SFY 2007 and increases to a high of 30 percent in SFY 2011.

Pay-As-You-Go and the Economy

The amount of current resources used to finance capital needs can be indicative of fiscal health. When a state or municipality is financially healthy or has accumulated a surplus, it can be inferred that it has increased ability to pay cash, instead of issuing additional debt for capital purposes.

As previously discussed, New York's use of current resources to finance capital projects has varied greatly throughout its recent history, ranging from over 75 percent of its non-federal capital program in 1985 to a low of only 13.5 percent in 1991. Between 1996 and 2001, the State enjoyed budgetary surpluses ranging from \$445 million to over \$3 billion. While the State did utilize \$1.1 billion in Debt Reduction Reserve Funds for either debt retirement or PAYGO financing between 1999 and 2002, the State, on average for those years, utilized cash for 38 percent of its non-federal capital financing. As a result of increasing debt and underutilizing cash financing during its years of surplus, the State created a greater debt service burden in times of need. While there is not an industry standard for PAYGO financing, rating agencies state that the level of PAYGO should be balanced as part of the larger financial picture.

Debt should be used as a policy tool and should be structured to support capital investment activity throughout a business cycle. Maintaining infrastructure and other capital projects should be a continuing process. During downturns in the economy when revenue collections fall, the State has the responsibility to ensure the continuation of these projects, along with other spending priorities.

Besides allowing these projects to continue during downturns in the economy, the use of debt also helps keep the economy from sliding further into recession as: 1) workers remain employed and 2) the State spends money purchasing goods and services from the private sector. This spending provides income to businesses, which in turn allows them to maintain a stable workforce during the recession. The continued employment and business income allows for higher levels of spending on other goods and services, which in turn builds the foundation for recovery.

However, as the economy improves and revenue collections increase, the additional money should be used to pay down the existing debt or to pay for capital projects by increasing PAYGO financing. Paying down the debt and using current resources in place of debt during upswings in the economy enables the State to keep debt levels manageable. Failure to do so during these times makes it more difficult to use this stabilizing tool in the future because the debt servicing costs will continue to grow, resulting

in increased borrowing costs that have the potential to lower the State's credit worthiness in bad economic times, thereby increasing the costs of borrowing when it may be needed the most.

Projected Revenues

In October 2006, the Division of the Budget released the 2006-07 Mid-Year Financial Plan Update, which projected All Funds receipts for the State out to SFY 2010-11. The forecasted growth over this period is expected to be 3.6 percent, with a high of 5.1 percent in SFY 2006-07 and a low of 2.7 percent in SFY 2010-11. Over the same period, the Division of the Budget forecasts an average annual rate of growth for personal income of 5.3 percent. This is consistent with other major forecasters, such as Global Insight, who expect the average annual rate of growth in New York to be 5.4 percent. Average annual growth rates of this magnitude assume that New York's economy will continue to grow at a moderate pace.

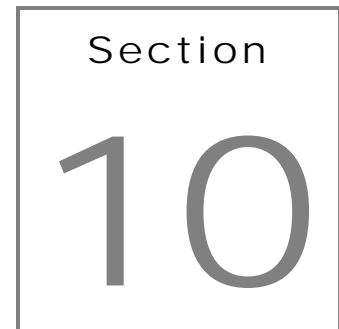
Figure 16

New York State All Funds Receipts	
(in millions)	
2000	\$73,409
2001	\$81,123
2002	\$83,247
2003	\$88,073
2004	\$98,989 (1)
2005	\$100,576
2006	\$107,339
2007*	\$112,517
2008*	\$115,895
2009*	\$120,840
2010*	\$124,367
2011*	\$127,726

* Projected

(1) Note that revenues from the 2003-04 fiscal year include \$4.2 billion in proceeds from bonds issued to finance the assignment of a portion of the State's future tobacco settlement revenues.

Source: New York State Office of the State Comptroller



Debt Reform Act of 2000 - Statutory Debt Limits

Chapter 59 of the Laws of 2000 added Article 5-B, sections 67-a and 67-b, to the State Finance Law. These provisions established statutory limitations, to be phased in beginning April 1, 2000, on State-Supported debt and are commonly referred to as the Debt Reform Act of 2000.

