



# The Financial Outlook for the Health and Hospitals Corporation

**Alan G. Hevesi**  
New York State Comptroller

**Kenneth B. Bleiwas**  
Deputy Comptroller

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- The Corporation projects a budget gap of \$612 million for FY 2006, which represents 14.8 percent of revenues.
- The Governor's Executive Budget would widen the gap by as much as \$275 million.
- The Corporation has lost market share. For example, its share of Medicaid inpatient discharges declined from 30 percent in 1995 to 25 percent in 2002.
- The Corporation provided charity care to more than 400,000 New Yorkers last year at a cost of \$243 million.
- Third-party payers, such as private insurers and Medicaid, funded 89 percent of the Corporation's expenses in FY 1999, but will fund only 75 percent by FY 2005.
- Pension contributions are projected to grow from \$21.7 million in FY 2003 to more than \$200 million by FY 2007.
- The cost of judgments and claims has risen from \$79 million in FY 1995 to a projected \$184 million in FY 2005.
- The Corporation reduced the number of inpatient beds by 28 percent between fiscal years 1994 and 2000, which increased occupancy rates from 84 percent in FY 1994 to 91.4 percent in FY 2000.
- The Corporation reduced staffing levels by about 30 percent between fiscal years 1994 and 2000.
- Since FY 1996, more than \$1.5 billion has been invested in the Corporation's facilities. These investments modernized acute care facilities, and constructed new ambulatory care facilities.

The Health and Hospitals Corporation ("the Corporation") operates eleven acute care hospitals, four long-term care facilities, six freestanding diagnostic and treatment centers, many hospital-based and neighborhood clinics, a certified home health agency, and its own managed care health service provider, MetroPlus.

The Corporation's primary mission is to provide comprehensive medical and mental health services to patients regardless of their ability to pay. The Corporation's audited financial statements show that it provided \$615 million in uncompensated care in FY 2004.

Over the past decade, the Corporation has taken a number of steps to reduce costs, increase revenues, and improve services in an effort to improve its bottom line. Nonetheless, the Corporation's cash position has been eroding since FY 2000 because of a loss of market share, outdated reimbursement formulas, and rising pension contributions.

New York City recently increased its subsidy to the Corporation by \$150 million annually, but the Corporation still projects a cash deficit of \$612 million for FY 2006, and similar gaps in subsequent years. Moreover, these estimates do not provide for wage increases for employees who have not yet reached new collective bargaining agreements; and for other factors that could increase costs above the Corporation's forecasts.

The Corporation is making progress on a number of cost-reduction and revenue-enhancement initiatives to close the budget gap projected for FY 2006, but fundamental reforms will require changes at the federal and State level. The budgets proposed by the Governor and the President, however, could set back the Corporation's efforts to balance its budget. Unless the Corporation's gap-closing efforts are successful, the City could be called upon to provide additional assistance.

## Cash Versus Accrual Accounting

Accrual accounting recognizes revenues when they are earned and expenses when they are incurred. In contrast, cash accounting records revenues when they are received and expenses when they are paid. While all financial entities must track their cash condition in order to pay bills, accrual accounting generally provides a more accurate account of financial condition because it consistently recognizes revenues and expenses and minimizes differences due to timing.

The Governmental Accounting Standards Board requires the Corporation to prepare its annual audited financial statements on an accrual basis, which the Corporation does. The Corporation also voluntarily issues unaudited quarterly financial statements on an accrual basis. Although the New York State Financial Emergency Act also requires the Corporation to prepare its four-year financial plan on an accrual basis, the Corporation prepares its financial plan on a cash basis.

The State Comptroller, as part of his ongoing efforts to improve the financial reporting of public authorities, has recommended that the Corporation prepare its budget and financial plan on both an accrual and cash basis, and reconcile the differences so that a more complete picture of the Corporation's finances can be obtained. In response to a draft of this report, Corporation officials agreed to prepare cash and accrual financial plans, and the City of New York has agreed to submit them to the Financial Control Board beginning with the Mayor's Executive Budget in May 2005.

