
Review of the Financial Plan of the City of New York

Report 3-2018



OFFICE OF THE NEW YORK STATE COMPTROLLER

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Message from the Comptroller

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As the State's chief financial officer, I have a constitutional and statutory responsibility to monitor the finances of the City of New York.

This report discusses the economic, fiscal and social challenges facing New York City in an effort to promote an informed discussion. I encourage every City stakeholder to learn more about these issues and to participate fully in the public debate.

Thomas P. DiNapoli
State Comptroller



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I. Executive Summary

On June 6, 2017, the City of New York adopted a budget for fiscal year 2018, the earliest the City has adopted a budget since 1992. The next day, the City submitted a modification to the FY 2017 financial plan and a new four-year financial plan covering fiscal years 2018 through 2021 (“the June Plan”) to the New York State Financial Control Board (see Figure 1). The June Plan reflects the adopted budget for FY 2018 and other technical changes.

The City projects a surplus of nearly \$4.2 billion in FY 2017, the largest since FY 2008. The surplus was generated from unneeded reserves (\$2.1 billion) and a citywide savings program (\$1.8 billion), and was used to balance the FY 2018 budget.

Although the FY 2018 budget is balanced, the out-year budget gaps have grown over the past year. The City now projects budget gaps of \$3.5 billion in FY 2019, \$2.8 billion in FY 2020 and \$2.3 billion in FY 2021.

The gaps are still relatively small as a share of City fund revenues (averaging 4.3 percent), and are manageable under current conditions. The budgets for these years include annual reserves of \$1.25 billion. If not needed, the reserves could be used to narrow the projected gaps.

Despite the favorable outlook, a number of trends deserve close watching. Tax collections, after increasing at an average annual rate of 6.9 percent during fiscal years 2011 through 2015, slowed to less than half that rate in FY 2016. Last year collections slowed further, to 1.8 percent, as nonproperty taxes declined for the first time since FY 2010.

Job creation has slowed as the labor market has tightened. (The unemployment rate fell from its recessionary peak of 10 percent to 4 percent in March 2017, the lowest level in 41 years.) The City is on pace to add 70,000 jobs in 2017, compared with 86,000 in 2016 and an average of 128,000 in each of the two prior years.

The current job expansion, which is already the largest on record and the second-longest in duration, will be the longest if it continues to the end of 2017. The June Plan assumes that the expansion will continue without interruption. With each passing year, however, the likelihood of an economic setback grows because changes in the business cycle are inevitable.

The municipal work force is the largest since the fiscal crisis, and the cost of employee health insurance and debt service is projected to grow more than twice as fast as tax revenues during the financial plan period.

City-funded spending (after adjusting for reserves and savings from prior years’ expenses) is projected to rise by 5.8 percent, which is three times faster than inflation.

Notwithstanding these trends, changes in federal fiscal policies present the greatest and most imminent risk to the City’s financial outlook. The June Plan anticipates the receipt of \$7.8 billion in federal aid in FY 2018, representing more than 9 percent of the operating budget.

The President’s proposed budget is the first step in the federal budget process and offers clues to the programs most at risk. The proposed budget focuses heavily on cuts to social safety net and nondefense discretionary programs. The Office of the State Comptroller (OSC) estimates that this budget would reduce federal funding to the City’s operating and capital budgets by \$827 million in the current fiscal year. The House Budget Committee recently approved a blueprint that calls for deep cuts in Medicare, Medicaid and other safety net programs.

The U.S. House of Representatives approved legislation that would roll back the gains made under the Affordable Care Act (ACA). The ACA greatly increased the number of Americans with health insurance by offering subsidies to

taxpayers who purchase health insurance and by giving states the option to expand Medicaid eligibility to 138 percent of the federal poverty level, with the federal government paying most of the cost.

The Congressional Budget Office estimated that up to 23 million Americans would lose health insurance by 2026 (including 14 million Medicaid enrollees) under the House bill. Medicaid funding to the states would be cut by a total of up to \$834 billion over 10 years.

The Governor estimated that the House bill would cost New York State \$6.9 billion over four years. An estimated 1.1 million City residents would be at risk of losing Medicaid coverage, and another 460,000 could lose coverage through insurance plans offered by the State's health insurance exchange.

Regardless of the outcome of legislative proposals in the U.S. Senate to roll back or repeal the ACA, the debate over health care and Medicaid funding to the states will likely continue. Any reduction in Medicaid funding could have an impact on the State's budget, which could affect the amount of aid the City receives from the State.

The Health and Hospitals Corporation also continues to face serious financial challenges. Changes in the health care law could further complicate the Corporation's financial outlook.

Given these risks, the City has prudently increased the general reserve to a record \$1.2 billion in FY 2018 and has set aside \$250 million in the Capital Stabilization Reserve. It has also replenished the Retiree Health Benefits Trust, which now has a record balance of nearly \$4.2 billion.

OSC has identified other budget risks of up to \$443 million in FY 2018 and slightly larger amounts in subsequent years (see Figure 2). However, these risks could be offset by the general reserve and other resources that are likely to materialize during the fiscal year. For example, it is likely that the City will reduce the size of its reserve for property tax offsets, such as delinquencies, as the fiscal year progresses.

In conclusion, the City's economy is strong, the FY 2018 budget is balanced and the out-year gaps are manageable under current conditions. While potential changes in federal fiscal policies constitute the greatest risk to the City since the Great Recession, the City has increased its reserves to record levels. In light of the risk, the City should continue to identify opportunities for agency savings, which will provide added budgetary flexibility.

FIGURE 1
New York City Financial Plan
(in millions)

	FY 2018	FY 2019	FY 2020	FY 2021
Revenues				
Taxes				
General Property Tax	\$ 25,812	\$ 27,539	\$ 28,905	\$ 30,028
Other Taxes	30,138	31,246	32,459	33,688
Tax Audit Revenue	850	721	721	721
Subtotal: Taxes	\$ 56,800	\$ 59,506	\$ 62,085	\$ 64,437
Miscellaneous Revenues	6,488	6,648	6,863	6,850
Unrestricted Intergovernmental Aid	---	---	---	---
Less: Intra-City Revenue	(1,815)	(1,737)	(1,739)	(1,744)
Disallowances Against Categorical Grants	(15)	(15)	(15)	(15)
Subtotal: City Funds	\$ 61,458	\$ 64,402	\$ 67,194	\$ 69,528
Other Categorical Grants	880	868	859	856
Inter-Fund Revenues	671	664	602	602
Federal Categorical Grants	7,811	7,014	6,915	6,901
State Categorical Grants	14,419	14,872	15,371	15,727
Total Revenues	\$ 85,239	\$ 87,820	\$ 90,941	\$ 93,614
Expenditures				
Personal Service				
Salaries and Wages	\$ 27,250	\$ 28,625	\$ 29,426	\$ 30,065
Pensions	9,572	9,871	9,943	10,005
Fringe Benefits	10,111	10,816	11,715	12,505
Retiree Health Benefits Trust	---	---	---	---
Subtotal: Personal Service	\$ 46,933	\$ 49,312	\$ 51,084	\$ 52,575
Other Than Personal Service				
Medical Assistance	5,915	5,915	5,915	5,915
Public Assistance	1,594	1,605	1,617	1,617
All Other	28,803	27,723	27,760	28,000
Subtotal: Other Than Personal Service	\$ 36,312	\$ 35,243	\$ 35,292	\$ 35,532
Debt Service	6,528	7,225	7,861	8,331
FY 2016 Budget Stabilization & Discretionary Transfers	---	---	---	---
FY 2017 Budget Stabilization	(4,169)	---	---	---
Capital Stabilization Reserve	250	250	250	250
General Reserve	1,200	1,000	1,000	1,000
Subtotal	\$ 87,054	\$ 93,030	\$ 95,487	\$ 97,688
Less: Intra-City Expenses	(1,815)	(1,737)	(1,739)	(1,744)
Total Expenditures	\$ 85,239	\$ 91,293	\$ 93,748	\$ 95,944
Gap to be Closed	\$ ---	\$ (3,473)	\$ (2,807)	\$ (2,330)

Source: NYC Office of Management and Budget

FIGURE 2
OSC Risk Assessment of the New York City
Financial Plan
(in millions)

	<i>Better/(Worse)</i>			
	FY 2018	FY 2019	FY 2020	FY 2021
Gaps Per NYC Financial Plan	\$ ---	\$ (3,473)	\$ (2,807)	\$ (2,330)
Debt Service	125	---	---	---
Miscellaneous Revenues	75	75	75	75
Pension Contributions	---	140	280	425
Special Education Medicaid Reimbursement	(79)	(79)	(79)	(79)
Uniformed Agency Overtime	(125)	(125)	(125)	(125)
Homeless Shelters	(125)	(125)	(125)	(125)
Tax Revenues	(150)	(150)	(150)	(150)
Health and Hospitals Corporation	(164)	(164)	(164)	(164)
Sale of Taxi Medallions	---	(107)	(257)	(367)
Sales Tax Asset Receivable Corporation	---	(150)	---	---
Revenue from HHC Development Opportunities	---	---	(100)	---
OSC Risk Assessment¹	(443)	(685)	(645)	(510)
Potential Gaps Per OSC^{2,3}	\$ (443)	\$ (4,158)	\$ (3,452)	\$ (2,840)

¹ Wage increases at the projected inflation rate after the expiration of current agreements could increase the City's costs by \$90 million in FY 2018, \$270 million in FY 2019, \$691 million in FY 2020 and \$1.3 billion in FY 2021. The agreements have yet to be negotiated. As a result, the actual cost could be less or greater than the estimate based on the projected inflation rate.

² The June Plan includes a general reserve of \$1.2 billion in FY 2018 and \$1 billion in each of fiscal years 2019 through 2021, which, if not needed, could be used to help close the projected budget gaps. In addition, the Capital Stabilization Reserve has a balance of \$250 million in each of fiscal years 2018 through 2021.

³ The Retiree Health Benefits Trust, which the City has used in the past as a rainy-day fund, has a balance of nearly \$4.2 billion.

II. Economic Trends

New York City's economy remains strong, but job growth has slowed as the labor market has tightened. While moderate job growth is likely to continue, at least in the near term, potential changes in federal fiscal and monetary policies could significantly impact the local economy.

The National Economy

The nation added 13.9 million jobs between 2010 and 2016, nearly double the number lost during the Great Recession. Despite solid gains, growth has been uneven throughout the nation, with employment in nine states still below prerecession levels in 2016.

National employment reached a record 146 million jobs in June 2017. However, job growth slowed from 2.1 percent in 2015 to 1.7 percent in 2016. While it remains solid, job growth has slowed further to an annualized rate of 1.5 percent during the first half of 2017.

The nation's gross domestic product (GDP) grew by only 1.5 percent in 2016, which was one of the slowest years during the recovery. Although the first quarter of 2017 was weak (1.2 percent), most economists expect annual growth to pick up to 2.2 percent.

The unemployment rate declined to 4.3 percent in May 2017 (a 16-year low) and remained near that level in June (4.4 percent). Initial claims for unemployment insurance are at their lowest levels since the 1970s. A broader measure of unemployment that includes those who have stopped looking for work and those in part-time jobs who want full-time positions has dropped to the lowest level since before the Great Recession (8.4 percent).

Despite strong job growth, inflation has been muted during the current recovery. However, the Federal Reserve expects inflation to pick up as wage pressures grow.

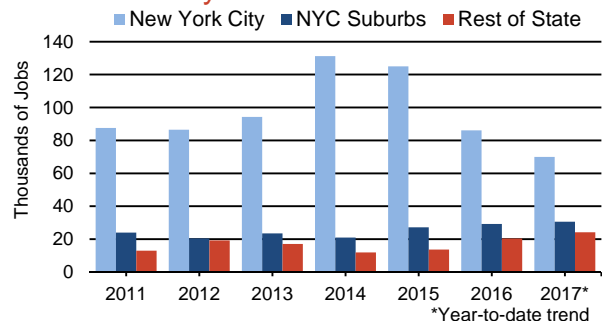
After keeping interest rates near zero for seven years to help support the economy, the Federal Reserve began to increase short-term interest rates in December 2015. The Fed has raised rates three additional times (with the last increase in June 2017) and has indicated it will raise rates further. The Fed also intends to begin reducing its \$4.5 trillion balance sheet, which was expanded to support the financial system.

New York State

Between 2009 and 2016, New York State added 855,900 jobs (three and a half times the number lost during the recession). More than 90 percent of the jobs were added in the downstate region (i.e., New York City, Long Island, and Westchester, Rockland and Orange counties).

The rate of job growth has begun to slow, increasing by 1.3 percent during the first half of 2017, after growing by 1.8 percent in 2015 and by 1.5 percent in 2016. While job growth has slowed in New York City, it has picked up in the City's suburbs and in the rest of the State (see Figure 3). Nonetheless, the rate of growth in the rest of the State remains sluggish, increasing by less than 1 percent so far this year.

FIGURE 3
Job Growth Concentrated in
New York City and Its Suburbs



Sources: NYS Department of Labor; OSC analysis

The State's unemployment rate has fallen from the recessionary peak of 8.9 percent to 4.5 percent in June 2017. This is near the national rate and the State's prerecession level.

New York City

New York City is experiencing the largest job expansion in the post–World War II period. Between 2009 and 2016, 630,000 jobs were added (six times the amount lost during the recession). The City has continued to add jobs during 2017, and employment reached a record of nearly 4.4 million jobs in June 2017.

After the City added an average of 128,000 jobs in each of 2014 and 2015, job growth slowed to 86,000 in 2016. Growth has slowed even further in 2017, although it picked up in May and June. As of June, the City was on pace to add 70,000 jobs in 2017. The June Plan assumes job growth will slow to 53,000 jobs in 2017.

Job growth has slowed as the labor market has tightened. The City's unemployment rate (4.4 percent in June 2017) remains close to the 41-year low reached in March 2017 (4 percent). However, unemployment rates vary across neighborhoods and demographic groups.

A broader measure of unemployment that includes those who have stopped looking for work and those in part-time jobs who want full-time positions dropped to 7.9 percent in the first half of 2017, which was lower than before the recession.

Despite employment growth, wage gains have been weak. However, the June Plan assumes that average salaries will increase by 2.8 percent in 2017 (and by more in subsequent years) as the record-low unemployment rate puts pressure on employers to pay higher salaries to fill vacancies. It remains to be seen whether the

increase will occur, and if so, whether it will be concentrated in only a few sectors.

The slowdown in job growth is occurring across many sectors of the economy (see Figure 4). The most notable exceptions are the health care and social assistance sectors, where job growth has strengthened.

The health care sector accounted for nearly 15 percent of the jobs added during the recovery. The sector added jobs even during the recession, and the pace of growth has nearly doubled since 2010 to reach a gain of 21,700 jobs in 2016. Strong growth continued during the first half of 2017.

