Review of the Financial Plan of the City of New York

Report 5-2019

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

New York City's economy is strong and continues to set new records. It added 715,000 jobs between 2009 and 2017, the largest and longest job expansion in the post–World War II period. After growing by 81,000 jobs in 2017, employment reached 4.4 million, a new record and 615,000 higher than the prerecession peak. Although job growth has since slowed, the City is on pace to add more than 72,000 jobs in 2018.

The strong demand for labor has pushed down the unemployment rate from 9.5 percent in 2010 to 4.5 percent in 2017. Since then, it has fallen to 4.2 percent, the lowest level in 42 years.

Last year, strong job gains were reported in health care and business services, a trend that has continued into 2018. Job growth has picked up in construction, although it has slowed in the leisure and hospitality sector.

Pretax profits in the securities industry, an important component of the City's economy, grew by 42 percent in 2017 and by 9 percent in the first quarter of 2018. Bonuses were 17 percent higher in 2017 according to an estimate from the Office of the State Comptroller (OSC).

Nearly 63 million people visited New York City in 2017, a new record and the eighth consecutive year of growth. Ticket sales for Broadway shows increased by 20 percent (the largest increase in 25 years) to a record level. Hotel occupancy remained stable at 87 percent, even though the market added more rooms.

The real estate markets are also strong. Since 2001, 38.8 million square feet of office space have been added to the City's skyline, and millions more will become available over the next few years with the completion of Hudson Yards. Residential market values now exceed $900 billion, the highest on record and 48 percent higher than the prerecession peak.

The benefits of the strong economy are reflected in New York City's most recent four-year financial plan, which was released on June 14, 2018 (the "June Plan").

The June Plan projects a surplus of nearly $4.6 billion in FY 2018, the largest in 10 years. The surplus, which was used to balance the FY 2019 budget (see Figure 1), resulted mostly from a reallocation of unneeded reserves and higher tax revenues.

Tax collections exceeded the City's forecast at the beginning of FY 2018 by $2.2 billion, driven by higher personal income tax collections. Personal income tax collections increased by more than 15 percent in FY 2018, the fastest rate in 13 years, and collections exceeded the City's initial forecast by $1.5 billion. Most of the unanticipated revenue resulted from conditions that are not expected to recur in FY 2019, although collections are still likely to exceed the City's conservative forecast (see Figure 2).

The FY 2018 citywide savings program is expected to generate, on average, more than $900 million annually. The program, however, relies heavily on reestimates, funding shifts and debt service savings; only a small share of the savings will come from efficiencies that improve agency operations. Since the beginning of FY 2018, new needs increased agency spending by $1 billion in FY 2018 and slightly larger amounts in subsequent years.

City-funded spending is projected to increase by 5.7 percent in FY 2018 and 6.5 percent in FY 2019 after adjusting for surplus transfers, reserves and savings from prior years' expenses. Spending is driven by the cost of current labor agreements, agency spending, rising health insurance and debt service costs, and the impact of State actions.

The largest State impact comes from the requirement that the City match the State's contribution of $418 million to the Metropolitan Transportation Authority's Subway Action Plan, which is intended to halt the deterioration in the City's subway system. How the MTA's next five-year capital program is funded could also impact the City's financial plan.

Debt service is already projected to grow by 42 percent over the next four years. In the past, similar predictions did not materialize because interest rates remained below the City's assumptions and capital commitments were less than planned. While commitments are likely to fall short of the ambitious target for FY 2019, they are rising and so are interest rates.

The unfunded liability for post-employment benefits other than pensions (mostly health insurance) exceeds $88 billion and the cash cost will reach $3 billion by FY 2022, an increase of 31 percent over five years. To its credit, the City continues to contribute to the Retiree Health Benefits Trust, which now has a balance of nearly $4.4 billion, the highest amount ever.

Conditions at the New York City Housing Authority (NYCHA) have deteriorated from years of inadequate capital investment. Despite commitments from the State and the City to increase funding, NYCHA's five-year capital program addresses just a fraction of its $32 billion in capital needs during that period.

The Health and Hospitals Corporation also faces serious challenges. While a two-year delay in federal cuts has relieved pressure, the Corporation must continue to implement corrective actions. Otherwise, the City may be called upon to increase its financial support.

The June Plan projects budget gaps of $3.3 billion in FY 2020, $2.9 billion in FY 2021 and $2.3 billion in FY 2022. The financial plan includes reserves of nearly $1.4 billion in FY 2019 and $1.25 billion in subsequent years. If unneeded, these resources could be used to help close the projected budget gaps.

Shortly after the June Plan was released, the City reached a tentative labor agreement with District Council 37. It also announced an agreement with the Municipal Labor Committee to generate $1.7 billion in health insurance savings during the financial plan period to help fund the 2017-2021 round of bargaining.

If the economic terms of the tentative agreement with District Council 37 were applied to the entire work force as the City assumes, the FY 2020 budget gap would increase by more than $700 million to $4 billion even after taking into account anticipated health insurance savings.

While the potential budget gap for FY 2020 is sizable, the City has a year to close it. In recent years, the City has relied on surplus resources from prior years to balance the budget. To help generate a surplus in FY 2019, the City will need to implement additional cost-reduction measures, but it will also need to limit unplanned spending.

Although the current economic expansion shows no signs of weakening after eight years of growth, rising trade tensions or some unforeseen development could trigger a setback, complicating efforts to balance the budget.

In addition, the financial plan does not reflect the potential for future federal or State budget cuts. Growing federal deficits, which may reach $1 trillion by 2019, will likely increase pressure on Congress to cut entitlement and other federal programs, which would adversely affect both the City and the State.

In closing, the City's economy is strong and the FY 2019 budget is balanced under current conditions. However, the out-year budget gaps are considerably larger than those projected one year ago, and there are budget risks that could make closing the gaps more difficult. To its credit, the City has increased its reserves, a practice it should continue given the risks on the horizon.

FIGURE 1
New York City Financial Plan
(in millions)

	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
Revenues					
Taxes					
General Property Tax	$ 26,214	$ 27,789	$ 29,295	$ 30,711	$ 31,702
Other Taxes	31,504	31,231	32,333	33,330	34,072
Tax Audit Revenue	1,299	1,056	721	721	721
Subtotal: Taxes	$ 59,017	$ 60,076	$ 62,349	$ 64,762	$ 66,495
Miscellaneous Revenues	7,206	6,792	6,731	6,737	6,716
Unrestricted Intergovernmental Aid	- - -	- - -	- - -	- - -	- - -
Less: Intra-City Revenue	(2,238)	(1,825)	(1,771)	(1,776)	(1,776)
Disallowances Against Categorical Grants	85	(15)	(15)	(15)	(15)
Subtotal: City Funds	$ 64,070	$ 65,028	$ 67,294	$ 69,708	$ 71,420
Other Categorical Grants	1,072	880	872	867	861
Inter-Fund Revenues	637	682	641	638	638
Federal Categorical Grants	8,964	7,592	7,129	7,108	7,092
State Categorical Grants	14,854	14,976	15,302	15,763	16,246
Total Revenues	**$ 89,597**	**$ 89,158**	**$ 91,238**	**$ 94,084**	**$ 96,257**
Expenditures					
Personal Service					
Salaries and Wages	$ 27,151	$ 28,746	$ 29,620	$ 30,368	$ 30,069
Pensions	9,632	9,852	9,903	10,162	10,367
Fringe Benefits	10,008	10,737	11,643	12,414	13,094
Retiree Health Benefits Trust	100	- - -	- - -	- - -	- - -
Subtotal: Personal Service	$ 46,891	$ 49,335	$ 51,166	$ 52,944	$ 53,530
Other Than Personal Service					
Medical Assistance	5,915	5,915	5,915	5,915	5,915
Public Assistance	1,583	1,605	1,617	1,617	1,617
All Other	30,925	30,342	28,848	29,167	29,446
Subtotal: Other Than Personal Service	$ 38,423	$ 37,862	$ 36,380	$ 36,699	$ 36,978
Debt Service	6,105	6,987	7,473	7,856	8,560
FY 2017 Budget Stabilization	(4,180)	- - -	- - -	- - -	- - -
FY 2018 Budget Stabilization	4,576	(4,576)	- - -	- - -	- - -
Capital Stabilization Reserve	- - -	250	250	250	250
General Reserve	20	1,125	1,000	1,000	1,000
Less: Intra-City Expenses	(2,238)	(1,825)	(1,771)	(1,776)	(1,776)
Total Expenditures	**$ 89,597**	**$ 89,158**	**$ 94,498**	**$ 96,973**	**$ 98,542**
Gap to be Closed	**$ - - -**	**$ - - -**	**$ (3,260)**	**$ (2,889)**	**$ (2,285)**

Source: NYC Office of Management and Budget

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

	Better/(Worse)			
	FY 2019	**FY 2020**	**FY 2021**	**FY 2022**
Gaps Per NYC Financial Plan	**$ - - -**	**$ (3,260)**	**$ (2,889)**	**$ (2,285)**
Tax Revenues	400	250	250	250
Miscellaneous Revenues	52	61	71	72
Debt Service	50	22	22	22
Pension Contributions	- - -	58	115	173
Homeless Services	(47)	(47)	(47)	(47)
Special Education Medicaid Reimbursement	(63)	(63)	(63)	(63)
Uniformed Agency Overtime	(125)	(125)	(125)	(125)
Collective Bargaining Costs	(227)	(704)	(929)	(1,344)
Fair Fares	- - -	(212)	(212)	(212)
OSC Risk Assessment	**40**	**(760)**	**(918)**	**(1,274)**
Potential Gaps Per OSC[1,2]	**$ 40**	**$ (4,020)**	**$ (3,807)**	**$ (3,559)**

[1] The June Plan includes a general reserve of $1.125 billion in FY 2019 and $1 billion in each of fiscal years 2020 through 2022. In addition, the Capital Stabilization Reserve has a balance of $250 million in each of fiscal years 2019 through 2022. If not needed, these resources could be used to help close the projected budget gaps. The June Plan also includes reserves ($100 million in each of fiscal years 2019 and 2020, rising to $400 million beginning in FY 2021) to fund potential changes in the actuarial assumptions and methodologies used to calculate employer pension contributions.

[2] The Retiree Health Benefits Trust, which the City has used in the past as a rainy-day fund, has a balance of nearly $4.4 billion (net of any prepayments).

II. Changes Since the Beginning of the Fiscal Year

The City made a number of changes to its revenue and expenditure forecasts since the budget was adopted in June 2017. As a result of these changes, the City projects a surplus of nearly $4.6 billion in FY 2018 (the largest since FY 2008), which was used to balance the FY 2019 budget. The surplus resulted mostly from higher-than-planned tax collections and a reduction in unneeded reserves (see Figure 3). Savings from the citywide savings program were needed to offset unplanned agency spending.

Tax collections exceeded the City's estimate at the beginning of the fiscal year by $2.2 billion, driven by higher-than-planned personal income tax collections ($1.5 billion). The unexpected windfall resulted from solid job gains and wage growth, a large increase in Wall Street bonuses, strong capital gains realizations and changes in federal law.