Unfortunately, the Debt Reform Act did little to provide fiscal discipline or ensure that future debt is affordable. The legislation made the following three statutory amendments:

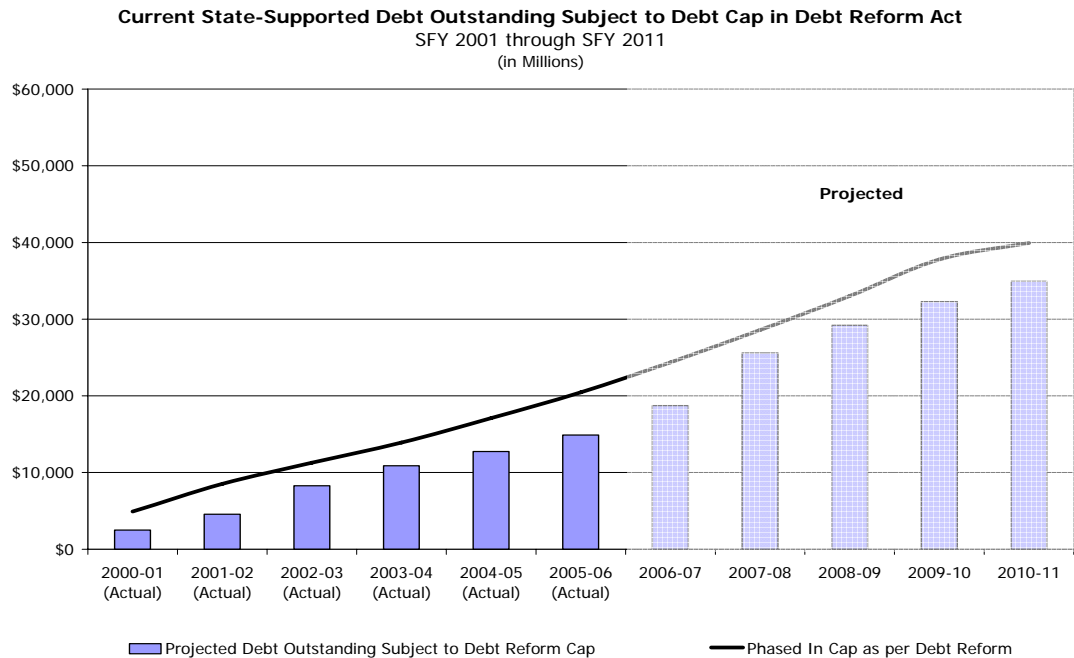
- Cap the level of debt outstanding to 4 percent of personal income for debt issued after April 1, 2000. This cap is phased in over 10 years and will reach 4 percent in SFY 2009-10.
- Cap debt service on new debt issued after April 1, 2000 at 5 percent of All Funds receipts. This cap is phased in over 13 years.
- Provide that debt can only be used for capital works or purposes and that State-Supported debt cannot have a maturity longer than 30 years.

According to the Division of the Budget, the State remains well under the caps established in 2000.³¹ However, the debt counted under these statutory State-Supported debt caps does not include all borrowing funded with State resources. Furthermore, the law ignored the roughly \$35 billion in outstanding debt that existed at the time of its enactment by excluding it

³¹ The Division of the Budget annually reports on debt that is counted under the cap along with other State-Supported debt outstanding.

from debt counted under the caps. To get a true picture of the State's obligations, it is necessary to consider all State-Funded debt as defined in this Study. Figures 17 through 19 compare the Debt Reform Act's measure of State-Supported debt outstanding subject to its cap with this Study's definition of State-Funded debt. Figure 17 shows, utilizing solely the statutory definitions, the State is currently below the cap with room to spare throughout the next five years.

Figure 17



Note: New Debt Projections Subject to Debt Reform Cap pursuant to February 2006-07 Capital Program and Financing Plan Updated in October 2006