FIGURE 4
Job Growth by Sector

Employment Sectors	2015	2016	2017
Strong Growth			
Health Care	14,300	21,700	23,900
Social Assistance	5,400	6,100	6,900
Slowing Growth			
Business Services	31,000	23,400	20,900
Leisure and Hospitality	19,300	9,800	8,600
Information	4,000	3,600	3,200
Construction	10,100	7,000	3,500
Other Services	4,800	2,300	3,300
Educational Services	10,800	5,500	4,700
Financial Activities	10,100	6,500	2,800
Government	4,500	2,500	1,700
Losing Jobs			
Retail Trade	1,800	(3,000)	(400)
Trans., Warehousing & Utilities	6,100	2,500	(1,300)
Manufacturing	1,200	(1,500)	(2,600)
Wholesale Trade	1,700	(300)	(5,200)
Total Jobs Added	125,000	86,100	70,000

Note: 2017 is an OSC forecast.

Sources: NYS Department of Labor; OSC analysis

Health care now provides 500,000 jobs in the City's hospitals, doctors' offices, clinics and home health care agencies. Potential federal changes to health care, including cuts in Medicaid funding, could impact both services and jobs in New York City.

Job growth in the social assistance sector began to pick up in 2014. Growth has been concentrated in day care centers and services for senior citizens and disabled people.

The business services sector accounted for about one-quarter of the jobs added since 2009. While job growth is slowing, it is on pace to add 20,900 jobs in 2017.

The leisure and hospitality sector accounted for about one-fifth of the jobs added during the past seven years, but job growth slowed sharply in 2016 to half the rate of the prior years. Growth has continued to slow thus far in 2017.

While construction employment is at a record level, the industry is on pace to add a third of the jobs added two years ago.

The traditional retail sector in New York City, as in the nation, is undergoing fundamental changes as consumers have shifted to purchasing more items online. Several large chains have closed stores or declared bankruptcy, and pressure on the sector is likely to continue.

Last year, the retail sector lost 3,000 jobs (after contributing more than 10,000 jobs annually between 2009 and 2014), despite strong job growth at online retailers. During the first half of 2017, the retail sector lost 400 jobs.

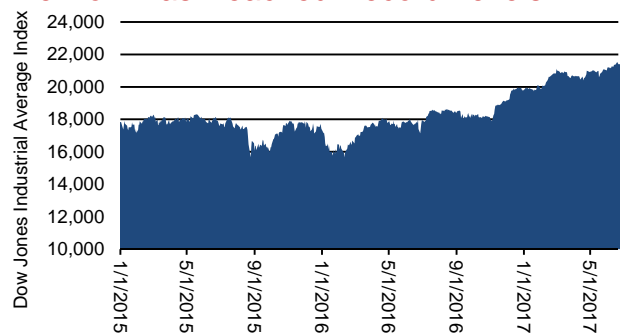
Securities Industry

The securities industry is an important part of the City's economy. Even though it accounts for only 5 percent of all private sector jobs, it is responsible for one-fifth of private sector wages. The industry added jobs over the past three years (2,800 jobs in 2014, 4,500 jobs in 2015 and 3,700 jobs in 2016), but it is still 6 percent smaller than before the 2008 financial crisis.

The pretax profits for the broker/dealer operations of New York Stock Exchange member firms (the traditional measure of securities industry profitability) increased by 21 percent in 2016 to \$17.3 billion, reversing a three-year trend of declining profits. Profits were not driven by higher revenues, but by cost-cutting and lower noncompensation expenses (which include the cost of legal settlements).⁴

After the presidential election, the Dow Jones Industrial Average rose by 17.7 percent through July 21, 2017 (see Figure 5). This boosted trading revenues at Wall Street firms and returns for the City and State pension systems.

FIGURE 5
The Dow Has Reached Record Levels



Source: S&P Dow Jones Indices

⁴ Noncompensation expenses declined for the second consecutive year, by nearly \$3.8 billion in 2016.

The June Plan assumes that securities industry profits will decline by 10 percent in 2017. However, profits were up 80 percent during the first quarter of 2017, driven by strong growth in trading revenues.

Despite sharply higher profits in 2016, OSC estimates that the average bonus paid to securities industry employees in New York City increased by only 1 percent, to \$138,210 (the first increase in three years). The June Plan assumes bonuses will increase in 2017 by 2.7 percent.

Industry profitability could be affected by changes in public policies. The President has indicated that he supports lowering the corporate tax rate and reducing regulations for the financial sector. While fewer regulations could boost profits, it could also lead to greater risk-taking and increased volatility. Brexit could also benefit New York City if some London financial firms move their operations to New York City.

Tourism

Tourism is an important part of the City's economy. The number of visitors to New York City reached a record 60.7 million in 2016. According to NYC & Company, the official tourism and marketing organization of New York City, the number of visitors is expected to set another record in 2017 with 61.7 million visitors, despite fewer overseas visitors.

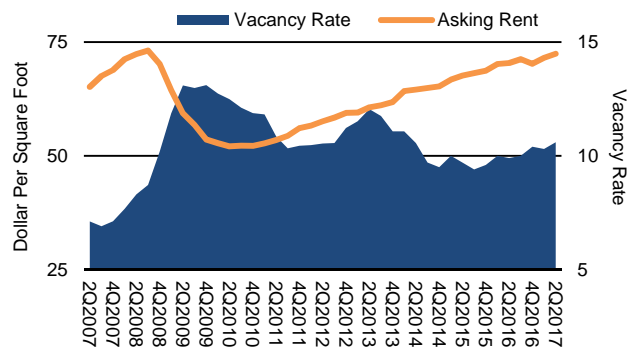
Commercial Real Estate

The commercial real estate market accounts for 42 percent of City property tax collections. Building values have risen sharply since the recession, increasing by 55 percent between fiscal years 2010 and 2017, according to data from the New York City Department of Finance.

Rising office employment in New York City has encouraged the development of new office buildings. Since 2010, the number of office workers has increased by 209,100 (15.7 percent) and the amount of office space has increased by 22 million square feet. According to Jones Lang LaSalle, another 11 million square feet of office space will enter the market by 2020.

Although the vacancy rate is still much lower than during the recession, it edged up during 2016 (see Figure 6) as new inventory came on the market faster than it could be absorbed. The vacancy rate was 10.5 percent during the first half of 2017. Asking rents in Manhattan reached \$72.00 per square foot, the highest level since the recession and only slightly below the prerecession peak.

FIGURE 6
Manhattan Office Sector



Sources: Jones Lang LaSalle; OSC analysis

III. Changes Since the Beginning of the Fiscal Year

The June Plan incorporates a number of changes since the FY 2017 budget was adopted one year ago (see Figure 8, next page). While City fund revenues are expected to be higher by a net of \$358 million in FY 2017, nonproperty taxes were lower by \$1 billion. The shortfall was offset by higher property tax collections, audit payments and miscellaneous revenues.

The City lowered its forecast of City fund revenues for fiscal years 2018 through 2020 because of continued weakness in nonproperty taxes and another delay in the sale of taxi medallions. The June Plan also reflects a modest tax reduction program, which would provide property tax relief to veterans, senior citizens and disabled people.

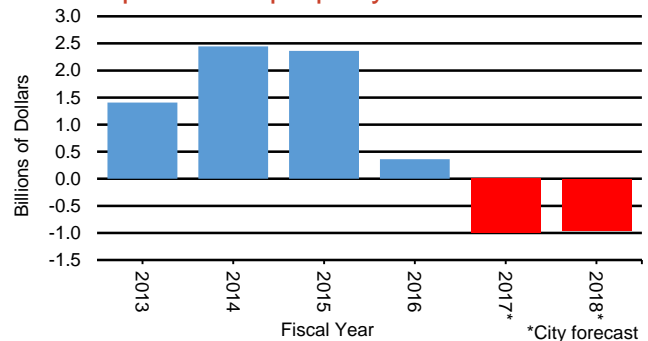
Since the beginning of FY 2017, the City has identified \$511 million in new agency spending (a cumulative total of nearly \$5 billion through FY 2020). Nearly all of the increase comes from agency needs, mainly for homeless services and new education initiatives. The June Plan also reflects the impact of the approved State budget, which will increase costs by modest amounts.

The City has freed up \$2.1 billion in reserves since the start of the fiscal year. It drew down the general reserve by \$980 million and the capital stabilization reserve by \$500 million. The City also benefited by a \$628 million reduction in the reserve for disallowances. It also anticipates savings of \$500 million from overestimating prior years' expenses.

As a result of these changes, the City now projects a surplus of nearly \$4.2 billion in FY 2017, driven by the drawdown in unneeded reserves and the citywide savings program. (The savings program is expected to generate \$6.6 billion over five years.) The FY 2018 budget gap, which grew by nearly \$1.4 billion since June 2016, was closed by transferring the FY 2017 surplus to FY 2018.

In most years, the surplus has been driven by unanticipated nonproperty tax collections. For example, collections (excluding audits) exceeded the City's expectations by \$1.4 billion in FY 2013 and by about \$2.4 billion in each of fiscal years 2014 and 2015 (see Figure 7), helping to offset the impact of unplanned spending.

FIGURE 7
Unanticipated Nonproperty Tax Collections



Note: Excludes audits.
Sources: NYC Office of Management and Budget; NYC Comptroller; OSC analysis

In FY 2016, nonproperty tax collections were higher by just \$362 million, accounting for only a small share of the \$4 billion surplus. Nonproperty tax collections are expected to be lower than initially forecast by \$1 billion in FY 2017 and \$954 million in FY 2018. If these collections continue to disappoint, closing the out-year budget gaps could be more challenging, especially if the City also has to address unplanned spending or cuts in federal aid.

The budget gaps for fiscal years 2019 and 2020 have increased by an average of \$500 million since June 2016, in part because the City increased its reserves in those years, but mostly because tax collections are expected to be lower than previously projected.

The City projects budget gaps of \$3.5 billion in FY 2019, \$2.8 billion in FY 2020 and \$2.3 billion in FY 2021. The gaps are relatively small as a share of City fund revenues (averaging 4.3 percent). The budgets for these years include annual reserves of \$1.25 billion. If not needed, the reserves could be used to narrow the gaps.

FIGURE 8
Financial Plan Reconciliation—City Funds
June 2017 Plan vs. June 2016 Plan
(in millions)

	<i>Better/(Worse)</i>			
	FY 2017	FY 2018	FY 2019	FY 2020
Projected Gaps Per June 2016 Plan	\$ ---	\$ (2,816)	\$ (2,945)	\$ (2,326)
Revenue Reestimate				
General Property Tax	422	402	619	714
Sales Tax	(122)	(238)	1	29
Business Taxes	(484)	(317)	(218)	(221)
Real Estate Transaction Taxes	(142)	(380)	(401)	(374)
Personal Income Tax	(344)	(45)	(231)	(145)
Other Taxes	91	113	104	82
Tax Reduction Program	---	(87)	(91)	(95)
Tax Audits	537	136	7	7
Subtotal: Taxes	(43)	(416)	(210)	(3)
All Other	400	(34)	(35)	84
Total	358	(449)	(245)	82
Citywide Savings Program				
Agency Actions	1,296	946	876	931
Debt Service	518	421	232	254
Total	1,814	1,367	1,108	1,185
Reserves				
General Reserve	980	(200)	---	---
Reserve for Disallowances of Federal and State Aid	628	---	---	---
Capital Stabilization Reserve	500	(250)	(250)	(250)
Total	2,108	(450)	(250)	(250)
New Needs/Offsets				
Department of Homeless Services	(204)	(256)	(264)	(271)
Department of Education	(94)	(150)	(175)	(221)
Uniformed Agencies	(92)	(196)	(157)	(202)
Other Health and Social Services	(21)	(141)	(122)	(138)
Retiree Health Benefits Trust	(100)	---	---	---
Pension Contributions	27	138	(19)	(160)
City Council Initiatives	---	(381)	---	---
Prior-Years' Payables	500	---	---	---
All Other	(93)	(765)	(336)	(436)
Total	(77)	(1,751)	(1,073)	(1,428)
Enacted State Budget Impact	(34)	(68)	(68)	(68)
Net Change During FY 2017	4,169	(1,353)	(528)	(481)
Surplus/(Gap)	\$ 4,169	\$ (4,169)	\$ (3,473)	\$ (2,807)
Surplus Transfer	(4,169)	4,169	---	---
Projected Gaps Per June 2017 Plan	\$ ---	\$ ---	\$ (3,473)	\$ (2,807)

Note: Personal income tax includes the State's School Tax Relief Program.

Sources: NYC Office of Management and Budget; OSC analysis

IV. Impact of State Actions

On April 9, 2017, the State Legislature completed action on a budget for State fiscal year (SFY) 2017-2018, which began on April 1, 2017. The budget increases education aid to New York City by \$387 million in FY 2018. While this was \$165 million less than the amount anticipated in the City's January 2017 financial plan, the shortfall had no impact on existing programs.

As outlined below, the State budget includes three actions that the City estimates will increase its costs by \$34 million in FY 2017 and by \$68 million annually in subsequent years.

- State reimbursement for foster care was reduced by \$22 million in FY 2017 and by \$44 million annually thereafter, including State tuition payments for special education students in foster care attending private schools.
- A reduction in State support for students in private special education settings will increase the City's costs by an estimated \$10 million in FY 2017 and \$20 million annually thereafter.
- A reduction in State funding for child care will increase the City's costs by \$2 million in FY 2017 and by \$4 million annually thereafter.

The State increased funding for charter schools for the upcoming school year, but the State budget requires future increases to be paid by the City. The City estimates that, if not offset by changes in State education aid to the City, the cost to the City could be \$101 million in FY 2019, rising to \$417 million in FY 2021. Such costs are not reflected in the June Plan.

The State approved the Affordable New York Housing Program, which replaces the expired 421-a tax abatement program. The new program provides real estate developers in New York City with property tax abatements for up to 35 years based on the number of affordable units created and whether they meet certain construction wage

requirements. The program is not expected to adversely impact the City's budget during the current five-year financial plan period, but it could reduce property tax collections in future years by more than the amounts anticipated under the expired program.

The State raised the age of criminal responsibility for most crimes from 16 years to 17 years, effective on October 1, 2018, and to 18 years, effective on October 1, 2019. The City has not yet made an estimate of the potential impact of raising the age of criminal responsibility, which could affect its financial plan beginning in FY 2019. The City would be required to contribute to the cost unless the State waives the local share (which would be based on proof of financial hardship).

The State has appropriated \$2.5 billion for the creation and preservation of 100,000 affordable housing units and 6,000 supportive housing units statewide. Funding for New York City will include, but not be limited to, \$200 million for the New York City Housing Authority and \$100 million for the development of affordable housing for low-income households.

The enacted State budget establishes the Clean Water Infrastructure Act and provides \$2.5 billion. Of that amount, \$200 million has been set aside for New York City. The City will be eligible to apply for some of the remaining \$2.3 billion in funding.