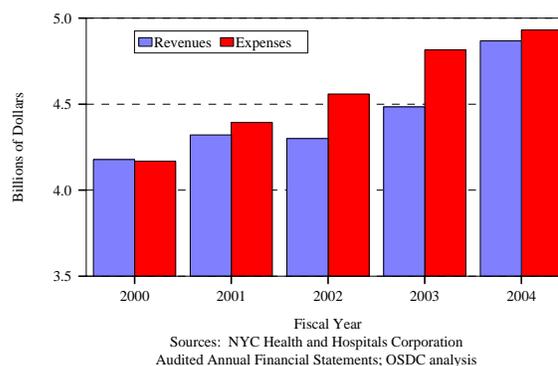
## Expenditures Outpace Revenues

In FY 2000, the Corporation's cash receipts exceeded expenses by \$104 million and its financial statements were balanced in accordance with generally accepted accounting principles ("GAAP") for the fifth consecutive year. These impressive accomplishments reflect management actions that were taken to reduce costs and to obtain additional reimbursement for past services.

According to the Corporation, the implementation of mandatory Medicaid managed care and State and federal budget cuts in FY 2000 represented the start of a downward trend for the Corporation and

other hospitals and health care providers. Although the Corporation achieved a GAAP-balanced budget in FY 2000, it did so only by eliminating, in tandem with the City, an accrued pension liability of \$93 million. Without this adjustment, the Corporation would have reported a loss of \$84 million. Also, after FY 2000, the Corporation obtained far less revenue from settlements of appeals on insurance reimbursement, which it had relied upon to help balance budgets during the preceding four years.

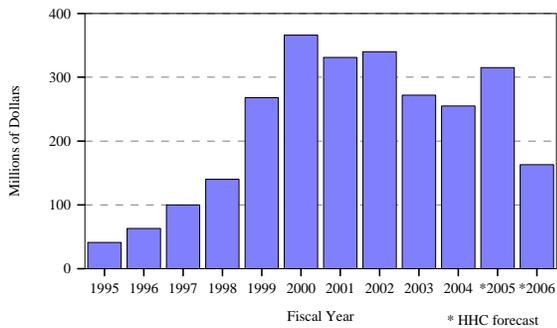
**Graph 1**  
**Expenditures Grow Faster Than Revenues**



As shown in Graph 1, the Corporation reported annual deficits on an accrual basis during each of fiscal years 2001 through 2004. Expenditures grew by 4.3 percent, on average, during fiscal years 2000 through 2003, but revenues grew at an average annual rate of only 2.4 percent. To help the Corporation balance its budget, the City increased its subsidy to the Corporation by \$200 million in FY 2005. The gap between revenues and expenditures narrowed in FY 2004 because the City prepaid most of the subsidy planned for FY 2005, which also helped to increase the Corporation's closing cash balance in that year.

The Corporation built up a cash balance of \$366 million by the end of FY 2000, mostly from the receipt of large retroactive third-party reimbursements. In FY 2001, however, the Corporation began to draw down its cash reserves as a result of operating losses. The Corporation now projects that it will end FY 2005 with a cash balance of \$315 million, which will decline to \$163 million by the end of FY 2006 (see Graph 2).

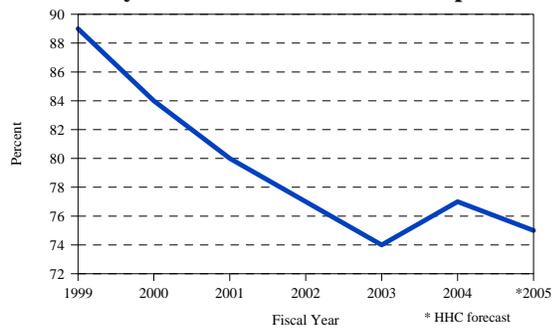
**Graph 2**  
**Accumulated Cash Balances**



Sources: NYC Health and Hospitals Corporation; OSDC analysis

The Corporation's financial difficulties are reflected in the decline in revenue from third-party payers as a percent of the cost to provide services. As shown in Graph 3, third-party revenues funded 89 percent of the Corporation's expenses in FY 1999, but that share declined to 74 percent by FY 2003 and is projected to be 75 percent in FY 2005.<sup>1</sup>

**Graph 3**  
**Third-Party Revenues as a Percent of Expenditures**



Sources: NYC Health and Hospitals Corporation Audited Financial Statements and Unaudited Accrual Forecast; OSDC analysis

