

Fiscal 2009 Preliminary Budget Response

Comment on the
Fiscal 2009
Preliminary Budget

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EXECUTIVE SUMMARY

In accordance with Section 247 of the New York City Charter, the New York City Council (Council) is pleased to submit its response to the Mayor's Preliminary Fiscal 2009 Budget (Response).

Since January, when the Mayor released his Preliminary Fiscal 2009 Budget (Preliminary Budget), several factors have contributed to an even gloomier economic outlook in the coming year for the nation and for New York City. These include:

- A growing consensus among economists that the national economy is already in recession (according to a March 2008 *Wall Street Journal* poll);
- The amount of equity that homeowners have in their homes has fallen to its lowest level since the Great Depression;^a and
- On March 17, 2008, Bear Stearns, one of the world's largest and most prominent investment banks, announced that it was in the process of being acquired by JPMorgan Chase with the U.S. Federal Reserve agreeing to guarantee up to \$29 billion of Bear Stearns's assets in an effort to stave off wider chaos in financial markets stemming from the mortgage crisis.

Despite these factors, the City's economy remains more stable than the nation's. However, there are darkening clouds on the City's horizon that signal a coming recession.

- Employment growth in the City has slowed to 1.6 percent in January 2008, down from 2.7 percent in January 2007.
- The investment banks that power Wall Street and our local economy have lost half of their market value since June 2007.

It is likely that the City's economy will fall into a recession somewhat later than the rest of the country and somewhat later than predicted by the Mayor's Office of Management and Budget (OMB). Most likely, the City will not recover from this recession until sometime in Fiscal 2010. The City is currently facing two years (the current fiscal year and Fiscal 2009) in which tax revenues will decline, followed by three years in which the growth in tax revenues will be about half of what they were in Fiscal 2005-2007. Therefore, the Council must be prepared to take a serious and comprehensive look at the City's spending, tax policy and savings so that it can make responsible choices to ensure that the City remains on economically sound footing in the coming years.

It is important to note that while New York City is not on the verge of bankruptcy as it was in the 1970s, nor is it reeling from the double blows of a massive terrorist attack followed by a recession as it was in late 2001, the City could face a severe economic downturn resulting in

^a Board of Governors of the Federal Reserve, *Flow of Funds*, 4th quarter, 2007.

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substantially lower tax revenues that the City has not experienced in recent years. And these substantially lower revenues could continue for a few years to come.

The measures needed to weather this downturn are not the drastic ones required in times of emergency, such as laying-off City workers or imposing large tax increases. However, to preserve the gains the City has made since its dramatic recovery from the September 11th attacks and their aftermath, while leaving the next Administration and Council in a strong financial position, may require extraordinary measures.

In the Fiscal 2009 Preliminary Budget the Mayor proposed a 2.5 percent across-the-board reduction for all City agencies for Fiscal 2008, as well as a 5 percent cut for Fiscal 2009. In addition, during the Council's Preliminary Budget hearings, the Director of OMB announced that the Administration was looking to cut an additional 3 percent from agency budgets in Fiscal 2009. The motivation behind this step, according to the Budget Director, are risks to the City's budget posed by the serious possibility of a deeper or longer recession, as well as risks posed by proposed decreases in State aid contained in the former Governor's State Executive Budget.

Agency Spending Should Be Reduced

The Council believes that the City should be looking at a program to eliminate the gap (PEG) in the range of \$800 million to \$1 billion. The size of the PEG proposed by the Mayor in the Fiscal 2009 Preliminary Budget is within this range. While the Council believes that all agencies should be reviewed for reductions and savings, we propose achieving a PEG of this size in a manner that better protects certain priorities. The Council believes that the Department of Education (DOE), comprising almost one-third of the City's budget, must be included in the PEG, but has identified alternative areas in DOE's budget for reductions that would substantially lessen the impact on City schools.

This Response proposes approximately \$160 million in additional agency spending reductions for Fiscal 2009, about two-thirds of which are identified in DOE's central budget and approximately one-third in other agencies. The Council proposes using these reductions to eliminate more harmful cuts proposed to schools and libraries.

The Council also proposes to work with the agencies to identify certain areas of the budget that could sustain additional reductions, perhaps even up to an additional 3 percent, without significantly impacting services that the agencies and Council deem to be core services. Such additional reductions should be utilized to reduce out-year budget gaps. However, any such reductions should be done with sensitivity to neighborhoods and populations of the City that are in need of higher levels of government services.

Additional Forecasted Tax Revenue Should be Used to Reduce Gaps

The Council's revenue estimate recognizes \$260 million in additional revenue in the current year and \$390 million in Fiscal 2009 for a combined additional total of \$650 million. This additional revenue is due in part to the fact that the Council's revenue estimate forecasts that the City will enter into a recession at a later date than anticipated by OMB, but that it may not recover as early

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as predicted. Because the City is likely to need these extra resources at the back end of the recession, this Response proposes using all of this additional revenue to reduce the size of the Fiscal 2010 budget gap.

Agency Re-estimates Should be Used for Additional Savings and Shared Priorities

This Response identifies over \$550 million in agency savings and re-estimates. These are areas where the Council Finance Division (Council Finance) believes OMB has overestimated the cost of certain agency expenditures and/or believes that additional savings can be achieved. In the past, a substantial number of Council-identified re-estimates have been accepted by OMB and used to reduce the amount of budgeted agency spending. The Council proposes that these savings be divided and used as “savings” to further reduce the out-year budget gaps; a portion of these savings should also be used to fund priorities shared by the Council and the Administration.

The Council and the Administration must work together to develop programs to address shared priorities not only in the area of education but also in such areas as assistance to homeowners at risk of foreclosure, health initiatives, and programs for youth and seniors. Improving our public schools and the education of our residents has always been a shared priority of the Council and the Administration. We are still tackling problems of our middle schools, working towards expanding access to universal pre-kindergarten, reducing class size and have just recently restored 6 day/week library service. An economic downturn should not cause us to retreat from areas in which we have just begun to see progress.

We must move toward a budget model in which programs are funded based on criteria set forth by the Council and the agencies in terms of program goals. This model will result in a more effective and efficient use of City resources than the current model in which there is a set of programs administered by the agencies, all too often without Council input, and a second set of supplemental programs initiated by the Council, all too often without agency input.

Summary of Resources and Proposed Actions

In this Response the Council identifies a total of \$1.368 billion in additional resources from additional tax revenue, agency savings and re-estimates, and additional agency cuts. The Council proposes using a substantial portion of these resources to reduce out-year budget gaps to levels below those in the Preliminary Budget to ensure the soundness of the Fiscal 2010 Budget. The Council would use alternative agency cuts in DOE and other agencies to restore as much of the proposed DOE reductions that directly impact the schools and classrooms as possible, and to continue to fund 6-day library service. Finally, the Council proposes using a portion of the agency savings to address shared priorities of the Council and the Administration in the most efficient and effective manner by working together to establish funding priorities and the best ways of achieving them.

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Additional Resources	Proposed Council Actions
+ \$650 million projected revenue	Save all additional revenue
+ \$160 million agency reductions	Use to offset reductions to schools/libraries
+ \$558 million re-estimates	Use some to further offset reductions Use some for shared priorities Save to reduce out-year gaps
<hr/>	
+ \$1.368 billion total	
<hr/>	
+ Additional judiciously-made cuts	Save to further reduce out-year budget gaps

In its totality, this Response proposes to:

- Reduce the amount of agency spending on programs in light of the current decline in revenues and anticipated years of reduced revenue growth;
- Use additional anticipated revenues and additional savings and efficiencies to protect the fiscal stability of the City by using this money to balance the Fiscal 2010 Budget, and decrease the size of out-year budget gaps;
- Reduce spending in certain areas and achieve savings and efficiencies and use this money to protect, to the greatest extent possible, the gains that the City has made over the last several years in improving public schools and continuing to fund 6-day library service;
- Protect, to the greatest extent possible, the reductions in property taxes achieved over the last several years;
- Use a portion of additional savings and efficiencies to efficiently and effectively accomplish goals shared by the Council and the Administration in such areas as mortgage foreclosure assistance, health care and services for our youth and seniors; and
- Realize these aforementioned goals prior to funding new spending initiatives.

Continue Budget Reforms to Insure Long-term Financial Stability

The Council has been working over the past two years to strengthen the City financially so that our priorities and commitments may be maintained even during times of economic decline. For example, the Council, together with the Administration, put \$2.5 billion aside to fund future retiree health benefits. Together, we paid down \$1.25 billion in outstanding debt. And, last year, while faced with another record surplus, we enacted a 7 percent property tax reduction for the current fiscal year instead of increasing spending to a level that would have been unsustainable.

In addition, at the Council's urging and through hard work by both the Administration and Council, the City is well on its way to having a more transparent budget that reveals the actual amount of spending on various agency programs. Prior to this reform, the budget was presented only in terms of large appropriations that failed to specify the amount of agency spending on individual agency programs. The Council has just completed a preliminary budget hearing process that has, for the first time, used new information that identifies agency spending on programs (programmatic budgeting) to view agency budgets as a whole in terms of how spending in various program areas serve the agency's core functions.

The Council hopes that this type of budgeting and analysis will lead to a budget process in which agencies can be reviewed for potential savings and reductions in order to fund other areas in need of additional resources. By reviewing agency spending by program, reductions can be better tailored to ensure that cuts have the least amount of service impacts.

The Council is committed to extending its programmatic budgeting reforms to the remaining City agencies whose programmatic budgets have not been completed, as well as to DOE. Due to its unique status as a State-created entity, the budget of the DOE, which is the largest of any agency, is also the least transparent, making it extremely difficult for the Council to determine where savings, if any, can be achieved.

An exchange which took place on March 20, 2008 at the Education Expense Preliminary Budget Hearing between the Speaker and the New York City School's Chancellor not only illustrates the Council's efforts in working with the agencies to find additional cuts while reducing problematic ones, but also highlights the need for additional budget transparency in DOE's budget. During that exchange the Chancellor agreed that funding for the DOE's Lead Teacher Program, which provides bonuses for lead teachers who teach and provide professional development in low performing schools, should be included in the budget. After being questioned regarding other areas that the DOE could cut to fund programs such as the Lead Teacher Program, the Chancellor agreed that reductions could be made to the DOE's central communications office. The Council is heartened that cooperation with the Chancellor will lead to this outcome, but believes that in order to be able to effectively review the budgeting in the area of public education and protect essential classroom activities, the transparency and availability of information in DOE's budget must be improved.

In contrast, other Commissioners were reluctant to answer questions regarding areas in their agency budgets that could absorb additional cuts. The innovative approach called for in this Response would require the cooperation of every agency so that budget reductions can be

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accomplished in the most responsible manner in terms of protecting priorities, and, conversely, shared priorities can be funded in the most fiscally responsible manner.

In addition to programmatic budgeting, the Council's Response calls for long-term reforms in budget planning to help keep the City on sound financial footing. First, the Council believes that the City needs a statutory "rainy day" fund that would bring reserves into the regular budget process. Because State law prevents the City from establishing a true "rainy day" fund, the City currently uses the end of the year "surplus roll" as a reserve to prepay certain expenses or debt. Creating a "rainy day" fund in statute, on the other hand, would be more transparent than the current practice and would allow the Council and the Administration to address appropriate target levels of reserves.

Regardless of whether or not the City is given the authority to establish a "rainy day" fund, we believe it is necessary to work together with the Administration to begin to set forth guidelines on the target amounts and conditions under which the City should add to or draw down reserves. At a very minimum, the Council believes that a discussion is necessary between the Council and the Administration on the management of the surplus roll. As a start to the discussion, the Council recommends that when times become better, the City work toward maintaining a target of reserves equal to 12.5 percent of expenditures, thus providing a cushion for the inevitable next cyclical downturn in the City's economy.

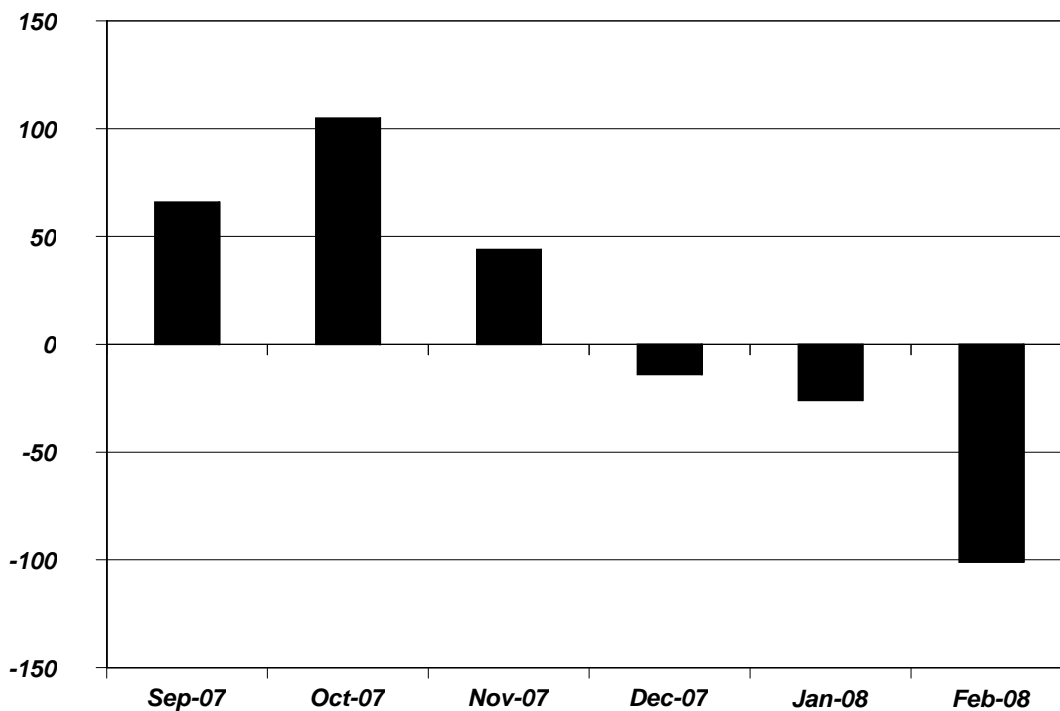
THE ECONOMY AND TAX REVENUE

THE NATIONAL ECONOMY— A MILD RECESSION

Over the last three months the economic news has not been good. Although a number of factors have contributed to this news, the following graph of USA private sector employment (Figure 1) provides a simple and straightforward analysis.