The City overestimated the amount needed to cover property tax delinquencies, refunds and tax abatements, resulting in $489 million in higher property tax collections in FY 2018. The City raised its forecast for subsequent years based on the continued strength in the real estate market (by $728 million in FY 2021 and more than $1 billion in FY 2022).

While business tax collections continued to fall short of the City's expectations, the shortfall is expected to be offset in fiscal years 2018 and 2019 by higher revenue from tax audits.

The City also expanded the citywide savings program, which is projected to generate, on average, more than $900 million annually through FY 2022. Nearly one-third of the savings will come from debt service and most of the rest will come from reestimates and funding shifts. Only a small portion (one-fifth) will come from actions that improve agency operations.

These resources were needed to fund unplanned spending. Since the beginning of FY 2018, City agencies identified spending needs of $1 billion in FY 2018 and slightly larger amounts in subsequent years. In FY 2018, more than half of the needs were concentrated in the Department of Homeless Services ($380 million) and the uniformed agencies ($181 million). Other agencies with significant needs included the Department of Education, the Department of Small Business Services, and the Department of Information Technology and Telecommunications.

The City Council proposed new initiatives with an estimated cost of $388 million as part of the budget adoption process for FY 2019. The Mayor and the City Council also agreed to a program to provide half-fare MetroCards to low-income residents with an estimated half-year cost of $106 million. The June Plan does not include the cost of these initiatives beyond FY 2019.

The City eliminated from its financial plan any expectation of proceeds from the sale of taxi medallions. The City had previously anticipated $107 million in FY 2019 ($929 million through FY 2022) from the sale, but the market for new medallions has collapsed with the introduction of ride-share services such as Uber and Lyft.

After taking these changes into account, the June Plan projects budget gaps of $3.3 billion in FY 2020, $2.9 billion in FY 2021 and $2.3 billion in FY 2022. Shortly after the June Plan was released, the City reached a tentative labor agreement with District Council 37. The projected budget gaps would increase significantly if the entire work force reaches similar agreements.

The FY 2019 budget includes a general reserve of $1.125 billion and a capital budget stabilization reserve of $250 million. The budgets for subsequent years include reserves of $1.25 billion. If not needed, the reserves could be used to narrow the projected gaps.

FIGURE 3
Financial Plan Reconciliation—City Funds
June 2018 Plan vs. June 2017 Plan
(in millions)

	Better/(Worse)			
	FY 2018	FY 2019	FY 2020	FY 2021
Projected Gaps Per June 2017 Plan	**$ - - -**	**$ (3,473)**	**$ (2,807)**	**$ (2,330)**
Revenue Reestimates				
Personal Income Tax	1,519	305	345	224
General Property Tax	489	288	432	728
Business Taxes	(414)	(360)	(397)	(507)
Tax Audits	449	335	- - -	- - -
All Other Taxes	174	(51)	(169)	(173)
Subtotal: Taxes	**2,217**	**517**	**211**	**272**
Proceeds of Taxi Medallion Sales	- - -	(107)	(257)	(367)
All Other	271	133	79	210
Total	**2,488**	**543**	**33**	**115**
Citywide Savings Program				
Agency Actions	709	898	538	569
Debt Service	325	195	279	356
Total	**1,034**	**1,093**	**817**	**925**
Reserves				
General Reserve	1,180	(125)	- - -	- - -
Capital Stabilization Reserve	250	- - -	- - -	- - -
Reserve for Disallowances of Federal and State Aid	100	- - -	- - -	- - -
Reserve for Collective Bargaining	40	75	75	75
Pension Reserve	- - -	(100)	(100)	(400)
Total	**1,570**	**(150)**	**(25)**	**(325)**
New Agency Needs				
Homeless Services	(380)	(313)	(311)	(310)
Uniformed Agencies	(181)	(105)	(101)	(100)
Department of Education	(138)	(207)	(241)	(254)
Small Business Services	(50)	(81)	(33)	(24)
Department of Information Technology & Telecom.	(35)	(55)	(89)	(129)
All Other	(221)	(420)	(281)	(252)
Total	**(1,005)**	**(1,181)**	**(1,056)**	**(1,069)**
Pension Contributions	(60)	119	139	243
Retiree Health Benefits Trust	(100)	- - -	- - -	- - -
City Council Initiatives	- - -	(388)	- - -	- - -
Fair Fares	- - -	(106)	- - -	- - -
Prior-Years' Expenses	400	- - -	- - -	- - -
All Other	248	(502)	(66)	(152)
State Actions	**1**	**(531)**	**(295)**	**(296)**
Net Change During FY 2018	**4,576**	**(1,103)**	**(453)**	**(559)**
Surplus/(Gap)	**$ 4,576**	**$ (4,576)**	**$ (3,260)**	**$ (2,889)**
Surplus Transfer	(4,576)	4,576	- - -	- - -
Projected Gaps Per June 2018 Plan	**$ - - -**	**$ - - -**	**$ (3,260)**	**$ (2,889)**

Sources: NYC Office of Management and Budget; OSC analysis

III. Federal and State Issues

As discussed below, changes in federal and State policies may have important implications for New York City's budget and its residents.

1. Changes in Federal Tax Policy

In December 2017, Congress approved revisions in the federal tax code that reduce corporate and personal income taxes by a net of nearly $1.5 trillion over 10 years (according to the Congressional Budget Office), cap the deductibility of state and local taxes at $10,000 and reduce the size of mortgages for which interest can be deducted.

Despite lower tax rates, some taxpayers in New York City will pay higher federal taxes beginning in 2018 because of the cap on the deductibility of state and local taxes. To mitigate this impact, the State will permit itself, New York City, and other school districts and counties to establish charitable gift trusts and accounts.[3] Taxpayers who make donations will receive a tax credit against their State personal income or local property taxes, and may be able to claim a charitable deduction against their federal tax liability.

The City has not yet determined whether it will create charitable accounts, or if it did, what limitations it would impose on the amount or percentage of such tax credits. While the Internal Revenue Service (IRS) has not yet issued a formal opinion on these charitable accounts, it has cast doubt on whether such contributions would be treated as charitable deductions for federal income tax purposes. An adverse interpretation by the IRS would likely be challenged in the courts.

On July 17, 2018, a coalition of four states, including New York, filed a lawsuit against the federal government challenging the constitutionality of the cap on the deductibility of state and local taxes.

2. Federal Budget

In February 2018, Congress approved a two-year budget agreement that increases the cap on military spending by $165 billion and raises the cap on nondefense spending by $131 billion. It also includes $89 billion for disaster relief in California, Florida, Puerto Rico and Texas, and suspends the debt limit for one year. Congress also agreed to extend funding for the Children's Health Insurance Program (CHIP) for 10 years.

As a result of the changes in federal tax policy and increased federal spending, the federal budget deficit could reach nearly $1 trillion in federal fiscal year (FFY) 2019, and even higher amounts in subsequent years. The combination of economic stimulus and growing budget deficits could increase interest rates, which will make it more expensive to service the federal debt and more difficult to stimulate the economy in the event of a recession. Rising federal deficits could also increase the risk of cuts to entitlement and other federal programs.

The President's budget proposal for FFY 2019 focused heavily on cuts to social safety net programs and nondefense discretionary spending. While no action has been taken on the budget proposal, pressure to cut federal spending may mount after the midterm elections in November 2018.

The President has also stated that he may veto legislation to fund government operations beyond September 30, 2018, if Congress excludes funding to extend the U.S.-Mexico border wall. A veto could result in a federal government shutdown, reducing or disrupting government services.

[3] The law also decouples the State tax code from the federal tax code, where necessary, to avoid more than $1 billion in State tax increases that would have resulted from the recent revisions in the federal tax code.

3. State Actions

On March 30, 2018, the State enacted a budget for the fiscal year beginning on April 1, 2018 (i.e., State fiscal year 2018-19). The State increased education aid to the City by more than 3 percent, similar to the statewide increase. Although education aid will rise by $334 million in FY 2019, the increase is $140 million less than anticipated by the City in the February 2018 financial plan.

The State took other actions that impose new mandates on the City or shift financial responsibility from the State to the City. In addition, the June Plan reflects the impact of State actions that were approved in prior years, but not previously reflected in the City's financial plan. In total, the City estimates that State actions had an adverse impact on its financial plan of $745 million in FY 2019 (see Figure 4). The City estimates that its operating costs will increase by $531 million in FY 2019 (and by about $300 million annually thereafter), and that it will incur one-time capital costs of $214 million in FY 2019.

In FY 2019, the largest impact comes from a requirement that the City match the State's $418 million contribution to the Metropolitan Transportation Authority's Subway Action Plan. The City will contribute $254 million toward the operating cost and $164 million to the capital cost of the program in FY 2019. The State budget also requires the City to match the State's $50 million capital contribution to Hudson River Park.

Although the State reauthorized the Close to Home program (which allows juvenile offenders to remain in their communities) for five years, it shifted financial responsibility for the program from the State to the City. The City estimates that this action will increase its costs by $31 million annually beginning in FY 2019.

Last year, 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. Under the law, the City will be required to contribute to the cost of implementation unless the State waives the local share (which would be based on proof of financial hardship).

The June Plan assumes the City's costs related to this legislation (known as Raise the Age) will total $108 million in FY 2019, growing to $131 million in FY 2020. The City intends to hire more than 1,100 full-time employees to comply with the law, mostly at the Administration for Children's Services (ACS). City officials recently

Figure 4
Financial Plan Impact of State Actions in FY 2019
(in millions) Better/(Worse)

	Operating Cost	Capital Cost	Total Impact
Subway Action Plan	$ (254)	$ (164)	$ (418)
Education Aid	(140)	- - -	(140)
Raise the Age	(108)	- - -	(108)
Close to Home	(31)	- - -	(31)
MTA Bus Company	3	- - -	3
Hudson River Park	- - -	(50)	(50)
Total	**$ (531)**	**$ (214)**	**$ (745)**

Note: Columns may not add due to rounding.
Sources: NYC Office of Management and Budget; OSC analysis

indicated that the cost could increase because the City has created a new civil service title at ACS to staff the juvenile detention centers, and the new title receives higher compensation than staff who currently perform similar work.

Although the State budget includes a dedicated appropriation of $100 million for State and local costs associated with the legislation, as well as other possible sources of funding, it remains to be seen whether the City will receive any of those funds.

The State also enacted legislation last year that requires school districts to fund increased tuition costs at charter schools beginning in FY 2019. The City had estimated that this requirement would increase costs by $101 million in FY 2019, growing to $633 million in FY 2022 if not offset by changes in State education aid to the City.

The City no longer believes that this requirement will increase its costs in FY 2019 because it had not reflected an increase in State funding for this purpose that was approved last year, and also because it overestimated the growth in charter school enrollment in FY 2018. While the City also lowered its estimate of the potential impact in future years ($119 million in FY 2020, growing to $478 million in FY 2022), these costs have not been included in the June Plan.

In addition, the City had not previously reflected in FY 2019 the impact ($150 million) of legislation enacted in 2016 that allows the State to reap the benefits of refinancing outstanding debt of the Sales Tax Asset Receivable Corporation.[4] However, the City realized the benefit of the refinancing in prior years. Thus, this State action will have no net impact on the City's finances over the long term.

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[4] For a detailed discussion of the Sales Tax Asset Receivable Corporation, see the Office of the State Comptroller's report 1-2017, *Review of the Financial Plan of the City of New York*, May 2016.