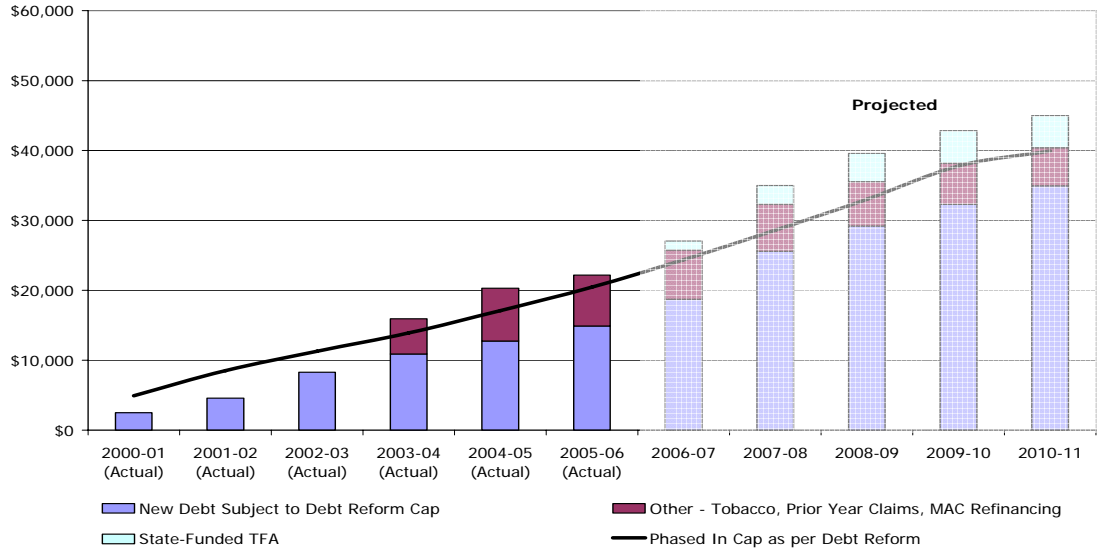
The fact that there is a gap between State-Supported debt outstanding and the statutory cap is misleading in that New York has authorized \$17.1 billion since 2003-04 that is not considered State-Supported as defined in section 67-a of the State Finance Law. This exclusion from the cap was done even though the debt service is funded exclusively with State resources. The 2006-07 Enacted Budget continues to exclude certain issues from the cap. For example, the cap does not account for \$9.4 billion to finance school construction in New York City to be issued by the Transitional Finance Authority (TFA). With these other obligations included, the State exceeds the statutory caps.³²

³² The City is expected to recognize the Building Aid Revenue Bonds (BARBs) as a debt in their Generally Accepted Accounting Principles (GAAP) financial statements because the City accounts for all activities of the New York City Transitional Finance Authority (TFA), a blended component unit of the City; however, the debt is not a general obligation of the City and is dependent upon future State aid for repayment.

DEBT REFORM ACT OF 2000 – STATUTORY
DEBT LIMITS

Figure 18

Current State-Supported Debt Outstanding Subject to Cap Plus Tobacco, Prior Year Claims and MAC Refinancing and State-Funded TFA
SFY 2001 through SFY 2011
(in Millions)

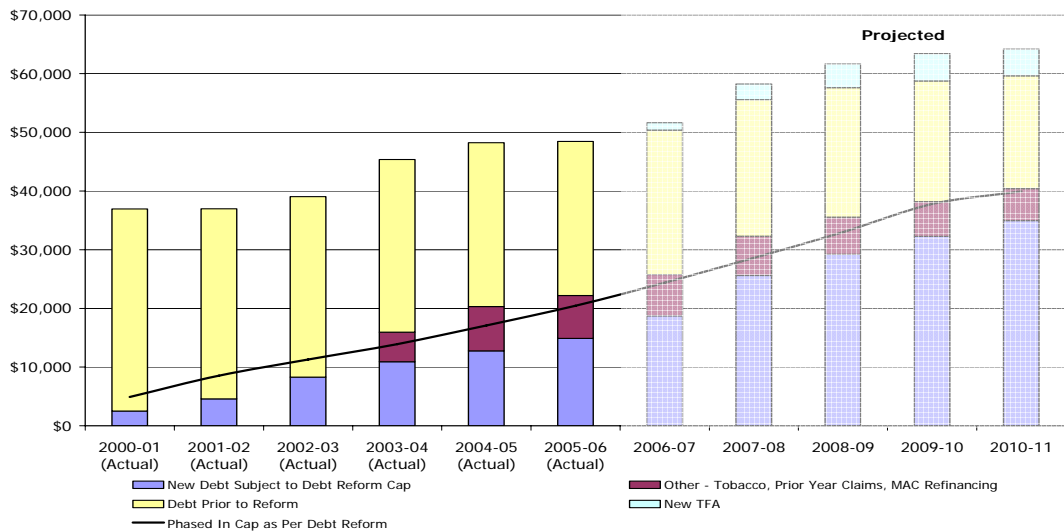


Note: New Debt Projections Subject to Debt Reform Cap pursuant to February 2006-07 Capital Program and Financing Plan Updated in October 2006