FIGURE 1: USA PRIVATE SECTOR EMPLOYMENT

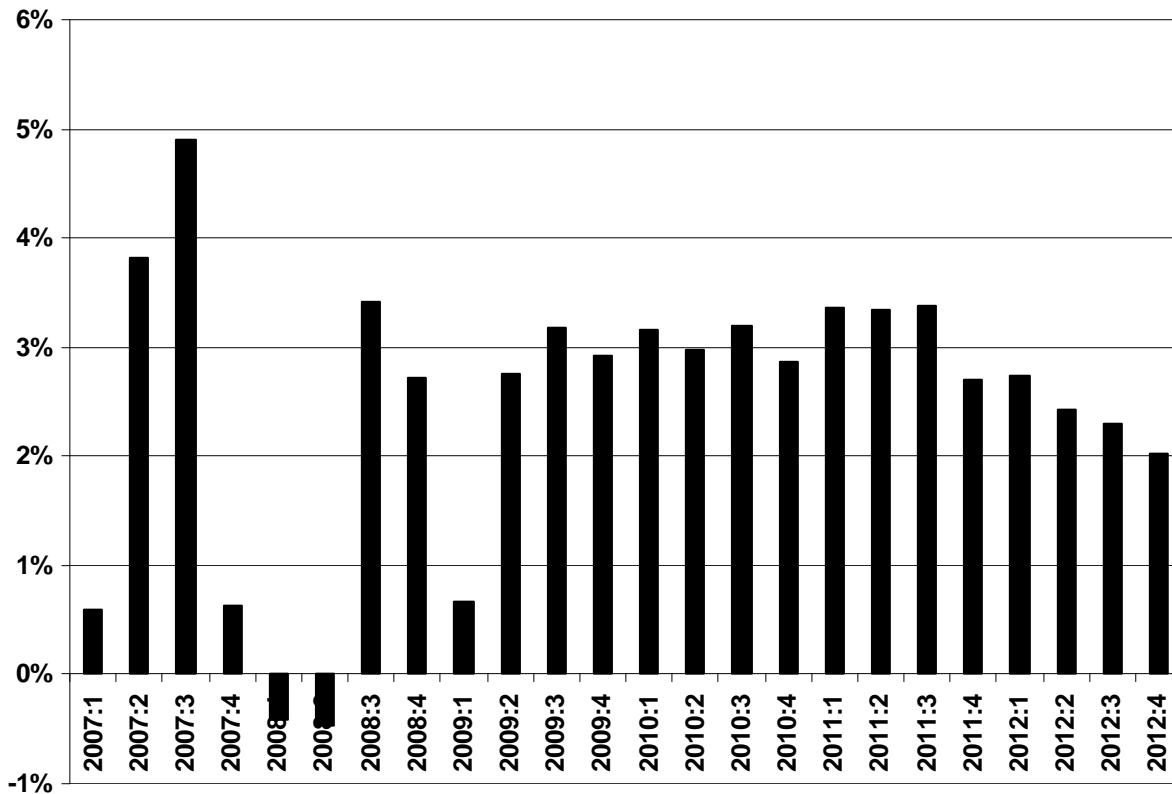
Change from Prior Month SA (thousands)



Source: BLS CES

As indicated, the national economy is slowing down and many economists believe that the country is currently in recession. In a March 2008 *Wall Street Journal* Forecaster's poll, 71 percent of the economists surveyed said that the economy was already in recession. Global Insight, the econometrics firm used by both Council Finance and OMB, agrees and expects the recession to be mild (however, they also note that there is a 25 percent chance that this recession may be severe).

FIGURE 2: GROWTH IN REAL GDP



Source: *Global Insight*, February 2008

The sources of this recession are well-known, substantially resulting from:

- The fall in the housing market and the related problems of subprime mortgages which has led to a credit crunch; and
- Oil prices approaching \$100 a barrel.

The problem now is the interaction between the financial sector and the rest of the economy. The banking system has capital write-offs of over \$146 billion related to housing and credit conditions. (As a rule of thumb reductions in bank capital reduce the amount of loans available by a multiple of 10 or 12.^b) With less available to lend and greater concern about risk, banks are tightening their lending standards especially in the residential and commercial real estate markets. This weakens the housing market and the general economy, which, in turn, increases losses in the financial system. In addition, these problems are not restricted to real estate-related activities. In recent weeks, we have witnessed problems with bond insurers, the municipal bond market, increasing credit card and auto loan delinquencies, and a run on a major investment bank.

Council Finance expects the recession to continue until the Federal economic stimulus package kicks in—sometime in the late spring or early summer (See Figure 2). But once the effects of this short-term stimulus cease, Council Finance predicts that the economy will experience

^b *Global Insight Executive Summary*, February 2008.

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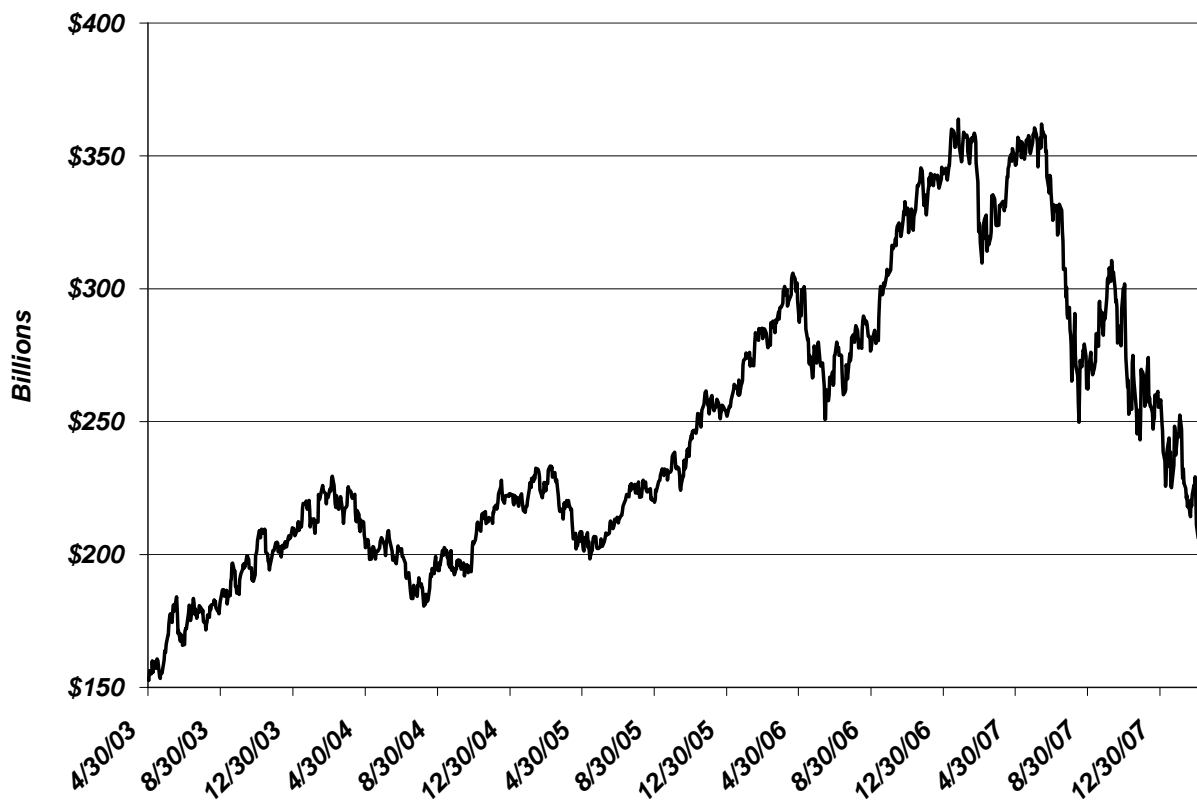
another downturn, most likely in the first quarter of 2009, possibly posing a risk of a double dip recession. Council Finance expects that by spring 2009 the national economy will continue on a more normal growth path. Unemployment, which lags behind Gross Domestic Product (GDP), is expected to peak in mid-2009 at 5.8 percent, compared to February 2008's rate of 4.8 percent.

THE FINANCIAL SECTOR – A RARE EVENT

In the second week of March of this year, the country experienced a rare event. A set of surprising events, which originated with the subprime mortgage problems, spread from one part of the credit market to another eventually leading to the unthinkable—a run on and virtual collapse of a major New York investment bank. These events resulted in an intervention by the Federal Reserve not seen since the Great Depression, and the loss of billions of dollars by investors and employees of Bear Stearns. The full consequences of this event are still unknown; yet, we know that the securities industry and the financial sector have been hurt and that these difficulties will affect New York City's economy.

The securities industry, whose key components are the investment banks and brokerages, has been responsible for 20 to 25 percent of the private sector wages in the City in recent years. But its importance goes beyond this. This industry has been an important source of growth during the City's recent boom and it will be the mechanism by which current national economic problems will be transmitted to the City's economy.

FIGURE 3: MARKET CAPITALIZATION OF INVESTMENT BANKS & BROKERAGE



Source: Standard & Poor 500 Investment Bank & Brokerage subcomponent.

Figure 3 provides an overview of investment banks' performance over the last five years. Between the spring of 2003 and June of 2007, the market value of the investment banks more than doubled from around \$150 billion to just over \$340 billion. Among other things, this is largely the result of the market's belief in the profitability of these institutions. During this period the financial industry – with roughly 5 percent of national employment – earned between 30 and 40 percent of all corporate profits.^c At roughly the same time, from Fiscal 2004 to 2007, the City's general corporation tax (GCT) revenues also more than doubled – from \$1.5 to \$3.1 billion – largely due to those industry profits.

Since June 2007, when problems in the mortgage and housing markets started to spread to the credit markets and banking institutions, the industries have lost almost half of their peak value, falling to \$188 billion. How much of this is a panic and how much reflects real losses and diminished future prospects is difficult to determine.

Within the City, employment in this sector is still above last year's level (March 2007) but nationally 34,000 layoffs have been announced and more are pending. Moreover, signs that the industry's problems are spreading to other parts of the City's economy are clear. Law firms and other parts of the business services sector that supply the industry have also been negatively impacted. Employment in legal services and accounting are down from last year.^d JPMorgan Chase is backing away from its planned construction at Ground Zero, and other firms are planning to sublet unneeded office space.^e

Council Finance expects this industry to lose jobs over the next year but it should recover by late 2009. The average wage in the industry will remain below Fiscal 2007 (\$389,000) until Fiscal 2010. Similarly, industry total revenues will remain below Fiscal 2007 levels until Fiscal 2010.

THE CITY ECONOMY – SIGNS OF SLOWDOWN

Unlike the national economy, the City's economy is probably not in a recession at the moment. As of December 2007, the Federal Reserve Bank of New York's index of coincident indicators was still positive. For December 2007 through February 2008, the bulk of the bonus season, withholdings for the City's income tax were still above the same time last year, suggesting that income in the City is unlikely to fall in the first quarter. But there are clear signs of trouble ahead—especially the turmoil confronting the financial industry. Other warnings include falling employment in banking and other parts of the business service sector, and the decline of a forward-looking index—the NAPM-NY Business Condition Index for New York City.

The expansion that has been going on at a brisk pace since the end of 2002 will probably end this spring. Employment in the private sector will most likely fall in the second half of 2008 and remain constant in the first half of 2009; however, the annual averages will be positive for both years. Total private sector wage disbursement will grow slower than inflation in 2009 and will not return to the pace of the last few years during the forecast period.

^c *The Economist*, March 22, 2008, "The Financial System: What Went Wrong," p. 80.

^d *Wall Street Journal Law Blog*, January 11, 2008.

^e *Wall Street Journal*, March 17, 2008.

TAX REVENUES

The slowing economy is already taking its toll on City tax revenues, but part of the decrease in Fiscal 2008 is also due to tax cuts. Last year the Council, working with the Mayor, reduced the City's property tax by 7 percent, created a new child care credit, exempted all clothing and footwear from the sales tax, reduced double taxation on City residents that pay the unincorporated business tax, and enacted a set of business tax reforms aimed at small businesses. Together, these cuts will reduce City tax revenues by nearly \$1.3 billion in Fiscal 2008. Without them, Council Finance's forecast for this year's revenues would be the same as last year's and OMB would see a 0.75 percent decrease (See Figure 4). OMB has the City going into recession in late calendar year 2007 which, according to Council Finance, is a bit too early (this is the source of the difference between the two Fiscal 2008 forecasts).

For Fiscal 2009, Council Finance has a slightly more optimistic view of wages and business earnings than OMB, which gives the City slightly greater growth. Council Finance's real concern, however, is about the growth of revenues coming out of the recession. Coming out of the last recession, in 2003, the strong real estate market kept up property tax revenues and aided transaction tax revenues. While low interest rates allowed refinancing of mortgages—aiding mortgage recording tax revenues—it also allowed the City to save on the expense side by refinancing a lot of the City's debt. It is unlikely we will have either of these to help us in Fiscal 2010 - 2012. Further, in 2001, the investment banks were not hurt in the way that they are hurt now and their resurgent growth provided the boom we experienced until recently. Council Finance expects revenue growth in Fiscal 2010 – 2012 to be half of what it was in the boom years of Fiscal 2005 – 2007.

FIGURE 4: GROWTH IN TAX REVENUES

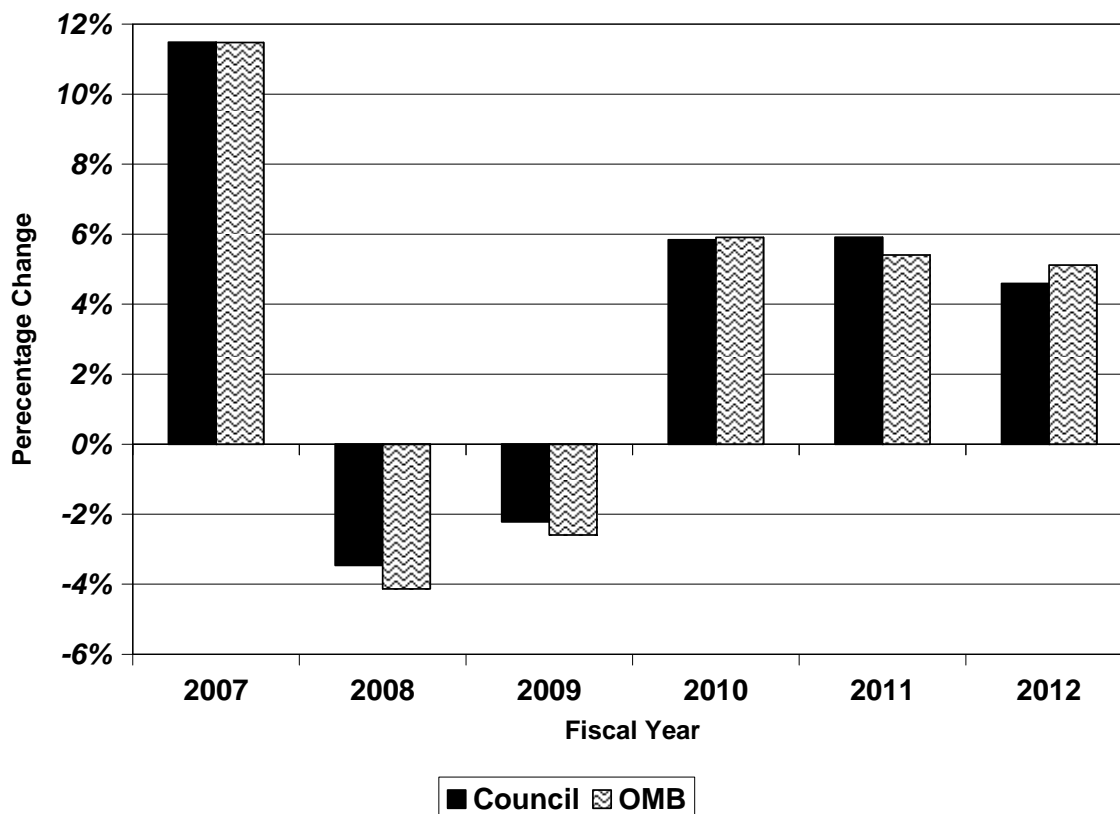


TABLE 1: COUNCIL FINANCE TAX REVENUE FORECAST
(IN MILLIONS, ABOVE/(BELOW) FISCAL 2009 PRELIMINARY BUDGET)

	2008	2009	2010	2011	2012
Real Property	\$0	(\$51)	(\$94)	(\$2)	\$233
Other Property Taxes	\$41	\$99	\$191	\$271	\$287
Personal Income	\$81	\$131	\$74	\$219	\$80
Business Taxes	\$98	\$154	\$229	\$187	(\$93)
Sales	\$29	\$53	(\$8)	(\$48)	(\$65)
Other Taxes	\$10	\$6	(\$1)	(\$20)	(\$18)
Total Taxes	\$258	\$392	\$390	\$607	\$423

A full discussion of the Council’s economic and tax revenue forecast is found in Appendix I.

MANAGING THE BUDGET ACROSS THE BUSINESS CYCLE

New York City’s tax revenues are cyclical—rising in good times and falling in bad. These variations can change as much as 10 percent from one year to the next. To account for this, the City has relied on a number of tools including, most importantly, the City’s annual use of the “surplus roll”.