IV. Revenue Trends

The June Plan assumes revenues will total $89.2 billion in FY 2019. Nearly three-quarters ($65 billion) of this amount is derived from tax collections and other locally generated revenues (i.e., City funds), with the remainder coming from sources such as federal and State categorical aid. Growth in City fund revenues is projected to slow to 1.5 percent in FY 2019 following an increase of 6.2 percent in FY 2018.

The strong growth in City fund revenues in FY 2018 was driven by an 8 percent increase in tax collections (see Figure 5), the largest gain in five years. Personal income tax collections, for example, exceeded the City's estimate at the beginning of the fiscal year by $1.5 billion. The unanticipated revenue resulted from changes in federal law, a large increase in Wall Street bonuses and a near doubling in capital gains.

The June Plan reasonably assumes that the factors that contributed to the surge in personal income tax collections in FY 2018 will not recur. In fact, the FY 2018 surge may come partly at the expense of future revenue. As a result, the City expects tax collections to increase by 1.8 percent in FY 2019 and by an average of 3.4 percent in subsequent years. This forecast assumes continued job and wage growth.

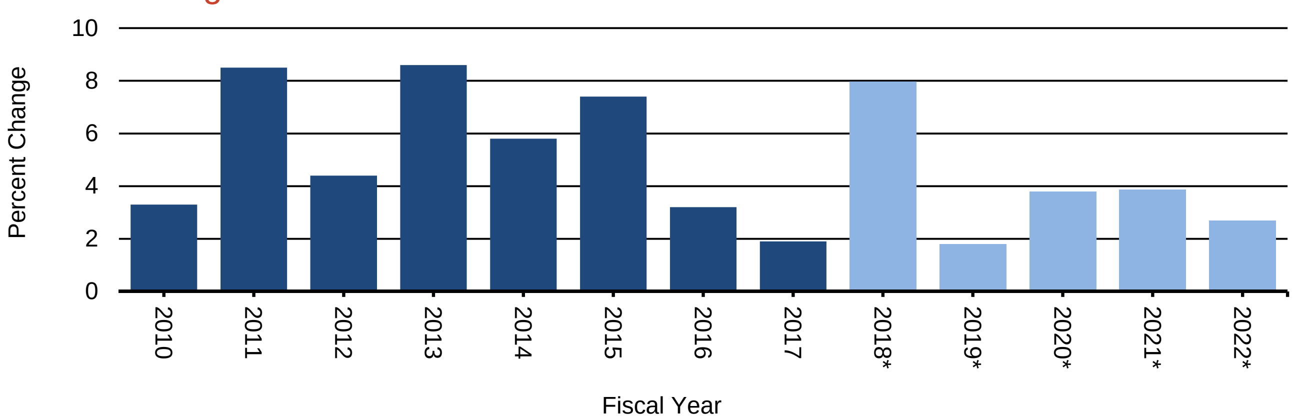
New York City's economy is strong and continues to set new records. It added 715,000 jobs between 2009 and 2017, the largest and longest job expansion in the post–World War II period. After growing by 81,000 jobs in 2017, employment reached a record 4.4 million, 615,000 more than the prerecession peak. Although the rate of job growth has slowed, the City is still on pace to add more than 72,000 jobs in 2018.

With record job gains, the unemployment rate has declined from a recessionary peak of 10.1 percent in January 2010 to 4.2 percent in June 2018, the lowest level in 42 years.

Job growth has remained strong in health care and business services, and has picked up in construction and the securities industry. Wall Street profits rose by 42 percent in 2017, and increased by 9 percent in the first quarter of 2018. A record 62.8 million visitors came to the City in 2017, and the City's tourism agency expects another record in 2018. The June Plan assumes the local economy will continue to expand throughout the financial plan period.

Based on current trends, OSC estimates that revenues could exceed the City's forecast by about $450 million in FY 2019 and by more than $300 million in subsequent years.

FIGURE 5
Annual Change in Tax Revenues



Note: Includes revenue from tax audits.
Sources: NYC Office of Management and Budget; OSC analysis

*City forecast

FIGURE 6
Trends in City Fund Revenues
(in millions)

	FY 2018	FY 2019	Annual Growth	FY 2020	FY 2021	FY 2022	Average Three-Year Growth Rate
General Property Tax	$ 26,214	$ 27,789	6.0%	$ 29,295	$ 30,711	$ 31,702	4.5%
Personal Income Tax	13,360	12,378	-7.4%	12,969	13,390	13,722	3.5%
Sales Tax	7,411	7,762	4.7%	8,167	8,491	8,779	4.2%
Business Taxes	5,613	5,864	4.5%	5,978	6,108	6,094	1.3%
Real Estate Transaction Taxes	2,476	2,397	-3.2%	2,359	2,437	2,511	1.6%
Other Taxes	2,644	2,830	7.0%	2,860	2,904	2,966	1.6%
Tax Audits	1,299	1,056	-18.7%	721	721	721	-11.9%
Subtotal: Taxes	**59,017**	**60,076**	**1.8%**	**62,349**	**64,762**	**66,495**	**3.4%**
Miscellaneous Revenues	4,968	4,967	0.0%	4,960	4,961	4,940	-0.2%
Grant Disallowances	85	(15)	NA	(15)	(15)	(15)	0.0%
Total	**64,070**	**65,028**	1.5%	**67,294**	**69,708**	**71,420**	**3.2%**

Sources: NYC Office of Management and Budget; OSC analysis

The June Plan is based on the trends shown in Figure 6 and discussed below.

1. General Property Tax

According to the final tax roll released by the New York City Department of Finance on May 25, 2018, the market value of all properties in the City reached a new record of nearly $1.3 trillion in FY 2019. Residential properties accounted for $904 billion of that amount. Property tax revenues are projected to increase by 6 percent to reach $27.8 billion, reflecting the continued growth in taxable property values.

Property values increased by 6.8 percent in FY 2019, comparable to the average growth rate during the past five years. Values for large residential properties (i.e., apartments and cooperatives) rose the fastest, increasing by 8.8 percent.

The City has set aside $1.8 billion as a reserve for delinquencies, refunds and tax abatements during FY 2019. This is $273 million more than the amount needed in FY 2018, when the City overestimated the amount of the reserve by $489 million. It is likely that some portion of the additional resources will not be needed and will be reallocated as the fiscal year progresses.

The June Plan assumes that collections will slow during the remainder of the financial plan period. Part of the slowdown reflects the expectation that rising interest rates will hold down growth in property values. In addition, home values could be impacted by the new federal tax code, which limits the deductibility of state and local taxes and reduces the size of new mortgages for which interest can be deducted.

On April 24, 2017, Tax Equity Now New York (a coalition of advocates, property owners and tenants) filed suit against the State and the City claiming that the current real property tax system in New York City violates the State and federal constitutions and the Fair Housing Act. The lawsuit alleges that the City's property tax system imposes unequal tax burdens upon similarly valued properties within the same property class and imposes disproportionate financial burdens on racial minorities. Oral arguments on a motion by the State and City to dismiss the case were heard on June 13, 2018.

On May 31, 2018, the Mayor and the City Council Speaker announced the formation of an advisory commission to make recommendations on reforming the property tax system to make it simpler, clearer and fairer while ensuring that there is no reduction in revenues.

2. Personal Income Tax

Personal income tax collections surged in FY 2018, growing by an estimated 15.6 percent (the fastest rate of growth since FY 2005).[5] While the strength of the City's economy contributed to the growth, changes in taxpayer behavior and other factors were responsible for most of the increase.

The June Plan assumes that estimated payments (i.e., quarterly payments made on nonwage income) increased by 40 percent in FY 2018, yielding $984 million more than the City's initial forecast. After an initial surge in collections in December 2017, many observers attributed the rise to tax prepayments made by taxpayers when such payments were still fully deductible.[6] However, collections remained strong in the April and June quarterly installments.

It is now clear that the surge resulted not just from tax prepayments, but also from higher-than-expected tax liabilities from economic activity. According to the City, growth was also driven by nonwage income (e.g., pass-through business income, interest and dividends) and a near doubling of capital gains, helped by the strength in the financial markets.

Withholding (i.e., the amount of tax taken from employees' paychecks) increased by an estimated 8.2 percent in FY 2018, the fastest rate of growth since FY 2004. The June Plan assumes collections will be $244 million more than the City initially projected, reflecting a large increase in securities industry bonuses as well as stronger-than-expected job and wage growth.

Some of the growth in bonuses may have resulted from an acceleration of deferred compensation for top executives while it was still a deductible expense in 2017. Earlier this year, OSC estimated that securities industry bonuses increased by 17 percent in 2017, the largest increase in four years.

Also contributing to the growth of both withholding and estimated tax payments was a 2008 federal law that required the repatriation of deferred compensation held overseas. The law offered taxpayers 10 years to repatriate income (and to pay taxes on such income) with a deadline of December 31, 2017. Most of this income was held by hedge fund managers.

In addition, the City had assumed State distribution payments would decline in FY 2018, but payments were $356 million higher than anticipated.[7] The June Plan assumes that such payments will decline by $180 million in FY 2019, but payments are likely to exceed the City's forecast by at least $150 million.

The June Plan also assumes that personal income tax collections will return to their pre-surge trend in FY 2019. OSC generally concurs, but current trends suggest that job growth will be stronger than projected by the City. As a result, withholding could be higher by $200 million annually beginning in FY 2019.

[5] All personal income tax growth rates are adjusted for changes in the administration of the New York State School Tax Relief Program (STAR).

[6] Under the revised federal tax law, the deductibility of state and local taxes is limited to $10,000 beginning in 2018.

[7] The State administers the City's personal income tax. The State remits to the City an estimate of its share each month, and the State subsequently reviews the results and makes adjustments as necessary.

3. Sales Tax

Sales tax collections increased by an estimated 5.5 percent in FY 2018, the strongest growth in four years.[8] The gain reflects higher wages, high consumer confidence, strong holiday sales and a record number of tourists. In addition, the City received a large payment from the State as part of a settlement with a single taxpayer.

The June Plan assumes that growth in the sales tax will slow to 4 percent in FY 2019, with collections reaching $7.8 billion. The slowdown reflects the City's expectations of a slight easing in the rate of job growth and a reduction in bonus income. Tourism spending, however, is expected to remain strong, as NYC & Company (the City's tourism agency) forecasts that the number of visitors to the City will rise by 3.7 percent in 2018 to reach a new record of 65.1 million.

OSC believes collections could be higher than the City expects by $50 million in FY 2019 and similar amounts in subsequent years. This is based on the strength of current trends (collections grew by 6.9 percent in the first six months of calendar year 2018) and OSC's expectation of stronger job growth.

On June 21, 2018, the U.S. Supreme Court ruled that states can require internet merchants to collect sales taxes on all online transactions, overturning an earlier decision that required only sellers with a physical presence in a state to collect sales taxes. New York State already requires large internet retailers (such as Amazon) to collect sales taxes, and there were attempts during the negotiations of the past two state budgets to expand collections to smaller retailers.