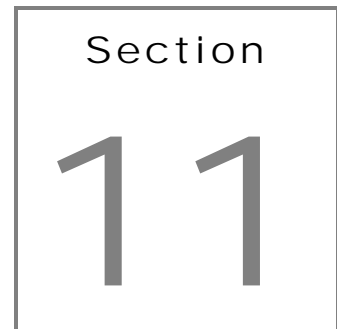
Finally, the Debt Reform Act of 2000 did not acknowledge outstanding debt that existed prior to April 1, 2000—nearly \$35 billion. If that debt is included, the caps were breached from the beginning.

Figure 19

Outstanding Debt Cap Projections - State-Funded Debt
SFY 2001 through SFY 2011
(in Millions)



Note: New Debt Projections Subject to Debt Reform Cap pursuant to February 2006-07 Capital Program and Financing Plan Updated in October 2006



Recommended Reductions in State-Funded Debt Outstanding

The projected level of State-Funded debt issuance over the next five fiscal years, as identified in this Study, is excessive and should be curtailed. An excessive debt burden limits the State's flexibility and could harm its future credit position. Debt and financial management policies should provide a framework to ensure that the issuance of additional debt is affordable. However, the existing policies and limitations implemented with the Debt Reform Act of 2000 will never effectively restrain the growth of debt because of various loopholes built into the law.

A comprehensive debt policy, including an all-encompassing definition of State-Funded debt coupled with real limits on debt issuance, is necessary to bring the State's debt burden to a more affordable level. Firm policies with respect to the limited issuance of future debt would help protect and perhaps enhance the State's credit ratings, particularly in view of potential future spending needs. At the same time, the State must ensure that necessary capital asset investment is not impaired. A debt limitation policy must balance the State's need to provide enough debt capacity to finance needed capital assets, while at the same time limiting the creation of an excessive debt service burden that could lead to a deteriorated credit position.

- ***State-Funded Debt Outstanding to Personal Income.*** This ratio is a key indicator of fiscal position because it compares debt levels to the tax base that generates revenues that can be used to repay debt. The State Comptroller's Debt Reform proposal recommends capping the level of State-Funded debt outstanding at 5 percent of personal income. If no reforms are enacted, the State-Funded debt outstanding to personal income ratio is projected to remain between 6.7 percent and 7.1 percent over the life of the Capital Program and Financing plan,

above the Comptroller's target level of 5 percent for this indicator. Although personal income typically grows faster than debt outstanding, the 2006-07 Enacted Budget adds a significant amount of new debt, primarily for education. This increase in debt issuance negates the growth in personal income which is why the ratio stays relatively the same throughout the Plan. The Comptroller recommends reducing outstanding State-Funded debt by limiting debt issuance to 95 percent of the previous year's issuances. In doing so, it is expected that the level of State-Funded debt outstanding will decline to an amount equal to 5 percent of personal income within SFY 2016-17. The State would reach the current statutory cap of 4 percent of personal income (if it applied to all State-Funded debt outstanding) in 2019-20 if the same issuance limitation were applied.

- ***State-Funded Debt Service to All Funds Revenues Ratio.*** This ratio illustrates the State's ability to respond to changes in revenue and spending by comparing the amount of State resources necessary to meet its debt obligations compared to its overall revenue base. The State's current ratio of 4.4 percent is projected to increase to 5.6 percent by SFY 2011, indicating that debt service is projected to consume a larger share of the State's resources.

While it is reasonable to use All Funds receipts as a basis of comparison, included in this revenue is federal funding, much of which is earmarked for specific purposes and cannot be used for debt service needs. A different assessment of the State's debt service burden would measure debt service against State generated revenues. This will more adequately measure the State's debt service burden compared to State generated revenues available for repayment. If comparing State-Funded debt service with State generated receipts, the ratio would grow from 6.0 percent in 2005-06 to 8.2 percent in 2010-11.