After the State budget was enacted, the State Legislature extended mayoral control of the City school system for two years and reauthorized the tax rates for several local taxes for three years. It also approved mayoral proposals to enhance property tax reductions for home owners who qualify for senior, disabled and veterans programs.

The impact of the Governor's proposed budget on the Metropolitan Transportation Authority is discussed later in this report (see Section X).

V. Federal Actions

New York City, like many jurisdictions across the nation, faces the potential loss of federal aid. If this were to occur, the City would come under pressure to make up for the shortfall with its own funds rather than allow vital services to be cut.

The City's budget assumes the receipt of \$7.8 billion in federal aid in FY 2018, representing more than 9 percent of its operating budget. More than two-thirds of the funding would be devoted to social services and education programs, with most of the balance going to housing and health programs.

However, these estimates exclude most federal Medicaid funds, which do not flow through the City's budget. Instead, doctors and hospitals are reimbursed directly for the services they provide to enrollees in the Medicaid program. OSC estimates that the federal share of Medicaid in New York City exceeds \$18 billion.⁵

In addition, there are a number of public authorities that have close financial relationships with the City and rely heavily on federal funding to fulfill their missions. These include the Health and Hospitals Corporation (HHC), the New York City Housing Authority (NYCHA) and the Metropolitan Transportation Authority (MTA). Cuts in federal funding to these agencies could require the City to increase its financial assistance.

The HHC is the largest municipal hospital system in the nation (serving 1.2 million patients annually) and is already in the midst of a financial crisis. Nearly half of its operating budget is funded with federal aid (\$3.3 billion).⁶

NYCHA is the largest housing authority in the nation, housing more than 400,000 residents. The nonrent portion of its operating budget is funded mostly by the federal government

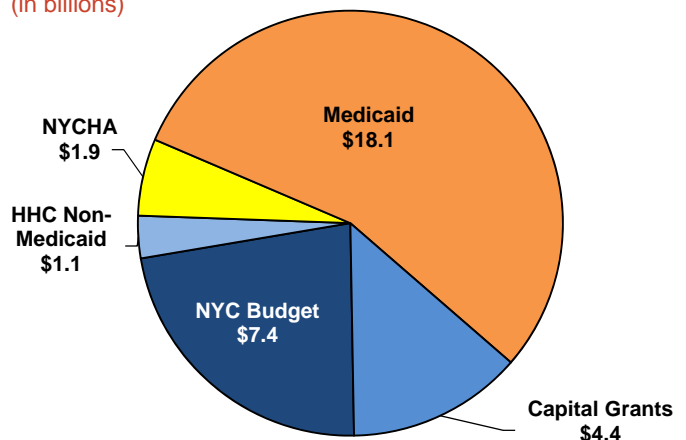
(\$1.9 billion). NYCHA's five-year \$4.3 billion capital program is also dependent on federal aid.

The MTA does not receive any operating budget aid from the federal government, but it is dependent on federal grants to fund its five-year capital program. The 2015-2019 capital program counts on \$7.5 billion in federal funds, nearly one-quarter of the program's total value.⁷

In addition, the MTA is counting on \$2 billion in federal grants to help fund the second phase of the Second Avenue Subway. The Gateway project, which would build a new two-track tunnel under the Hudson River connecting Manhattan and New Jersey and which would expand Pennsylvania Station, is also dependent on federal assistance.

In total, federal aid approaches \$33 billion (see Figure 9) when the amounts in the City's operating and capital budgets are combined with Medicaid and the budgets of these three public authorities. The share that directly affects the City's operating budget totals \$7.8 billion.

FIGURE 9
Federal Aid to New York City
(in billions)



Note: NYC budget estimate adjusted to exclude \$366 million in federal Medicaid funding (mostly for administrative services), which is included in Medicaid. The HHC share of Medicaid is also included in the citywide total for Medicaid.

Sources: NYC Office of Management and Budget; OSC analysis

⁵ Consolidated Schedule of Expenditures of Federal Awards, City of New York Single Audit Report for the fiscal year ending June 30, 2016.

⁶ Mostly federal funding for Medicaid and Medicare programs.

⁷ The City has agreed to contribute \$2.5 billion to the MTA's five-year capital program.

City residents also receive billions of dollars in direct federal assistance, such as Social Security, veterans' benefits, Pell grants and the Supplemental Nutrition Assistance Program. Many nonprofit organizations are also dependent on federal aid to fulfill their missions.

The President's proposed budget for federal fiscal year 2018, which begins on October 1, 2017, focuses heavily on cuts to social safety net programs and nondefense discretionary spending. OSC estimates that the President's proposed budget would reduce federal funding to the City's operating and capital budgets by a total of \$827 million in FY 2018.⁸

The President's proposed budget would reduce federal funding to the City's operating budget by \$730 million. Most of the impact on the operating budget would come from the following proposals.

- Eliminate the Community Development Block Grant program, resulting in the loss of \$150 million. These funds are used mostly for housing-related activities, including inspections and emergency repairs.
- Reduce funding for the Temporary Assistance for Needy Families program, resulting in a loss of \$191 million. This program provides cash assistance to nearly 132,000 adults and children.
- Eliminate both the Social Services Block Grant and the Community Services Block Grant programs, resulting in a loss of \$116 million. These grants help fund services for victims of domestic violence, senior centers, summer youth employment and adult literacy programs.
- Eliminate Title II funding, resulting in the loss of \$108 million. These funds are used by the Department of Education for teacher professional development.

- Cut homeland security funding to New York City by 25 percent, resulting in a loss of up to \$55 million. These funds provide protection at a time when there are heightened risks from terrorism.
- Eliminate the 21st Century Community Learning Centers Program, which would result in the loss of \$40 million for after-school programs (including \$21 million in the Department of Education).
- Eliminate the Low Income Home Energy Assistance program, resulting in a loss of \$23 million. This program helps an estimated 700,000 City households heat their homes.

Federal funding to the City's capital budget would be reduced by \$97 million, resulting in the loss of federal funding for the Woodhaven Boulevard Select Bus Service project.

The President would also reduce funding to the three major public authorities that rely heavily on federal assistance. NYCHA estimates that the proposed budget could reduce federal support to its capital program by \$210 million and to its operating budget by up to \$130 million. NYCHA also estimates that 13,000 vouchers could be lost as a result of proposed cuts to the Housing Choice Voucher Program.

The MTA is counting on \$2 billion from the New Starts program to help fund the second phase of the Second Avenue Subway. However, federal funding would be available only to projects that have already received federal authorization, making the next phase of the project ineligible for federal aid. For the same reason, the President's budget would put at risk the \$29 billion Gateway project, which anticipates that the federal government will fund half of the cost.

⁸ Grant amounts used to estimate the impact of the President's proposed budget are based on the budgeted amounts as of the

City's adopted budget for FY 2018. The actual award could be more or less based on the method and timing of distribution.

The President would also make changes to programs that provide direct assistance to New York City residents, including the Supplemental Nutrition Assistance Program (SNAP), Social Security disability insurance and financial aid for college students. For example, the President would limit SNAP eligibility and require a funding match from states.

The U.S. Department of Agriculture estimates that these changes would reduce federal funding for SNAP across the nation by a cumulative total of \$191 billion over 10 years (a 31 percent reduction by 2026) when compared to current law. The state match would average 25 percent when fully implemented in 2023. A total of 1.7 million New York City residents receive SNAP benefits at a cost of \$3 billion each year.

The President has also proposed a \$1 trillion program over 10 years to rebuild the nation's infrastructure, including airports, bridges, highways and ports. The President's proposed budget includes \$200 billion over 10 years to fund infrastructure initiatives, which the federal government would use to leverage an additional \$800 billion in spending from nonfederal sources, such as the private sector. New York City could benefit from such an initiative, but details have not yet been made public.

The President has also outlined goals for federal tax reform. The proposed changes include reducing the business income tax rate from 35 percent to 15 percent; reducing the number of tax brackets for individuals from seven to three (35 percent, 25 percent and 10 percent); doubling the standard deduction; limiting itemized deductions to those associated with home ownership, charitable giving and retirement savings; and repealing the estate tax and alternative minimum tax.

Although the outline does not include sufficient detail to permit a full evaluation, the proposed tax reduction program has the potential to harm middle-class taxpayers, adversely affect the economy and increase the size of the federal deficit. Eliminating or capping the exemption for municipal bonds, as proposed by Congress in the past, could increase the City's borrowing costs.

The President's budget is just the first step in the federal budget process. The Budget Committee in the U.S. House of Representatives recently approved a blueprint that calls for deep cuts to Medicare, Medicaid and nondefense discretionary spending. Congress has yet to produce tax reform or infrastructure bills.

In May 2017, the House of Representatives approved the American Health Care Act of 2017 to replace parts of the Affordable Care Act (ACA). The ACA prohibits insurance companies from denying insurance to people with preexisting conditions, requires all insurance plans to provide 10 essential benefits, and allows parents to keep their children on their health insurance plans until age 26 at no additional cost.

The ACA increased the number of Americans with health insurance by offering subsidies to lower-income taxpayers who purchase health insurance through government-sponsored health insurance marketplaces. It also expanded Medicaid eligibility to 138 percent of the poverty level, with the federal government paying more than 90 percent of the cost for states that agree to expand eligibility.

The House bill would eliminate the ACA's enhanced federal reimbursement rate to states for people who enroll in Medicaid after December 31, 2019, and would reduce health insurance subsidies and cap federal Medicaid funding to the states.

The Congressional Budget Office estimated that under the House bill, 23 million Americans would lose health insurance by 2026 (including 14 million Medicaid enrollees). Medicaid funding to the states would be cut by \$834 billion over 10 years compared to current law, a cumulative reduction of 17 percent (and a nearly 25 percent reduction in 2026).

The bill would also permit states to request waivers from the mandates regarding preexisting conditions and essential benefits. Moreover, Medicaid funding to New York State would be reduced by the amount that counties outside of New York City are required to contribute to the cost of Medicaid (nearly \$2.3 billion).

The Governor estimated that the House bill would cost New York State \$6.9 billion over four years. An estimated 1.1 million City residents would be at risk of losing Medicaid coverage, and another 460,000 could lose coverage through insurance plans offered through the State's health insurance exchange.

OSC estimates that New York City would lose up to \$305 million annually beginning in 2020 from the elimination of the enhanced federal Medicaid reimbursement rate for new enrollees to states that expanded Medicaid eligibility. The provision requires states to share the additional federal Medicaid funding with localities, such as New York City, which contribute to the cost of Medicaid.

Regardless of the outcome of legislative proposals in the U.S. Senate to roll back or repeal the ACA, the debate over health care and Medicaid funding to the states will likely continue. Any reduction in Medicaid funding could have an impact on the State's budget, which could affect the amount of aid the City receives from the State. The City accounts for about 60 percent of the State's Medicaid costs.

VI. Citywide Savings Program

In November 2016, the Mayor announced a citywide savings program that was expected to generate \$2.1 billion during fiscal years 2017 through 2021. The January 2017 financial plan included actions that doubled the value of the program to nearly \$4.2 billion, and the April 2017 financial plan further increased the value to \$6.1 billion.

The June Plan increases the size of the citywide savings program to \$6.6 billion during fiscal years 2017 through 2021. Nearly half (\$3.2 billion) of the program's value would be generated during fiscal years 2017 and 2018, with more than \$1.1 billion generated annually thereafter (see Figure 10).

Reestimates are expected to generate a total of \$1.1 billion in FY 2017, but about half of that amount in subsequent years. In FY 2017, the City will benefit from the receipt of \$422 million in nonrecurring federal and State grants for social services and public transportation programs for prior years, and other nonrecurring savings.

Efficiencies are expected to generate \$159 million in FY 2017, although the savings are expected to grow to \$363 million by FY 2021 when the initiatives are fully implemented. Efficiencies make up less than one-quarter of the five-year value of the citywide savings program.

As part of these efforts, the City has implemented a partial hiring freeze for some administrative and managerial positions, which is expected to generate \$102 million in one-time savings. Some positions may no longer need to be filled, generating recurring savings.

More than one-third of the savings from efficiencies is expected to come from shifting financial responsibility for certain programs from the City to the federal or State governments. The City also anticipates savings from a number of initiatives implemented across multiple agencies aimed at reducing procurement, leasing, equipment and overtime costs.

Nearly one-fourth of the savings in the citywide savings program (\$1.6 billion) would come from lower debt service. Almost one-quarter of this amount would come from the City not needing to borrow to meet its cash flow needs during the financial plan period, given its large cash reserves. Another \$206 million would come from no longer needing to make interest support payments for Hudson Yards Infrastructure Corporation bonds. Savings from variable-rate debt, excess State building aid and delays in capital commitments make up most of the balance.

The citywide savings program includes some initiatives that may fall short of target, and thus the State Comptroller recommends that the City be prepared with alternative initiatives.

FIGURE 10
Citywide Savings Program
(in millions)

	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	Total
Agency Actions						
Reestimates	\$ 1,137	\$ 579	\$ 566	\$ 590	\$ 601	\$ 3,473
Efficiencies	159	366	310	341	363	1,540
Subtotal	1,296	946	876	931	964	5,013
Debt Service	518	421	232	254	190	1,615
Total	\$ 1,814	\$ 1,367	\$ 1,107	\$ 1,185	\$ 1,154	\$ 6,627

Note: Totals may not add due to rounding.
Sources: NYC Office of Management and Budget

VII. Revenue Trends

The June Plan assumes that revenues, including federal and State categorical aid, will total \$85.2 billion in FY 2018. Locally generated revenues (i.e., City funds) will account for 72 percent (\$61.5 billion) of this amount, with tax collections accounting for the largest share.

After increasing at an average annual rate of 6.9 percent during fiscal years 2011 through 2015, growth in tax collections slowed to 3.2 percent in FY 2016 and 1.8 percent in FY 2017. Property tax collections remained strong, but nonproperty tax collections declined in FY 2017 for the first time since FY 2010 (see Figure 11). Although audit revenue reached a record high, the decline in nonproperty tax collections was caused by a decline in real estate transactions and business tax collections.