## Bad Debt and Charity Care

During the past three fiscal years, the Corporation has focused its efforts on enrolling eligible uninsured patients into Child Health Plus, Family Health Plus, and Medicaid; and on publicizing and expanding the availability of charity care to households with incomes below 400 percent of the federal poverty level, under an initiative known as HHC Options. As a result, the number of uninsured patients served by the Corporation has

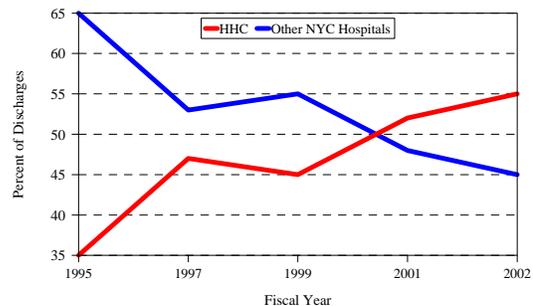
<sup>1</sup> Third-party receipts represent reimbursement for medical care from insurance or other coverage programs such as Medicaid and Workers Compensation, as well as "self-pay" patients.

declined from about 560,000 in FY 2000 to 435,000 in FY 2004.

Even though the Corporation experienced an 11 percent reduction in the total number of inpatient discharges between fiscal years 1995 and 2002, the uninsured represented a slightly larger share of the total discharges in FY 2002 (9.5 percent) because the number of uninsured inpatients served by the Corporation has remained essentially unchanged. In addition, the Corporation has assumed greater responsibility for inpatient care to the uninsured relative to other hospitals located in New York City.

According to data from the New York State Department of Health, the Corporation served 35 percent of the citywide inpatient discharges in FY 1995 that paid none or only a portion of their medical care costs. By 2002, the Corporation served 55 percent of the citywide uninsured inpatient discharges (see Graph 4).<sup>2</sup> In response to a draft of this report, Corporation officials acknowledged this trend but stated that they believe the Corporation's own data, which shows an increase from 30 percent in FY 1995 to 45 percent in FY 2002, is more accurate.

**Graph 4**  
**Share of Citywide Uninsured Inpatient Discharges**



Sources: NYS Department of Health SPARCS Annual Report; OSDC analysis

The Corporation is the City's largest provider of health care to the uninsured and incurs large amounts of uncompensated costs. Uncompensated care consists of medical care costs not fully covered by insurance or self-paying patients, and costs incurred from providing charity care.

<sup>2</sup> New York State Department of Health Statewide Planning and Research Cooperative System (SPARCS) Annual Report.

The Corporation receives supplemental payments from New York State's Bad Debt and Charity Care Pools as partial reimbursement for serving a disproportionate share of medically indigent patients relative to other hospitals in New York State. The Corporation received \$574 million from the State's Bad Debt and Charity Care Pools in FY 2004 and, according to the Corporation's audited financial statement, provided uncompensated care of \$615 million in that year.<sup>3</sup>

According to a recent report issued by the Governor's Working Group on Health Care Reform, the formula used to determine payment levels for bad debt and charity care has not changed since 1996. Other factors that account for the Corporation's financial difficulties include increased competition for Medicaid patients; the shift from inpatient to outpatient services, which receives less favorable reimbursement; outdated reimbursement formulas; and rapidly rising pension contributions.

## **Medicaid**

Medicaid is the Corporation's largest revenue source, providing about half of the Corporation's total receipts. Medicaid consists of fee-for-service and managed care receipts.

### *Fee-for-Service*

Fee-for-service receipts constitute reimbursement for medical care based on rate and fee structures that are set by the State at a level intended to reflect the approximate cost of services. Fee-for-service receipts declined from \$1.8 billion in FY 1996 (excluding \$430 million from rate appeals) to a projected \$1.6 billion in FY 2005, reflecting the City's implementation of Medicaid managed care in FY 1999.

### *Managed Care*

In managed care, health plans reimburse health care providers with a fixed dollar amount per enrollee for a defined length of time, as negotiated in contracts, instead of paying actual service costs.

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<sup>3</sup> According to its financial statements, the Corporation maintains records of the estimated cost of services furnished under its charity care policy, which totaled \$243 million in FY 2004. The Corporation also estimates the amounts of probable credit losses in patient accounts receivables based on collection studies and historical write-off experience; these totaled \$372 million in FY 2004.

This arrangement, known as rate capitation, transfers some of the financial risks from the plan to the provider.