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In general, money left over at the end of the fiscal year is ‘rolled’ into the next year. This money is used to prepay certain expenses, such as debt service, because generally accepted accounting principles (GAAP) require the City to end the year with a balanced budget. In order to comply with GAAP and State law, the City always has some money left over at the end of the year—and even during financially difficult times the City leaves itself a little cushion. As a result, there is always a “surplus” available.

The most important aspect of this roll-over is the difference between the amount that is rolled in from prior years and used to pay this year’s expenses compared to what is rolled out into the next fiscal year. For example, if the amount that the City is rolling over to the next fiscal year is less than the amount that was rolled over into the current fiscal year, the City would be running an operating deficit. In this particular case, the City is spending more money in the current year than it is taking in from taxes, aid and other revenues, and paying for this spending with money rolled in from previous years. On the other hand, if the amount the City rolls over for the next year is greater than the amount rolled over into the current year, the City would be running an operating surplus. GAAP does not preclude the City from running either an operating deficit or surplus.

Since 1981, the City has had 10 operating deficits averaging more than \$2.6 billion and 17 operating surpluses—some of those exceeding \$4 billion.^f

While utilizing the surplus roll has become common practice for the City, there has been very little discussion regarding policies or rules which should guide this practice. In essence, the City has been using its ‘roll’ as a reserve—similar to a “rainy day” fund. State law currently precludes the City from establishing a statutory “rainy day” fund; however, establishing such a fund would bring these reserves into the regular budget process and result in greater transparency. The Council has introduced State legislation to achieve this.

But regardless of whether a rainy day fund is created in statute, or instead, current practices continue, policy decisions regarding the use of the surplus should be made by both the Administration and the Council. Together, the Council and the Administration need to answer the following: What should be the targeted level of the fund/surplus? Under what conditions should we add to the fund/surplus? How much and under what conditions should there be withdrawals from the fund/surplus?

To date, every state in the nation, except for one state, has a “rainy day” fund. The average of those states’ end-of-year balances, including “rainy day” funds and surpluses, have ranged from a low of 1.1 percent of expenditures in 1991, to close to 11 percent of expenditures in 2006.^g New York City practices are similar regarding our use of the surplus—nearly disappearing in 1991 and rising to over 9 percent of expenditures in 2000. While many states set maximums for rainy day funds, about a quarter of the states have no cap at all.

The surplus rolled into Fiscal 2008 was \$4.6 billion, which is equivalent to around 7.5 percent of total expenditures or roughly 10 percent of City funded expenditures. While it may seem like a

f Dall W. Forsythe, *Cyclical Budget Management in New York City*, School of Public Affairs, Baruch College.

^g National Association of State Budget Officers.

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substantial amount, given current economic conditions, this surplus will only last for another year and half. In other words, it cannot get us through the ongoing slowdown. In the Fiscal 2009 Preliminary Budget, the City plans to roll \$4.119 billion from Fiscal 2008 into Fiscal 2009 which would result in Fiscal 2008 having an operating deficit of \$481 million. The Fiscal 2009 Preliminary Budget, while balanced by GAAP rules, contains a \$3.769 billion operating deficit caused by rolling \$4.119 billion in at the start of the year but only having \$350 million left over to roll into the next. The Fiscal 2010 Budget is not balanced and has an operating deficit of \$4.574 billion and a budget gap of \$4.224 billion.

The source of these troubles is the anticipated recession, which has much in common with the recessions over the last 25 years. While current reserves are prudent, it would not be unreasonable to have larger reserves. There is a balancing act here, while it is nice to have reserves, large reserves have a downside. These large reserves can be used to temporarily fix long-term structural problems making them harder to deal with once the reserves are exhausted and there could be a tendency for future Administrations and/or other elected officials facing election to dip into these reserves to provide unsustainable spending programs or tax relief. There is no single answer to this but, arguably, a reserve of 12.5 percent would provide a reasonable financial cushion.

The City has another reserve that could be used as a “rainy day” fund, the Health Care Trust Fund (“the Fund”). This Fund was set up to partially pre-pay a large liability—post-employment health care for City employees. This is, however, an imperfect mix. You never know when you will need to withdraw from a “rainy day” fund and, therefore, investments should be relatively liquid. On the other hand, funding post-employment health care is a long-term issue, such as the City’s pension, and the Fund does not need the same degree of liquidity and can go for higher returns. Tapping the Health Care Trust Fund should not be part of normal cyclical management but only used as an emergency measure. Long-term issues like post-employment health care should be dealt with as separate and important policy goals.

The City has run operating deficits in the years that one would expect. Not all of them were recessions, but there were notable economic events associated with them. For example, Fiscal 1995 saw a crisis in the bond market that caused City business taxes to fall 17.6 percent, about the same size as the reduction anticipated this year. As a rule, anticipated withdrawals should accompany a forecasted downturn in the City’s economy, and where tax revenues, corrected for changes in tax policy, are expected to stagnate or fall. Obviously, emergencies and unexpected changes in markets are justifications for withdrawals during budget modifications.

In recent years, the City’s cyclical management has been responsible. A more transparent process will help it stay this way. To this end, regular reporting on the size of the City’s rainy day fund and other reserves, actual and planned changes in these reserves, should be formalized as part of the budget process. This will require both State legislation and a change to the New York City Charter. The guidelines suggested above should be standards that budget monitors use to evaluate budgetary actions, but not rules that legally constrain those actions.

RISKS TO THE CITY'S BUDGET

STATE FISCAL YEAR 2008-09 BUDGET

In January 2008, the former Governor released a proposed State Executive Budget that contained almost \$750 million in risks to aid upon which the City was anticipating and which the City's Preliminary Budget relies. Those risks posed by the proposed State Budget were in three principal areas: (1) State education aid, (2) revenue sharing, and (3) welfare cuts. The Council is heartened by the fact that proposals by both houses of the legislature and the new governor would alleviate many of these drastic cuts and, therefore, does not assume them in our Budget Response. However, any level of assistance provided to the City in the State budget that is less than anticipated in the Preliminary Budget is an additional risk that would have to be absorbed by the City.

AGENCY PROGRAM REDUCTIONS

The Council believes that certain agencies can accomplish several of their functions more efficiently. In addition, the Council believes that certain areas of the budget may be ripe for reduction since declining levels of service needs may not have been accompanied, over the years, by similarly reduced levels of spending.

During the Council's Fiscal 2009 Preliminary Budget hearings, agencies were questioned about programs and functions that perhaps are currently funded at levels higher than required. In total, this Response proposes approximately \$160 million in Fiscal 2009 spending reductions, of which about two-thirds are identified in DOE's central operations, and about one-third in other agencies. Those areas where the Council believes spending can be reduced without harming core agency functions are listed below.

HRA REDUCTIONS – UP TO \$17 MILLION

Certain areas in the City's Human Resources Administration (HRA) were developed or expanded in the 1990s to deal with the City's large welfare caseload. Although the City's welfare rolls have since dropped by almost 70 percent, certain welfare-related spending by HRA has not dropped proportionally. Most notably, spending on the fraud detection units of HRA has not been reduced. While the Council recognizes the deterrent effect of devoting some resources to these areas, staffing and resources on particular agency functions should trend in the direction of the need for those functions and services.

Bureau of Eligibility Verification

Savings: \$10 million

The Bureau of Eligibility Verification (BEV) conducts participant interviews, documents verification, and performs home visits in order to verify the eligibility of public assistance recipients. BEV was created in 1995 by the Giuliani administration. Its purpose was largely to help reduce the then-very large welfare caseload. In 1996, the welfare caseload peaked at 1.1 million. Today, the caseload is 350,000 (32 percent of what it was in 1996). Despite this drop in the caseload, BEV has maintained the same staffing levels since 1998. Further, the functions of this office are duplicative given that Job Center staff already determine the eligibility of public assistance recipients. The Council is proposing a reduction equal to the welfare caseload reduction which should save the City approximately \$10 million annually.

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Vacancy Reduction

Savings: \$4 million

According to data from the City's Financial Management System (FMS), several programs in HRA have high vacancy rates, though the Preliminary Budget includes a vacancy reduction PEG for HRA. When you compare actual staffing levels to the number of budgeted positions in the 2009 Preliminary Budget, there are six programs within the agency that have vacancy rates above 10 percent, and in four of those programs the vacancy rate is above 15 percent. Overall, the agency wide vacancy rate is almost 8 percent.

During the 2009 Preliminary Budget hearing, HRA Commissioner Robert Doar testified that the agency believes the appropriate vacancy rate for HRA is 5 percent. If the vacancy rate of every program within the agency is set at 5 percent, over 400 budgeted positions would be eliminated. Eliminating these positions would result in \$4 million in savings.

Software Technical Assistance

Savings: \$2.4 million

Software upgrades at HRA should be postponed until the Health and Human Services Connect project has determined what changes should be made to the social services system's IT environment. In the 2007 January Financial Plan, the Administration added \$2.4 million in HRA for a contract to provide technical assistance and software upgrades for the agency's computers. The Council believes that this funding is not necessary for HRA to maintain core functions and thus can be eliminated in the 2009 Budget, and that any such funding for IT upgrades determined to be necessary should await the determinations of the HHS Connect Initiative.

Child Support Services Enhancement

Savings: \$407,000

Automatic referrals to the Office of Child Support Enforcement (OCSE) are declining, so recent funding increases were not needed. In the 2007 April Financial Plan, HRA added 49 staff to OCSE. With this increase, OCSE has 941 positions in the 2009 Preliminary Budget. Because individuals who apply for or receive public assistance are automatically referred to OCSE, the reduction in the welfare caseload means that the number of cases that are automatically referred to OCSE has been reduced. Given that the 2009 Preliminary Budget projects the welfare caseload to continue to be reduced, the number of automatic referrals to OCSE should continue to decline. As a result, OCSE should be able to operate at the staffing level that it had before the enhancement it received last year.

DOE REDUCTIONS – UP TO \$134 MILLION

The Council recognizes that all agencies, including the DOE, which receives approximately one-third of the City's budget, will have to sustain cuts. However, it is critical to replace cuts that directly affect schools with cuts from DOE's central operations. The lack of transparency of DOE's budget and its inconsistency with the City's budget makes this effort extremely difficult. Thus, it is critical that while DOE and the Council work to find alternative reductions, the Administration and Council must work together to reform DOE's budgeting practices. (See Continuation of Budget Reforms on page 27).

6000 Laptops for the ARIS System

Savings: \$4.7 million

With an OTPS budget of \$239 million for its central administrative offices, the Department has the capacity to fund internally the purchase of 6,000 laptop computers for teachers and other staff

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to access the Assessment, Review, and Instruction System (“ARIS”) that the DOE began introducing this year. The January Plan includes a \$4.705 million in new needs to purchase 6,000 laptop computers. Due to a change in the capital eligibility guidelines, the DOE was unable to purchase the ARIS laptops with its \$59 million capital allocation for ARIS but nevertheless purchased these computers using expense funds. While we are not seeking to eliminate the ARIS program, we recommend that the proposed new need funding be diverted to reverse education budget cuts to schools since the Department has already purchased these computers.

Office of Communications, Media Relations & Community Affairs Savings: \$500,000

The Department maintains a relatively large office that currently has a staff of 26 employees and a budget of approximately \$3 million. This office handles press relations, organizes town hall meetings and conducts other outreach activities. This office does not do the lion’s share of parental outreach -- work that is handled by the Office of Family Engagement and Advocacy. At the Committee on Education’s hearing on the Preliminary Budget, the Chancellor estimated that this office could reduce its spending by approximately ten percent or \$300,000. We believe that the office could withstand a larger reduction of \$500,000.

Administrative Holding Codes in DOE Savings: \$1.36 million

The Preliminary Budget for Fiscal 2009 schedules \$1.12 billion of the DOE’s budget in holding codes. By leaving so much of the Department’s budget essentially unallocated, the Administration gives the DOE a tremendous amount of flexibility in how it spends its \$17 billion budget, and also intensifies the opacity of the Department’s budget.

The budget for Central Administration includes \$13.6 million scheduled in holding codes. This equals about three and one-half percent of the budget. While the Department has made significant cuts to the Department’s central and local administrative spending during the past several years, resources devoted to certain centrally-based initiatives have held steady or increased. Spending on special projects and new initiatives should be closely examined for savings, which could easily total at least 10 percent of the funding parked in holding codes, or \$1.36 million.

DOE Services Contracts Savings: \$127 million

The DOE’s Preliminary Contract Budget for Fiscal 2009 is \$3.167 billion, \$257.3 million or almost 9 percent more than the Contract Budget for Fiscal 2008. Despite the Administration’s assertion that all areas of spending by the Department are being considered for budget reductions, the January Plan does not contain any budget cut targeted specifically at spending on service contracts.

For example, we expect that the DOE could achieve savings from its \$42.8 million in contracts for professional services, which include its spending on management consultants and quality reviewers. Some of these contracted services could be performed by existing staff or simply done without. Contracts for Information Technology, where spending is planned to total \$45.6 million next year, is another area of contracting where savings can be found perhaps by bringing jobs in-house and more carefully monitoring contractors. Contracts with private bus companies, which will top \$1.1 billion next year, should be carefully scrutinized for savings and competitively bid upon expiration of the term. While the DOE is locked into paying bus

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companies more next year, we question why the budgeted increase of over 11 percent is so high. All categories of DOE service contracts should be scrutinized for savings.

We propose an across-the-board, four percent reduction in the Fiscal 2009 Contract budget totaling \$126.7 million. This reduction would still allow the DOE to increase its spending on contracts overall by \$130.6 million so that the Department could meet the contractually required increases it pays for services. Just as the DOE believes that it can use its purchasing power to get better deals on the prices it pays for certain commodities, the Council believes the DOE can get better deals on the prices it pays for many services. A modest, four-percent reduction in payment to private contractors could spare the schools from much of their planned cuts.

BUSINESS INTEGRITY COMMISSION INTEGRATION – UP TO \$3 MILLION

The Business Integrity Commission (BIC) has its origins in the City’s efforts to rid the private carting industry and the markets of corruption in the 1990s. Often these types of anti-corruption initiatives have their biggest return in the first several years; after that it becomes a matter of oversight and maintenance to prevent corruption from creeping back into the industries. If this is the case, it may make sense to integrate the functions of BIC into the Department of Consumer Affairs, since the latter oversees other licensed businesses. This action could produce a net savings of almost \$3 million in administrative, lease and support services costs while leaving specialists such as market specialists and auditors in place.

CITY COUNCIL SAVINGS – AT LEAST \$2 MILLION

While the Council’s budget is a tiny fraction of the budget of some of the large administrative agencies, the Council is charged by the City Charter as not only the local legislature, but the body responsible for land use, adoption of the City Budget, and as a counterweight to the entire executive branch. The Council has for the first time in its history made significant reductions to its budget. In its Fiscal 2009 operating budget, the Council recommended to reduce its budget by 4.3 percent, or \$2.35 million

OTHER AGENCY REDUCTIONS -- UP TO \$4 MILLION

The Council has identified other agency reductions totaling almost \$4 million in table 3 below.

TABLE 2: OTHER AGENCY REDUCTIONS

Agency Reduction	Agency	FY 2009 Savings
Office of Emergency Preparedness Increase	DHS	(\$1,114,000)
Improvements to Men’s Intake	DHS	(\$1,000,000)
Information Technology Consultants Increase	DHS	(\$780,000)
Vacancies In Highway Tree Maintenance Positions	DPR	(\$500,000)
Expansion of Law Dept.’s Senior Attorney Program	Law	(\$462,000)
Total		(\$3,856,000)

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AGENCY RE-ESTIMATES AND EFFICIENCIES

The Council's alternative financial plan identifies a combined \$558.2 million in agency savings in Fiscal 2008 and Fiscal 2009. These savings represent budgetary areas identified by the Council for which the January Plan has over-projected costs for programs and services. The following is a summary of the Council's re-estimate savings.