In FY 2018, the City expects that tax collections will increase by 4 percent, assuming a resumption of growth in nonproperty tax collections. Although this forecast is still below the rate of growth that occurred earlier in the expansion, it may be optimistic given current trends. OSC believes tax collections could be lower by \$150 million in FY 2018 (business taxes account for much of the shortfall), but there are

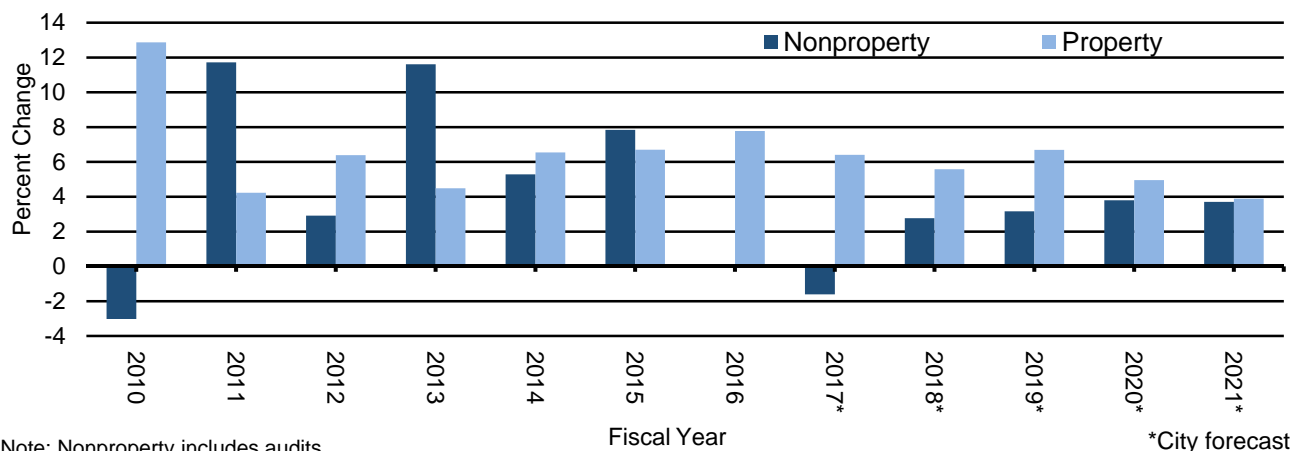
reserves and other sources of revenue that could more than offset the shortfall.

Other factors will also impact tax collections beginning in FY 2018. Sales tax collections will be lower under current State law (by \$150 million in FY 2019) as the State recoups savings that accrued to the City from refinancing bonds of the Sales Tax Asset Receivable Corporation at lower interest rates.

The June Plan also anticipates \$731 million in miscellaneous revenue from the sale of taxi medallions during fiscal years 2019 through 2021, and \$100 million in FY 2020 from development opportunities at properties leased to the Health and Hospitals Corporation. As discussed later in this section, the receipt of these proceeds is uncertain.

The June Plan reflects the impact of mayoral proposals to enhance property tax reductions for senior-citizen, disabled and veteran home owners. The expansion is valued at \$87 million in FY 2018 and rising to \$98 million in FY 2021. The proposals have been approved by the State Legislature, but await action by the Governor.

FIGURE 11
Annual Change in Property and Nonproperty Tax Collections



Note: Nonproperty includes audits.

Sources: NYC Office of Management and Budget; OSC analysis

FIGURE 12
Trends in City Fund Revenues

(in millions)

	FY 2017	FY 2018	Annual Growth	FY 2019	FY 2020	FY 2021	Average Three-Year Growth Rate
General Property Tax	\$ 24,447	\$ 25,812	5.6%	\$ 27,539	\$ 28,905	\$ 30,028	5.2%
Personal Income Tax	11,067	11,841	7.0%	12,073	12,624	13,166	3.6%
Sales Tax	6,994	7,319	4.6%	7,881	8,245	8,592	5.5%
Business Taxes	5,525	6,027	9.1%	6,224	6,375	6,615	3.2%
Real Estate Transaction Taxes	2,501	2,298	-8.1%	2,359	2,462	2,510	3.0%
Other Taxes	2,816	2,740	-2.7%	2,800	2,848	2,903	1.9%
Tax Audits	1,251	850	-32.1%	721	721	721	-5.3%
City Tax Programs	- - -	(87)	NA	(91)	(95)	(98)	4.0%
Subtotal: Taxes	54,601	56,800	4.0%	59,506	62,085	64,437	4.3%
Miscellaneous Revenues	5,083	4,673	-8.1%	4,911	5,124	5,106	3.0%
Grant Disallowances	613	(15)	NA	(15)	(15)	(15)	0.0%
Total	60,297	61,458	1.9%	64,402	67,194	69,528	4.2%

Note: Growth in personal income tax collections in FY 2018 would be 2.2 percent after adjusting for changes in the School Tax Relief Program.
Sources: NYC Office of Management and Budget; OSC analysis

The June Plan is based on the trends shown in Figure 12 and discussed below.

1. General Property Tax

Strong growth in property values has helped drive tax revenue growth throughout the current economic expansion. Between fiscal years 2010 and 2017, property values rose by an average of 5.7 percent annually and collections increased by \$8 billion, or an average annual gain of 6.1 percent. In FY 2018, continued growth in property values is projected to boost property tax collections by 5.6 percent, to \$25.8 billion.

The City estimates that citywide property values total \$1.1 trillion. Growth was strongest (at about 10 percent) for large residential properties. Values for one-, two- and three-family homes grew by more than 8 percent, and values for commercial properties increased by 6 percent.

At the beginning of FY 2017, the City allocated \$1.8 billion for a reserve to cover delinquencies in collections, refunds and tax abatements. Over the course of the year, it reduced the reserve to \$1.4 billion, freeing up \$400 million for other purposes.⁹ For FY 2018, the City raised the reserve to \$1.9 billion because it expects a higher level of refunds and uncollected taxes. If conditions permit, the City may draw down any unneeded reserves as the year progresses, freeing up to \$500 million for other purposes.

Property tax collections are forecast to grow by an average of 5.2 percent in fiscal years 2019 through 2021. Although property values are expected to grow at a slower rate, revenue growth will be boosted by gains in market values in prior years that are still being phased in.¹⁰

⁹ The reserve averaged \$1.3 billion annually during fiscal years 2010 through 2016.

¹⁰ State law requires changes in assessed values for commercial and large residential properties to be phased in over five years.

Thus, recent increases in assessed values will continue to boost tax revenues during the financial plan period.

2. Personal Income Tax

After increasing at an average annual rate of 8.3 percent during fiscal years 2010 through 2015, growth in personal income tax collections slowed to 1 percent in FY 2016 as job growth eased and capital gains and securities industry bonuses declined.

Collections increased at a similar pace in FY 2017 (0.9 percent).¹¹ While withholding collections from workers' paychecks grew by 5.4 percent (see Figure 13), other components of the tax declined.

Estimated payments (generated from capital gains and other nonwage income) declined by 12.8 percent in FY 2017. Given the weakness in nonwage income, the final year-end payments (primarily collected between January and April) declined by 7.7 percent.

The declines in estimated and final payments were partially offset by higher payments from the State to correct for earlier distributional errors.¹² These payments are expected to reach a record \$804 million in FY 2017.

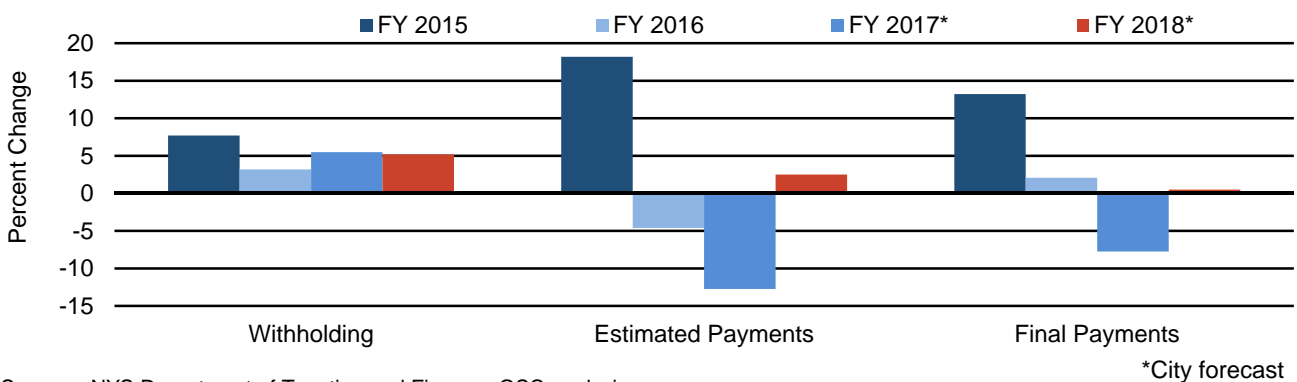
The June Plan assumes that personal income tax collections will pick up slightly in FY 2018 (increasing by 2.2 percent), with collections reaching \$11.8 billion. While the growth in withholding (5.2 percent) is expected to remain at a similar pace as last year, estimated payments are projected to increase for the first time in three years as the recent rally in the financial markets boosts capital gains.

Given the weakness in estimated payments during FY 2017, OSC projects that these payments could be \$50 million less in FY 2018 than assumed in the June Plan.

The shortfall, however, could be more than offset by higher State payments for distributional errors. The June Plan assumes these payments will drop to \$559 million in FY 2018, well below the \$804 million received in FY 2017.

The City projects that the growth in personal income tax collections will continue to strengthen, averaging 4.1 percent in fiscal years 2019 through 2021, as rising wages offset slowing job growth. However, potential changes in federal fiscal policies may impact economic activity and change taxpayer behavior in ways not yet reflected in the City's forecasts.

FIGURE 13
Changes in Personal Income Tax Components



Sources: NYS Department of Taxation and Finance; OSC analysis

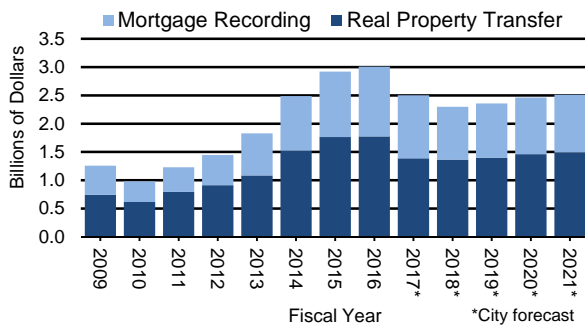
¹¹ Adjusted to account for changes in how the State reimburses the City for benefits provided to home owners and renters under the School Tax Relief program.

¹² The State collects the personal income tax for both the State and the City, and remits an estimate of the City's share each month. The State subsequently reviews the results and makes adjustments as necessary.

3. Real Estate Transaction Taxes

Revenues from real estate transaction taxes (the mortgage recording tax and the real property transfer tax) declined by 16.9 percent in FY 2017, following several years of rapid growth after the Great Recession (see Figure 14). This was the first decline since FY 2010 and was driven by a steep drop-off in the number of commercial transactions.

FIGURE 14
Real Estate Transaction Tax Collections



Sources: NYC Comptroller; NYC Office of Management and Budget

The June Plan assumes collections will decline by another 8.1 percent in FY 2018. However, the number of commercial transactions is stabilizing and long-term interest rates are not likely to rise as quickly as anticipated by the City. Thus, collections may not decline as sharply as projected by the City in FY 2018.

4. Sales Tax

The growth in sales tax collections has weakened in recent years, from an average of 5.7 percent in fiscal years 2013 and 2014 to 3.8 percent in FY 2015 and then 3.2 percent in FY 2016.¹³ Growth remained subdued in FY 2017 (at 3.4 percent), reflecting slower job growth and store closings.

The June Plan assumes that sales tax collections will increase by 4.5 percent in

¹³ Adjusted for the impact of the sales tax intercept.

¹⁴ The City believes that businesses had overpaid their taxes when the law was changed, which generated large credits the

FY 2018 to reach \$7.3 billion as higher wages boost consumer spending. Nonetheless, given current collection trends and the slowdown in job growth, OSC projects that sales tax collections could be lower than the City expects by \$50 million annually beginning in FY 2018.

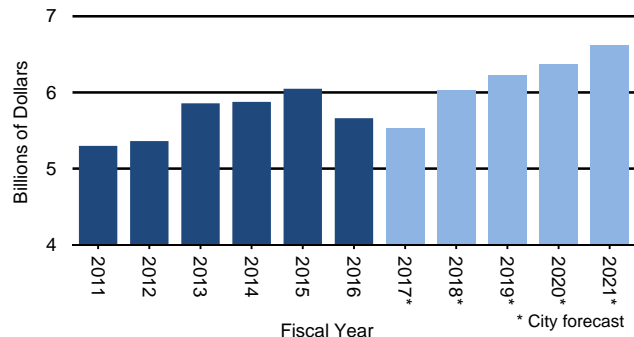
5. Business Taxes

Business tax collections have exhibited weakness since the State passed a corporate reform bill in April 2015 that combined the City’s banking and general corporate taxes. While this change was intended to be revenue-neutral, collections fell short of the City’s forecast by \$471 million in FY 2016.

A similar trend also developed in FY 2017 when collections totaled \$5.5 billion, \$484 million less than projected at the beginning of the fiscal year. This shortfall occurred despite the City drawing down \$185 million in business tax overpayments that were placed in reserve in FY 2015 when the tax law changes were first implemented.

The June Plan assumes that in FY 2018 total business tax collections will increase by 9.1 percent to \$6 billion (see Figure 15). This reflects the City’s belief that businesses have now adjusted to the new tax law.¹⁴

FIGURE 15
Business Tax Collections



Sources: NYC Comptroller; NYC Office of Management and Budget

businesses were able to use to reduce their payments in fiscal years 2016 and 2017.

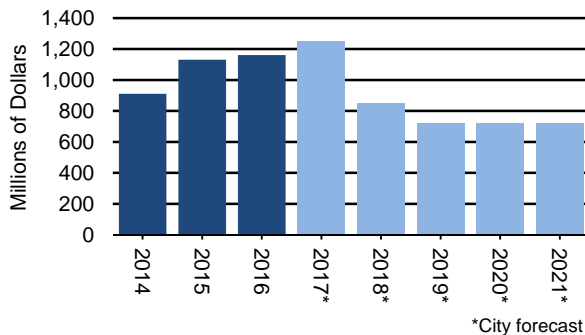
OSC remains concerned that the tax law changes have not been revenue-neutral, and notes that June quarterly payments (the next installment on tax year 2017 liabilities) were weak compared to the same month in previous years. Given collection trends in recent years, OSC believes business tax collections could be \$200 million less than the City expects.

6. Audit Revenue

Each year, the Department of Finance conducts audits of individuals and businesses to ensure compliance with the tax code. Audit collections have averaged \$1.1 billion during fiscal years 2014 through 2016.

In FY 2017, audit revenue exceeded the City's initial forecast by \$537 million. The June Plan assumes that audit revenue will decline by \$502 million to \$850 million in FY 2018 (see Figure 16), but that collections will likely be stronger. The audit period now under review covers tax year 2011 and later years when the economic recovery was strongest. As a result, OSC expects audit revenue to exceed the City's estimate by at least \$100 million annually.

FIGURE 16
Audit Collections



Sources: NYC Comptroller; NYC Office of Management and Budget

7. Miscellaneous Revenues

Miscellaneous revenues include recurring resources (such as licenses, fines and fees) and nonrecurring resources (such as proceeds from the sale of taxi medallions or City property). The

June Plan assumes that recurring revenues will decline by 5.3 percent in FY 2018. Based on current collection trends, OSC estimates that recurring revenues could be higher by \$75 million annually beginning in FY 2018.