Receipts from Medicaid managed care are projected to grow from \$84 million in FY 2001 to \$540 million in FY 2005.<sup>4</sup> Corporation officials, however, are concerned that managed care could contribute to the erosion of the Corporation's revenue base because the level of reimbursement for inpatient care is generally lower than under fee-for-service.

### *Competition for Market Share*

In the 1990s, voluntary hospitals in the City began to compete with the Corporation for Medicaid patients in response to lower reimbursement rates from commercial insurers and Medicare. According to the New York State Department of Health, the Corporation's share of citywide Medicaid inpatient discharges declined from 30 percent in 1995 to 25 percent in 2002—evidence of increased competition for these patients.<sup>5</sup>

The Corporation owns a managed care plan, MetroPlus, which competes with about 30 other managed care plans to enroll New York City residents who are beneficiaries of public health insurance programs. The Corporation's share of citywide enrollment in the largest program, Medicaid, declined from 13.7 percent in December 1999 to 11.5 percent in July 2004 because of competition from other managed care plans. The MetroPlus share of total citywide enrollment has grown slightly, from 10.7 percent (66,000 members) in December 1999 to 11.3 percent (210,000 members) in July 2004, reflecting efforts to enroll Child Health Plus and Family Health Plus beneficiaries.

## **Ambulatory Services**

Ambulatory or outpatient care generates no more than 20 percent of the Corporation's third-party receipts, even though the Corporation's staff

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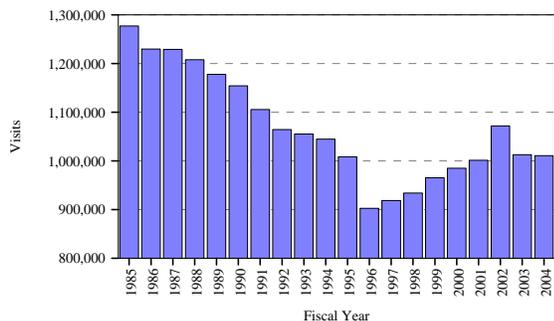
<sup>4</sup> The number of City residents enrolled in Medicaid managed care plans has more than tripled, growing from 395,007 in July 2000 to 1,382,615 in July 2004.

<sup>5</sup> The Corporation's share of Medicaid fee-for-service inpatient discharges declined from 29 percent in 1995 to 27 percent in 2002, and its share of Medicaid managed care inpatient discharges declined from 47 percent in 1995 to 17 percent in 2002.

attends to 5.5 million ambulatory care visits each year. The Governor's Working Group on Health Care reported that New York State's Medicaid outpatient reimbursement formula has not been updated or amended since 1993.

The Corporation reports that it spent an average of \$200 for each clinic visit in calendar year 1999, but Medicaid reimbursed the Corporation only \$84 per visit. The Corporation also estimates that Medicaid paid \$119 for each emergency room visit, though the actual cost was nearly three times that amount.

**Graph 5  
Emergency Department Visits**



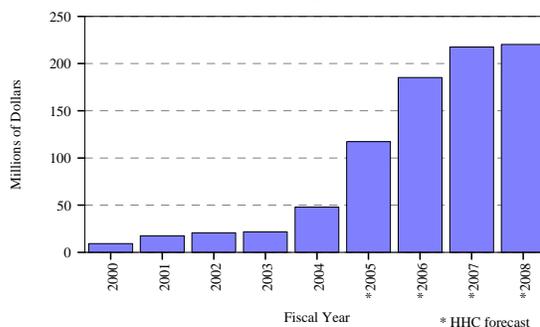
Sources: Mayor's Management Report; OSDC analysis

Emergency room visits have increased since FY 1996—after a 30 percent reduction between 1985 and 1996 (see Graph 5)—which has further complicated the Corporation's financial situation. This pattern is consistent with those experienced by other hospitals. The recent increase is attributed to a number of factors, including enforcement of the Emergency Medical Treatment and Labor Act, which requires certain urgent care treatment to be provided in emergency departments instead of in clinics. Without changes in Medicaid rates, the rising use of emergency department services will contribute to the Corporation's budget gaps.

### Pension Contributions

Pension contributions are projected to grow from \$21.7 million in FY 2003 to \$117 million in FY 2005, and then to more than \$200 million by FY 2007 (see Graph 6), which is an average annual rate of 78 percent during fiscal years 2004 through 2007. The growth in pension contributions largely reflects pension fund investment shortfalls in prior years, and benefit enhancements.