TABLE 3: AGENCY RE-ESTIMATES

	Fiscal 2008	Fiscal 2009	Fiscal 2010	Fiscal 2011	Fiscal 2012
Program/Action					
Heat, Light and Power	(\$49,847,968)	(\$58,837,952)	(\$48,837,952)	(\$33,837,952)	(\$18,837,952)
ECTP Maintenance	(\$22,000,000)	(\$28,000,000)	(\$23,000,000)	(\$18,000,000)	(\$18,000,000)
18-B Attorney Program	(\$6,718,295)	(\$3,033,634)	(\$3,033,634)	(\$3,033,634)	(\$3,033,634)
Judgment and Claims	(\$134,806,000)	(\$187,705,919)	(\$238,206,000)	(\$295,306,000)	(\$356,306,000)
Community College Payments	(\$3,819,376)	(\$7,019,376)	(\$11,019,376)	(\$17,019,376)	(\$23,019,376)
Fitness for Trial Payments	(\$6,376,525)	(\$10,776,525)	(\$17,276,525)	(\$30,276,525)	(\$42,276,525)
Criminal Justice Contracts	(\$5,171,253)	(\$3,581,000)	(\$3,581,000)	(\$3,581,000)	(\$3,581,000)
State Wireless E-911 Surcharge	(\$2,500,000)	(\$2,500,000)	(\$2,500,000)	(\$2,500,000)	(\$2,500,000)
EMS Revenues	(\$11,058,154)	(\$14,405,654)	(\$14,405,654)	(\$14,405,654)	(\$14,405,654)
TOTAL	(\$242,297,570)	(\$315,860,059)	(\$361,860,140)	(\$417,960,140)	(\$481,960,140)

HEAT, LIGHT AND POWER

The City's heat, light, and power bills are paid through the Department of Citywide Administrative Services (DCAS). Over the course of the past several years, significant accruals have occurred in this area. Despite actual and projected increases in energy costs due to higher energy prices, the annual amounts budgeted for heat, light, and power still exceed the likely costs. Therefore, the City Council recommends removing significant accruals in each year of the Plan. Whereas actual costs in Fiscal 2006 and 2007 were only \$613.9 million and \$670 million, respectively, the January Plan funds heat, light and power cost at \$759 million annually.

EMERGENCY COMMUNICATIONS TRANSFORMATION PROJECT (ECTP) MAINTENANCE

Because few of the infrastructure improvements that the spending in this allocation would support have been made, the removal of these funds would have no negative impact on public safety. Originally proposed three years ago, the ECTP represents the City's large-scale program to reconfigure and improve the City's emergency communications infrastructure relating the E-911 System. Whereas ECTP Capital Budget funds totaling more than \$1 billion have been appropriated, Expense Budget funds were also appropriated in the City's Financial Plan to cover the project's maintenance costs. These funds currently stand at \$48 million annually. Because of significant delays in the project, relatively few of the infrastructure improvements have been made to date, and fewer than planned are likely to be made in Fiscal 2008-2010. Therefore, the maintenance funds budgeted in the Expense Budget can reasonably be reduced without jeopardizing public safety. The City Council recommends removing funds approximating \$20 million annually beginning in Fiscal 2008.

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ASSIGNED COUNCIL (18-B) ATTORNEY PROGRAM

18-B attorneys are assigned cases by judges when no institutional provider is available. Significant 18-B accruals were taken by the Administration in each of the past several years. Last June, a \$10 million baseline reduction was made, starting in Fiscal 2007. The January Plan now removes another \$15 million from Fiscal 2008. Because of still other likely accruals, the City Council recommends the removal of \$6.7 million in Fiscal 2008, and \$3 million annually beginning in Fiscal 2009.

JUDGMENT AND CLAIMS (J&C)

The City is self-insured and makes its judgment and claims payments from a fund held in the Miscellaneous Budget. Although the City has made strides to lower the amount of its J&C payments, the baseline J&C budget increased dramatically. Whereas actual payments totaled \$503.2 million in Fiscal 2006 and \$499.5 million in Fiscal 2007, the J&C budget stands at \$634.8 million in Fiscal 2008, \$687.7 million in Fiscal 2009, \$738.2 million in Fiscal 2010, \$795.3 million in 2011, and \$856.3 million in Fiscal 2012. Therefore, the City Council recommends removing likely accruals of \$134.8 million in Fiscal 2008, increasing to more than \$350 million in Fiscal 2012.

COMMUNITY COLLEGE PAYMENTS TO OTHER COUNTIES

A fund exists in the Miscellaneous Budget to pay other counties for New York City students enrolled in community colleges in those counties. Although the Administration has taken savings in Fiscal 2007 and Fiscal 2008 in recognition of likely accruals, no such adjustment has been made for Fiscal 2009 and the outyears. Therefore, the City Council recommends that \$3.8 million be removed from the City's Financial Plan for Fiscal 2008, increasing to more than \$20 million by 2012.

OBLIGATORY COUNTY EXPENSES – FITNESS FOR TRIAL PAYMENTS

A fund exists in the Miscellaneous Budget to pay the City's obligatory expenses to the State for mental institution costs associated with persons arrested in New York City who need to be observed as to their fitness to stand trial. Although the Administration has taken savings in Fiscal 2007 and Fiscal 2008 in recognition of likely accruals, no such adjustment has been made for Fiscal 2009 and the outyears. Therefore, the City Council recommends that \$6.4 million in Fiscal 2008, rising to \$42.3 million in Fiscal 2012, be removed from the City's Financial Plan.

CRIMINAL JUSTICE CONTRACTS

There is a line item in the Miscellaneous Budget used to fund contracts entered into by the Office of the Criminal Justice Coordinator. There is funding in this budget code in excess of the amounts of the contracts for those services which include services such as alternatives to incarceration programs and victims' services. Because of this over-budgeting, criminal justice contract accruals are likely. These accruals are assumed to be \$5.1 million in Fiscal 2008 and \$3.6 million in Fiscal 2008 and the out-years.

STATE WIRELESS E-911 SURCHARGE REVENUES

The City receives revenues each year from E-911 surcharges paid by wireless cell phone users. The Administration has frequently recognized increases in these revenues, including in the

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January Plan. However, the City Council believes that additional revenues are likely. The Council recommends removing \$2.5 million annually from the NYPD's City tax levy budget in recognition of the likely receipt of these non-City revenues.

EMERGENCY MEDICAL SERVICE (EMS) REVENUES

The City receives revenues each year from EMS ambulance transports. Whereas in many recent Plans the Administration has recognized increases in these revenues, the City Council believes that the January Plan underestimates the likely revenues that will be generated. Therefore, the Council recommends removing \$11 million in Fiscal 2008 and \$14.4 million annually thereafter from the NYPD's City tax levy budget in recognition of the likely receipt of these non-City revenues.

MEETING SHARED PRIORITIES

The Council proposes using all of the additional forecasted revenue and a large portion of the remaining additional resources discussed up to this point in the Response to increase resources available in later years. The plan proposed in this Response could increase the size of the surplus roll from \$350 million proposed by the Mayor, to over \$1 billion. In addition, the \$160 million in agency program reductions alone would offset the majority of cuts proposed in the Preliminary Budget to the schools and libraries. The Council's Response would provide the funds to address these priorities as well as the funds to meet other priorities shared by the Council and Administration – priorities which should be cooperatively determined and crafted, so as to further them more efficiently and effectively.

EDUCATION – RESTORE CUTS TO SCHOOLS

The Preliminary Budget proposes a \$180.7 million cut to schools' budgets for fiscal year 2009. These reductions would almost entirely reverse the school budget increases made in the Fiscal 2008 budget. Chancellor Klein stated at the DOE preliminary budget hearing that no one is saying that our schools have sufficient funds but that DOE is like a small rowboat trying to navigate ocean waters. The Speaker offered to squeeze into the boat and help row. Education is without a doubt a shared priority of both sides of City Hall. The Council is committed to finding alternative reductions and savings both within and outside the DOE to reduce the impact of these proposed cuts on the schools.

In January 2008, the DOE removed 1.75 percent of each district and high school's base budget. Principals are responsible for implementing reductions to their school budgets, and have the authority to determine what to cut. During the current school year, it is unlikely that the budget cuts will lead to reductions in school staffing. However, it is likely that principals are making cuts to planned purchases of supplies, teacher overtime, and enrichment programs. The larger cuts proposed for Fiscal Year 2009 are likely to have a much greater impact.

The Council understands the need to include DOE in the PEG process because it is the largest agency representing almost one-third of the City's budget. However, the Council believes it is critical to maintain the progress being made in improving our public schools. We are finally providing funding to reduce class size, paying our teachers more competitive salaries, and trying to solve the problems of failing schools and our troubled middle schools. To force schools to

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absorb cuts that could affect extra help for students, after-school programs, and textbook purchases could undermine these efforts. The Council is dedicated to finding other reductions in the DOE and in other agencies to offset the impact of these cuts.

LIBRARIES – MAINTAIN 6-DAY SERVICE

In Fiscal 2008 the City Council, with the cooperation of the Administration, baselined the necessary funding to provide all library branches with “6-day” service. These service levels, which currently average 46 hours at each branch, have proved to be overwhelmingly popular in the communities they serve. In addition to the increased service, each of New York City’s three library systems have been able to more effectively plan for materials acquisitions, technology upgrades and long-range staff development. The Council and the Administration should not retreat from this joint accomplishment only one year after its achievement.

The Fiscal 2009 Preliminary Budget proposes to cut five percent, or \$16 million, from the lump-sum allocations provided from the City to each library system. This funding, which amounts to over \$323 million in Fiscal 2008, provides each library with financial support for staff, maintenance, energy and materials. Recently it has been proposed by OMB that all agencies look to cut an additional three percent in the next fiscal year. This would mean an additional loss to library funding of over \$9 million. In total, if these cuts are realized, the libraries would lose 60 percent of the new baselined funding for 6-day service. Cuts of this magnitude would unavoidably lead to closed branches, reduced programs, and lost jobs.

Libraries historically have supported New Yorkers of all ages, anchored the neighborhoods in which they are located, and provided much more than they were designed to do. As we strive to enhance educational opportunities for young people, all of our libraries are increasing their involvement in training our youth through intensive after-school and summer activities. Libraries have also expanded their role in providing services to our seniors, teaching them how to use new technology and offering a greater variety of programs. Also, libraries have been a key component in the lives of newly arriving New Yorkers, offering immigrants the chance to enhance language and job training skills.

The historic agreement to provide six-day service recognizes that the need exists to keep libraries open on more days and for longer hours. Especially in times of economic hardship, libraries are a free and universally available learning center, community hub and a safe space for all New Yorkers.

OTHER SHARED PRIORITIES

Last year, the Council and HPD both decided it was imperative to begin a program to help homeowners at risk of foreclosure. Working together we created an entity that would be responsible for funding community based organizations (“CBO”) meeting certain criteria. The Mayor’s Preliminary Budget listed this as a shared priority with the Council and committed to find funding for it.

This year, the Administration has asked the Council to explore the possibility of combining funding it added to the budget for immigrant adult literacy services to an Administration adult literacy program. Using larger organizations to assist smaller CBOs, the Administration hopes to

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reach more adults more efficiently. By working with the Administration to formulate criteria that will encourage funding of CBOs that have expertise in reaching certain communities, the Council hopes to ensure that those reached include members of these populations.

Efforts such as these must become the rule rather than the exception. The Council and the Administration must work together to develop programs to address their shared priorities. If done correctly, these programs will be more efficient and more effective than a set of Administration social programs shadowed by a set of parallel Council-initiated programs that seek to supplement the Agency programs.

This is not to say that there will never be a need for Council initiated and designated programmatic funding that may be outside of what an agency views as its core function. During prior Administrations, were it not for the Council's insistence on designating funding for such programs, critical needs such as those for alternatives to incarceration programs and legal services may have been seriously under-funded. But when agencies and Council Members share significant priorities, they should attempt to address those priorities, and craft those program parameters together.

The Mayor's Preliminary Budget contained a unique section this year. That section stated that, ". . .as has become customary, the Mayor and the City Council leadership have discussed certain shared priorities that both parties agree need to be addressed..." That list included:

- The joint Council/HPD Mortgage Foreclosure Assistance Program
- HIV/AIDS prevention programs and HIV Rapid Testing
- Child Advocacy Centers
- Family Justice Centers
- Aging
- Buildings

Between now and budget adoption time, the two sides of City Hall must work together to decide how much funding is needed to accomplish all of the shared goals and how such funding should best be distributed. The Council believes that over the long term, such work will lead to more effective and efficient services.

TAX POLICY PROGRAM

SALES TAX FREE WEEK/ECONOMIC STIMULUS PROPOSAL

To encourage New Yorkers and visitors to spend their Federal income tax rebates in the City, the New York City Council proposes a sales tax free week this summer, from July 28, 2008 until August 3, 2008, in time for school spending and shortly after the rebates contained in the Federal economic stimulus package are sent out. The New York City, New York State and MTA sales taxes which total 8 3/8 percent would be suspended within the City, on retailing, arts, entertainment and recreation.^h This would create what is essentially a citywide 'sale' that would

^h NYC and NYS tax rates are each 4 percent. The MTA rate is 3/8 percent.

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encourage people to get out and spend. Although the loss of the sales tax revenue will have a negative impact on the City's budget in Fiscal 2009, the Council believes that the stimulus effects of the increased spending will be worth the cost in lost tax revenue.

Congress recently enacted and the President signed the Economic Stimulus Package Act of 2008. The Act provides an income tax rebate of up to \$600 for a head of household and \$1,200 for a married couple filing jointly with an extra rebate of \$300 per child.¹ This will be paid to households in the late spring to early summer of 2008.

There is a problem with temporary rebates of this kind. While low income households typically spend their rebates, middle class households often save theirs. This is something one would expect from economic theory, and studies of the 1975 temporary rebate found that only one fourth of the rebate was spent.¹ The new rebate is focused on the middle and upper middle class, and the rules are such that many low income households will not be able to receive the full credit. But to have an economic stimulus effect, rebates need to be spent.

During the tax free week, sales taxes on most items bought at retail including furniture and home furnishings, electronics and appliances, retail food and beverages, health and personal care, sporting goods, books and music would be suspended. So would sales taxes on arts and entertainment including sporting events. Sales taxes on utilities, gasoline stations, motor vehicles, health care, information and most services would remain in place. There currently is no New York City sales tax for clothing and footwear, or on admissions to most entertainment and cultural events. New York State and the MTA's sales tax on clothing and footwear valued at \$110 or more would also be suspended. There will be a cap so that very expensive items priced at \$2,000 and more remain subject to the tax.

A sales tax free week would reduce City tax revenues by \$38 million. New York State would lose \$42 million in sales tax revenues and the MTA \$4 million.

EFFORTS TO MAINTAIN PROGRESS IN PROPERTY TAX REDUCTION

Maintaining the 7 Percent Property Tax Reduction and the \$400 Rebate: During an economic downturn, the Council believes that the first reaction should not be to raise taxes on homeowners and business owners. For this reason the Council will attempt, to the extent possible given economic conditions and the need to address other core priorities, to maintain the property tax decreases it has enacted.