In addition, the State authorized the sale of 2,000 additional taxi medallions in 2012. After the sale of 350 medallions in FY 2014, the City has repeatedly postponed the sale of the remaining 1,650 medallions because the growing presence of alternatives to taxis, such as Uber and Lyft, has significantly impacted the market.

The average sale price for a taxi medallion peaked at \$1 million in calendar year 2014, but by 2016 the average sale price was nearly cut in half, and 65 percent of the sales were foreclosures. Weakness in market conditions has continued in the first half of 2017, and the average sale price fell to \$309,300.

The June Plan still anticipates selling the remaining medallions over five years, and assumes sale proceeds of \$731 million during the financial plan period (\$107 million in FY 2019, \$257 million in FY 2020 and \$367 million in FY 2021). This forecast assumes that the average medallion will sell for \$728,000, more than double the current market price. Until the City tests the market, there is a risk that the expected amount may not be realized.

The City also expects to receive \$100 million in FY 2020 from development opportunities at properties leased to the Health and Hospitals Corporation. The City intends to transfer the proceeds to the Corporation to help balance its budget. If these development opportunities do not materialize as expected, the City may be called upon to make up the difference, or the Corporation may be required to implement deeper cuts than already planned.

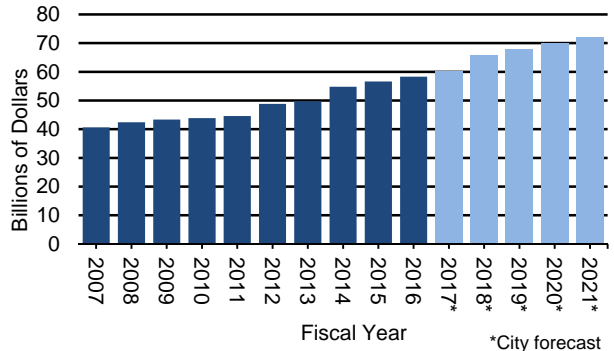
VIII. Expenditure Trends

The adopted budget for FY 2018 totals \$85.2 billion, including programs funded with federal and State categorical grants. The portion funded with locally generated revenue (i.e., City funds) totals nearly \$61.5 billion. After adjusting for surplus transfers, which can mask expenditure trends, City-funded spending (including reserves) would reach nearly \$65.6 billion (see Figure 17).

City-funded spending is projected to grow by 9.1 percent in FY 2018. Excluding reserves and savings from prior years' expenses, spending is projected to grow by 5.8 percent (three times faster than the projected local inflation rate), driven by the cost of labor agreements and higher costs for employee fringe benefits and debt service.

The full-time work force (including jobs funded by federal and State categorical grants) increased by 17,228 employees between fiscal years 2013 and 2016 (see Figure 18). In FY 2016, the City added 9,829 employees, the largest one-year increase since FY 2004. (Teachers, police officers and correction officers accounted for

FIGURE 17
Growth in City-Funded Expenditures

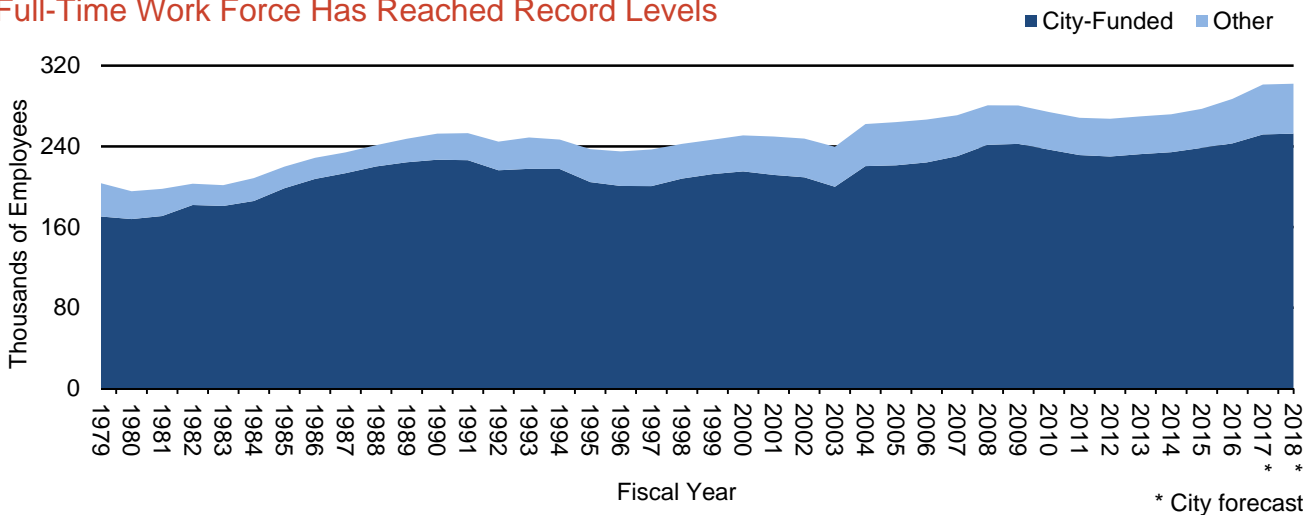


Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

nearly two-thirds of the new hires.) These additions increased the work force to the highest level since the 1975 fiscal crisis (287,002 full-time employees, of which 242,878 were City-funded).

The June Plan assumes the addition of 14,387 employees during FY 2017, with hiring concentrated in the health and welfare agencies and the Department of Education. As of May 2017, the City was 7,422 positions short of its hiring target, with most of the vacancies in the

FIGURE 18
Full-Time Work Force Has Reached Record Levels



Note: Staffing levels are as of June 30 of each fiscal year.
Sources: NYC Office of Management and Budget; OSC analysis

health and welfare agencies, and civilian positions at the Police Department. The June Plan assumes these positions will be filled in FY 2018.

Personal service costs increased by 38 percent between fiscal years 2010 and 2017, reflecting the expansion of the work force, collective bargaining costs and higher costs for employee fringe benefits. These costs are projected to rise by another 22 percent (\$7.4 billion) by FY 2021.

The June Plan is based on the trends shown in Figure 19 and discussed below.

1. Collective Bargaining

As of July 2017, the City had negotiated new labor agreements through FY 2018 with all of the major unions that represent nearly all of the City's work force. The agreements call for wage increases of 10 percent over seven years for civilian employees and 11 percent over seven years for uniformed employees. The City expects

the remaining unions with expired contracts to reach conforming agreements.

The agreements also compensate members of the United Federation of Teachers (UFT) and other employees for two annual wage increases of 4 percent that were provided to most other municipal unions in 2009 and 2010 but not to these employees.

In November 2015, a three-member arbitration panel awarded police officers two annual wage increases of 1 percent for fiscal years 2011 and 2012, which was consistent with the City's financial plan.

In January 2017, the City and the Patrolmen's Benevolent Association (PBA) reached agreement on a contract that calls for wage increases of 9 percent over a five-year period, which conforms to the wage pattern for other uniformed employees. The contract was ratified by the PBA's members in February 2017.

FIGURE 19
Trends in City-Funded Spending
(in millions)

	FY 2017	FY 2018	Annual Growth	FY 2019	FY 2020	FY 2021	Average Three-Year Growth Rate
Salaries and Wages	\$ 17,207	\$ 18,815	9.3%	\$ 20,099	\$ 20,813	\$ 21,281	4.2%
Pension Contributions	9,251	9,427	1.9%	9,727	9,798	9,861	1.5%
Medicaid	5,813	5,813	0.0%	5,813	5,813	5,813	0.0%
Debt Service	5,840	6,264	7.3%	6,967	7,610	8,087	8.9%
Health Insurance	4,516	4,939	9.4%	5,389	5,914	6,532	9.8%
Other Fringe Benefits	2,733	2,799	2.4%	2,993	3,298	3,465	7.4%
Energy	710	760	7.0%	780	811	849	3.8%
Judgments and Claims	616	552	-10.4%	567	585	600	2.8%
Public Assistance	626	708	13.1%	713	719	719	0.5%
Retiree Health Benefits Trust	100	---	NA	---	---	---	NA
Other	13,234	14,100	6.5%	13,577	13,390	13,401	-1.7%
Subtotal	60,646	64,177	5.8%	66,625	68,751	70,608	3.2%
Prior Years' Expenses	(500)	---	NA	---	---	---	NA
General Reserve	20	1,200	NA	1,000	1,000	1,000	NA
Capital Stabilization Reserve	---	250	NA	250	250	250	NA
Total	\$ 60,166	\$ 65,627	9.1%	\$ 67,875	\$ 70,001	\$ 71,858	3.1%

Note: Debt service has been adjusted for surplus transfers.

Sources: NYC Office of Management and Budget; OSC analysis

The PBA contract calls for officers to receive a salary differential (2.25 percent of base salary) for patrol duties associated with the Mayor’s neighborhood policing initiative. The cost of the differential will be offset by a reduction in the salary schedule for newly hired police officers.

These labor agreements are expected to cost a total of \$13.8 billion during fiscal years 2014 through 2018 (the end of the contract period). The cost will be partially offset by resources that had been set aside by the City in its labor reserve prior to reaching new wage agreements (\$3.5 billion), and from health insurance savings (\$4.4 billion) from a separate agreement between the City and its unions. The net budgetary impact will total \$5.9 billion.

However, the cost of the agreements continues to grow beyond the contract period. The net budgetary impact will be greatest during fiscal years 2018 through 2021, and will peak at \$4 billion in FY 2021. Beginning in FY 2018, the cost will continue to rise after the expiration of the contracts because of lump-sum payments to compensate members of the UFT and other employees for the time they went without wage increases, as well as the full impact of wage increases granted in prior years.

The June Plan includes resources to fund annual wage increases of 1 percent after the expiration of the current round of collective bargaining, which will begin during FY 2018 for most employees. The actual cost of the next round of collective bargaining will be determined through negotiation or arbitration, and could be higher than assumed in the June Plan. Wage increases at the projected inflation rate, for example, would increase costs by \$90 million in FY 2018,

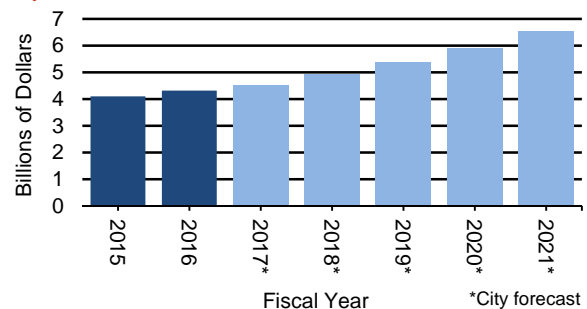
\$270 million in FY 2019, \$691 million in FY 2020 and nearly \$1.3 billion in FY 2021.

In April 2017, the State approved legislation, jointly supported by the City and the PBA, which increases the disability pension benefits of police officers hired after June 30, 2009.¹⁵ Under the legislation, police officers who elect to receive the improved benefit will contribute an additional 1 percent of their salaries toward the cost of the benefit. The legislation was consistent with legislation enacted in 2016 to improve the disability benefits of firefighters.

2. Health Insurance

To help fund wage increases for municipal employees, the City and the Municipal Labor Committee agreed, in May 2014, to draw down \$1 billion from the Health Stabilization Fund and to identify cumulative health insurance savings of \$3.4 billion during fiscal years 2015 through 2018. Despite these savings, the City-funded cost of health insurance will reach \$6.5 billion by FY 2021 (see Figure 20), nearly \$2.3 billion (53 percent) more than in FY 2014 before the agreement took effect.

FIGURE 20
Health Insurance Costs Continue to Grow
City-Funded



Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

¹⁵ Police officers hired after June 2009 are eligible for disability payments equal to 50 percent of their highest five-year average salary, offset by 50 percent of their Social Security Disability

Insurance benefit. Officers hired before that date are eligible to receive 75 percent of their highest salary with no Social Security offset.

The agreement calls for savings of \$400 million in FY 2015, \$700 million in FY 2016, \$1 billion in FY 2017 and \$1.3 billion in FY 2018, with recurring savings of \$1.3 billion in subsequent years. The City has met the target for fiscal years 2015 through 2017, and is on track to realize \$1.3 billion in savings in FY 2018 and in subsequent years.

More than three-quarters of the \$3.4 billion in cumulative savings has come from lower-than-planned increases in health insurance premiums and other administrative actions. Cost-containment initiatives are expected to save \$687 million (mostly from higher co-payments), or 20 percent of the total.

3. Pension Contributions

After rising rapidly between fiscal years 2003 and 2012, the growth in City-funded pension contributions slowed during the following three years. The slower rate of growth reflected the impact of changes in assumptions and methodologies used to calculate City pension contributions, better-than-expected investment earnings, and savings from lower-cost pension plans for employees hired after March 31, 2012.

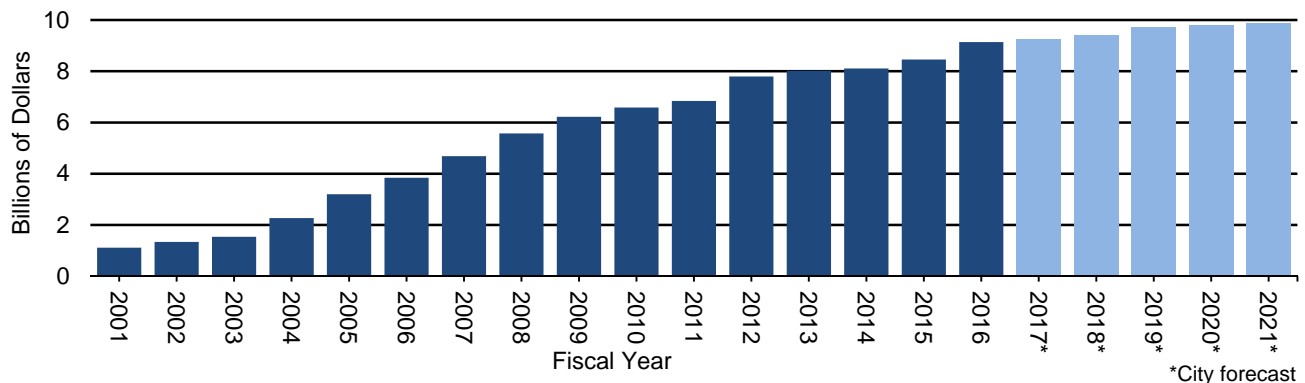
Pension contributions resumed growing in FY 2015, and are projected to rise from \$8.1 billion in FY 2014 to \$9.7 billion by FY 2019 before leveling off (see Figure 21). This trend reflects revised mortality tables to account for longer life expectancies and lower-than-expected investment earnings during fiscal years 2015 and 2016. Pension contributions will average nearly 15 percent of City fund revenues during the financial plan period.