Moody's Investor Service recently estimated that new legislation to expand online taxation could allow New York State to generate about 0.5 percent to 1.0 percent in additional sales tax collections annually. Since the State also administers the sales tax for its counties and localities, an expansion of internet taxation would also apply to those jurisdictions. An increase of the magnitude projected by Moody's could generate an additional $39 million to $78 million annually in collections for New York City.

4. Business Taxes

New York City levies two business taxes: the business corporation tax and the unincorporated business tax. The business corporation tax was created in April 2015 through State legislation that combined the City's banking and general corporation taxes. The change was intended to be revenue-neutral, but since implementation, collections have declined and fallen short of expectations.

The federal Tax Cuts and Jobs Act provided an incentive to corporations to repatriate overseas income. However, such income is not taxable under State and City law.

Profitability in the securities industry has improved in recent years, even as the industry employs 6 percent fewer workers than before the financial crisis. Pretax profits for the broker-dealer operations of New York Stock Exchange member firms rose by 42 percent in 2017 to reach $24.5 billion, the highest level since 2010. That momentum has carried into the first quarter of 2018, with profits totaling $6.7 billion, 9.4 percent more than one year earlier.

[8] All sales tax growth rates are adjusted to account for the State's recoup of savings that accrued to the City from refinancing bonds of the Sales Tax Asset Receivable Corporation.

Despite strong profits in the securities industry and signs of an improvement in collections during the second half of FY 2018, business corporation tax collections fell short of the City's expectation at the beginning of the fiscal year (by $542 million). Collections declined by an estimated 2.8 percent to $3.3 billion in FY 2018, the third consecutive year of lower collections. The City attributes the decline to weak nonbanking corporate profits and to companies drawing down overpayments made in FY 2015, when the law changed.

In FY 2019, the June Plan assumes that collections will increase for the first time in three years, growing by 7.3 percent to reach $3.6 billion, driven by strong Wall Street profitability and lower levels of overpayments. Although collections are less likely to fall short of the City's target in FY 2019, collections would be $389 million lower than the City's forecast of one year ago.

Collections from the unincorporated business tax have been affected by some of the same factors impacting the personal income tax. Receipts surged in December 2017 as many taxpayers accelerated payments from 2018 in response to the new federal tax law, and collections remained strong through the remainder of the fiscal year. As a result, collections are expected to increase by 13 percent in FY 2018, yielding $128 million more than expected at the start of the year.

The June Plan assumes, as it does for the personal income tax, that collections for the unincorporated business tax will return to trend in FY 2019. The factors that contributed to the growth in FY 2018 are not expected to recur, which will hold these collections to $2.3 billion in FY 2019, a gain of less than 1 percent.

5. Real Estate Transaction Taxes

Although property values continue to rise, real estate transaction activity has weakened over the past two years. More recently, there have been some signs of improvement, particularly for commercial transactions,[9] including growth in commercial mortgage refinancing activity that comes partly in anticipation of higher interest rates.

The City expects commercial transaction activity to continue to improve in FY 2019, aided by favorable investment provisions in the new federal tax law. Rising interest rates, however, are expected to dampen mortgage activity. As a result, collections from the real estate transaction taxes are expected to decline by 3.2 percent in FY 2019, to $2.4 billion.

6. Miscellaneous Revenues

Miscellaneous revenues (generated from fines, fees, water and sewer charges, and other sources) exceeded the City's forecast at the beginning of FY 2018 by $271 million. While the City no longer anticipates proceeds from the sale of taxi medallions because market conditions have deteriorated, miscellaneous revenues are likely to exceed the City's current forecast by $100 million annually based on historical trends.

However, the State Legislature has not yet reauthorized the City's school speed zone camera program, which begins to expire on July 25, 2018. Unless reauthorized, miscellaneous revenues could be lowered by $48 million in FY 2019, $39 million in FY 2020, $29 million in FY 2021 and $28 million in FY 2022.

9 For example, in FY 2018 the City benefited from Google's purchase of Chelsea Market for $2.4 billion.

V. Expenditure Trends

The June Plan assumes expenditures in FY 2019 will total nearly $89.2 billion, including programs funded with federal and State categorical grants. The portion funded with locally generated revenue (i.e., City funds) totals $65 billion.

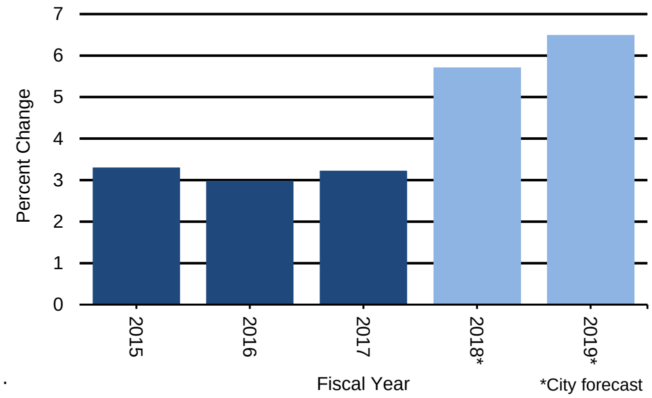
The June Plan assumes that City-funded spending (after adjusting for surplus transfers that can mask expenditure trends) increased by 5.7 percent in FY 2018 (excluding reserves), nearly twice the average of the three prior years (see Figure 7).

Spending is projected to grow by 9.3 percent in FY 2019. Even after excluding reserves and savings from prior years' expenses, spending would increase by 6.5 percent (more than three times faster than the projected inflation rate). Spending is driven by current labor agreements, higher agency spending, rising health insurance and debt service costs, and the impact of State actions.

The June Plan assumes annual wage increases of 1 percent after the expiration of current contracts. Shortly after the June Plan was released, the City reached a tentative agreement with District Council 37 that would increase wages by 7.4 percent over 44 months. The City also announced an agreement with the Municipal Labor Committee to generate $1.7 billion in health insurance savings during the financial plan period to help pay for wage increases for the municipal work force. The impact of these developments are not reflected in the June Plan.

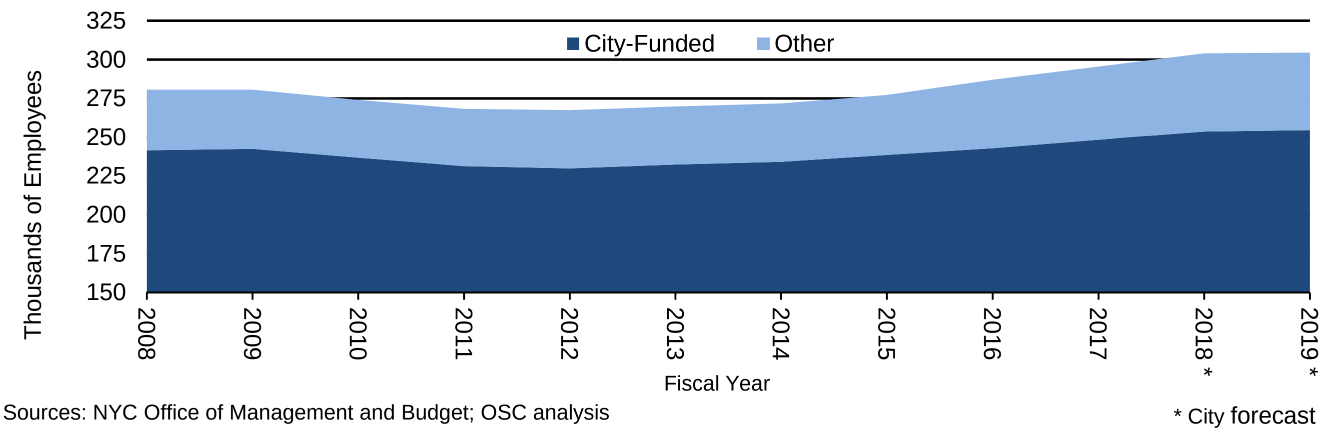
Since FY 2012, the City's full-time work force (including positions funded by federal and State categorical grants) has increased by more than 28,000 employees to reach 295,455 in June 2017, the highest level since the 1975 fiscal crisis (including 248,349 City-funded employees; see Figure 8). As of April 30, 2018, the City has added 2,659 employees, and plans to add another 6,435 by June 30, 2019.

FIGURE 7
Growth in City-Funded Expenditures



Sources: NYC Office of Management and Budget; OSC analysis

FIGURE 8
Full-Time Staffing Levels



Sources: NYC Office of Management and Budget; OSC analysis

FIGURE 9
Trends in City-Funded Spending
(in millions)

	FY 2018	FY 2019	Annual Growth	FY 2020	FY 2021	FY 2022	Average Three-Year Growth Rate
Salaries and Wages	$ 18,354	$ 20,096	9.5%	$ 20,978	$ 21,471	$ 20,735	1.0%
Pension Contributions	9,488	9,707	2.3%	9,759	10,017	10,223	1.7%
Debt Service	5,877	6,729	14.5%	7,222	7,612	8,320	7.3%
Medicaid	5,813	5,813	0.0%	5,813	5,813	5,813	0.0%
Health Insurance	4,700	5,302	12.8%	5,834	6,441	6,992	9.7%
Other Fringe Benefits	2,846	2,974	4.5%	3,258	3,409	3,537	5.9%
Energy	784	785	0.1%	800	824	843	2.4%
Judgments and Claims	572	557	-2.6%	572	587	602	2.6%
Public Assistance	713	713	0.0%	719	719	719	0.3%
Retiree Health Benefits Trust	100	- - -	NA	- - -	- - -	- - -	NA
Other	14,807	15,553	5.0%	14,349	14,454	14,671	-1.9%
Subtotal	**64,054**	**68,229**	**6.5%**	**69,304**	**71,347**	**72,455**	**2.0%**
Prior Years' Expenses	(400)	- - -	NA	- - -	- - -	- - -	NA
General Reserve	20	1,125	NA	1,000	1,000	1,000	NA
Capital Stabilization Reserve	- - -	250	NA	250	250	250	NA
Total	**$ 63,674**	**$ 69,604**	**9.3%**	**$ 70,554**	**$ 72,597**	**$ 73,705**	**1.9%**

Note: Debt service has been adjusted for surplus transfers.
Sources: NYC Office of Management and Budget; OSC analysis

The June Plan is based on the trends shown in Figure 9 and discussed below.

1. Collective Bargaining

On June 26, 2018, the City and the District Council 37, which represents about one-quarter of the municipal work force, reached a tentative labor agreement for the 2017-2021 round of bargaining. If approved, the agreement will increase wages by 7.4 percent (compounded) over a 44-month period.[10]

The City has a long history of pattern bargaining, and it expects the tentative agreement to set the framework for the 2017-2021 round of negotiation. According to the City, similar wage agreements with the entire work force would cost $8.8 billion during the financial plan period.

At the same time the City announced the agreement with District Council 37, it announced that it had reached an agreement with the Municipal Labor Committee (MLC) to generate health insurance savings of $200 million in FY 2019, $300 million in FY 2020 and $600 million in FY 2021, plus recurring savings of $600 million beginning in FY 2022.

A Tripartite Health Insurance Policy Committee (including representatives from the City and the MLC, plus an independent arbitrator) will be established to recommend modifications in the way health care is currently provided or funded.

[10] The first wage increase of 2 percent, retroactive to September 2017, would be paid after the agreement is approved by the union members. The agreement also calls for wage increases of 2.25 percent in September 2018 and 3 percent in October 2019.