The Council considers the 7 percent property tax reduction implemented last year and the renewal of the \$400 property tax rebate for resident homeowners important accomplishments

¹ *The credit starts to phase out at AGI \$75,000 (\$150,000 for married filing jointly). Taxpayers with AGI over \$87,000 (\$174,000 for married filing jointly) will receive no rebate. There is a minimum rebate of \$300, for those who had at least \$3,000 in qualifying income in 2007. Taxpayers whose 2007 tax was less than the \$600 maximum credit will not receive the full credit. They will receive the tax they paid or the minimum credit whichever is higher. This keeps some low income households from fully benefiting from the credit.*

¹ *David Leonhardt, Economic View: Rebate History Doesn't Repeat Itself, New York Times, June 24, 2001.*

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along with achievements gained in protecting and expanding core services, such as education and libraries.^k

Renewal of the Co-op/Condo Property Tax Abatement: The Council calls for renewal of the Co-op/Condo Property Tax Abatement which was originally enacted in response to Council efforts to establish equity between class one homeowners and owners of co-ops and condos.

Evidence suggests that tax inequity still exists between class one and class two homeowners. Removal of the abatement would create a steep rise in taxes during a time when increasing property values have kept property taxes high. On the tentative assessment roll for Fiscal 2009, class two co-op owners will see about an 8 percent increase in assessments over Fiscal 2008, and condominium owners more than a 12 percent increase.

The current abatement has been in effect since 1997 and was renewed twice before, in 2001 for fiscal years 2002 through 2004, and for four years beginning with Fiscal 2005. The amount of the abatement is 25 percent of the property tax liability for units in buildings where the average assessed value per unit (BAV) is \$15,000 or less, and 17.5 percent for units where the average assessed value is more than \$15,000.

In Fiscal 2007, owners of more than 417,000 coop and condo units received an average abatement of about \$740 per unit. In Fiscal 2009, co-op and condo owners will save \$330 million in property taxes, rising to \$372 million in 2012.

The Council has included renewal of the abatement in its State agenda and, in cooperation with the Mayor, plans to seek State legislation renewing the abatement this spring. The Mayor's Preliminary Budget includes the cost of the renewal of the current co-op/condo property tax abatement throughout the plan period.

CONTINUATION OF BUDGET REFORMS

Over the last twelve months, the Council has made great strides in reforming the City's budget process. As part of the 2008 Adopted Budget, the Council succeeded in getting the Administration to publish a Program Budget for the first time. This new budget presentation gives Council members and the public greater insight into where the City is devoting its resources. Building on the success of the Program Budget, the Council has developed a Performance-Based Budget that combines information on program spending with data on program performance. In the future, the Council will press the Administration to adopt this innovative presentation of the City's budget.

^k Last year, in an agreement reached with the Mayor, the Council implemented a 7 percent across-the-board reduction in the property tax, lowering the average rate from \$12.283 per \$100 of assessed value to \$11.423. Additionally, the Council adopted a local law, after State legislative action, to extend the \$400 property tax rebate for resident homeowners for another three years (Fiscal 2008 through 2010).

PROGRAM BUDGETING

Two years ago, the Council confronted a City budget that failed to answer basic questions about how agencies spend money. Responding to this lack of transparency, the Council urged the Administration to adopt Program Budgeting, a concept first developed by the Independent Budget Office (IBO), in order to make the budget more accountable to legislators and the public. Shortly before the 2008 budget was adopted, the Administration agreed to begin producing a Program Budget for each City agency. This new presentation for the first time shows agency spending in terms of meaningful program categories, establishes a link between the expense and revenue budgets, and compares budgeted spending to what was spent in prior years. In the 2009 Preliminary Budget, Program Budgets for fifteen City agencies were released, with a commitment from the Administration to publish a Program Budget presentation for every City agency in the future.

PERFORMANCE-BASED BUDGETING

Building on the success of the Program Budget, the Council has gone a step further and developed a Performance-Based Budget for City agencies. While traditional budgets simply describe where money is being spent, Performance-Based Budgeting connects measures of program performance to the costs of programs. The Performance-Based Budgets match performance measures from the Mayor's Management Report with the financial information contained in the Program Budget. By aligning program results with program costs, Council members and the public can see where taxpayer money is being spent and what outcomes are being achieved through that spending. The goal of Performance-Based Budgets is to focus budgeting on the results and outcomes of programs, which will enable Council members and agency managers to make better informed decisions about where the City should be directing its resources. Performance-Based Budgets for fifteen City agencies were unveiled as part of the Council's 2009 Preliminary Budget hearings.

REFORM OF DOE'S BUDGET

The Department of Education's budget, like those of other City agencies, is divided into units appropriation related to broad categories of the agency's activities. The budget nevertheless fails to provide meaningful information about the DOE's resource needs, its spending, or its programs. The DOE's budget is extraordinarily opaque for the following three reasons: 1) the units of appropriation are too large; 2) the DOE's budgeting system (FAMIS) is not aligned with the City's budgeting system (Financial Management System); and 3) its current system requires large sums be kept in holding codes.

The DOE's budget contains 26 U/As related to various functions for school support services, administration, fringe benefits, and school spending for examples. While it could be argued that the U/As are aligned with particular services provided by the DOE, the scope of such service areas are so vast in many cases that they are meaningless. The best example of this is the U/As related to spending by public schools. There are only four, PS and OTPS U/As for general education instruction and PS and OTPS U/As for special education instruction. Funding scheduled in these U/As total \$7.8 billion and is used for everything from pre-kindergarten classrooms, to high school sports, and middle school academic intervention services. It is

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impossible to know by reading the DOE's budget how much the agency spends on the great diversity of educational programs provided by the City's more than 1,400 schools.

The misalignment of the Department's internal budgeting system (FAMIS) with the City's budget system (FMS) makes it difficult to rely on the information presented in the budget. The City has begun to marry the two systems and the OTPS budget is now aligned at the U/A level. The PS budget in FMS, however, does not match DOE's PS budget. Only the DOE, therefore, knows how many people work for the Department at any given time. It is impossible for Council Finance to verify this information from FMS as it can for any other agency. Some of this is a legacy of the time when the old Board of Education was outside Mayoral control.

The difficulties caused by fact that DOE is not aligned with FMS are compounded by the fact that more than \$1 billion is scheduled in holding codes. The budgetary holding codes allow the DOE to keep a massive portion of its money in reserve. The Administration has explained that holding codes are employed simply because it is not known where the money should be budgeted. This explanation is not sufficient. During the course of the year, DOE maintains large holding codes and never reveals how the funding will be allocated. The Department aligns its spending with the budget only after the fact – at the close.

The work done by DOE is too important: its budget deserves careful and informed consideration. Making its budget more transparent can only aid in this.

ELIMINATE LARGE UNSPECIFIED ALLOCATIONS

Just as the DOE budget contain over \$1 billion in holding codes which prevent the Council and public from determining how that money is used, there are some programs in other parts of the budget that contain large unspecified allocations.

The Center for Economic Opportunity (CEO): Funded at \$65 million in the 2009 Preliminary Budget, the CEO has the laudable aim of reducing poverty in three populations: disconnected youth, the working poor and young children. However, for Fiscal Year 2009 the entire \$65 million is contained in a single holding code in the Miscellaneous budget. The Council cannot accept a CEO budget that does not detail what this \$65 million will fund. Once this greater detail is provided, the Administration and Council should work together to determine what aspects of this program are most critical and require funding for next fiscal year and whether or not any aspects of this program should be reduced in light of current economic conditions.

CAPITAL BUDGET REFORM

The Council plays an important role in the capital budget process. The Charter sets forth a capital budget process in which a substantial amount of information is required to be provided by the Administration regarding individual capital projects. Pursuant to Section 214 of the Charter, capital projects contained in the capital budget should be listed separately and include: (1) a brief description and the location of the project; (2) estimated costs, appropriations, sources of funds, the period of probable usefulness, any terms and conditions of the project, and the estimated dates of completion of all stages of the project; and (3) a breakdown of capital projects by

community districts and borough. The inclusion of a capital project in the capital budget constitutes an order to the agency to prepare a scope of the project if sufficient appropriations have been made. The Administration is then required to provide progress reports – which must include schedules, clear explanations of delays, and project completion dates – for each capital project contained in the capital budget. This information enables the Council and the public to determine which individual capital projects have been included and the progress, if any, has been made on these projects.

Despite these Charter provisions, the Administration will oftentimes combine multiple capital projects in one budget line, portraying disparate projects as a single capital project. For example, in the Fiscal 2008 Preliminary Budget, a project involving the reconstruction of the Minetta Playground appeared in the same budget line as a sidewalk reconstruction at City Hall Park and as a project for the development of the High Line Park. These budgetary actions have hindered the Council and public's ability to identify what projects are being pursued, during what time-frame and at what cost to taxpayers. As a result, the Council's ability to properly oversee the capital budget and set forth capital budgetary priorities is greatly diminished.

STEPS TOWARD REFORMING THE CAPITAL BUDGET PROCESS

Additional Information on Capital Projects

As part of the Fiscal 2007 adopted budget, the Council and the Administration agreed to one term and condition related to all lines in the capital budget. This term and condition requires that each agency make sure that the Financial Management System (FMS) is “adequately updated with project milestones and explanations for any delays in the schedules of each [capital] project.” To the best of Council Finance's knowledge, the Administration has been working towards full compliance with this term and condition thereby allowing the Council to better evaluate each agency's capital program in relation to cost overruns and project delays. The information also provides a point of reference for an agency-by-agency comparison of overall capital program performance. In an effort to better meet the charter requirements, the Administration should continue to improve the amount of information it provides on capital projects.

Additional Safeguards on Capital Money for City Purposes on Non-City Property

In March 2008, a Memorandum of Understanding (MOU) was signed by OMB and Council Finance to better ensure that City capital funds that go to outside organizations for particular capital projects (“Non-City Capital Projects”) have important public purposes and put the City in the best position to ensure that the funding is serving the public purpose.

Pursuant to the MOU, the Administration and Council have agreed that beginning in Fiscal 2009 an appropriation for a Non-City Capital Project shall only be made to not-for-profit organizations that demonstrate the capacity to comply with all legal requirements, demonstrate the financial and administrative ability to complete the project, and have an existing contractual relationship with the City.

Transparency in Capital Project Funding

In addition, in the Fiscal 2009 capital budget, the Council will for the first time attach the names of the sponsoring Council Members to individual capital projects. This will provide additional transparency and accountability to the capital budget process.

THE CAPITAL BUDGET

New York City is the economic engine of the nation. It is a world leader in financial services, fashion, media and advertising, tourism, culture, and countless other industries. More than 3.7 million people work in New York City,¹ and many of them come from surrounding cities and states to take advantage of the job opportunities here. The transportation network that moves this labor market is extensive and includes bridges, highways, ferries, trains, buses, and subways.

Investment in capital assets is also vital for New York City's economy because it creates good paying jobs in the construction industry and supports the economy during economic downturns. As mentioned earlier, every \$1 billion invested by the MTA generates over 8,700 jobs – many of these in construction and related fields. According to the New York State Department of Labor, the median annual wage for construction laborers is \$41,120 and \$102,640 for construction managers.^m Therefore, by making much needed capital investments in both existing infrastructure and new development, the City creates and supports the middle class of New York City.

As has been shown time and again, periods of economic boom are followed by periods of economic decline in both the nation and New York City. Public sector investment in capital construction helps to stimulate the economy when these downturns hit Wall Street. By continuing to invest in public infrastructure as the economy heads south, government can help fend off higher unemployment and support the economy until private sector investment picks up.

Investment in new and existing capital assets – the nuts and bolts of our City – is the foundation on which all this activity is built. It is what makes the City work. In Fiscal 2002, about \$15 billion was spent on capital infrastructure in New York City by local, state and federal government entities. New York City and the Metropolitan Transportation Authority (MTA) accounted for most of this spending, contributing \$6.3 billion and \$5.7 billion, respectively. To put this into perspective, it has been estimated that every \$1 billion in MTA capital spending generates approximately 8,700 jobs, \$454 million in total wages, and \$1.5 billion in economic activity in the metropolitan region.ⁿ It is clear that both public and private entities have a stake in the future of this system.

Despite its importance to New York City's economic viability, public investment in infrastructure is lagging. It is estimated that about \$5.4 billion is needed to bring existing City-controlled capital assets into a state of good repair, a term referring to when a system's components are in good condition and are replaced on a normal maintenance cycle. Yet the City

¹ New York State Department of Labor and the Bureau of Labor Statistics.

^m <http://www.labor.state.ny.us/workforceindustrydata/apps.asp?reg=nys&app=descriptor>

ⁿ *New York State Comptroller, 2008.*

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has only planned to spend \$2.6 billion over the next ten years on this cause,^o leaving a \$2.8 billion deficit.

The MTA has also been deficient in funding its state of good repair need. Due to deferred maintenance during the 1960's and 1970's, the MTA faced a multi-billion dollar shortfall in state of good repair funding in 1982. Although some progress has been made to fund routine maintenance and repair, 60 percent of subway stations are currently not in a state of good repair. To bring the entire MTA system of rolling stock, station, tunnels, bridges, and signals up to this standard, \$15 billion would need to be invested today.^p

Now, even if funding was available to bring all these capital assets to a state of good repair, it would be operationally impossible for City agencies and the MTA to plan and execute all this work in one, five or even ten years. Nevertheless, it is imperative that we remain committed to maintaining our current class of assets as we continue to build upon them.

^o *Citizens Budget Commission.*

^p http://www.nyc.gov/html/planyc2030/downloads/pdf/maintainyc_transportation.pdf

APPENDIX 1. CITY COUNCIL ECONOMIC AND TAX REVENUE FORECAST

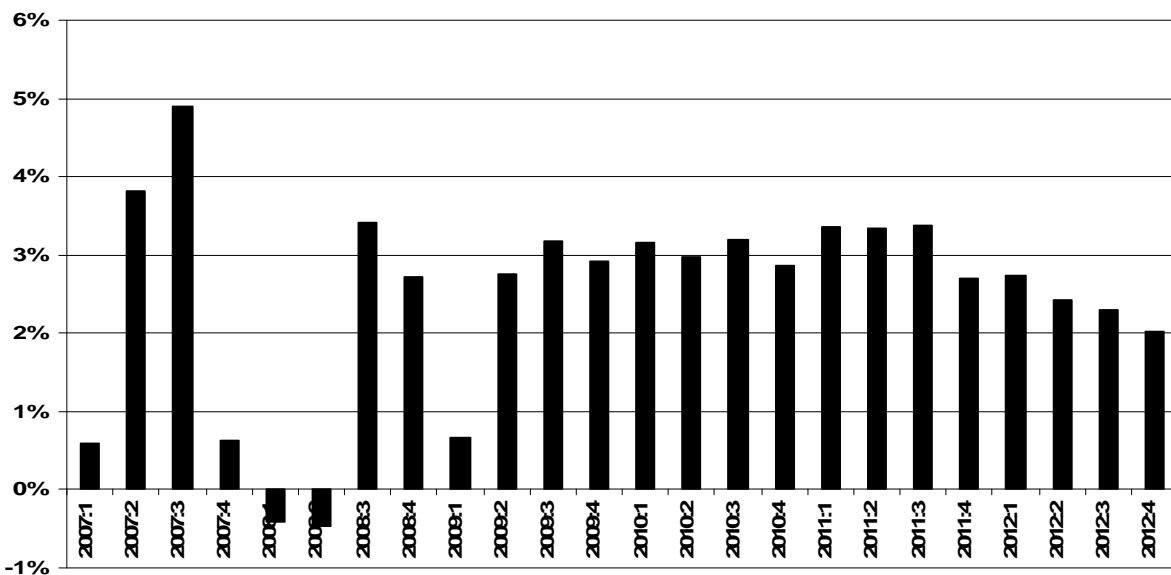
THE ECONOMY

THE NATIONAL ECONOMY: RISK ESCALATES

The economic news over the last three months has not been very good. The national economy is slowing down, growing at the rate of only 0.6 percent in the fourth quarter of 2007. The unemployment rate is rising, having reached 5.0 percent, and projected to rise further. The establishment survey of the Bureau of Labor Statistics is now reporting net reductions in employment, with a loss of 63,000 payroll jobs in February, following the shedding of 22,000 jobs in January. Housing starts and housing prices are falling, and there is evidence that the non manufacturing sector is shrinking. News from the financial sector is generally bad, large losses continue to be reported, the credit crunch continues and the crisis has led to the failure of a major investment bank. Reacting to this, economists have revised their forecasts downward. In mid November the economists in the Federal Reserve Bank of Philadelphia’s Survey of Professional Forecasters pegged the risk of a negative growth in the first half of 2008 at less than 25 percent. In the mid February survey the risks were pegged at 47.3 percent for 1st quarter 2008 and 42.9 percent for 2nd quarter 2008. In the March Wall Street Journal Forecaster’s Poll 71 percent of economists surveyed said that the economy was already in a recession.