The unfunded net liability of the City's five pension systems has also grown, rising by \$11.7 billion to \$64.8 billion in FY 2016. In the aggregate, the pension systems had sufficient assets to fund (on a market-value basis) 65.6 percent of their accrued pension liabilities at the end of FY 2016, which was 4.5 percentage points less than in the prior year.

In FY 2017, the pension funds had earned an estimated 13 percent on their investments, compared with an expected return of 7 percent for the full fiscal year. As a result, the City could realize savings of \$140 million in FY 2019, \$280 million in FY 2020 and \$425 million in FY 2021.

FIGURE 21
Pension Contributions

City-Funded



Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

The City has engaged the services of an independent actuarial consultant, as required under the City Charter, to conduct a biennial audit of the pension system. The June Plan assumes that the assumptions and methodologies used to calculate pension contributions will remain unchanged.

The prior consultant recommended that the pension systems revise their overtime assumptions to reflect the increased use of overtime, which would have raised contributions by about \$250 million annually, but this recommendation was not implemented. The consultant may affirm the recommendations of the previous consultant or make other recommendations, which could increase (or decrease) planned contributions.

4. Debt Service

City-funded debt service grew slowly between fiscal years 2011 and 2016, but growth will accelerate during the financial plan period (see Figure 22) as the City expands the capital program. Debt service increased at an annual average rate of 3.4 percent between fiscal years 2011 and 2016, but will grow by 7.5 percent annually over the next five years to reach \$8.1 billion by FY 2021. In total, debt service would increase by \$2.4 billion (43 percent).

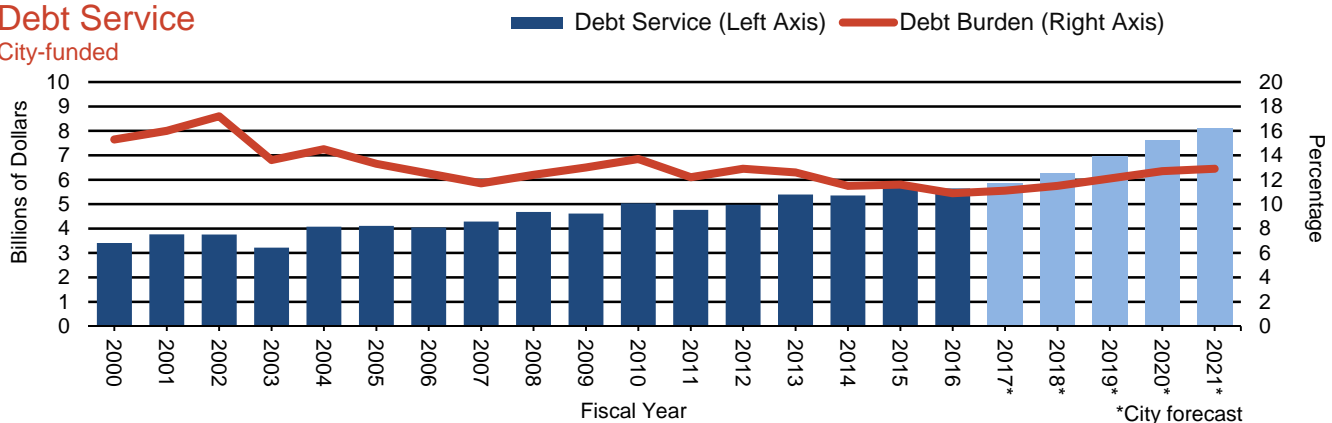
Borrowing is expected to more than double from \$3.7 billion in FY 2016 to more than \$9 billion annually from fiscal years 2019 through 2021. By FY 2021, debt outstanding would reach \$91.7 billion, \$22 billion more than in FY 2016.

Figure 22 also shows that debt service as a share of tax revenue (i.e., the debt burden) would rise from 10.9 percent in FY 2016 to 12.9 percent in FY 2021. Although debt service would account for a larger share of tax revenue, the share would remain below 15 percent, a level that is considered high. To prevent debt service from rising too quickly as a share of tax revenues, the City has created a capital stabilization reserve (\$250 million annually beginning in FY 2018).

The City's debt service projections are based on a number of assumptions, which may lead to an increase or decrease in the debt burden. For example, the debt service forecasts assume that the City will meet its annual capital commitment target, but the City has a long history of falling short of this target. The June Plan assumes City-funded capital commitments will total \$16.7 billion during FY 2018, compared with \$6.7 billion, on average, during fiscal years 2011 through 2017.

FIGURE 22
Debt Service

City-funded



Note: Debt service amounts are adjusted for prepayments and defeasances.
Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

Debt service is also dependent on interest rates. In recent years, interest rates have been at historic lows and the City has realized significant savings from refinancing outstanding debt and from variable-rate debt. Since the beginning of FY 2017, for example, the City has realized \$1.6 billion in debt service savings during the financial plan period.

The Federal Reserve has begun to raise short-term interest rates, which could reduce the opportunities for debt service savings in future years. In the near term, the City may continue to realize debt service savings given its conservative interest-rate assumptions. For FY 2018, OSC estimates that the City could realize savings of \$125 million from lower-than-expected variable interest rates.

Changes in federal tax policy could also affect the City's borrowing costs. Congress and the President support revising the federal tax code, including a reduction in personal income taxes. A reduction in the top tax rate could reduce the appeal of tax-exempt bonds. In the past, Congress has also considered capping or eliminating the federal tax exemption for municipal bonds. If that were to occur, New York City might have to increase the interest rate on its bonds to attract investors, which would increase borrowing costs.

5. Medicaid

Medicaid provides health insurance to low-income children and adults, and is the largest payer of long-term care. It also provides subsidies to health care providers, such as the Health and Hospitals Corporation, which serve large numbers of low-income patients and uninsured patients.

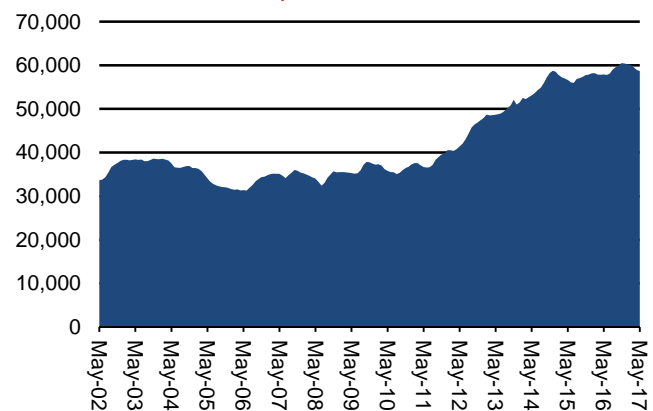
Medicaid enrollment grew slowly in the years following the recession, but accelerated with the implementation of the federal Affordable Care Act (ACA) in January 2014. Currently, 40 percent of the City's population is enrolled in Medicaid.

The June Plan assumes that the City-funded share of Medicaid will total \$5.8 billion in FY 2018 (9 percent of City-funded revenue) and will remain at that level because the State assumed financial responsibility for the growth in the local share. These estimates assume no change in federal Medicaid policies. However, Congress is considering legislation that would roll back the gains under the ACA and greatly reduce federal Medicaid funding to the states.

6. Homeless Services

The number of homeless people residing in shelters operated by the Department of Homeless Services (DHS) increased rapidly beginning in 2011, reaching a record of nearly 60,500 in November 2016 (see Figure 23). Despite an increase in homeless prevention initiatives and subsidized housing, the caseload continued to grow until recently. Over the past six months the caseload has declined by 3 percent, to 58,660 in May 2017.

FIGURE 23
Homeless Shelter Population Remains Elevated



Source: NYC Department of Homeless Services

In February 2017, the Mayor released a comprehensive plan to address homelessness. The plan calls for building 90 new borough-based shelters across the City over the next five years to reduce the reliance on costly

commercial hotels. The City has already opened five shelters and intends to open more during the summer. The Mayor’s plan also calls for expanding homeless prevention initiatives and housing programs.

To address homelessness statewide, the State approved a \$2.5 billion plan to create and preserve affordable and supportive housing. The plan includes \$100 million dedicated to the City for this purpose. In addition, the plan includes statewide funding for supportive (\$950 million), affordable (nearly \$500 million) and senior housing (\$125 million), among other initiatives. These funds will be distributed on a competitive basis, and the City will benefit from the creation of new State-funded housing for the homeless.

The cost of homeless services has increased in recent years, growing from \$1 billion in FY 2013 to a record \$1.8 billion in FY 2017. The trend reflects the growth in the shelter population and the City’s greater reliance on costly short-term housing (e.g., commercial hotels).

The June Plan assumes the cost will decline to \$1.6 billion in FY 2018 (\$889 million in City funds), driven by a reduction in the single-adult shelter population. Although the portion of the shelter population that consists of families with

children has declined, the single-adult population continues to rise, reaching a record level of 13,994 individuals in May 2017. Until the single-adult caseload begins to decline, the City-funded cost of sheltering the homeless could be higher by \$125 million annually beginning in FY 2018.

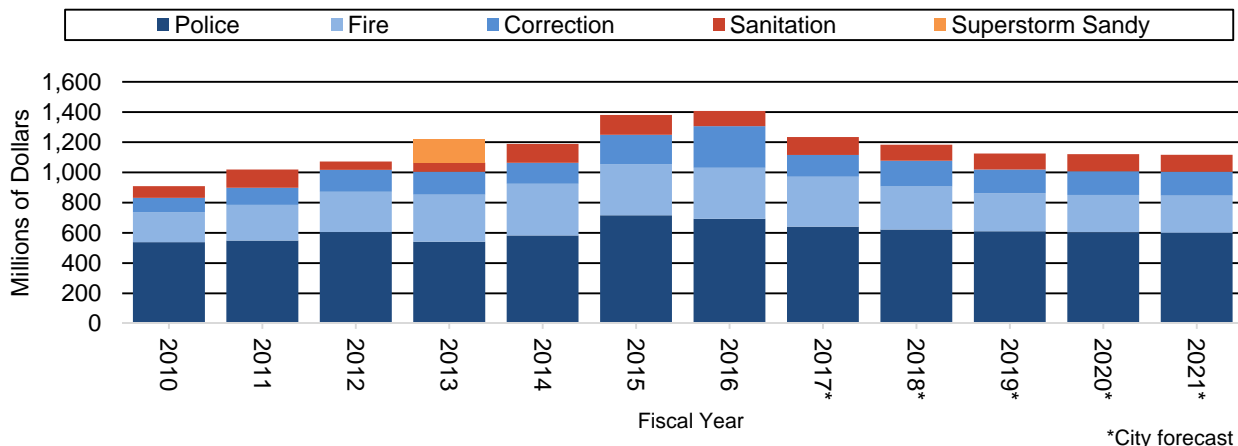
7. Uniformed Agencies

Overtime costs (both for uniformed and civilian employees) in the four uniformed agencies increased by 55 percent between fiscal years 2010 and 2016, reaching a record \$1.4 billion (see Figure 24). The increase has been concentrated in the Police Department and the Department of Correction.

Overtime costs at the Police Department were \$693 million in FY 2016, half of the total for all four uniformed agencies. In FY 2017, overtime at the Police Department will exceed \$700 million, about \$60 million more than forecast by the City.

Overtime costs at the Department of Correction doubled between fiscal years 2014 and 2016, reaching a record \$275 million, and will remain at about that level in FY 2017. The growth was largely driven by a high attrition rate (which led to understaffing) and new federal mandates. In an effort to reduce overtime, the Department of

FIGURE 24
Uniformed Agency Overtime



Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

*City forecast

Correction added nearly 1,100 correction officers through May of this fiscal year and plans to add another 673 officers by the end of FY 2018. The June Plan assumes that uniformed staffing will reach 10,420 by the end of FY 2018, the highest since FY 2002.

The Mayor recently announced his conditional support for calls to close the nine inmate facilities located on Rikers Island, where the City houses about 7,000 inmates. The Independent Commission on New York City Criminal Justice and Incarceration Reform has recommended that the City replace these facilities with modern correctional facilities in each of the City's boroughs at a cost of \$10.6 billion.

Overtime will exceed \$1.4 billion in FY 2017, about \$200 million more than expected by the City. These unplanned costs, however, were offset by savings in other personal service costs and the receipt of federal funding (including reimbursement for protecting the President and his family).

The June Plan assumes that overtime will decline by \$200 million in FY 2018, but this seems unlikely given current trends. While there may be some reduction in overtime, OSC estimates that overtime could exceed the City's forecast by \$125 million annually beginning in FY 2018.

8. Public Assistance

The largest public assistance programs in New York State are the Family Assistance (FA) and Safety Net Assistance (SNA) programs. The FA program, which is fully federally funded, provides five years of lifetime benefits to low-income families with children. The SNA program provides benefits to families that have exhausted

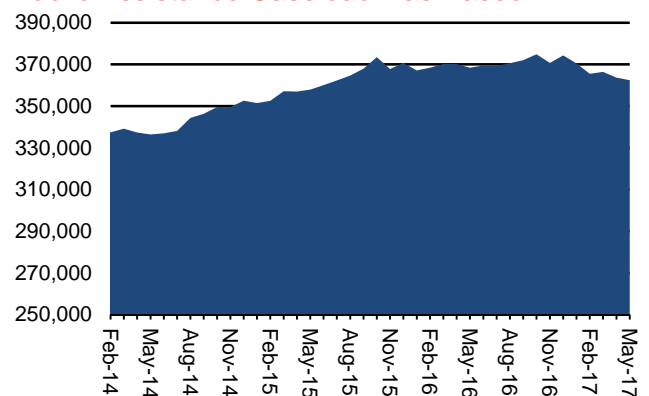
their federal benefits and to low-income individuals who are ineligible for federal benefits.

The FA caseload fell sharply in response to reforms enacted in the 1990s, including the introduction of time limits and work requirements. After five years, there was a sharp increase in SNA enrollment as families exceeded their lifetime FA benefits and transferred to the State program.

The City's public assistance caseload rose by 11 percent between May 2014 and December 2016 to exceed 374,300 (see Figure 25). Most of the increase occurred in the SNA program, which accounts for about 60 percent of the total caseload and is funded by the State and City.

Since December 2016, the caseload has declined by nearly 3 percent to 362,400 in May 2017. There has been a reduction in the number of families receiving assistance and the SNA caseload has stabilized. Despite these trends, the June Plan assumes that the caseload will resume growing, averaging 371,000 during FY 2018. The City expects the City-funded cost of public assistance to increase by 13 percent to \$708 million in FY 2018, but it could realize savings if current trends continue.¹⁶

FIGURE 25
Public Assistance Caseload Has Eased



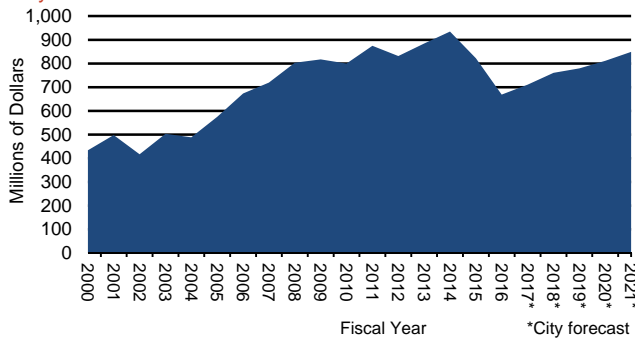
Source: NYC Human Resources Administration

¹⁶ The federal and State governments are expected to fund \$887 million of public assistance costs in FY 2018.