- ***State-Funded Debt Outstanding per Capita.*** This ratio measures the State debt burden per taxpayer and can be compared to other individual measures, such as wages or personal debt. According to Moody's, New York has the fifth highest State debt per capita in the nation behind Connecticut, Massachusetts, Hawaii and New Jersey. While this study does not include the local debt burden in its ratios of debt per capita, according to the U.S. Census Bureau, when combining state and local debt, New York jumps to having the second highest debt per capita in the country, behind Alaska.³³

³³ U.S. Census data of 2002 State and local debt.

State-Funded Debt Level With Recommended Issuance Limitations

If the State were to limit the issuance of additional State-Funded debt to 95 percent of the prior year issuance level, the State would have \$61 billion in State-Funded debt outstanding in 2011—representing a reduction of \$3.2 billion from the current plan (see figure 20). The State would issue \$4.1 billion less over the five-year period. This lower level of issuances would also affect planned retirements.³⁴

Figure 20

State of New York Proposed State-Funded Debt Outstanding 2006-07 through 2010-11 (in thousands of dollars)					
	SFY 2007	SFY 2008	SFY 2009	SFY 2010	SFY 2011
Debt at Beginning of Year	48,464,211	51,657,613	54,590,121	57,186,375	59,180,068
Issuance	5,836,589	5,544,760	5,267,522	5,004,145	4,753,938
Retirement	(2,643,187)	(2,612,252)	(2,671,267)	(3,010,453)	(2,962,572)
Debt at end of Year With Issuance Limit	51,657,613	54,590,121	57,186,375	59,180,068	60,971,434
Debt at end of Year Without Issuance Limit	51,657,613	58,238,501	61,661,079	63,409,393	64,200,781
					Difference
					\$ 3,229,347

The 2005 Debt Affordability Study indicated that should the State follow the Comptroller's recommended issuance limits and issue \$1.8 billion less over five years, the result would be \$1.7 billion less debt outstanding at the end of five years. The State did not enact those recommendations and instead authorized an additional \$16.5 billion in new debt in the 2006-07 Enacted Budget, further adding to State's debt burden, even if the Comptroller's recommendations are enacted today. The debt added in the 2006-07 Enacted Budget illustrates that the longer these reforms are ignored, the worse the situation will become.

Figure 21

State of New York Projected State-Funded Debt Issuance 2006-07 through 2010-11 (in thousands of dollars)						
	SFY 2007	SFY 2008	SFY 2009	SFY 2010	SFY 2011	Total
General Obligation	226,800	403,000	545,300	628,300	588,300	2,391,700
Other State-Supported Public Authority	4,331,789	7,396,140	4,336,964	3,728,323	3,580,309	23,373,525
State-Funded TFA	1,278,000	1,394,000	1,394,000	635,000	-	4,701,000
Sub-Total (inc TFA)	5,836,589	9,193,140	6,276,264	4,991,623	4,168,609	30,466,225
95% Issuance Limit	5,836,589	5,544,760	5,267,522	5,004,145	4,753,938	26,406,954
Difference	-	3,648,380	1,008,742	(12,522)	(585,329)	4,059,271

³⁴ For the purposes of this Study, retirements were lowered proportionately beginning in 2008-09.

RECOMMENDED REDUCTIONS IN STATE-
FUNDED DEBT OUTSTANDING

Figure 22

State of New York					
Effect of Projected New Debt Issuances on Debt Ratios					
	SFY 2007	SFY 2008	SFY 2009	SFY 2010	SFY 2011
State-Funded Debt Outstanding to Personal Income - Without Issuance Limitation	6.7%	7.1%	7.1%	7.0%	6.7%
State-Funded Debt Outstanding to Personal Income - Reduced Issuance	6.7%	6.6%	6.6%	6.5%	6.4%
State-Funded Debt Outstanding Per Capita - Without Issuance Limitation	\$2,680	\$3,014	\$3,183	\$3,265	\$3,297
State-Funded Debt Outstanding Per Capita - Reduced Issuance	\$2,680	\$2,825	\$2,952	\$3,047	\$3,132
State-Funded Debt Service to All Funds Revenues - Without Issuance Limitation	4.4%	4.6%	5.0%	5.3%	5.6%
State-Funded Debt Service to All Funds Revenues - Reduced Issuance	4.4%	4.6%	4.8%	5.0%	5.2%

Recommendations

The State is well above the benchmark for outstanding State-Funded debt, as recommended in the Comptroller's February 2005 report, *New York State's Debt Policy - A Need for Reform*. Prioritizing capital spending and the use of future debt capacity is imperative before debt grows to a level that significantly impairs the State's ability to respond to other spending needs. Furthermore, the State needs to take additional steps to increase accountability and transparency in its debt management process, as well as effectively constrain additional debt by establishing meaningful limits on new debt issuances.