Global Insight, the econometrics firm used by both Council Finance and OMB, also changed its view of the economy between December and February. Their December forecast was far from rosy, but they believed there was a 60 percent chance the economy would avoid a recession, experiencing four quarters of slow growth instead. By February they forecasted that the economy was, in all likelihood, in a mild recession, and there was a 25 percent chance that recession would be severe.

FIGURE 1: GROWTH IN REAL GDP



source: Global Insight, February 2008.

S

The sources of this recession are well known, two shocks:

- The fall in the housing market and the related problem of the credit crunch;
- Oil prices approaching \$100 a barrel.

The problem now is the interaction between the financial sector and the rest of the economy. The banking system has capital write-offs of over \$146 billion related to housing and credit conditions. As a rule of thumb reductions in bank capital reduce the amount of loans available by a multiple of 10 or 12. With less available to lend and greater concern about risk, banks are tightening their lending standards, particularly in the residential and commercial real estate markets. This weakens the housing market and the general economy, which in turn increases losses in the financial system. Problems are not restricted to real estate related activities. Recent weeks have seen problems with bond insurers, the municipal bond market, and increasing credit card and auto loan delinquencies.

A recession could cause banking system write-offs to rise to \$250 - \$300 billion and a severe recession could result in write-offs of \$400 billion, similar to that of the S & L crisis of the late 1980s.⁹

The Federal Reserve has reacted to this problem by reducing the federal funds interest rate by 3.0 percent. Lower short term interest rates tend to help financial institutions by lowering the cost of obtaining funds and improving their profitability.

FEDERAL STIMULUS

One of the channels by which Federal Reserve interest rate cuts aid the economy is by making it cheaper and easier for the financial system to make loans. But banking system losses weaken their ability to make loans and thus make it harder for the Fed to have the desired impact. This is where a fiscal stimulus can be of use.

Congress has recently enacted, and the President has signed, the Economic Stimulus Package Act of 2008. The Act provides an income tax rebate of up to \$600 for head of household and \$1,200 for a married couple filing jointly, with an extra rebate of \$300 per child.⁷ This will be paid to households in the late spring to early summer of 2008. It also provides for extra depreciation for businesses, and allows Fannie Mae/Freddie Mac (FNMA/FMC) to buy larger mortgages. The program will provide a boost in the third and fourth quarters of 2008, helping to end the recession. The extra depreciation will mostly have the effect of moving forward business equipment spending that would have occurred in the first quarter of 2009 into the end of 2008. This is one of the sources of the slowdown forecasted in 1st quarter 2009 in figure 1 above. Overall, the stimulus boosts growth in 2008 by 0.4 percent according to Global Insight, at the cost of slightly slower growth in 2009. The hope is that by 2009, the housing downturn will have passed its trough, no longer presenting a drag on the economy, and so preventing a resumption of negative growth.

⁹ Estimates of banking system write-offs are from Global Insight, February 2008.

⁷ The credit starts to phase out at AGI \$75,000 (\$150,000 for married filing jointly). Taxpayers with AGI over \$87,000 (\$174,000 for married filing jointly) will receive no rebate. There is a minimum rebate of \$300, for those who had at least \$3,000 in qualifying income in 2007. Taxpayers whose 2007 tax was less than the \$600 maximum credit will not receive the full credit. They will receive the tax they paid or the minimum credit whichever is higher. This keeps some low income households from fully benefiting from the credit.

NEW YORK CITY ECONOMY

Despite the national slowdown, New York City's economy has maintained robust growth up through most of 2007, but is beginning to show symptoms of decelerating. According to the City Comptroller, the City's performance for 2007 surpassed the nation as a whole, with Real Gross City Product (GCP) growing by 3.0 percent compared to Real Gross National Product (GNP) at 2.2 percent.^s Through the first half of 2007, the City's fortunes have been relatively insulated from the weakening housing market nationwide. Its residential real estate prices held up admirably, fueled by the demand for living in the City. It was also not dependent on the afflicted construction and manufacturing industries.

Since the late summer of 2007, however, the subprime mortgage meltdown, and the resulting plummet of asset-backed securities, has severely crippled the intermediary function of banking, a major sector in the City. The result has been a severe credit crunch and ongoing Wall Street losses. After NYSE member firms amassed stellar profits of \$20.9 billion for 2006, and 2007 1st and 2nd quarter earnings of \$4.7 billion and \$4.2 billion, respectively, the 3rd quarter 2007 reported losses of \$3.8 billion, the heaviest decline on record.^t In summary, the net earnings of the first three quarters of 2007 amounted to only 62 percent of the same period in 2006. Fourth quarter earnings are expected to be appreciably worse, with the seven principal U.S. investment banks reporting losses of \$17 billion.^u

Consequently, Council Finance expects a slowdown in the City's economy in 2008 and 2009, with significant downside risks of it becoming more severe. Real GCP grew by a healthy 3.13 percent in the 4th quarter 2007, and is projected by Global Insight to grow by 2.65 percent in the 1st quarter 2008. Growth will continue to dip, but remain positive, ranging between 1 and 2 percent through the 1st quarter 2009. The City's economy will continue to recover, passing 3 percent by 1st quarter 2010.

The City's private payroll employment grew by 1.63 percent in January compared to the same time the previous year. After growing by 2.4 percent in 2007 adding 74,800 jobs,^v private employment growth is expected to be relatively flat in 2008 at around 0.4 percent. It will slowly pick up to about 0.7 percent in 2009, passing 1 percent by 2010.

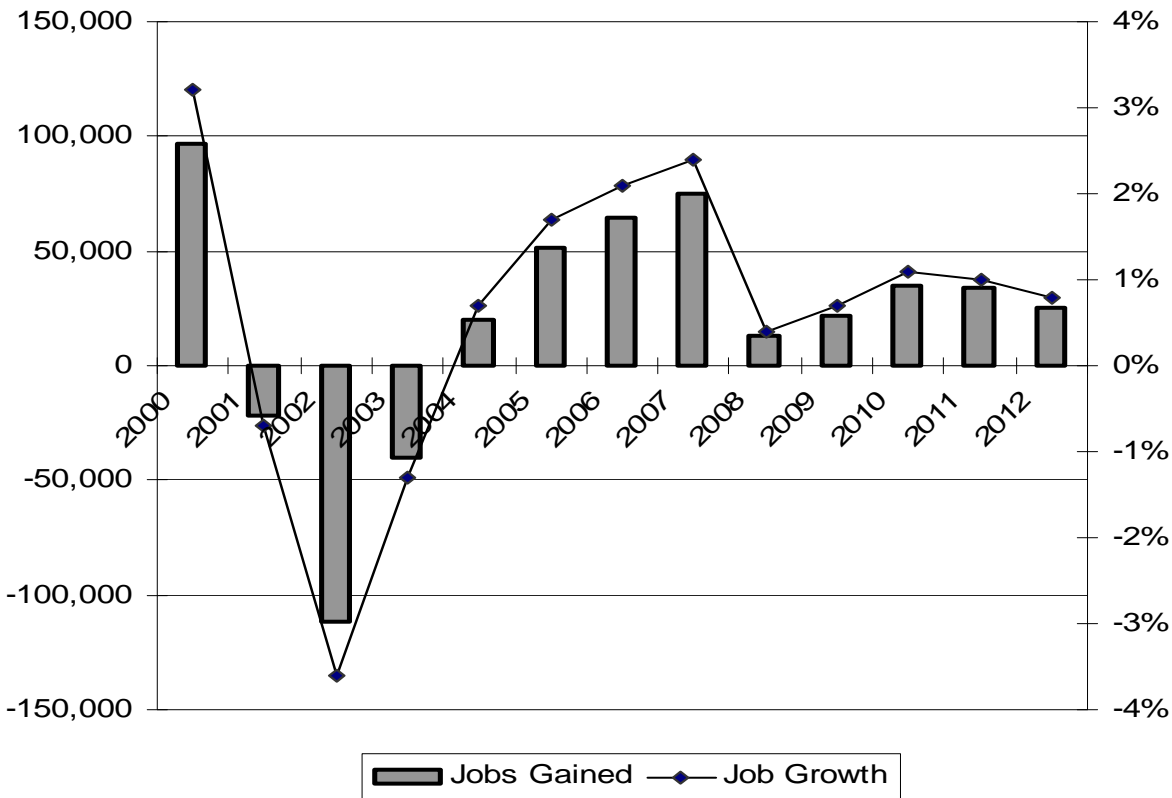
^s OMB has a much lower GCP forecast, 0.3 percent. This seems excessively pessimistic about the second half of 2007 and out of line with some other parts of OMB's forecast.

^t SIFMA December 2007. City budget documents usually discuss NYSE member profits.

^u Council Finance calculation based on fourth quarter reports of major investment banks.

^v Council Finance calculations from New York State Department of Labor establishment survey.

GROWTH IN NEW YORK CITY TOTAL PRIVATE EMPLOYMENT



Source: Global Insight, February 2008

There are six sectors that represent the main drivers of the City’s economy. As of January 2008, all six sectors still showed positive job growth compared to the same time the previous year.^w

- Finance (up 8,200 or 1.78%)
- Business Services (up 5,700 or 0.99%)
- Information (up 4,200 or 2.59%)
- Leisure and Hospitality (up 12,300 or 4.40%)
- Health Care (up 10,600 or 1.95%)
- Education (up 700 or 0.46%)

Most job losses are concentrated in the manufacturing sector, which employs a small percentage of City workers.

The average wage in the City will grow significantly below trend throughout the financial plan. Wage growth in the financial sector, however, is expected to drop from 11.7 percent in 2007 to negative growth of -1.8 percent in 2008. This reflects the impact of Wall Street’s downturn on sector wages and bonuses, which comprise on average around 25-30 percent of City personal income tax revenue.

^w Council Finance calculations based on January over January growth, data New York State Department of Labor establishment survey.

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On a brighter note, bonuses in the finance and insurance sector for 2007-2008 are projected by the New York State's Division of Budget (DOB) as falling by only 5.5 percent compared to last year's exceptional performance.^x Also, December through February's personal income tax withholdings, representing the available wage data for the bonus season, is still 6.05 percent above last year's levels. This suggests that the City's wage performance will at least not be a disaster.

Turning to real estate, last year's growth in office-based employment and the limited availability of office space has pushed overall Manhattan office rents to \$65 per square foot in December 2007, a 29 percent increase year-over-year. Corresponding vacancy rates dropped to 5.7 percent, compared to 6.7 percent the year before.^y There is relatively little new office space under construction in Midtown, and major additions downtown will not become available before 2009. The commercial real estate market is now facing challenges from the generalized increases in financing costs, and with reduced demand for office space, additional office-based jobs decrease. On the other hand, the weak dollar is helping to boost foreign investment. With this mix of limited office supply and milder demand, commercial rents are expected to remain strong, especially in 2008, but increases in asking rents are likely to be more tempered.

The City's housing prices have largely maintained their value through most of 2007, bucking the downward trend nationwide. Prices have begun to drop, however, towards the end of 2007, as mortgage conditions tightened and defaults increased. The Case Shiller Home Price Index dropped by 5.8 percent in January 2008 compared to the same time the previous year. The OFHEO^z price index, which includes homes that meet the mortgage requirements of Fannie Mae and Freddie Mac, increased by only 0.4 percent in the 4th quarter 2007 compared to the 4th quarter 2006. Council Finance estimates that City home values will decrease by at least 3 percent in 2008 and by 4 percent in 2009.

The Manhattan condo and coop market has been especially strong through 2007. The average sales price of a one bedroom coop was \$716,480 in the 4th Quarter 2007, a 17.5 percent increase year-over-year. Condos were \$861,860, a 4.9 percent increase.^{aa} With reduced bonuses and other income sources, demand is expected to slacken in 2008.

New York City is finally showing signs of an economic slowdown, lagging a few months behind the U.S. as a whole. This is largely due to the subprime mortgage and other high risk credit contagion spread by Wall Street. Incomes of New Yorkers are expected to decline this year, both directly from the finance sector and indirectly through the unavailability of credit and decreased investment.

^x *DOB 21 Day Amendment Forecast.*

^y *Cushman & Wakefield.*

^z *Office of Federal Housing Enterprise Oversight.*

^{aa} *MillerSamuel.*

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ECONOMIC FORECAST – CITY COUNCIL FINANCE DIVISION

	2007	2008	2009	2010	2011	2012
National						
GDP	2.2%	1.2%	2.0%	3.2%	3.3%	2.8%
Payroll Employment	1.1%	0.3%	0.6%	1.4%	1.7%	1.4%
CPI (Consumer Price Index)	2.9%	3.3%	1.4%	1.8%	1.9%	2.0%
Federal Funds Rate	5.0%	2.4%	2.7%	4.5%	4.7%	4.7%
10 Year Treasury Note Yield	4.6%	3.4%	3.9%	5.2%	5.4%	5.4%
S&P 500 Stock Index Change	12.7%	-7.1%	9.2%	6.9%	5.8%	6.0%
New York City						
Private Sector Employment	2.4%	0.4%	0.7%	1.1%	1.0%	0.8%
Average Wage	8.9%	2.6%	3.0%	4.2%	4.6%	4.4%
Total Revenue from SIFMA*	2.8%	-10.4%	13.7%	17.3%	14.9%	9.7%
CPI-U (CPI for NYC area)	2.8%	2.0%	2.1%	2.4%	2.3%	2.3%

*Securities Industry and Financial Markets Association

TAX REVENUE

After several years of double digit growth, the City's tax revenue is slowing down. As of February, collections from the major taxes were only approximately 1.3 percent ahead of the same time last year and \$241 million over the Fiscal 2009 Preliminary Budget Plan. For comparison, the first eight months of Fiscal 2007 collections were 9.5 percent ahead of Fiscal 2006.^{bb} Some of this slowdown is due to changes in tax policy. Last year the Council, working with the Mayor and the State Legislature, reduced the City's property tax by 7 percent, created a new child care credit, exempted all clothing and footwear from the sales tax, reduced double taxation on City residents that pay the unincorporated business tax, and enacted a set of business tax reforms aimed at small businesses. All together these will reduce City tax revenue by nearly \$1.3 billion in Fiscal 2008. Much of the slowdown is still due to the economy. As one might expect from the economic analysis above, the first taxes affected by the slowdown are those related to banking and the sale of property. The mortgage recording tax collections are down 20.3 percent and the bank corporation tax collections are 29.2 percent behind the same time last year. Most other taxes are holding up well. PIT withholdings are up 8.0 percent so far this year and bonus season collections in December through February are up 6.1 percent from last year.

BUSINESS TAXES

Collectively, the City's business taxes—the unincorporated business tax (UBT), general corporation tax (GCT) and banking corporation tax (BCT)—are showing almost exactly the same amount of revenue through February in Fiscal 2008 as the first eight months of Fiscal 2007. This near equality disguises dramatically different performances of the constituent taxes. The UBT is doing quite well so far, delivering 19.9 percent revenue growth. The GCT is mildly behind last year, dropping 1.6 percent. BCT revenue is getting severely battered, falling 29.2

^{bb} Council Finance calculations for the City's major taxes without audits.