9. Energy

Energy costs (i.e., electricity, fuel and heat) reached a record high of \$935 million in FY 2014 (see Figure 26), but then declined sharply as prices for electricity, fuel and heat all fell. The June Plan assumes that energy costs will increase at an average annual rate of 4.6 percent during the financial plan period.

FIGURE 26
Energy Costs
City-Funded



Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

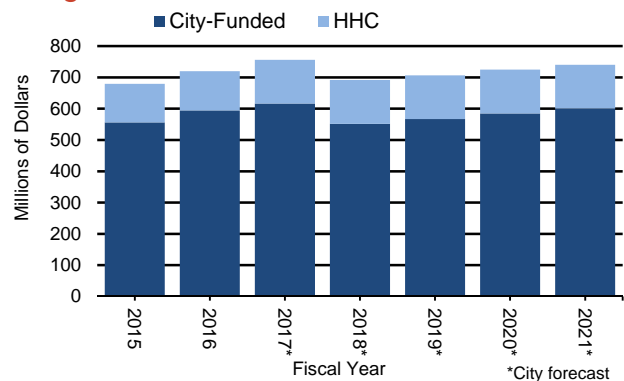
While costs would reach \$849 million by FY 2021, they would still be lower than the level of energy costs incurred in FY 2013. Moreover, energy costs have eased in recent years as new energy sources have entered the market, putting downward pressure on prices. As a result, costs may not increase as quickly as assumed in the June Plan.

The Governor has announced an agreement to close the Indian Point nuclear power plant by 2021. The agreement will not affect New York City or the Metropolitan Transportation Authority because these entities have long-term agreements with the New York Power Authority, which has not purchased electricity from Indian Point since 2013.

10. Judgments and Claims

The cost of judgments and claims, including those associated with the Health and Hospitals Corporation, has risen over the past three years. The increase has been driven largely by several large settlements. The June Plan assumes that the cost will decline in FY 2018 to \$692 million, and then increase slowly in subsequent years (see Figure 27).

FIGURE 27
Judgments and Claims Costs



Sources: NYC Comptroller; NYC Office of Management and Budget; NYC Health and Hospitals Corporation; OSC analysis

While the Health and Hospitals Corporation is required to reimburse the City for costs related to its activities, it was unable to do so during fiscal years 2016 and 2017 as a result of ongoing financial challenges, and it is unclear whether it will be able to reimburse the City for these costs in the future.

IX. 10-Year Capital Plan

In April 2017, the City released its biennial 10-year capital strategy, which totals \$95.8 billion. The strategy is \$6.3 billion larger than the preliminary strategy released in January 2017, and \$12 billion larger than the 10-year strategy proposed two years earlier.

Most of the increase from two years ago is concentrated in environmental protection, transportation and housing. The City would fund \$88.9 billion of the cost with debt supported by locally generated revenues, an increase of \$13.4 billion from May 2015. The balance would be funded with federal and State grants.

As shown in Figure 28 and discussed below, more than two-thirds of the capital resources would be invested in projects involving education, environmental protection, transportation and housing.

Education projects would be allocated \$20.5 billion, mostly to support the construction of new schools and the rehabilitation and expansion of existing schools (\$15.3 billion). The remainder would support emergency repairs, administrative costs, technology upgrades, Smart Schools Bond Act projects and enhanced security systems (\$5.2 billion).

Environmental protection projects (\$18.1 billion) would focus on maintaining and protecting the City’s water supply, including pollution control,

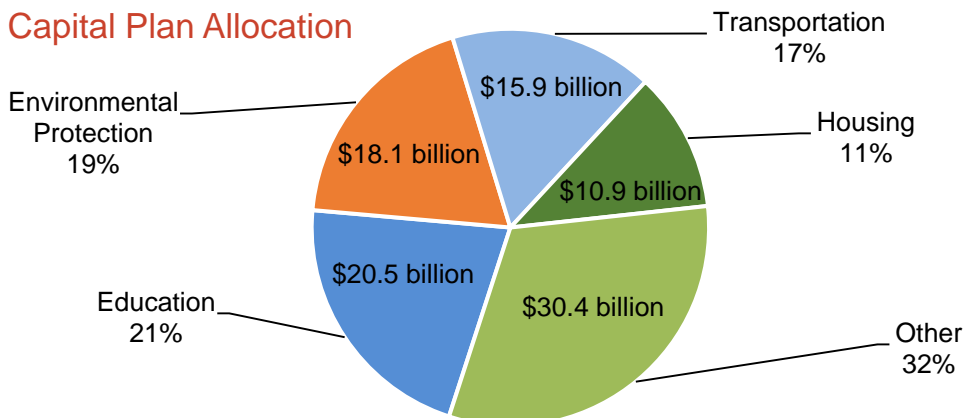
maintenance and upkeep of the water supply and distribution system, and sewers. The City’s third water tunnel, which delivers water from upstate reservoirs, would be allocated \$987 million for the completion of construction.

Of the \$15.9 billion allocated to transportation projects, \$8.2 billion would support the reconstruction and rehabilitation of bridges, including \$2.8 billion for a bridge on the Brooklyn-Queens Expressway and the East River bridges. Another \$5.9 billion would fund street and sidewalk reconstruction, such as resurfacing 7,640 lane miles.

The capital strategy would provide the MTA with \$655 million over the next 10 years. However, the City has agreed to provide the MTA with \$2.5 billion for its 2015-2019 capital program. The City has indicated that it will provide proportional matches concurrently with additional State funds in accordance with the funding needs of the capital program.

Housing projects would receive \$10.9 billion, including \$6.8 billion for the construction and preservation of affordable housing. Funding for housing has increased by \$8 billion since 2013 as the Mayor continues his program to construct and preserve 200,000 affordable apartments by 2024. The New York City Housing Authority would receive \$1.4 billion, including \$1 billion to repair 729 roofs.

FIGURE 28
10-Year Capital Plan Allocation



Sources: NYC Office of Management and Budget; OSC analysis

X. Semi-Autonomous Entities

1. Health and Hospitals Corporation

The Health and Hospitals Corporation (the largest municipal hospital system in the country) continues to face serious financial challenges. Factors contributing to the crisis include large numbers of uninsured patients, increased competition for Medicaid patients and high overhead costs. The number of patients who receive services at the Corporation's facilities continues to decline, which has caused patient revenues to decline.

The Corporation has increasingly relied on the City to meet its financial obligations, but the City was confident during most of FY 2017 that additional assistance would not be needed.¹⁷ However, it became clear during the closing weeks of the fiscal year that the receipt of \$600 million in supplemental Medicaid payments would be delayed. As a result, the City allowed the Corporation to delay repaying \$403 million owed to the City until FY 2018.¹⁸

In total, the Corporation is scheduled to pay the City \$742 million in FY 2018. The receipt of supplemental Medicaid payments previously expected in FY 2017 would fund most of this obligation, but there is no assurance that the full amount will be realized.

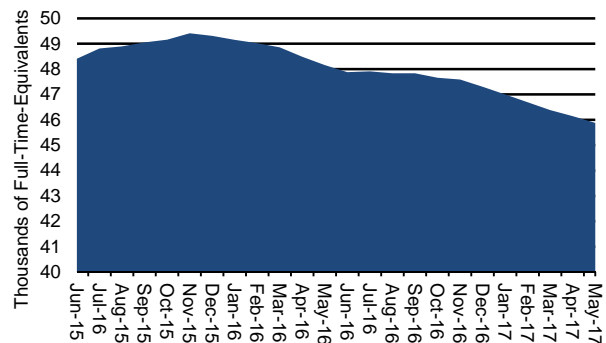
The Corporation has not yet identified the sources of the remaining funds, casting doubt on whether the Corporation will be able to fulfill its obligation to the City in FY 2018. In the past under similar circumstances, the City has forgiven or allowed the Corporation to delay repayment of medical malpractice claims (\$140 million) and employee fringe benefits (\$24 million). The Corporation has not fulfilled all of its financial obligations to the City in the year in which they were due for at least seven fiscal years.

The Corporation is implementing a transformation plan to improve its financial situation, with the expectation of generating cumulative resources of \$6.7 billion over the next four years. Without the benefit of these actions, losses would grow from \$1.1 billion in FY 2018 to \$1.9 billion by FY 2021.

The transformation plan assumes that the Corporation will restructure health care services (\$1.4 billion), improve revenue collections (\$632 million), create procurement efficiencies (\$582 million), reduce staffing (\$400 million) and increase MetroPlus enrollment (\$284 million).

While the Corporation has not yet announced the details of its restructuring program, it has made progress in reducing staffing after some initial difficulties. Staffing has declined by almost 3,528 full-time-equivalent positions between November 2015 and May 2017 (see Figure 29), a reduction of 7 percent.

FIGURE 29
Health and Hospitals Corporation Staffing



Sources: Health and Hospitals Corporation; OSC analysis

The Corporation has also made progress in improving revenue collections and reducing procurement costs. However, it remains to be seen whether the Corporation can meet its ambitious targets during the financial plan period.

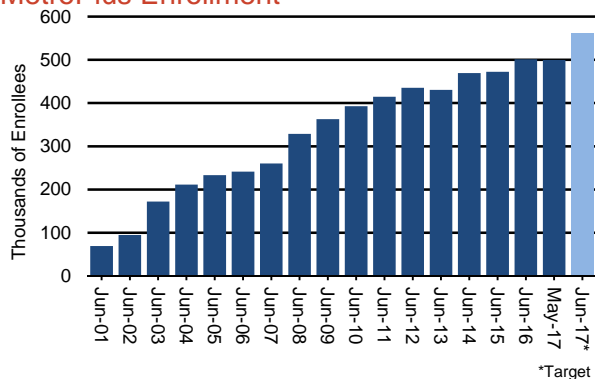
¹⁷ In FY 2018, the City will provide \$1.8 billion in financial support, representing nearly one-third of the Corporation's total revenues.

¹⁸ In FY 2017, the City prepaid \$300 million in FY 2018 subsidies to the Corporation, which gave it additional budgetary flexibility.

Enrollment in MetroPlus increased through June 2016, but not as fast as the Corporation had hoped. In April 2015, the Corporation announced a MetroPlus enrollment target of 1 million members by the end of calendar year 2020, but one year later the target was reduced by one-third to 675,000 members.

The Corporation had expected MetroPlus enrollment to increase by almost 60,000 members during FY 2017, but as of May 1, 2017, it had declined by more than 1,700 members (see Figure 30). In response, the Corporation is likely to again revise its enrollment target downward.

FIGURE 30
MetroPlus Enrollment



Sources: Health and Hospitals Corporation; OSC analysis

The transformation plan also counts on the receipt of an additional \$2.3 billion in federal funding over the next four years. However, this seems unlikely given the health care debate currently taking place in Congress. It is more likely that existing revenue streams could be put at risk.

About half of the Corporation’s budget is funded by the federal government (about \$3.3 billion annually). Some of these resources may be at risk because Congress is considering legislation that would eliminate the enhanced Medicaid reimbursement rate for certain new enrollees, reduce health insurance subsidies and cap federal Medicaid funding to the states.

If enacted into law, such legislation would adversely affect the Corporation’s budget. The Corporation estimates that 200,000 of its patients could lose insurance coverage, resulting in the loss of \$500 million annually in patient revenue under the House bill. The Senate bill includes similar provisions.

It is clear that the Corporation is facing serious financial challenges. Changes contemplated at the federal level present the greatest risk to the Corporation’s future and to the health of millions of New Yorkers.

2. New York City Housing Authority

The New York City Housing Authority (NYCHA) is an important component of the City’s supply of affordable housing. NYCHA manages approximately 176,000 apartments that house nearly 400,000 residents, which amounts to 8 percent of the City’s rental apartments. As of March 2017, nearly 257,000 families were waiting for apartments to become available.

Federal funds make up 59 percent (\$1.9 billion) of NYCHA’s operating budget and 90 percent of the portion not funded with rent proceeds. The capital budget also relies heavily on federal funding. However, as a result of shortfalls in federal funding, coupled with other fiscal and management challenges, the City’s public housing properties have fallen i/nto disrepair.

In response, NYCHA has developed a 10-year plan to close projected budget gaps and to improve the condition of its facilities. As part of the plan, the City has increased its financial support, and NYCHA is reducing administrative costs. In 2017, NYCHA decreased the number of administrative staff by 156 positions while increasing its maintenance staff by 239 positions.

Although NYCHA’s financial plan projects surpluses of \$21 million in 2017 and \$61 million in 2018, these estimates assume the receipt of \$140 million in 2017 and \$133 million in 2018

from the sale of development rights. While NYCHA continues to have discussions about such opportunities, it has not yet reached agreements to realize the anticipated amounts. In addition, NYCHA is concerned that the President's budget would reduce federal funding in 2018 (by up to \$130 million to its operating budget and by \$210 million to its capital budget).

NYCHA's five-year capital program is also greatly underfunded. The City has agreed to increase its contribution by \$413 million to nearly \$1 billion, and the recently enacted State budget allocates \$200 million for capital projects. Even with these additional resources, the capital program would fall \$11.5 billion short of NYCHA's stated capital needs. NYCHA is working on a revised capital needs assessment, which is likely to show a much larger unfunded capital need.

To narrow the gap in its capital program, NYCHA is counting on \$3 billion in public and private financing by enrolling 15,000 units over 10 years in the federal Rental Assistance Demonstration (RAD) program. NYCHA closed its first RAD transaction in December 2016, securing \$325 million for capital improvements to 1,400 units in Far Rockaway, Queens. It also received federal approval to seek financing for an additional 1,700 units (\$300 million). Nevertheless, there is no assurance that the remaining units will be approved or that the full \$3 billion in financing will be realized.

3. Metropolitan Transportation Authority

In September 2016, OSC issued a report that concluded that the Metropolitan Transportation Authority (MTA) had recovered from the recession but that it still faced challenges. Labor agreements were set to expire beginning in December 2016, and the State and City had not identified the sources of \$9.2 billion of their

\$10.8 billion commitment to the MTA's capital program.

On January 15, 2017, the MTA reached a labor agreement with the Transport Workers Union (TWU), its largest union. The agreement covers the period from January 2017 to May 2019, and calls for a total wage increase of slightly more than 5 percent and enhanced dental benefits.

Although the costs of wage increases were partly offset by savings from other contract provisions, the net cost of the TWU agreement was still greater than the MTA had budgeted. However, the MTA has been able to accommodate the increase within its financial plan.