FIGURE 10

Budgetary Impact of Pattern Labor Settlements

(in millions)

	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
Pattern Cost (2017-2021 Contract Period)	**$ (255)**	**$ (781)**	**$ (1,730)**	**$ (2,657)**	**$ (3,390)**
Offsets					
Labor Reserve	113	354	726	1,128	1,446
Anticipated Health Insurance Savings	- - -	200	300	600	600
Total Offsets	**113**	**554**	**1,026**	**1,728**	**2,046**
Net Budgetary Impact	**$ (142)**	**$ (227)**	**$ (704)**	**$ (929)**	**$ (1,344)**

Sources: NYC Office of Management and Budget; OSC analysis

According to the agreement, the savings are guaranteed and are enforceable through arbitration. In addition, the annual savings targets could be met with nonrecurring savings, which may include drawing down resources from the health stabilization fund, which currently has a balance of nearly $1.7 billion.

After taking into account the savings anticipated in the health insurance agreement and funding that was previously set aside in the City's labor reserve, the net cost of the 2017-2021 round of bargaining would grow from $142 million in FY 2018 to $1.3 billion in FY 2022 (see Figure 10). The City is expected to reflect these costs in its financial plan in November 2018.

While the City assumes that all of the unions that represent the municipal work force will reach agreements similar to the District Council 37 agreement, in the past uniformed personnel have received larger increases.

In March 2018, the Patrolmen's Benevolent Association (which represents police officers) filed a petition with the New York State Public Employment Relations Board requesting the appointment of a three-member arbitration panel. According to State law, arbitration awards for disputes between the City and police officers are binding on both parties and limited to two years.

In June 2018, the City and the United Federation of Teachers (UFT) reached an agreement to provide six weeks of paid parental leave at 100 percent of salary for more than 120,000 UFT members. While the City estimates that the benefit will cost $51 million annually, the cost is expected to be fully offset, mostly from extending the UFT's current collective bargaining agreement by about two and a half months (from November 30, 2018 to February 13, 2019).

2. Health Insurance

In May 2014, the City and the MLC reached an agreement to generate health insurance savings for the City's budget to help fund wage increases for municipal employees. Under the agreement, the City and the unions agreed to generate a cumulative total of $3.4 billion during fiscal years 2015 through 2018, and $1.3 billion in recurring savings beginning in FY 2019.

In June 2018, the Commissioner of Labor Relations reported that the City exceeded the cumulative four-year target by $131 million and the recurring savings target by $40 million. These savings will be credited toward the new health insurance savings agreement.

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 account for one-fifth of the savings ($693 million), mostly from higher co-payments.

In total, the two health insurance savings agreements with the MLC are expected to generate cumulative savings of $10.3 billion through FY 2022 and recurring savings of $1.9 billion beginning in FY 2022. If the savings are realized as planned, the growth in health insurance costs during the financial plan period would slow from an average annual rate of 10.4 percent to 8 percent, but costs could still reach $6.4 billion by FY 2022, 36 percent more than the cost in FY 2018.

3. Pension Contributions

After rising rapidly between fiscal years 2003 and 2012, the growth in City-funded pension contributions slowed during the next two 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.

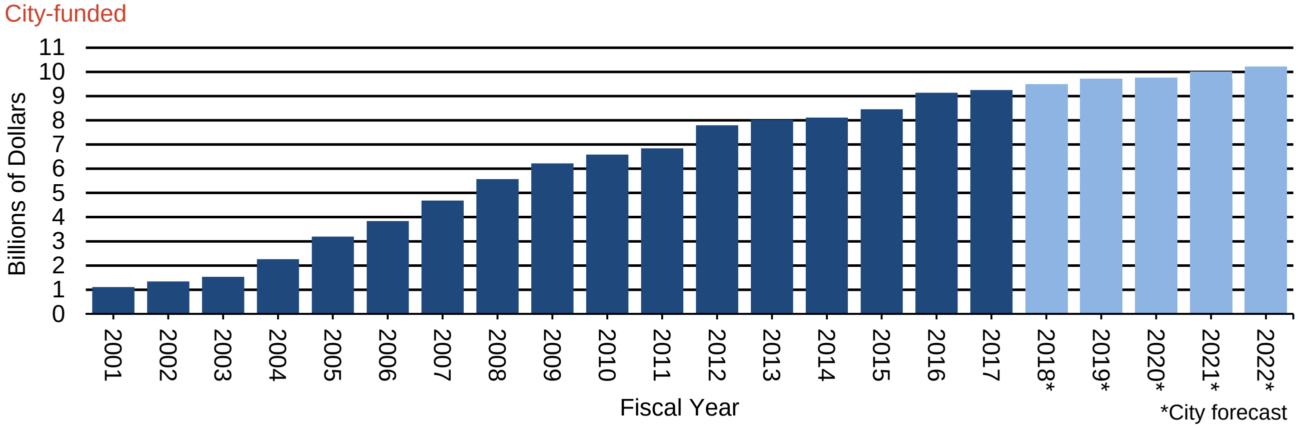
As shown in Figure 11, the June Plan assumes that pension contributions will rise slowly during the financial plan period, from nearly $9.3 billion in FY 2017 to $10.2 billion in FY 2022 (averaging 14.6 percent of City fund revenues over the same period).

The pension funds have earned, on average, 7.9 percent on their investments since the earnings assumptions was lowered to 7 percent. OSC estimates that the pension funds earned about 9 percent on their investments in FY 2018. As a result, the City could realize savings of $58 million in FY 2020, $115 million in FY 2021 and $173 million in FY 2022.

In the four years since the City adopted new, more transparent financial reporting standards for pension liabilities in FY 2014, the financial condition of the City's five actuarial pension systems has improved. In the aggregate, the pension systems had enough assets to fund (on a market-value basis) 71 percent of their accrued pension liabilities as of the end of FY 2017 (see Figure 12). During this period, the unfunded net liability for all five systems declined by $3.6 billion to $56.3 billion.

The June Plan includes reserves ($100 million in each of fiscal years 2019 and 2020, rising to $400 million beginning in FY 2021) to fund potential changes in the actuarial assumptions and methodologies used to calculate employer pension contributions.

FIGURE 11
Pension Contributions
City-funded



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

FIGURE 12
Funded Status of the NYC Retirement Systems
(As of June 30, 2017)

Pension System	Funded Status
Board of Education Retirement System	81%
New York City Employees' Retirement System	75%
Police Pension Fund	75%
Teachers' Retirement System	68%
Fire Pension Fund	61%
All Systems	**71%**

Sources: NYC Retirement Systems; NYC Comptroller; OSC analysis

Potential changes may follow recommendations issued by an independent actuarial consultant, who recently completed a charter-mandated biennial audit of the pension systems and is expected to issue final recommendations in July 2019. Based on the preliminary findings, the consultant may recommend changes to reflect recent trends such as higher overtime and lower mortality rates for active employees, and to reduce long-term inflation and investment earnings assumptions.

4. Debt Service

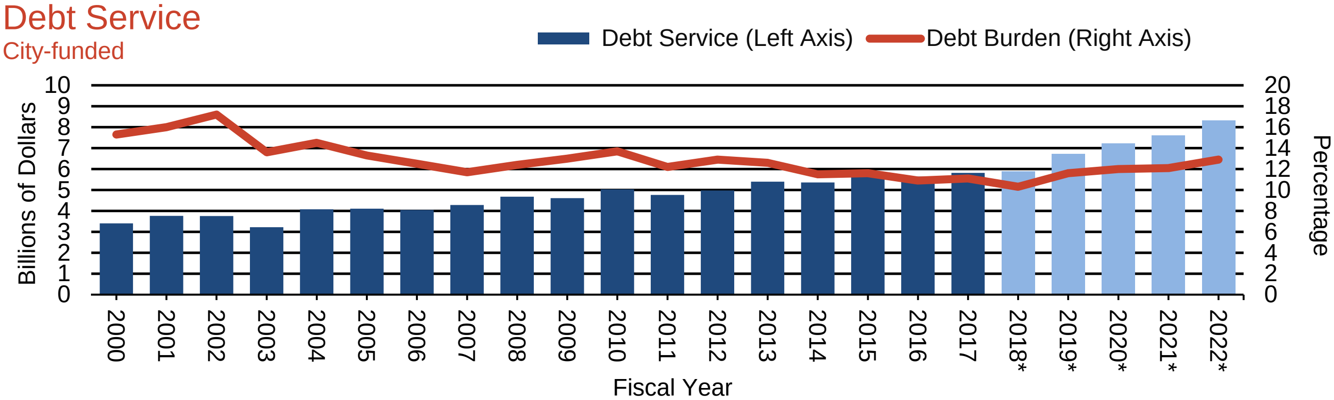
City-funded debt service increased at an average annual rate of only 2.3 percent during fiscal years 2014 through 2018 because of historically low interest rates that reduced the cost of new issuances and created opportunities to refinance outstanding debt. Largely as a result, the City has realized debt service savings of $416 million in FY 2018 and an average of $578 million in the three prior years.

The June Plan assumes that debt service will increase by 42 percent over the next four years (an average annual rate of 9.1 percent) to reach $8.3 billion by FY 2022 (an increase of more than $2.4 billion; see Figure 13). As discussed below, while debt service may grow more slowly, the opportunities for future savings may be reduced compared to recent years.

For example, municipalities are no longer permitted under federal law to refinance outstanding bonds on a tax-exempt basis more than 90 days in advance of their call date. In recent years the City has realized annual savings of about $100 million from this practice.

While the City's interest rate assumptions remain conservative, the Federal Reserve has been increasing short-term interest rates, and the combination of low unemployment and rising inflation could push up long-term rates. As a result, the variance between actual interest rates and those assumed in the financial plan are likely to narrow, reducing the potential for savings.

FIGURE 13
Debt Service
City-funded



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

*City forecast

Despite these developments, the City could still realize debt service savings, at least in the near term, because interest rates are likely to remain below the City's assumptions and commitments are likely to fall short of the City's ambitious target for FY 2019. The City could also realize savings when the Dormitory Authority refinances bonds issued on behalf of the Health and Hospitals Corporation (estimated at $91 million over four years).

Debt service as a share of tax revenue (i.e., the debt burden) has fallen from 12.6 percent in FY 2013 to 10.3 percent in FY 2018. The June Plan assumes that the debt burden will rise to 12.9 percent by FY 2022, but this estimate is based on conservative assumptions for revenue, interest rates and capital commitments.