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percent from last year, underscoring the commercial banks' shouldering the initial brunt of the subprime meltdown. Total business collections are still 4.6 percent over plan.

The difficulty in forecasting business taxes and, to a lesser extent the personal income tax, comes from the nature of losses in the subprime/credit markets. The full scale of these write downs is still unknown, and the write downs are not necessarily losses for tax purposes. So when (and if) these losses translate into tax losses is hard to judge. The drop in GCT revenue has been relatively mild up through February. It appears that March's collections will adhere to the same pattern, though lower than last year, it will be higher than the Preliminary Budget Plan.

Council Finance estimates that in Fiscal 2008, total business tax revenues will be down 15.5 percent. The BCT will take, by far, the largest fall, but it is coming down after remarkable growth of 85 percent in Fiscal 2007. The reductions in the UBT and the GCT will be more modest. Business revenue will pick up in Fiscal 2010 and 2011, with positive growth of 9.9 percent and 6.3 percent respectively.

Global Insight forecasts that nationally, state and local corporate income taxes will fall 11 percent in Fiscal 2008 and will not recover until Fiscal 2010, with tepid growth in Fiscal 2011 and 2012. This is a result of expected weak growth in corporate profits. The fall in financial sector profits will be larger than in the corporate sector as a whole, which is reflected in the Council Finance forecast.

PERSONAL INCOME TAX

The City's personal income tax (PIT) has been holding up well through February. For the first eight months of Fiscal 2008, collections are up 7.4 percent compared to the same period last year, with a strong performance of both withholding and estimated payments. As mentioned above, the bonus season is decent or at least not a disaster.

Council Finance predicts a mild 1.5 percent decrease in PIT revenues for Fiscal 2008. Fiscal 2009 will witness a more pronounced drop of 5.8 percent due to a fall in financial sector employment, a weaker 2008-2009 bonus season, and a decline in capital gains realizations. Wall Street banks have already shed 34,000 jobs in the past nine months, a significant portion of which reside in the City.^{cc} The Congressional Budget Office (CBO) expects personal income tax liabilities from realized capital gains to fall by a total of 11 percent in 2008 and 2009, but to exceed 2007 levels by 2010.^{dd} PIT revenues will resume growth in Fiscal 2010 at 4.4 percent, picking up momentum in 2011 at 8.3 percent.

SALES, UTILITY, AND HOTEL TAXES

Sales tax revenue is estimated by Council Finance to grow by 2.5 percent in Fiscal 2008. Comparing the actual collections through February, revenue growth from the first eight months of Fiscal 2008 comes to 4.6 percent over the same period in 2007. The growth in Fiscal 2008 collections is tempered by the extension of the tax exemption on shoes and clothing to items priced \$110 and above. In Fiscal 2009 revenues are expected to fall by a mild 0.8 percent. This lackluster growth is attributed to lower employment, reduced bonuses, and increased restraint of

^{cc} Bloomberg, March 24, 2008.

^{dd} Congressional Budget Office, "Budget and Economic Outlook Fiscal Years 2008 to 2018," January 2008.

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apprehensive consumers. The strength in tourism offsets what would have been even less spending. Sales revenue growth will resume in Fiscal 2010 and 2011 with annual 4.2 percent growth.

The utility tax is expected to grow by 2.7 percent in Fiscal 2008. The first eight months of the year show a 7.7 percent increase over the same period in 2007, reflecting the massive increase in oil prices to over \$100 a barrel. Oil prices are expected to soften over the year in response to reduced consumption as the economy cools down. Moderate revenue growth of 3.2 percent is expected in Fiscal 2009, due to increased electricity consumption (including more days in the year requiring cooling and heating), and increased telecommunication use. The out-years project slower revenue growth of around 2 percent.

The hotel tax projects continued strong growth in Fiscal 2008 at 12.3 percent over the previous year. Growth has been stoked by 46 million tourists in calendar year 2007, a 4.5 percent increase over the previous year. City tourism, in turn, is encouraged by the increased amenities and safety in the City, and the continuing decline of the dollar. Hotel tax revenues are projected to increase by 5.7 percent in Fiscal 2009, by 8.8 percent in 2010, and by 6.2 percent in 2011.

REAL PROPERTY TAX

The growth in market values and assessed values on the revised tentative assessment roll for Fiscal 2009 released by the Department of Finance (DOF) on January 16th was lower than OMB anticipated in either the Fiscal 2008 Adopted Budget or October Plan, due to slower growth in the commercial and residential real estate markets. As a result, in the Preliminary Budget OMB decreased the property tax levy by \$167 million in Fiscal 2009 from the October Plan estimate, for a total levy of \$15,388 million.

Council Finance anticipates that there will be a further reduction in market value, assessed value, and the real property tax levy, below OMB's estimate, as a result of downward adjustments in assessments for class two residential properties for corrections to market value based on the gross income multiplier methodology (see discussion below). Council Finance anticipates that revenue from the property tax will be \$51 million below OMB's estimate in Fiscal 2009, \$94 million and \$2 million lower than OMB's forecast for Fiscal 2010 and 2011, respectively, but higher than OMB's estimate by \$233 million in Fiscal 2012, because of Council Finance's more optimistic outlook for economic growth.

MARKET VALUE: The market value of the City's nearly 1,000,000 parcels of taxable real estate increased only 2.8 percent on the tentative roll over the prior year, evidence that the City's property values are beginning to experience some of the softening in the real estate markets. The total value of taxable real estate is still high, at \$818.4 billion. With the exception of class one properties which experienced its first decline in value in years, the other three classes of properties experienced market value growth, although the rise in value for classes two and four was substantially below last year's double-digit growth. Property values dropped in Brooklyn, Queens and Staten Island, because of the high concentration of class one homes in these boroughs. Growth was still strong in Manhattan, the borough with the highest concentration of commercial property, and the Bronx, where market value growth was bolstered by large increases in the value of multi-family properties.

The most notable change to the assessment roll this year was the change in the way DOF determined the market value for class two multi-family properties with more than 10 units. For the first time, DOF used the Gross Income Multiplier (GIM) approach to value these properties rather than the net income capitalization method. (For several years DOF has used the GIM method to value class two properties with less than 11 units.) Net income capitalization uses the income stream and expenses of a building and applies an appropriate capitalization rate to determine the full value of the property. DOF found that the expense ratios for multi-family buildings often varied so greatly that they were an unreliable indicator of value and tended to lower the values of those properties that overstated their expenses. The GIM method avoids using building expenses, and applies a gross income multiplier based on property type to the income stream of a building in order to determine market value. DOF hopes this method will be more accurate and make the estimate of market values for multi-family properties more predictable in the future. Initially, DOF developed two different GIM schedules; one for rental buildings and another for co-op and condo buildings. However, this approach was found to be open to legal challenge. DOF revised its GIM and combined the two schedules into one GIM schedule which it applied to both rental buildings and co-op and condo properties. DOF mailed out a revised change of notice on February 15th to more than 150,000 properties. The effect of the revision is virtually "revenue neutral"; it doesn't change the total assessed value for class two, but rather increases the values for rental buildings and decreases them for co-op and condos.

Market value growth has been remarkable since September 11, 2001, until this year. Total market value has more than doubled since Fiscal 2002, while class one (one-, two-, and three-family homes) market value has increased by 134 percent. As can be seen in the table below, class one properties experience the first decline in market value in several years, decreasing by nearly 1 percent from Fiscal 2008—evidence that home prices are beginning to soften, since growth in market value closely mirrors the trend in sales prices. In fact, this is the first decrease in class one market value since Fiscal 1994, occurring after a long run of double digit growth since Fiscal 2001.

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MARKET VALUE GROWTH BY TAX CLASS SINCE FISCAL 2002

Fiscal Year	All	Class 1	Class 2	Class 3	Class 4
2002-2003	9.5%	13.5%	9.4%	4.7%	3.9%
2003-2004	8.6%	13.6%	3.6%	2.7%	4.5%
2004-2005	15.8%	21.7%	18.9%	6.6%	3.0%
2005-2006	13.6%	14.6%	13.4%	13.5%	11.6%
2006-2007	9.8%	12.9%	7.3%	6.8%	5.2%
2007-2008	18.1%	16.3%	24.7%	-2.9%	19.0%
2008-2009F	2.8%	- 0.9%	8.1%	7.4%	6.2%
2002-2009F	108.6%	134.0%	121.0%	44.9%	66.0%

Sources: New York City Department of Finance, Annual Report on the NYC Real Property Tax, Fiscal Year 2007; Tentative Assessment Roll, Fiscal Year 2009.

Strong growth in market value for residential properties (class one) relative to the other classes has increased the share of total market value to nearly 52 percent from 46 percent in Fiscal 2002. Conversely, the share of commercial property (class four) has decreased from 28 percent in 2002 to 22.5 percent in Fiscal 2009.

BILLABLE ASSESSED VALUE: The total taxable or billable assessed value (BAV) on the tentative roll, before accounting for the STAR and veterans exemptions, increased by \$9.8 billion from Fiscal 2008 for a total of \$135.6 billion. The 7.8 percent increase in value is only slightly less than the 8 percent growth experienced last year. The continued growth in BAV for class two and four properties reflects strong market value growth over the past several years. During periods of economic growth, increases in market value result in a substantial “pipeline” of accumulated assessed value that is phased-in for classes two and four (assessed value increases are phased in over five years for these two classes of property). Large yearly increases in market value for class one properties are rarely captured in BAV growth because State law caps class one growth in assessed value at 6 percent a year and 20 percent over five years. However, after a long period of high market value growth, the cap on assessment increases lowers the “real” assessment to market value ratio. In Fiscal 2009, this ratio will drop to about 3 percent. The “target” assessment ratio for class one is 6 percent. While the cap on assessment increases acts as a break on steep increases in assessed value in any one year, the assessments can still increase up to the cap even when market value is declining, until the target assessment ratio is reached. This is the case with class one properties in the upcoming fiscal year, where market values are declining, while the BAV is anticipated to increase by nearly 5 percent. Contrast this with Fiscal 2008, when class one experienced a growth in market value of more than 16 percent, yet assessed value only increased by 4 percent.

However, the final assessment roll, released on May 25th, is always lower than the tentative roll, due to Tax Commission actions, DOF changes by notice, and completion of exemption processing. In the Preliminary Budget, OMB estimates that the final roll BAV will be \$0.8 billion or 0.6 percent lower than the tentative roll, resulting in final roll increase of 7.2 percent over Fiscal 2008—growth of 8.1 percent for class two, 7.8 percent for class four, and 4.3 percent for class one. Because of the high growth in market value from prior years resulting in a large accumulation of assessed value in the pipeline for classes two and four, OMB has carried through the high growth in the BAV throughout the plan period, though at a declining rate to

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account for OMB's forecast of a slowdown in the real estate markets. OMB anticipates that the BAV will increase at an annual average rate of 6 percent from Fiscal 2010 through 2012.

Council Finance anticipates that the BAV in Fiscal 2009 will be \$448.5 million below OMB's estimate, bringing the total BAV for 2009 to \$134.0 billion. The reduction in the BAV accounts for downward adjustments in assessed value for class two and four properties as a result of successful protests of assessment increases. Total BAV increases by 6.8 percent over Fiscal 2008, with growth of 7.65 for class two properties and 7.4 percent for class four properties. The resulting reduction in the pipeline produces lower estimates of BAV than OMB's in 2010 and 2011, until 2012 when the BAV experiences stronger growth based on Council Finance's more gradual estimate of the economic slowdown. The average annual rate of growth for the period from 2010 through 2012 is 6.6 percent. Because of accumulated value in the pipeline, BAV growth remains strong throughout the plan period, particularly for class two and four properties. The taxable assessed value for these two classes has increased by more than 50 percent since Fiscal 2002, as illustrated in the chart below.

BILLABLE ASSESSED VALUE GROWTH BY TAX CLASS SINCE FISCAL 2002

Fiscal Year	All	Class 1	Class 2	Class 3	Class 4
2002-2003	5.6%	4.4%	7.7%	4.7%	4.4%
2003-2004	5.7%	4.5%	6.8%	2.7%	5.7%
2004-2005	3.8%	4.3%	5.2%	6.7%	2.3%
2005-2006	7.5%	4.9%	7.6%	13.5%	7.1%
2006-2007	4.5%	4.0%	4.9%	6.8%	4.1%
2007-2008	8.0%	4.0%	7.8%	-3.9%	11.2%
2008-2009 F	6.8%	4.3%	7.7%	3.1%	7.4%
2002-2009 F	50.1%	34.7%	58.4%	37.7%	50.1%

Sources: New York City Department of Finance, Annual Report on the NYC Real Property Tax, Fiscal Year 2007; Tentative Assessment Roll, Fiscal Year 2009; Council Finance's forecast of BAV for Fiscal 2009.

REAL PROPERTY TAX LEVY AND REVENUE: In the Preliminary Budget, OMB projects that the real property tax levy will increase at an average annual rate of 6 percent from Fiscal 2010 through 2012. Revenue is anticipated to show only a slight growth of less than one percent from 2007, due to a 7 percent reduction in the average tax rate implemented in Fiscal 2008. Revenue then jumps to a growth of more than 7 percent in Fiscal 2009. From 2010 through 2012, revenue will increase by an annual average rate of 6.2 percent.

Council Finance estimates that the levy will increase by 6.8 percent or by nearly \$1 billion from Fiscal 2008, to \$15,337 million, \$51 million below OMB's estimate. The levy will grow by an average annual rate of 6.6 percent for the period from Fiscal 2010 through 2012, resulting in levies that are \$94 million below OMB's forecast in Fiscal 2010, \$2 million lower in Fiscal 2011, and \$233 million higher than OMB's levy forecast for Fiscal 2012.

Both OMB and Council Finance assume continuation of both the 7 percent property tax reduction and the \$400 rebate through Fiscal 2012. Also included in the plan is the renewal of the current co-op/condo abatement program which sunsets this June.

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The long term trend in the high growth of market value for class one properties, along with the effects of the State-mandated class share system, have produced steady increases in class one's tax rate. Since Fiscal 2002, over the six-year period ending in Fiscal 2008, class one's tax rate has grown by nearly 33 percent. Even with the 7 percent reduction in the average tax rate in Fiscal 2008, class one's rate still increased by 2.4 percent from 2007. There may be a substantial increase in class one's tax rate again in Fiscal 2009. When combined with the increase in their assessments, class one homeowners may see a large increase in next year's tax bill, especially if the 7 percent reduction in the tax rate is not maintained.

REAL PROPERTY TRANSFER AND MORTGAGE RECORDING TAXES

In Fiscal 2007, revenue from the real property transfer (RPTT) and mortgage recording (MRT) taxes reached their historically highest level. Several multibillion dollar transactions provided a strong bolster to revenue, even as the volume of individual sales was decreasing. The Stuyvesant Town-Peter Cooper sale to Tishman Speyer Properties provided \$88 million in transfer tax and \$49 million in mortgage recording tax revenue. Collections were also bolstered by stronger than anticipated commercial transactions. Currently, the City has been weathering the national real estate market collapse by a strong demand to locate in the City, limited supply of offices and homes, especially in Manhattan, and a weak dollar attracting foreign investment. On the other hand, there are no additional off-the-chart sales as in the previous year.

In Fiscal 2008 revenue from both the transfer tax and the mortgage recording tax are anticipated to decrease by 14.5 percent and 24.1 percent respectively. This downward trend will continue in Fiscal 2009, with transfer and mortgage taxes falling by 21.0 percent and 16.8 percent respectively. Revenue will slowly return in the out-years. Transfer tax revenue will grow by less than 1 percent in both Fiscal 2010 and 2011. Mortgage recording is expected to grow by 3.9 annually for both years.