The agreement permits the TWU to reopen negotiations if the Long Island Rail Road (LIRR) unions receive larger wage increases than those provided to the TWU. The MTA has reached agreement with 75 percent of the unions representing the LIRR and all have followed the TWU pattern.

The enacted State budget for SFY 2017-18 appropriates \$4.5 billion in tax revenues and State subsidies for the MTA's operating budget, \$125 million less than the MTA anticipated in November 2016.

The MTA's financial plan reflects the impact of the enacted State budget and the TWU labor agreement. While it projects positive year-end cash balances through calendar year 2019 on the assumption that fares and tolls will increase by 4 percent biennially, it projects budget gaps of \$112 million in 2020 and \$493 million in 2021.

In May 2016, the State Capital Program Review Board (CPRB) approved a new five-year capital program for the MTA, covering the 2015-2019 period.¹⁹ The program had a total value of \$29.6 billion, including the portion devoted to

¹⁹ The CPRB is comprised of representatives of the Governor, the Speaker of the State Assembly, the Majority Leader of the State Senate and the Mayor of the City of New York.

bridges and tunnels, which is not subject to CPRB approval.

The CPRB recently approved an amendment to the 2015-2019 program. The revised program would increase the capital program by \$2.9 billion to \$32.5 billion. Of this amount, \$25.3 billion would be devoted to maintenance and modernization, and \$7.1 billion would be devoted to expansion projects.

Most of the increase (\$2 billion) is devoted to building a third LIRR track between Floral Park and Hicksville, and eliminating seven grade crossings along that route. The amount of funding for the second phase of the Second Avenue Subway would increase by \$700 million, raising the total amount in the current capital program to \$1.7 billion.

The State has agreed to contribute nearly \$8.5 billion toward the cost of the MTA's capital program. So far, it has appropriated \$5.5 billion and has identified sources of funding for \$1.1 billion of its commitment.²⁰

In addition to capital grants, the State's fulfillment of its capital commitment could include authorizing the MTA to issue bonds backed by an existing or new State revenue source.

The State intends to provide the MTA with these resources after the MTA has effectively exhausted all other MTA sources of capital funding, but no later than SFY 2025-26 or the completion of the capital program. The City has agreed to increase its contribution to \$2.5 billion, but its 10-year capital program only includes \$655 million.

The average number of miles that a subway train runs before it breaks down (mean distance between failures) has dropped for five straight years, from 172,000 miles in 2011 to 112,000 miles in 2016. Subway delays have averaged

more than 60,000 per month during 2017, twice the monthly average in 2013.

To address these deficiencies, the MTA has proposed an \$836 million subway stabilization program. The MTA has proposed that the cost of the program (\$450 million in additional operating costs and \$386 million in additional capital costs) be funded equally by the State and the City.

LIRR service has deteriorated as a result of inadequate maintenance of the tracks, switches and signals in Penn Station, which is owned and operated by Amtrak. Amtrak has begun emergency repairs during the summer months that have reduced the number of trains serving Penn Station by 20 percent. The LIRR has taken steps to mitigate the impact on riders.

The Governor has proposed expanding the capital program by an additional \$1 billion to address the deterioration of the performance of the City's subways and the LIRR. He has also directed the MTA chairman to review the priorities of the capital plan by August 28, 2017. The MTA has indicated that it will call for an additional capital investment of \$8 billion to purchase new subway cars and to install a modern signal system.

The MTA is dependent, in part, on the federal government to help fund capital improvements. Although it receives no operating budget subsidies, nearly one-quarter (\$7.5 billion) of the MTA's 2015-2019 capital program is expected to be funded by the federal government.

The President's proposed federal budget would effectively eliminate the New Starts program, which the MTA has used to fund expansion projects. The MTA is counting on the federal government to fund approximately \$2 billion of the \$6 billion estimated cost of the next phase of the Second Avenue Subway, but this funding may now be at risk.

²⁰ Of the \$1.1 billion, \$750 million would come from bond proceeds and another \$315 million would come from financial settlement funds.

4. Department of Education

New York City has the largest public school system in the nation, operating more than 1,800 schools and serving more than 1.1 million students. The June Plan allocates \$30.8 billion to the Department of Education in FY 2018 to cover the cost of educating students in the City's public schools. Of this amount, \$17.5 billion (57 percent) would come from the City and \$11.4 billion (37 percent) would come from the State, with \$1.8 billion (6 percent) from the federal government.

The recently enacted State budget increases general support for the City's public schools by \$387 million in FY 2018. The State has also increased funding for charter schools in the upcoming school year, but the State budget requires future increases to be paid by the City. On June 29, 2017, the State Legislature extended mayoral control of the City school system for two years.

The June Plan includes the Mayor's proposal to offer free full-day prekindergarten to all three-year-olds. Initially, the City will allocate \$36 million in FY 2018 to provide this service in two school districts. The amount will rise to \$177 million annually by FY 2021, when the program will cover eight districts. To serve all three-year-olds in every school district will require an additional \$700 million annually, which the City hopes will come from the State or federal governments.

The budget also allocates nearly \$29 million over the next five years to ensure that all classrooms are equipped with air conditioning by 2022. In addition, the budget provides \$10 million for supportive services for homeless students in FY 2018. The Independent Budget Office reports that 32,803 students were living in shelters in the 2015-16 school year.

The School Construction Authority's five-year capital plan provides \$15.5 billion in capital

funding between fiscal years 2015 and 2019. Of that amount, \$12.5 billion (81 percent) is funded by the City, \$2.5 billion (16 percent) is funded by the State (including \$783 million from the Smart Schools Bond Act), and \$500 million (3 percent) comes from the federal government and other sources. The capital plan funds the creation of 44,324 new seats in K-12 schools, 54 percent of the identified need of 82,811 seats. The remaining seats will not be funded until the next five-year capital plan.

Each year, the Department of Education submits Medicaid reimbursement claims for eligible services provided to special education students. However, the department has historically had difficulty substantiating such claims to the federal government.

Although the department hired a consultant to improve the claiming process, the computer system used to document claims also has encountered problems. The City plans to spend an additional \$97 million during the financial plan period (nearly \$16 million in FY 2017 and about \$20 million annually over the next four years) to address the shortcomings. The department is also making several other improvements to increase the likelihood of receiving Medicaid reimbursements.

In FY 2016, the department submitted claims totaling \$18 million, which is \$79 million less than the target at the beginning of the fiscal year. The June Plan is assuming that Medicaid reimbursements will more than double to \$41 million in FY 2017 and will reach \$97 million annually beginning in FY 2018. However, as of July 13, 2017, the City had received less than \$15 million in Medicaid reimbursements for FY 2017.

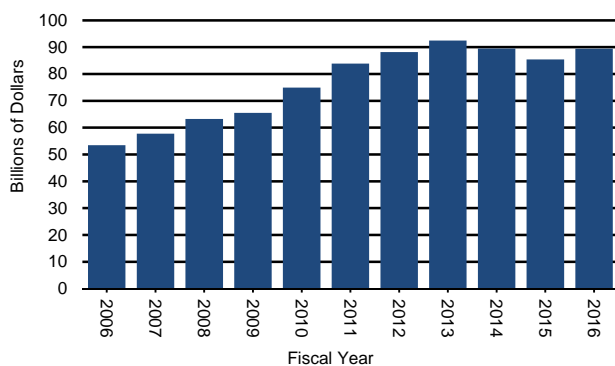
Until the department can demonstrate the ability to adequately document such claims, it remains uncertain whether the City can increase reimbursements above the FY 2016 level, putting \$79 million at risk beginning in FY 2018.

XI. Other Issues

1. Post-Employment Benefits

The City's unfunded liability for post-employment benefits other than pensions (OPEBs) increased by \$3.9 billion to \$89.4 billion in FY 2016, the first increase since FY 2013 (see Figure 31). The increase is driven mostly by revised mortality tables that reflect longer life expectancies.

FIGURE 31
Unfunded OPEB Liability



Sources: NYC Actuary; OSC analysis

In 2015, the Governmental Accounting Standards Board approved two rules (which take effect in FY 2018) that could increase the City's OPEB liability. For example, entities that do not fund their OPEB liabilities on an actuarial basis could be required to discount future costs using an interest rate that is lower than the assumed rate of return on investments, which would increase the unfunded liability.

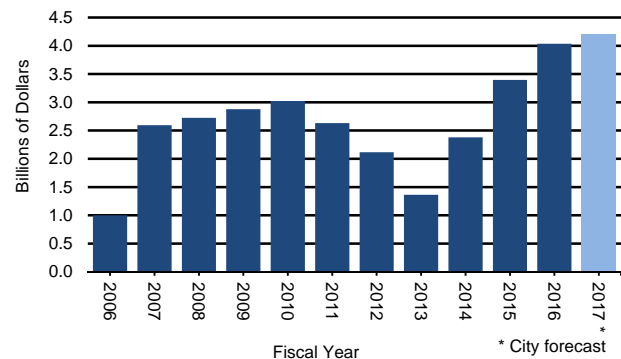
The City, like many employers, does not fund its OPEB liabilities on an actuarial basis but rather pays the annual cost of benefits to current retirees on a pay-as-you-go (PAYGO) basis. OPEB costs, on a PAYGO basis, are projected to rise from nearly \$2.2 billion in FY 2016 to \$2.9 billion in FY 2021, an increase of 34 percent over five years.

2. Retiree Health Benefits Trust

In FY 2006, the City established the Retiree Health Benefits Trust (RHBT) to help fund the future cost of OPEBs. During fiscal years 2006 and 2007, the City deposited \$2.5 billion of surplus resources into the RHBT. These resources were invested and earned interest, with the balance exceeding \$3 billion by FY 2010.

While the RHBT was intended to help fund future OPEB liabilities, it has been used as a rainy-day fund in the past. The City drew down much of the resources in the RHBT during fiscal years 2011 through 2013 as it managed through the Great Recession (see Figure 32). During fiscal years 2014 through 2016, the City rescinded a planned drawdown of \$1 billion and contributed \$2.3 billion to the RHBT (a total financial benefit of \$3.3 billion). In FY 2017, the City contributed an additional \$100 million, raising the RHBT balance to nearly \$4.2 billion, the highest amount ever.

FIGURE 32
RHBT Year-End Balance



Note: Adjusted for prepayments in fiscal years 2008, 2009 and 2017.
Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

3. Prior Years' Expenses

At the end of each fiscal year, the City estimates the amount of expenses that have been incurred but not yet paid, and the amount of revenues earned but not yet received. The City generally makes conservative estimates because an unfunded liability has a budgetary impact in the current fiscal year.

Over the past 10 years, the City has realized an average benefit of \$459 million annually from overestimating prior years' expenses and from underestimating prior years' receivables. The City realized a net benefit of \$322 million in FY 2016, largely from an overestimation of prior-year education expenses. The June Plan anticipates savings of \$500 million in FY 2017, but none in subsequent years.

4. Reserve for Disallowances

The City maintains a reserve for disallowances of federal and State aid. From fiscal years 1980 through 2005, the reserve averaged \$230 million annually, but the City began to increase the reserve in FY 2006 after federal audits found that claims for \$800 million in Medicaid reimbursement could not be fully documented. The reserve reached nearly \$1.2 billion by the end of FY 2011.

After most of the Medicaid liability had been settled, the City reduced the reserve to \$1 billion in FY 2012, based on a change in the methodology used to calculate the risk of future disallowances. Each year, the City Comptroller, in consultation with the City's independent auditor, performs a risk assessment to determine the adequacy of the reserve.

The City recently completed an assessment and found that disallowances over the past five years were lower than anticipated. Based on these

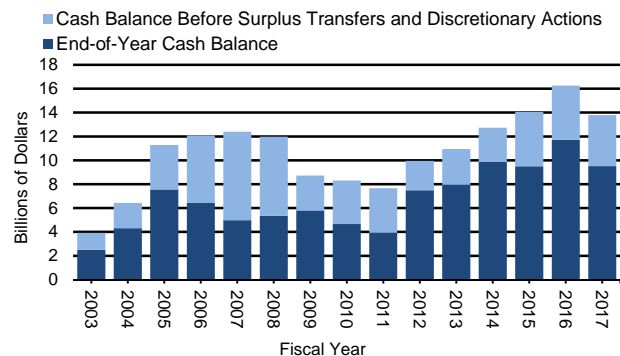
results, the City reduced the reserve by \$628 million in FY 2017, leaving nearly \$498 million in the reserve. The City will continue to contribute \$15 million annually to the reserve.

5. Cash Flow

The City's year-end cash balance rose sharply between fiscal years 2003 and 2007, reflecting the strength of the economy, and remained at about \$12 billion (before discretionary actions) through the end of FY 2008 (see Figure 33).²¹ Even though the year-end cash balance declined during the recession, the City has not needed to borrow to meet its short-term cash needs since FY 2004.

From FY 2011 through FY 2016, the City's cash position continuously improved, reaching a record level of \$16.3 billion in FY 2016 (before discretionary actions). The New York City Office of Management and Budget estimates that the City's year-end cash balance will decline in FY 2017 to \$13.8 billion (\$9.5 billion after discretionary actions). Given the amount of cash on hand, the City does not anticipate needing to borrow to meet its cash flow needs during the financial plan period, resulting in debt service savings of \$373 million.

FIGURE 33
Year-End Cash Balance



Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

²¹ Discretionary actions include surplus transfers and deposits into the Retiree Health Benefits Trust.

6. Credit Rating

The City-funded portion of the City's capital program is financed through general obligation (GO) bonds secured by the City's full faith and credit, and bonds issued by the Transitional Finance Authority (TFA) secured by personal income tax and (if needed) sales tax revenues. The City's GO ratings were last upgraded in the summer of 2007, and the City was able to maintain its ratings through the recession.²²

The City's strong credit ratings contribute to its ability to access the capital markets to meet its financing needs, and to help keep its borrowing costs at reasonable rates. The City's GO credit is rated AA by Standard & Poor's, AA by Fitch Ratings and Aa2 by Moody's Investors Service, while the TFA credit is rated higher (AAA by S&P, AAA by Fitch and Aaa by Moody's).²³ Both credits have a stable outlook from the three rating agencies.

The TFA's credit rating benefits from the strong statutory revenue streams used to secure its bonds, while GO ratings reflect the City's broad economic base, sound financial planning practices and demonstrated ability to close anticipated budget gaps. However, the rating agencies have expressed concern over the City's continued reliance on the financial services sector (although it is not as pronounced as in the past), a high debt burden and pressure from rising nondiscretionary costs.

²² Fitch Ratings and Moody's Investors Service recalibrated their ratings in April 2010 so that municipal ratings are comparable with ratings in other sectors. As a result, GO and TFA ratings were adjusted upward by one notch, though the adjustment does not reflect a change in credit quality.

²³ Fitch and S&P do not make a rating distinction between TFA senior and subordinate bonds. Moody's rates TFA subordinate bonds one notch lower (Aa1) than it rates senior bonds.

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