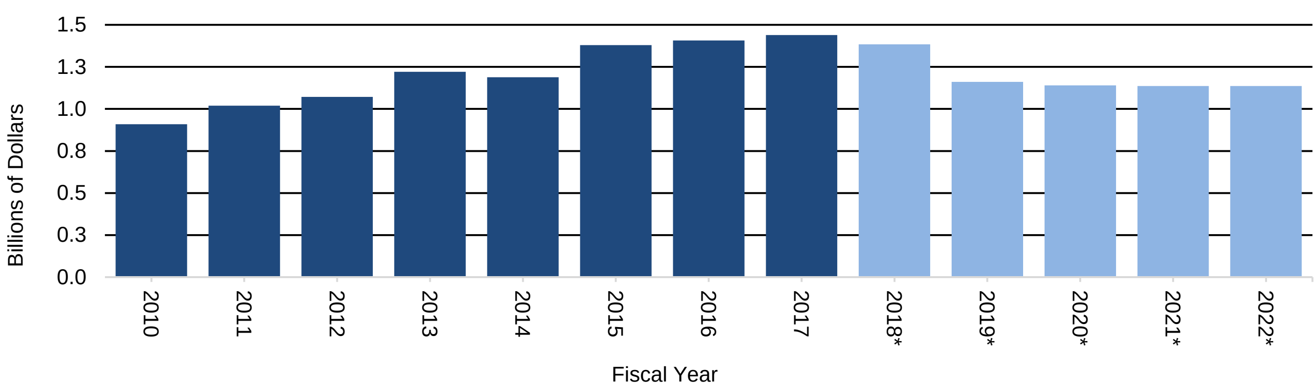
Although debt service is projected to account for a larger share of tax revenue, the share would remain below 15 percent, a level that is considered high. To prevent the debt burden from rising too quickly in the event of a rapid rise in interest rates or a sharp decline in tax revenue, the City established a capital stabilization reserve in FY 2016. The reserve is valued at $250 million annually during fiscal years 2019 through 2022.

5. Uniformed Overtime

Overtime costs in the four uniformed agencies totaled $1.4 billion in FY 2018 (see Figure 14), almost the same amount as the record level set in the prior year. While overtime exceeded the City's estimate at the beginning of the fiscal year by $202 million, these unplanned costs were mostly offset by savings in other personal service costs and by the receipt of federal and State categorical grants.

The June Plan assumes that overtime will total less than $1.2 billion in FY 2019, $223 million less than the FY 2018 forecast. Although the Department of Correction has made some progress in reducing overtime by hiring additional officers, overtime for the four agencies is still likely to approach last year's level. Until the agencies demonstrate savings in other areas, OSC retains a net overtime risk of $125 million annually beginning in FY 2019.

FIGURE 14
Uniformed Agency Overtime



* City forecast

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

6. Homeless Services

The number of homeless people residing in shelters operated by the Department of Homeless Services (DHS) remains at historic levels despite City efforts to prevent homelessness and to create permanent housing. In May 2018, the caseload totaled 59,180 (see Figure 15), a decline since the peak reached in February 2018 (60,713).

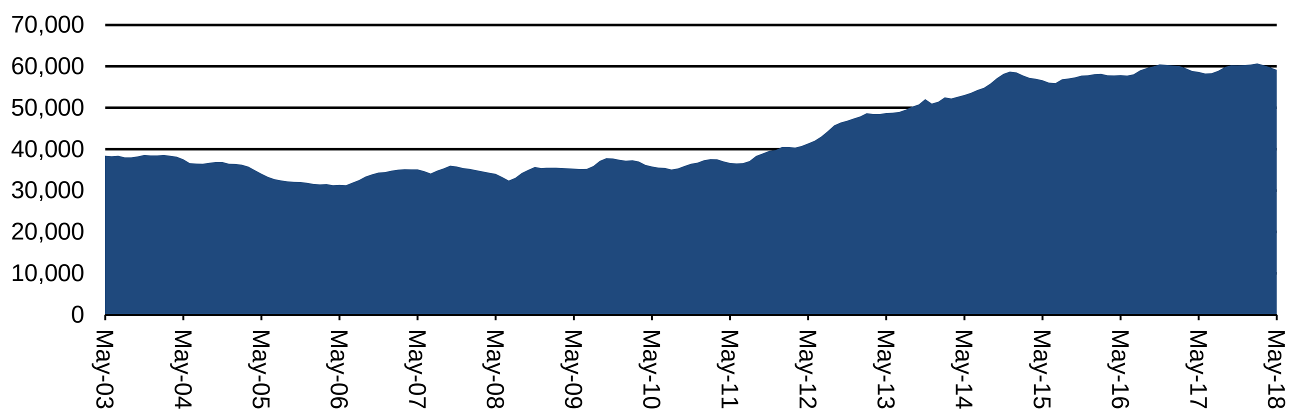
After increasing during the first four months of FY 2018, the average number of individuals who were part of families with children in the shelter system declined for seven consecutive months to 38,789 in May 2018, the lowest level in four years. However, families are staying in shelters for an average of 25 days longer compared to the same period in the prior year.

The number of single adults in shelters grew by an average of more than 1,000 people annually in fiscal years 2014 through 2017. The number of single adults in shelters continues to increase, and had grown by 1,368 through May 2018. The June Plan, however, assumes that the cost for housing single adults will decline by $47 million in FY 2019, which seems unlikely given current trends.

The Mayor reports that the City is only slightly behind schedule in building new shelters to accommodate the growing shelter population, and has been phasing out the use of cluster-site apartments to shelter people. The result is that the City has had to rely on placing people in more costly hotels as a bridge until the new shelters are available. The City reports that it spends $32 million each month on hotels to shelter the homeless. The Commissioner of Social Services has indicated that phasing out the use of hotels may take up to seven years.

Since the beginning of the fiscal year, the City has increased funding for shelters by $336 million in FY 2018 and $309 million annually through FY 2022. Three-quarters of the additional funding is allocated for single adults in the shelter system. The cost of providing homeless services is projected to total $2.1 billion in FY 2019, double what it cost five years earlier. The City-funded cost is projected to total $1.2 billion.

FIGURE 15
People in Homeless Shelters



Source: NYC Department of Homeless Services

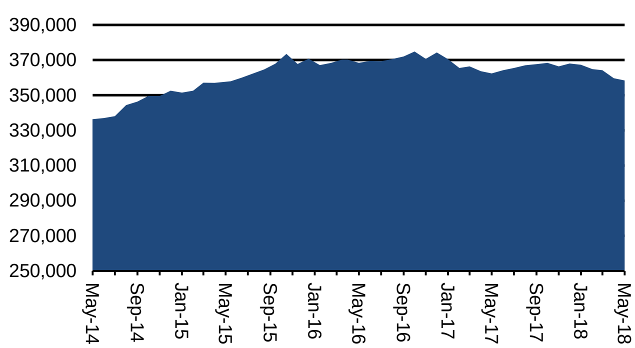
7. Public Assistance

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, which is funded by the State, the City and counties outside of the City, provides benefits to families that have exhausted their federal benefits and to low-income individuals who are ineligible for federal benefits.

The public assistance caseload averaged 367,200 during the first seven months of FY 2018, peaking at 368,424 in October 2017. Since then, the caseload declined to 358,400 people in May 2018, the lowest monthly caseload in three years (see Figure 16).

The June Plan assumes that the caseload will average 367,000 throughout the financial plan period, creating the potential for savings if the caseload remains at the current level. The City-funded cost of public assistance is expected to total $713 million in FY 2019 and increase slightly to $719 million beginning in FY 2020.

FIGURE 16
Public Assistance Caseload



Source: NYC Human Resources Administration

8. Medical Assistance

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) that serve large numbers of low-income patients and uninsured patients.

The Medicaid caseload grew steadily after the recession and accelerated after January 1, 2014, when Medicaid eligibility expanded under the federal Affordable Care Act (ACA). Enrollment reached almost 3.7 million people in December 2015, an increase of 16 percent (more than 510,000 people) since December 2013.

In January 2016, the Medicaid caseload fell (by 134,000) as the State transferred certain immigrants who were ineligible for federal Medicaid to the State-funded Essential Plan. Since then, the Medicaid caseload has gradually declined to less than 3.5 million as of October 31, 2017 (the latest data available).

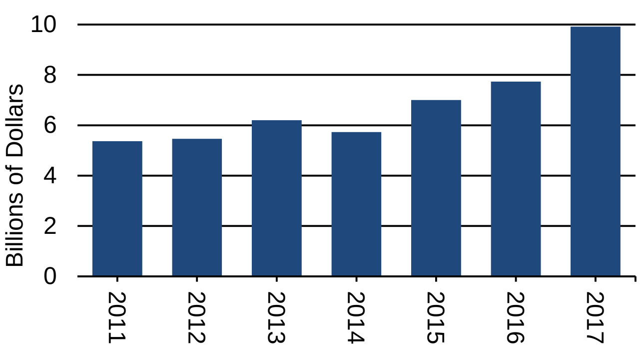
The June Plan assumes that the City-funded share of Medicaid will total $5.8 billion in FY 2018 (9 percent of City fund revenues) and will remain at that level because the State has assumed financial responsibility for the growth in the local share. These estimates assume there will be no changes in federal and State policies.

VI. The Capital Program

The City anticipates City-funded capital commitments of $67.4 billion ($74.9 billion in total funds) during fiscal years 2018 through 2022, 84 percent more than committed during the prior five years.[11] While the City has fallen short of its annual capital commitment targets in the past, actual commitments have been rising.

In FY 2017, City-funded commitments reached nearly $10 billion, 74 percent higher than the average during fiscal years 2011 through 2014 (see Figure 17). Commitments are expected to reach nearly $10.7 billion in FY 2018 and average more than $14 billion during fiscal years 2019 through 2022.[12]

FIGURE 17
City-Funded Capital Commitments



Sources: NYC Office of Management and Budget; OSC analysis

Consequently, City-funded capital expenditures are projected to rise from $7.4 billion in FY 2017 to $12.5 billion by FY 2022, which the City intends to fund exclusively through borrowing. As a result, debt service is projected to increase by 42 percent between fiscal years 2018 and 2022.

In the past, similar predictions went unrealized because interest rates remained well below the City's assumptions and capital commitments fell short of expectations. However, both interest rates and commitments are rising although not as fast as the City had planned. Moreover, for the first time in years the risk is higher (although still relatively low) that interest rates could approach the levels anticipated in the City's financial plan.

The City's agencies are authorized to commit $74.5 billion in City funds during fiscal years 2018 through 2022. As shown in Figure 18 and discussed below, about two-thirds of this amount would be invested in projects involving education, environmental protection, transportation and housing.

- Environmental protection projects would be allocated $14 billion to maintain the sewer system and protect the water supply, including the last phase of the third water tunnel.
- Education projects would be allocated $12.7 billion, mostly to support the construction of schools and the rehabilitation and expansion of existing schools.
- Transportation projects would be allocated $12 billion, mostly for bridge reconstruction and rehabilitation, street and sidewalk reconstruction, and reconstruction of the triple-cantilever section of the Brooklyn-Queens Expressway.

The City's capital commitment plan provides the Metropolitan Transportation Authority (MTA) with $828 million through FY 2022 (including $164 million for the MTA's Subway Action Plan). The plan, however, does not yet include $1.8 billion of the City's $2.7 billion funding commitment to the MTA's 2015-2019 capital

[11] The non-City-funded share of the capital program will be funded with federal and State grants.

[12] As of May 2018 the City had committed only $7.6 billion, but last year June accounted for one-quarter of all City-funded commitments for the year ($2.4 billion).