COMMERCIAL RENT TAX

Commercial rent tax revenue is expected to remain strong in 2008 due to positive though slower growth in office employment, and a tight market in commercial space. The following year will be weaker, as office employment is expected to weaken. Council Finance expects an 8.2 percent increase in revenue for Fiscal 2008, slowing down to 3.8 percent in Fiscal 2009. The out-years project 4.2 percent in Fiscal 2010 and 3.6 percent in 2011.

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TAX REVENUE FORECAST – CITY COUNCIL FINANCE DIVISION

	2008	2009	2010	2011	2012
Levels (Million \$)					
Real Property	\$12,999	\$13,868	\$14,855	\$15,855	\$16,893
Other Property	\$3,220	\$2,732	\$2,806	\$2,876	\$2,998
Business Taxes	\$5,083	\$4,784	\$5,256	\$5,589	\$5,694
Personal Income	\$7,578	\$7,135	\$7,446	\$8,060	\$8,292
Sales	\$4,733	\$4,695	\$4,887	\$5,094	\$5,378
Other Taxes	\$3,580	\$3,154	\$3,243	\$3,295	\$3,387
Total	\$37,193	\$36,368	\$38,492	\$40,769	\$42,642
Difference from OMB (Million \$)					
Real Property	\$0	-\$51	-\$94	-\$2	\$233
Other Property	\$41	\$99	\$191	\$271	\$287
Business Taxes	\$98	\$154	\$229	\$187	-\$93
Personal Income	\$81	\$131	\$74	\$219	\$80
Sales	\$29	\$53	-\$8	-\$48	-\$65
Other Taxes	\$10	\$6	-\$1	-\$20	-\$18
Total	\$258	\$392	\$390	\$607	\$423
Growth Rate					
Real Property	0.3%	6.7%	7.1%	6.7%	6.5%
Other Property	-15.4%	-15.1%	2.7%	2.5%	4.2%
Business Taxes	-15.5%	-5.9%	9.9%	6.3%	1.9%
Personal Income	-1.5%	-5.8%	4.4%	8.3%	2.9%
Sales	2.5%	-0.8%	4.1%	4.2%	5.6%
Other Taxes	4.0%	-11.9%	2.8%	1.6%	2.8%
Council Total	-3.5%	-2.2%	5.8%	5.9%	4.6%
OMB Total	-4.1%	-2.6%	5.9%	5.4%	5.1%

APPENDIX 2: TAX POLICY OPTIONS

The Council supports State legislation enacting the following two tax policy programs contingent upon the improvement in the economy and City tax revenues. These are initiatives which the Council has advocated for in the past, but failed to gain the necessary support to pass State legislation. The Council is very committed to providing a \$300 renter credit to City residents and tax relief for small business owners of S-Corporations. However, the Council recognizes that the cost of these tax benefits will have a significant impact on the City's budget in a time where there is much uncertainty about the effect of the economic downturn on the City's revenues. The Council believes that the reinstatement of the commuter tax on non-residents who work in the City, is fair. Commuters who use City tax supported resources should contribute to the support of the City. Therefore, the Council recommends implementation of the three tax policy options when economic and fiscal conditions permit.

ENACT THE COUNCIL'S PROPOSED RENTER'S TAX CREDIT

The City Council supports the passage of State legislation [A. 06849 (Wright)/S.03961 (Savino)] authorizing New York City to create by local law a renters credit of up to \$300. Such a local law would not be enacted till it is economically feasible to do so. This credit would help alleviate the burden on renters who absorb property tax increases through higher rents. This proposal is part of the Council's broader effort to make housing more affordable for all New Yorkers. The credit would be passed by the New York City Council at a time and at a level that is fiscally prudent.

It is generally accepted as fiscally reasonable to spend no more than 30 percent of income on rent. According to the most recent Census data, over 40 percent of renters in the City spend more than this threshold and the figure jumps to 67 percent for those renter household eligible for the credit. As documented by the most recent Housing and Vacancy Survey (2005), the median monthly rent in the City increased by nearly 32 percent from 1999 to 2005. Unfortunately, the increase in personal income of most renters has not kept pace with the growth in rent with incomes only increasing 23 percent during this same period.

Property taxes have played a roll in this. In the past six years (New York City Fiscal Years 2003-2008), the tax bills in multi-family buildings^{ee} have increased by 63 percent, despite the 7 percent rate reduction enacted last year.

Under the Council's proposal, this credit would ease rent costs for families making less than \$75,000 per year and individuals earning less than \$43,000 per year. If enacted by the City at the maximum level, qualifying renters would receive a flat \$300 refundable credit on their personal income tax that can be used either to pay their taxes or as a direct rebate to offset living expenses or for other needs.

Homeowners have faced similar pressure from property taxes and other housing costs, though they are generally better off than the renters targeted by this credit. Last year, the Council,

^{ee} Class two multi-family buildings, this includes co-op and condo owners, as well as renters.

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along with the Mayor, was able to secure an extension from the State Legislature of the \$400 property tax rebate for homeowners.

Approximately 1.1 million households may qualify for the renters credit and if enacted at the full level they would save \$261 million a year. The Council's plan would treat tenants more equitably with homeowners and provide tax relief to help New Yorkers with the ever-increasing pressure of rising rents.

Keeping New York affordable for working people is a top priority for the New York City Council. Acting now will allow the Council to provide aid to renters as soon as economic recovery makes it fiscally prudent to do so.

REDUCE DOUBLE TAXATION OF SMALL BUSINESS OWNERS/ ACCELERATE PHASE OUT OF INCOME PLUS COMPENSATION BASE

The Council supports passage of State legislation [S.6247-A (Padavan)/A.9482 (Farrell) of 2008] creating a tax credit for S-Corporation shareholders. Today, more than three quarters of all businesses in New York City have fewer than 20 employees. Many of the City's small businesses and independent workers are structured as S-Corporations. Currently, there are 123,000 S-Corporations in New York City. These businesses, spanning all sectors of New York City's economy, range from law to finance, and from retail to health care.

To help these small businesses grow and thrive, the Federal government offers an important tax break: an exemption from the Federal corporate income tax. All profits are passed on to the owners, who pay personal income taxes on their earnings. New York State also largely exempts these businesses from the corporate franchise tax. Yet, S-Corporation shareholders currently receive no local tax relief. Last year, we proposed a City credit based on a sliding scale that ranged from a 100 percent credit of general corporation tax (GCT) liability for City resident taxpayers with state taxable income of \$42,000 or less, and gradually phased out to zero percent for taxable income of \$250,000 or more. The credit reduces the personal income tax of New Yorkers who are shareholders in S-Corporations by \$35 million in its first full year. Last June, the Council enacted by local law a similar PIT credit for New Yorkers subject to the unincorporated business tax, lessening the double taxation of another group of small business owners. Equity considerations require a comparable treatment for S-Corporation shareholders.

This bill also would accelerate by one year the 50 percent phase-out of the alternative income-plus-compensation tax base of the City's general corporation tax recently approved by the State Legislature.

In order to prevent companies from lowering their taxable income by disguising dividends as salaries, the City's GCT uses an income-plus-compensation as an alternative tax base. Paying salaries to owners instead of dividends could lower the company's taxable income because salaries are deductible and dividends are not. The alternative tax calculation adds salaries paid to any shareholders who own more than 5 percent of the corporation's outstanding stock to net income.

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Due to changes in Federal laws and enforcement practices, the need for this alternative tax base calculation has diminished. This proposal would accelerate the 50 percent phase-out of this tax rate from four years under current law to three years, with the full 50 percent reduction occurring in 2010 instead of 2011. The most common type of taxpayer affected is a small to medium size firm. About 25,000 firms would benefit from this proposal. This will save owners of small businesses in New York City around \$35 million.

RESTORE THE NON-RESIDENT INCOME TAX (COMMUTER TAX)

The Council calls for the reinstatement of New York City's nonresident income tax. Due to the State's elimination of the City's modest "Commuter Tax" in 1999, individuals who work in the City yet live elsewhere pay no tax to the City on income they earn within its borders. This modest charge had cost the average commuter less than \$1.50 per day and amounted to 0.45 percent of wage earners' income, and 0.65 percent of the earnings of the self-employed.

The added fiscal burden caused by the repeal of the commuter tax has cost billions in cumulative revenue since its repeal. The increased revenue from the re-imposition of the commuter tax would help the City pay the cost of essential City services (police, fire, transportation and other vital services) utilized not only by City residents but also by commuters who come to the City every day.

If the commuter tax is reinstated, the City can raise an estimated \$525 million in Fiscal 2009.

APPENDIX 3. REVIEW OF ADMINISTRATION'S JANUARY PLAN

The Fiscal 2009 Preliminary Revenue Budget recognizes an additional \$1.567 billion in Fiscal 2008 resources compared to estimates made in the Adopted Budget. These resources will be used to prepay Fiscal 2009 expenses to help close the Fiscal 2009 budget gap that has grown considerably in the last six months. Of this amount, \$1.3 billion or 81 percent is attributable to special budget actions taken this year. These special actions include an additional \$500 million in tax enforcement revenue, a reduction in prior year payables totaling \$500 million, a reduction in the general reserve by \$200 million, and elimination of the \$100 million earmarked for pay-as-you-go capital spending.^{ff} The remaining \$267 million net increase in resources consists of savings from a 2.5 percent agency gap closing program of \$543 million, offset by reduced estimates of other revenue sources of \$136 million and increases in other agency spending of \$140 million.

At the time of adoption of the Fiscal 2008 budget, the projected budget gap for Fiscal 2009 was estimated at \$1.55 billion. During the first six months of the current fiscal year, the subprime mortgage crisis has extended into other areas of the financial sector leading to significant downward revisions in tax revenue starting in Fiscal 2008 and growing considerably thereafter. As a result, proposed downward revisions in tax revenue since budget adoption in June total \$1.47 billion in Fiscal 2009, \$1.24 billion in Fiscal 2010 and \$1.24 billion in Fiscal 2011. This marks a clear departure from the post 9/11 era when tax revenue revisions were consistently on the positive side.

^{ff} The Financial Plan also anticipates prepaying Fiscal 2009 TFA debt service in the amount of \$546 million.

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ELIMINATING THE FISCAL 2009 BUDGET GAP

(in millions)

FISCAL 2009 GAP TO BE CLOSED, JUNE 2007 PLAN	(\$1,550)
Additional Resources	\$3,593
Reversal of SMART Fund	\$220
Non-Tax Revenues	\$160
Debt Service Savings	\$108
Prepayments From Fiscal 2008	\$1,567
Savings in Pensions	\$153
Eliminate Pay-Go Capital	\$200
Agency PEG Program	\$885
Restructure Employee Health Insurance	\$200
State & Federal Actions	\$100
Additional Spending	(\$2,043)
Agency Expense Increases	(\$18)
Non-Property Tax Revenue	(\$1,289)
Property Tax Revenue	(\$181)
Energy Expenses	(\$78)
Collective Bargaining (UFT)	(\$438)
Employee Health Insurance	(\$39)
REMAINING GAP	\$0

Source: NYC January Financial Plan

On the expense side of the budget, estimates for collective bargaining costs, debt service, pension costs, energy costs and agency new needs as a group have increased significantly, especially in the out-years. These areas have increased modestly in Fiscal 2008 by \$140 million, and by \$88 million in Fiscal 2009 when compared to adoption. However, in Fiscal 2010, these expenses increase by \$1.1 billion. In Fiscal years 2011-12 these expenses increase by \$1.5 billion, and \$3.3 billion respectively.

The weakness in revenues and increased expenses for the current year and beyond required the Administration to: 1) eliminate the funding for the SMART program as well as eliminate the proposal to reduce the double taxation faced by S-Corporations, 2) extend the agency PEG program implemented this year to save \$885 million in Fiscal 2009, 3) propose increases in employee health contributions to save \$200 million annually, and 4) seek an additional \$100 million in federal assistance. These actions, combined with the additional resources from Fiscal 2008, bring the Fiscal 2009 budget into balance.

The above actions are insufficient to close the budget gaps starting in Fiscal 2010. At budget adoption, the Fiscal 2010 budget gap was \$3.4 billion and was anticipated to increase to \$4.4 billion by Fiscal 2012. The updated budget gaps as presented in the Preliminary Budget add approximately \$1 billion to each out-year budget gap. The Preliminary Budget provides options to address the out-year budget gaps, such as reducing expenditure growth to the rate of inflation, additional unspecified agency and programmatic reductions, debt service/asset sales, additional State and federal assistance, and reversing the 7 percent property tax rate reduction implemented in Fiscal 2008. Changes to the financial plan since adoption and the proposals to eliminate the budget gaps are presented in the following table.

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CHANGES TO THE FINANCIAL PLAN SINCE THE JUNE 2007 PLAN

In Millions	2008	2009	2010	2011	2012
Budget Gap at Adoption	\$0	(\$1,550)	(\$3,397)	(\$4,369)	(\$4,369)
Revenue Adjustments					
Tax Audits	\$500				
SMART Fund Reversal	\$50	\$220	\$260	\$275	\$275
Non Tax Revenue	\$60	\$160	\$19	\$13	\$22
Property Tax	\$15	(\$181)	(\$237)	(\$313)	\$489
Other Tax Revenue	(\$261)	(\$1,289)	(\$1,007)	(\$929)	\$317
Total Revenue Adjustments	\$364	(\$1,090)	(\$965)	(\$954)	\$1,103
Expense Adjustments					
Eliminate Pay-Go Capital	\$100	\$200	\$200	\$200	\$200
Reduce General Reserve	\$200				
Reduce Prior Year Payables	\$500				
Collective Bargaining	(\$92)	(\$438)	(\$1,075)	(\$1,610)	(\$2,264)
Pension Reestimates	(\$22)	\$153	\$12	\$210	\$413
Debt Service	\$32	\$108	\$149	\$97	(\$490)
Energy Costs	(\$27)	(\$78)	(\$152)	(\$183)	(\$187)
New Needs / Other	(\$31)	(\$57)	(\$42)	(\$30)	(\$738)
Total Expense Adjustments	\$660	(\$112)	(\$908)	(\$1,316)	(\$3,066)
Net Adjustments	\$1,024	(\$1,202)	(\$1,873)	(\$2,270)	(\$1,963)
Budget Gaps / Surplus After Adjustments	\$1,024	(\$2,752)	(\$5,270)	(\$6,639)	(\$6,332)
Gap Closing Program Fiscal 2009					
Agency Cuts	\$543	\$885	\$746	\$741	\$708
Additional Fed /State Aid		\$100	\$100	\$100	\$100
Increased Employee Health Contribution		\$200	\$200	\$200	\$200
Total Gap Closing Program for 2009	\$543	\$1,185	\$1,046	\$1,041	\$1,008
Prepayment of 2009 Expenses	(\$1,567)	\$1,567			
Remaining Budget Gaps	\$0	\$0	(\$4,224)	(\$5,598)	(\$5,324)
Gap Closing Program 2010					
Reduce Agency Growth to Inflation			\$1,000	\$1,900	\$2,100
Additional Agency Program Reductions				\$1,300	\$1,400
Debt Service / Asset Sales			\$500		
Reverse 7% Property Tax Reduction			\$1,223	\$1,298	\$1,359
Additional State and Federal Assistance			\$1,500	\$1,000	\$1,000
Total Out-Year Gap Closing Actions			\$4,223	\$5,498	\$5,859

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Although the City is on pace to record its biggest surplus to date, significant risks exist to the financial plan that may diminish this record performance. The Administration's financial plan does not include any impact resulting from implementing the Fiscal 2008-09 State Executive Budget proposed in January. The proposed state budget cuts anticipated general municipal aid in half as well as state funding for health and educational services in New York City. The Mayor's analysis of the proposed Executive State Budget identified \$750 million in net funding shortfalls through Fiscal 2009.