**Graph 6  
Pension Fund Contributions**



Sources: NYC Health and Hospitals Corporation; OSDC analysis

### Judgments and Claims

Judgments and claims against the Corporation include nonmedical claims, such as employment discrimination cases, but the majority of judgments and claims involve medical malpractice cases. These costs have risen from \$79 million in FY 1995 to a projected \$184 million in FY 2005. City officials assert that the growth in judgments and claims is due to an increase in the number and cost of medical malpractice cases with awards exceeding \$1 million.

The City paid the full cost of judgments and claims against the Corporation until FY 2002. Since then, the Corporation has assumed most of the responsibility in exchange for City funding of the Corporation's debt service. This arrangement provides the Corporation with an incentive to implement risk management initiatives.

In February 2002, the Corporation hired Caronia Corporation to provide early analysis of claims against the Corporation and to assist in litigation. Caronia is also assisting administrators at the Corporation's facilities with risk management, by analyzing and reforming hospital practices to avoid future lawsuits. The Corporation has realized lower costs in FY 2004, and expects \$20 million in annual savings starting in FY 2005.

### Capital Improvements

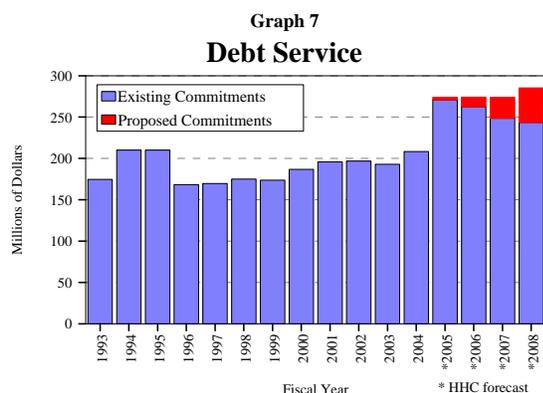
Since FY 1996, the Corporation has invested more than \$1.5 billion in its facilities. These investments modernized acute care facilities, renovated heating and ventilation systems, purchased new information systems, and constructed new ambulatory care facilities.

The Corporation's capital needs are financed primarily by bonds issued by the Corporation, the

City of New York, the Dormitory Authority of the State of New York, and the New York State Housing Finance Agency.

The Corporation's current five-year capital plan for fiscal years 2005 through 2009 includes \$1.2 billion for capital projects. The plan assumes funding of \$760 million from General Obligation bonds to be issued by the City; \$188 million from the Corporation from prior borrowings; and \$134 million from a combination of sources, including the borough presidents and the New York Power Authority. Sources of funding for the remaining \$123 million have not been obtained.

Assuming implementation of the current capital program, the Corporation's debt service costs will increase from \$208 million in FY 2004 to \$285 million by FY 2008 (see Graph 7).



### The Governor's Health Care Working Group

In 2003, Governor Pataki appointed a panel to study ways to reform New York State's health care system, focusing on Medicaid, long-term care, and acute care. The Governor's Working Group on Health Care Reform proposed that the State reallocate certain subsidies to hospitals that have increased the care they provide to the uninsured and underinsured. The group also recommended that the State reform Medicaid reimbursement rates for outpatient care, and develop a mechanism to adequately finance essential health services that do not generate high amounts of revenue, such as

**Table 1  
OSDC Risk Assessment  
(in millions)**

	2005	2006	2007	2008	2009
<b>HHC Projected Budget Gaps</b>	<b>\$ (44)</b>	<b>\$ (612)</b>	<b>\$ (486)</b>	<b>\$ (582)</b>	<b>\$ (636)</b>
<b>Budget Risks and Offsets</b>					
Governor's Proposed Budget	---	(275)	(275)	(275)	(275)
Wage Increases At DC 37 Pattern	(95)	(45)	(45)	(45)	(45)
Growth in OTPS	(31)	(62)	(95)	(98)	(100)
Pension Contributions	3	8	15	23	33
<b>Total</b>	<b>(123)</b>	<b>(374)</b>	<b>(400)</b>	<b>(395)</b>	<b>(387)</b>
<b>Potential Gaps to be Closed</b>	<b>\$ (167)</b>	<b>\$ (986)</b>	<b>\$ (886)</b>	<b>\$ (977)</b>	<b>\$ (1,023)</b>

Note: Wage increases during the next round of collective bargaining at the projected local inflation rate could widen the projected budget gaps by \$50 million in FY 2006, \$110 million in FY 2007, \$170 million in FY 2008, and \$235 million in FY 2009.

emergency care. Although the recommendations have the potential to benefit the Corporation, detailed proposals have not been released.