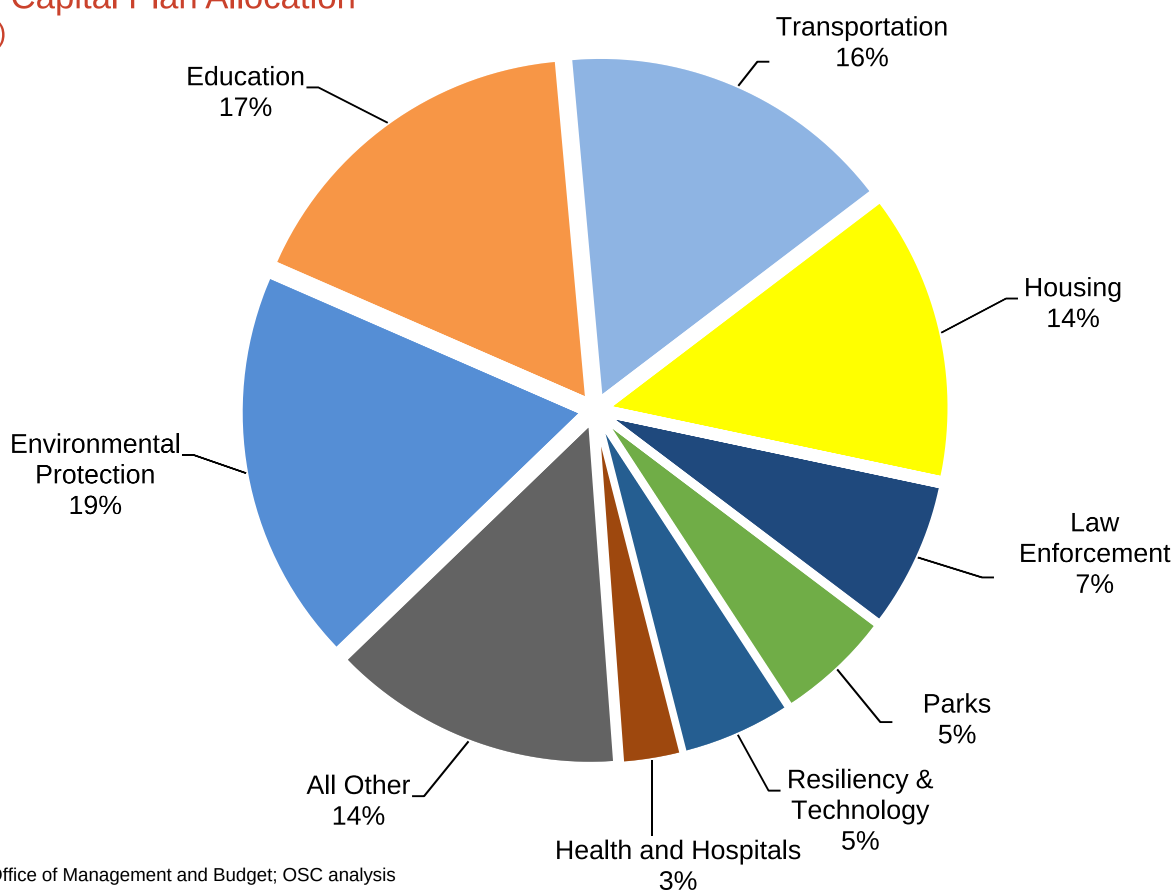
program. The City has indicated that it will provide proportional matches concurrently with additional State funds in accordance with the funding needs of the MTA's capital program.

Housing and economic development projects would be allocated $10.2 billion, including $1.5 billion for the New York City Housing Authority (NYCHA).

The capital commitment plan for fiscal years 2019 through 2022 does not yet include the additional $1 billion in capital funds that the City has agreed to provide NYCHA during these years as part of a consent decree with the U.S. Attorney's office (for a detailed discussion, see Section VII, "Semi-Autonomous Entities"). The adopted capital commitment plan will be released in the fall of 2018 and will likely reflect the additional funding for NYCHA.

The plan commits another $5.2 billion for law enforcement (e.g., the Police Department, the Department of Correction, and the courts); $4.1 billion for parks; $3.9 billion for resiliency, technology and equipment; and $2.1 billion for the Health and Hospitals Corporation. The remainder of the program ($10.4 billion) would be spread among various agencies, including cultural institutions, the Fire Department, public buildings and the Department of Sanitation.

FIGURE 18
Five-Year Capital Plan Allocation
(City Funds)



Sources: NYC Office of Management and Budget; OSC analysis

VII. Semi-Autonomous Entities

1. 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 $32.3 billion to the Department of Education in FY 2019 to cover the cost of educating students (see Figure 19). Since FY 2000, the City share has grown 10 percentage points to 57 percent, while the State share has fallen from 43 percent to an average of 37 percent since FY 2010.

In FY 2019, the City intends to contribute $18.3 billion (including the cost of debt service and employee benefits), while the State contribution is expected to total $11.9 billion. The federal government is expected to contribute $2 billion (6 percent). The department has increased staffing by more than 11,000 (including more than 9,700 pedagogues) between June 2014 and April 2018, and it plans to add more than 1,000 pedagogues by June 30, 2019.

The education budget includes funding for new policy initiatives and for the expansion and support of existing programs. For example, the FY 2019 budget allocates additional resources for Fair Student Funding, an initiative that was begun in the 2007-2008 school year. The initiative is designed to improve equity across the school system by taking into account certain needs, such as special education and English-language learners.

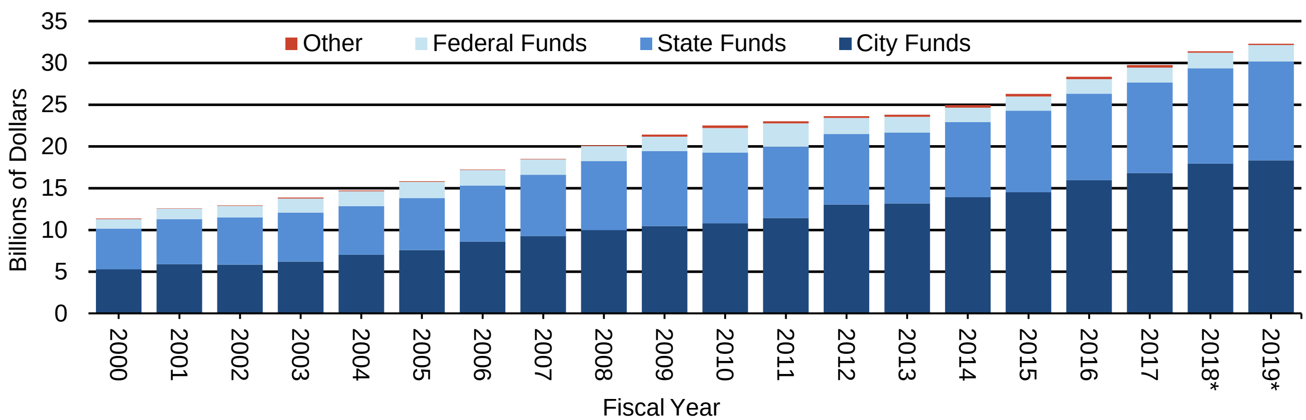
The budget also includes resources to expand 3-K for All, which will reach 12 high-need school districts by FY 2020. Other initiatives include funding for universal literacy, air conditioning in classrooms and students living in homeless shelters. According to the State Education Department, there were 38,000 homeless schoolchildren in the City's shelters during the 2016-17 school year.

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 is making several improvements to improve the process, it continues to fall short of target.

The June Plan anticipates $97 million annually in Medicaid reimbursement beginning in FY 2018. Last year, the department received $34 million, and as of June 22, 2018, the department had submitted claims for only $27 million in FY 2018. Until the department demonstrates the ability to increase claims above last year's amount, the receipt of $63 million annually remains at risk.

FIGURE 19

Education Funding by Source



Sources: NYC Office of Management and Budget; OSC analysis

*City forecast

2. Health and Hospitals Corporation

The Health and Hospitals Corporation provides health and mental health services to more than 1.1 million City residents. The Corporation faces significant challenges, including the declining use of services and the large share (more than one-third) of patients who lack health insurance.

As shown in Figure 20, the number of patients served by the Corporation (both inpatient and outpatient) declined by 91,000 patients (7 percent) between fiscal years 2010 and 2017. While the health care industry is moving toward outpatient settings, the Corporation experienced a decline of nearly 6 percent in outpatient visits in FY 2017 and a decline of 3 percent during the first seven months of FY 2018.

Despite steps in recent years to improve its financial position, the Corporation has increasingly relied on the City for financial assistance to fulfill its obligations. In FY 2018, the City provided an estimated $1.9 billion in financial support, representing nearly one-quarter of the Corporation's total revenues. For example, the City funds the nonfederal share of supplemental Medicaid, the cost of collective bargaining, and debt service on bonds issued on the Corporation's behalf.

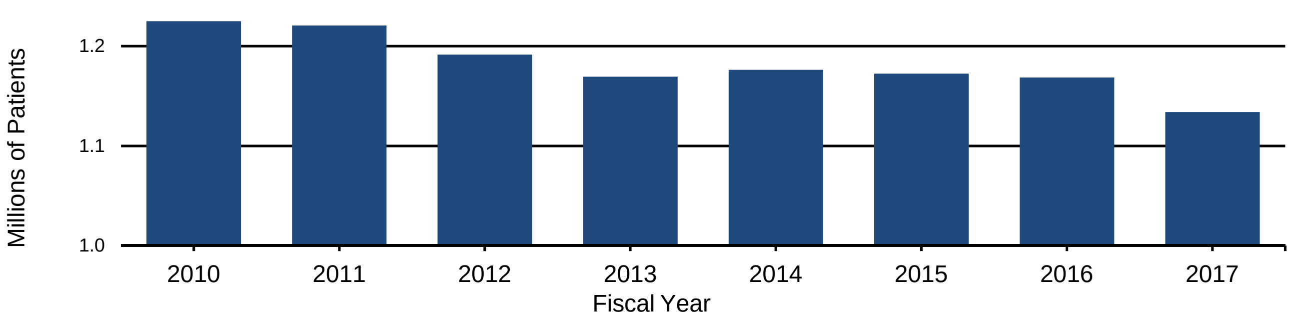
On May 24, 2018, the City released a cash-based financial plan for the Corporation covering fiscal years 2018 through 2022 (the "May Plan"). The May Plan assumed the receipt of almost $1.1 billion in previously unplanned Medicaid payments by the end of FY 2018. However, a significant portion was not received by the end of the fiscal year, although the City expects the remainder to be paid in early FY 2019. In light of the shortfall, the Corporation paid only half of the amount owed to the City in FY 2018, with the balance expected to be paid in FY 2019.

According to the City, the Corporation still expects its year-end cash balance to total $625 million by the end of FY 2019. This estimate assumes successful implementation of new cost-saving and revenue-generating initiatives. Even if these were unsuccessful, the Corporation would likely still have sufficient cash to meet its obligations in FY 2019.

In FY 2020, however, the Corporation would run out of cash unless it successfully implements its corrective action plan. If it is unable to do so, projected losses could grow from $619 million in FY 2020 to nearly $2.9 billion by FY 2022.

In January 2018, a new president took control of the Corporation, and he is assembling a new management team. The City and the Corporation should act quickly to take advantage of the temporary reprieve provided by a two-year delay in federal Medicaid cuts and the current cash cushion. Without effective corrective measures, the City could be called upon to further increase its financial support.