Establish a Debt Management Board

Clearly, New York State has to be held accountable for its actions regarding every State dollar, including those gained as a result of debt issuances. In order for this to take place, New York State should establish an effective oversight mechanism for new and refunded debt, as well as outstanding obligations. Over time, the voting public has been virtually excluded from managing the amount, the timing and the purpose of borrowed *public* dollars. The taxpaying public should have an understanding and a voice in the process.

Currently, the Division of the Budget and the Executive control a substantial portion of the process. The establishment of a Debt Management Board would provide coordinated monitoring and reporting of all debt, including debt issued by public authorities. The State Comptroller, the fiscal watchdog for the State, should be as active in planning, implementing, reporting and managing the State's borrowing from beginning to end, as the Executive. Furthermore, a qualified representative of the general public, knowledgeable and experienced in public finance, accounting or economics, should provide a voice outside of the budget-making process.

To increase accountability, complete and transparent information regarding debt practices and plans must be readily available to all New Yorkers. The creation of a Debt Management Board made up of the State Comptroller, the Executive and the public would be responsible for the assessment of Executive and legislative proposals and would be prepared to balance oversight with risk management practices.

The Debt Management Board would establish overall debt policy and regularly monitor and report on the State's debt affordability level. It also would have the authority to adopt guidelines and standards addressing the issuance of bonds and the management of bond proceeds and establishing guidelines for refinancing.

Limit State-Funded Debt Outstanding

In order to reduce the State's debt burden, the State Comptroller recommends limiting outstanding State-Funded debt to 5 percent of personal income. Since the State's current State-Funded debt burden is higher than the Comptroller's recommended limit (6.5 percent as of March 31, 2006), there is a need to limit future debt issuances to 95 percent of the prior year's issuances to not only slow the growth of outstanding debt, but eventually reduce outstanding debt until the recommended level is reached.

Prioritize Capital and Non-Capital Spending Needs

The State must stop issuing debt to finance deficits or to provide budget relief. Currently, almost 20 percent of State-Funded debt outstanding, or nearly \$9.4 billion, has no associated asset. That represents almost 9 percent of 2005-06 All Fund revenues. The debt service on this deficit financing is over \$775 million annually. Furthermore, almost 30 percent of outstanding State-Funded debt created assets for entities other than the State, even though State-wide resources will pay the debt service.

Risk

There are always risks that could jeopardize the Financial Plan and the State's ability to pay for spending needs. A notable risk to the financial and capital plans are the manner in which the State responds to the court order regarding the Campaign for Fiscal Equity (CFE) lawsuit; the risk associated with the CFE does not end with the current lawsuit. There has been significant debate on the possibility that other school districts around the State may file similar lawsuits.

RECOMMENDATIONS

In June 1995, the CFE filed a lawsuit challenging the constitutionality of the State's public school financing. In 2003, the State Court of Appeals issued a final decision requiring the State to determine the actual cost of providing a sound basic education in New York City, enact and implement appropriate reforms, and implement a system of accountability by July 30, 2004. With no formal State response by the court ordered deadline, the State Supreme Court appointed a three-member Special Master Panel, which studied the issue and, on November 30, 2004, recommended the State pay \$5.6 billion a year to New York City schools for operating expenses and another \$9.2 billion for capital costs such as constructing new schools. Governor Pataki appealed the court ruling, stating it is the Legislature's, and not the Court's, job to make education-funding decisions. On November 20, 2006, the State Court of Appeals effectively lowered the required operating aid to \$1.93 billion annually (in 2004 dollars).

The 2006-07 Enacted Budget authorized an additional \$9.4 billion in new debt to be issued by New York City's Transitional Finance Authority. The State share of this authorization, along with an additional \$1.8 billion provided to the City from the Expanding our Children's Education and Learning (EXCEL) program, also from the 2006-07 Enacted Budget, makes up the State's share of the New York City five-year capital plan for education (\$6.5 billion, or 50 percent). The additional capital funding is intended to address the capital portion of Court requirements.

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