### Budget Risks

The four-year financial plan prepared by the Corporation in February 2005 (the "February Plan") presents operating budget cash deficits of \$44 million in FY 2005, \$612 million in FY 2006, \$486 million in FY 2007, \$582 million in FY 2008, and \$636 million in FY 2009. Despite increasing its subsidy to the Corporation by \$200 million in FY 2005 and by \$150 million annually thereafter last June, the February Plan no longer reflects an increase in the subsidy in FY 2006 because the City used these resources to help balance the Corporation's FY 2005 budget.

Our review has identified a number of issues that could widen the projected budget gaps by an average of \$389 million annually beginning in FY 2006 (see Table 1). The largest of these risks is the Governor's proposed budget, which could widen the gaps projected by the Corporation by as much as \$275 million. If all of the risks we have identified materialize, the Corporation could face annual budget gaps of nearly \$1 billion beginning in FY 2006.

#### Governor's Executive Budget

The Governor has proposed a number of cost-containment and other measures that are intended to relieve the financial burden Medicaid places on the State and its localities. According to the State Division of the Budget, however, these measures would widen the Corporation's FY 2006 budget

gap by \$200 million; the Corporation estimates that the impact could be as much as \$275 million.

One of the most significant changes proposed by the Governor would permit the State Commissioner of Health to make changes to the formula for distributing bad debt and charity care funds to hospitals without going through the legislative process. The State Division of the Budget estimates that such a change would reduce bad debt and charity care revenues to the Corporation by \$80 million.

Other changes recommended by the Governor include reducing subsidies to teaching hospitals and the Medicaid reimbursement for inpatient detoxification (\$68 million and \$39 million, respectively); eliminating an inflation adjustment in Medicaid reimbursement (\$29 million); imposing a new tax on hospital receipts (\$25 million); and eliminating coverage for certain services in Family Health Plus (\$17 million).

#### *Collective Bargaining*

The February Plan does not include funding for wage increases for employees that have not yet reached new collective bargaining agreements. A recent City agreement with District Council 37 provided for a one-time cash payment of \$1,000 to each member and a 5 percent increase in wages and benefits during fiscal years 2004 and 2005, which would be partly offset with productivity savings. Wage increases modeled after the District Council 37 agreement, without any offsetting productivity savings, would increase costs by \$45 million annually starting in FY 2005. The Corporation also could be liable for \$50 million in retroactive wage and benefit increases for fiscal years 2003 and 2004, which raises the FY 2005 liability to \$95 million.

Furthermore, the February Plan makes no provision for wage increases for any employees beyond FY 2005. Wage increases at the projected inflation rate would widen the projected operating deficits by \$50 million in FY 2006, \$110 million in FY 2007, \$170 million in FY 2008, and \$235 million in FY 2009.

#### *Pension Contributions*

The rapid growth in pension contributions is one of the factors adding to the Corporation's financial difficulties. The Corporation's estimates, however,

do not reflect better-than-anticipated pension fund investment earnings in FY 2004, which will reduce future planned contributions by \$8 million in FY 2006, and as much as \$33 million in FY 2009. The City Actuary is considering changes in the methods and assumptions that are used to calculate pension contributions to the New York City Employees' Retirement System that could generate short-term savings for the Corporation.

#### *Other Risks*

The Corporation projects a 2 percent annual growth rate for expenses in the category of other than personal services (OTPS), which includes pharmaceuticals; contracted workers such as clinical technicians and agency nurses; supplies; information systems; and utilities. Even with a focused effort to control such costs already in place, OTPS costs rose by an average of 4 percent annually between fiscal years 2000 and 2004. If this growth rate continues, OTPS expenditures could exceed the February Plan estimates by \$31 million in FY 2005, \$62 million in FY 2006, \$95 million in FY 2007, \$98 million in FY 2008, and \$100 million in FY 2009.

#### **Closing the Gap**

To balance its budget, the Corporation intends to draw upon its cash reserves and has proposed a series of management actions to increase revenues and reduce costs. While the Corporation is making progress toward balancing the FY 2006 budget, the Governor and the President are proposing budgets that could set back these efforts.