FIGURE 20
Patients Served at the Health and Hospitals Corporation



Sources: NYC Mayor's Management Report

3. Metropolitan Transportation Authority

In July 2017, the MTA proposed an $836 million Subway Action Plan (SAP) to address the deterioration in the City's subways. The MTA suggested that the State and City split the cost, but an agreement could not be reached.

In November 2017, OSC concluded in a report that if new funding sources were not identified, the MTA might have to raise fares and tolls faster than planned to improve the subways. The report also raised concerns that the MTA still had not explained how the recurring cost of the SAP would be funded so the system would not fall back into disrepair.

On March 30, 2018, the State enacted a budget for State fiscal year (SFY) 2018-19. The State budget requires the State and the City to split the cost of the SAP in 2018. The State also imposed congestion surcharges (effective January 1, 2019) on all taxi trips, for-hire transportation trips and pooled for-hire trips that originate in or enter Manhattan south of 96th Street.

According to the MTA, the State estimates that the congestion surcharges will provide the MTA with $435 million annually. Under the law, $362 million will be used for the exclusive purpose of funding the SAP in 2019 (and about $300 million in subsequent years), while $50 million annually will be used to support outer-borough projects that improve connectivity to Manhattan as well as to reduce tolls on MTA bridges and tunnels. The remainder could be used by the MTA to support the operating or capital budgets.

The MTA's latest financial plan, released in February 2018, projects positive year-end cash balances through calendar year 2019, but budget gaps that grow from $403 million in 2020 to $602 million in 2021. The gap estimates already assume fare and toll increases of 4 percent in 2019 and in 2021. The MTA is expected to release a revised four-year financial plan on July 25, 2018.

The MTA's financial plan sets aside resources to fund annual wage increases of 2 percent after the expiration of current contracts.[13] The terms of the next round of collective bargaining will be determined through negotiation or arbitration, and the actual cost could be higher (or lower) than assumed by the MTA.

In May 2016, after a 17-month delay, the State approved a new five-year capital program for the MTA for the 2015-2019 period. The State initially agreed to commit $8.3 billion to the MTA's capital program, but it has since increased its commitment to $8.6 billion.

So far, the State has identified $1.3 billion in resources.[14] It intends to provide the remaining $7.3 billion 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 will contribute $2.7 billion and has already allocated $821 million, including $164 million for the SAP.[15]

The MTA partly depends on the federal government to help fund its capital improvements. The President's proposed budget, if enacted, would eliminate funding for new projects under the New Starts program. The MTA anticipates funding from this program will cover about $2 billion of the $6 billion estimated cost of the next phase of the Second Avenue Subway.

[13] The current contract with the Transport Workers Union, the MTA's largest union, will expire in May 2019.

[14] The $1.3 billion includes $989 million from bond proceeds and $315 million from financial settlement funds.

[15] The City has indicated that it will provide proportional matches concurrently with additional State funds. In addition to $164 million from the City's budget, the City will be credited with $10 million in proceeds expected from the recently enacted surcharge on for-hire vehicles.

In March 2018, the Long Island Rail Road (LIRR) released a plan to improve on-time performance. According to a recent report from the State Comptroller, last year the LIRR had its worst on-time performance in 18 years, and 2018 began with mixed results. The report found that Amtrak was responsible for more than half of the increase in the delays experienced by the LIRR, but the LIRR itself was responsible for more than twice as many delays as Amtrak.[16]

In April 2018, the MTA announced that it would develop a comprehensive plan to restructure New York City's public bus system as part of an effort to provide immediate and long-term improvements. Bus ridership has been in decline for years as riders abandon buses for alternative transportation options.

On May 23, 2018, the president of New York City Transit presented to the MTA board a comprehensive plan to improve subway and bus operations, and to modernize the subway system. For example, the plan calls for accelerating the installation of communications-based train control signals in the subway system.

The MTA has not released detailed estimates of the cost of the plan, but a preliminary estimate placed the cost at $19 billion during the first five years and $43 billion over 15 years. The Governor has proposed that the State and the City split the cost, similar to how the SAP was funded. The cost for the first five years is expected to be included in the MTA's 2020-2024 capital program, which will be released next year.

4. 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.

Federal funds make up 60 percent ($2 billion) of NYCHA's operating budget and 89 percent of the portion not funded with rent proceeds. As a result of inadequate capital investment, coupled with mismanagement, the City's public housing properties have fallen into disrepair.

On April 2, 2018, the Governor issued an executive order that declared a State disaster emergency at all NYCHA developments in the City. The order directed the Mayor, the City Council Speaker, and the president of the NYCHA Citywide Council of Presidents tenant group to appoint an independent emergency manager.

The emergency manager was tasked with developing a comprehensive emergency remediation plan for the use of $550 million in emergency State resources and any unspent State and City funds, as well as future City funding. Pursuant to the Governor's executive order, the City would have been required to provide additional capital funding beyond the amounts it had planned.

Before an emergency manager was appointed, the City and NYCHA reached a settlement with the U.S. Attorney for the Southern District regarding violations of federal lead paint safety regulations, as well as other federal regulations that require public housing agencies to provide housing that is "decent, safe, sanitary and in good repair."

[16] Office of the State Comptroller, Report 12-2018, *Long Island Rail Road: On-Time Performance by the Numbers*, March 2018.

As a condition of the consent decree, the City will be required to provide $4 billion in capital funding to NYCHA during fiscal years 2018 through 2027, $2 billion more than budgeted ($1 billion more than budgeted during the current four-year financial plan period). In addition, the City will be required to provide $2 billion in operating assistance during this period, an amount that is consistent with the City's intentions.

Under the consent decree, the U.S. Attorney will propose a monitor who will develop plans to ensure that NYCHA complies with all federal regulations concerning lead paint safety, its properties are free of mold and vermin and that elevators and heating systems are "functionally adequate, operable and in good repair." The monitor will be approved by a federal judge who will oversee the monitor's performance.

The Governor's office has announced that the State will suspend its requirement to appoint an emergency manager, but will act on the other provisions of the executive order, including providing $550 million in capital funds, once a monitor and remediation plan are approved by the federal court.

In 2011, NYCHA estimated that its total capital needs over the next five years totaled $17 billion. Although NYCHA was scheduled to release an updated assessment in 2016, it did not release one until June 2018. According to that update, NYCHA's capital needs totaled $31.8 billion over the next five years ($42.5 billion over 20 years). Despite the commitment of additional State and City funding, the amount of capital resources available to NYCHA during that period totals less than $8 billion, a fraction of its capital needs.

VIII. Other Issues

1. Fair Fares

The City intends to implement a pilot program proposed by the City Council, known as Fair Fares, to provide half-fares to low-income New Yorkers who use the subway or bus systems operated by the Metropolitan Transportation Authority, beginning on January 1, 2019.

The City Council estimated that it would cost $212 million annually to subsidize low-income residents at or below the federal poverty level who do not currently receive transportation subsidies (such as senior discounts).

The June Plan includes $106 million to fund the program during the second half of FY 2019, but the program is not yet funded in subsequent years. It is likely that the program will be popular and thus difficult to discontinue after six months.

We note that the City has not yet determined the program's eligibility requirements, which could affect the program's cost. More information will become available regarding the participation rate during the pilot period.

2. Post-Employment Benefits

One year earlier than required, the City has implemented new financial reporting standards for state and local governments that were promulgated by the Governmental Accounting Standards Board. The changes largely mirror those recently implemented for pension liabilities, impacting how governments measure and report the costs and liabilities of post-employment benefits other than pensions (OPEBs) in their financial statements, but not impacting how governments should fund their OPEB plans.

As a result of implementing the new standards, the City restated its FY 2016 unfunded liability for OPEBs, increasing it by $5 billion to $94.5 billion. The increase mainly reflects the impact of the City using an interest rate that is lower than the assumed rate of return on investments. The new standards require entities that do not fund their OPEB liabilities on an actuarial basis to discount future costs using an interest rate that is based in part on the 20-year municipal bond index rate, which can change significantly each year.

The City's unfunded liability decreased by $6.1 billion to $88.4 billion in FY 2017. The decrease was driven mainly by the impact of a higher interest rate assumption of 3.2 percent as of June 30, 2017, compared to 2.8 percent one year earlier. (The City Actuary estimates that a 1 percent increase to the interest rate would reduce the liability by $13.3 billion and a 1 percent decrease would increase the liability by $17 billion).

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 $2.3 billion in FY 2017 to $3 billion in FY 2022, an increase of 31 percent over five years.

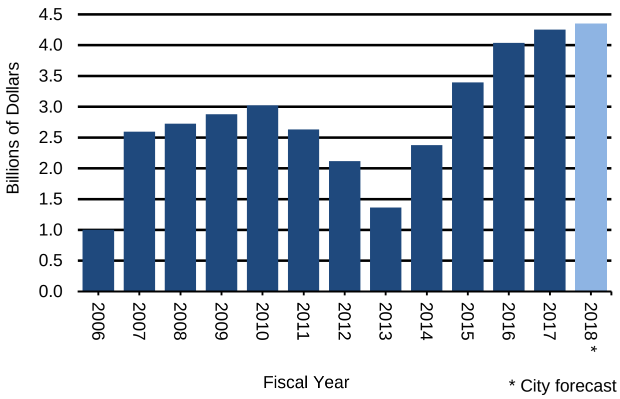
3. Retiree Health Benefits Trust

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 more than half of the resources in the RHBT during fiscal years 2011 through 2013 as it managed through the Great Recession (see Figure 21). 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 each of fiscal years 2017 and 2018, the City contributed an additional $100 million, raising the RHBT balance to nearly $4.4 billion in FY 2018, the highest amount ever.

FIGURE 21

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

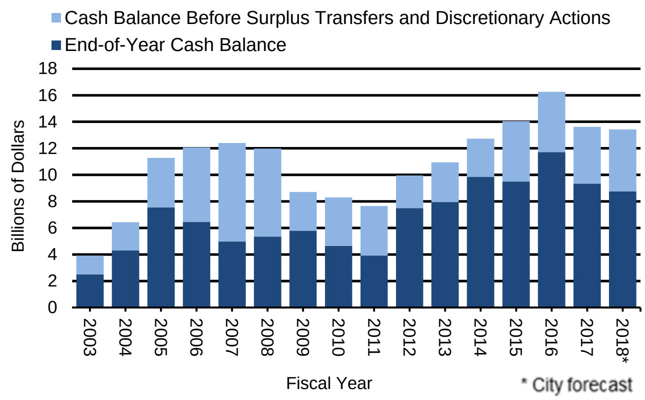
4. Cash Flow

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 22).[17] 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.

The City's cash position continuously improved during fiscal years 2011 through 2016, reaching a record level of $16.3 billion (before discretionary actions). The City's year-end cash balance declined in FY 2017 to $13.6 billion ($9.3 billion after discretionary actions), and the New York City Office of Management and Budget estimates that the City's year-end cash balance will total $13.3 billion (nearly $8.8 billion after discretionary actions), slightly less than last year. Given the amount of cash on hand, however, the City does not anticipate needing to borrow to meet its cash flow needs during the financial plan period.

FIGURE 22

Year-End Cash Balance



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

5. 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.[18]

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

[17] Discretionary actions include surplus transfers and deposits into the Retiree Health Benefits Trust.

[18] 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.

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).[19] 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.

[19] 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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