#### *Revenue Enhancements*

In the past, the Corporation relied heavily on rate appeals to help balance the budget. While the Corporation obtained a \$603 million settlement in FY 1996, revenues from this source have declined in recent years (see Table 2). The Corporation projects that Medicare rate appeals could generate \$19 million in FY 2005, \$50 million in FY 2006, \$21 million in FY 2007, \$32 million in FY 2008, and \$10 million in FY 2009.

The Corporation has hired three consulting firms to document the justification for rate appeals on claims previously rejected by the federal and State governments. As rate appeals are subject to federal and State approval, the amount and timing of any financial gain for the Corporation are uncertain.

**Table 2**  
**Third-Party Payer Rate Appeals**  
(in millions)

Fiscal Year	Settlement	Percent of Third-Party Revenues
1995	\$ 86	2%
1996	603	14%
1997	233	6%
1998	115	3%
1999	194	5%
2000	131	4%
2001	73	2%
2002	0	NA
2003	85	2%
2004	97	3%

Sources: HHC Audited Annual Financial Statements; OSDC analysis

The Corporation also is counting on \$33 million annually in Disproportionate Share (DSH) revenue, beginning in FY 2006. DSH revenue compensates hospitals that serve large percentages of uninsured patients relative to other hospitals, and helps to supplement Medicare and Medicaid reimbursement. Federal approval is required for the Corporation to recognize DSH revenues.

The Corporation estimates that improved billing practices could generate \$15 million in FY 2005, \$50 million in FY 2006, and \$75 million annually thereafter. The Corporation also plans to work with City agencies to identify additional sources of reimbursement for health services, which could generate another \$10 million in FY 2005 and \$35 million annually thereafter.

While the Corporation has yet to specify actions that would generate resources totaling \$193 million in FY 2006, \$221 million in FY 2007, \$285 million in FY 2008, and \$307 million in FY 2009, we note that the Corporation traditionally underestimates revenue from third-party payers by about \$100 million. In addition, the Corporation is hopeful that the federal government will continue to approve arrangements utilized by the Corporation to maximize federal reimbursement. These arrangements are expected to generate about \$120 million for the Corporation in FY 2006 and, if approved, would be used to narrow the projected budget gap. The President, however, has proposed greatly curtailing such arrangements as part of his

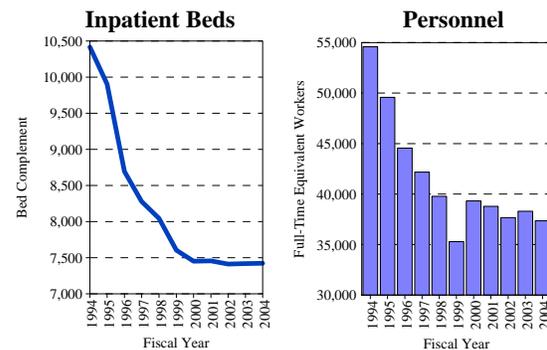
plan to reduce federal Medicaid costs by \$60 billion over a ten-year period.

## Spending Reductions

The February Plan assumes that the Corporation will implement efficiency measures to generate savings of \$31 million in FY 2005 and \$100 million annually for fiscal years 2006 through 2009. The Corporation has not itemized specific initiatives, but it has indicated it will reduce overtime and staffing levels, and is looking to identify savings in areas such as dietary services. Given the nature of the health care industry, cuts that affect services could impact the Corporation's ability to stay competitive.

In the past, the Corporation successfully implemented management actions that lowered its costs. As shown in Graph 8, the Corporation reduced the number of inpatient beds by 28 percent between fiscal years 1994 and 2000, which increased occupancy rates from 84 percent in FY 1994 to 91.4 percent in FY 2000 and allowed the Corporation to reduce staffing levels by about 30 percent. Similarly, the average length of stay for general care declined from 8.4 days in FY 1994 to 4.8 days in FY 2004. In recent years personnel levels have risen modestly and the occupancy rate declined to about 90 percent.

Graph 8



Sources: Mayor's Management Report; OSDC analysis

### Major contributors to this report include:

Michael Solomon    Director, Bureau of Agency Analysis  
Jane Moore            Report Editor  
Cheryl Pahaham  
Arfan Putra

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(212) 681-4824