New York City 2005-2006 Budget Outlook

Based on the Mayor's January 27, 2005 Financial Plan

Together with discussions of:

- MTA Operating Budget and 2005-2009 Capital Program
- Fiscal Implications of the Far West Side Proposal

February 2, 2005
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In his January 27 preliminary FY 2006 Executive Budget, Mayor Bloomberg's budget story is again upbeat, but with warning signs for the out-years and the predictable slights to the City Council and municipal unions

- A surge in real estate and financial sector-related tax revenues helped create projected $1.4B surplus for FY2005 (same as last year at this time)
- Tax revenue projections for this FY have jumped by $1.5B since the budget was adopted last June, with $1B of that coming since late October.
- The new $48.3B FY 2006 budget, which had been in deficit by $3.1B, is balanced with this year's $1.4B surplus, a further $500M in agency cuts, $750M in hoped-for new federal and state aid, and $325M in reduced municipal union health and pension costs.
- The Mayor's budget cuts $200M-$300M in spending for services (for children, seniors, libraries and cultural organizations, e.g.) that the Council fought to restore last year.
- At the same time, the Mayor proposes to repeat the $250M property tax rebate for homeowners this summer.

Budgets invariably include trade-offs.
Here are some of the Mayor's trade-offs.:

Trade-off

- The Mayor (with the support of the Council) takes $46M from the FY 2006 operating budget as part of a $1B commitment over the next ten years to pay the early debt service for the Hudson Yards Investment Corporation (discussed further below), yet ...

- … despite a $600M gap in the MTA's 2006 operating budget, the Mayor is willing to hold the nominal value of the city's $250M subsidy to the MTA at about the same level it has been for a decade, meaning that the "real", inflation-adjusted value of the City's contribution has fallen by about half over the period.

Trade-off

- The Mayor says there is no money for the City to increase school spending as part of the resolution of the Campaign for Fiscal Equity law suit, and

- In his five-year capital plan submitted at the same time, the Mayor wants to delay $1.3B in school construction spending, yet …

- … the Mayor wants to let expire the 2003 increases in the NYC personal income tax, which would provide $550M-$600M a year.

Since the fiscal low-point in late 2002, when the gap for 2003-2004 was projected at $7.5B, budget balance has come through a changing variety of means

- Property taxes were increased $1.8B in December 2002.
- The personal income and sales taxes were increased by $1B for 2 years.
- The State took over the remaining MAC debt, saving $500M a year.
- Port Authority airport leases were extended and back rent of $783M paid in FY05.
- Federal government temporarily increased Federal share of medicaid, saving $342M.
- City agency revenues increased and expenses reduced, saving $3.5B.
- Other items included debt refunding, asset sales and payment by the state of $200M prior years' school aid.

The pivotal factor in closing the FY05 budget was higher-than-projected tax collections. Between June 2004, when the FY05 budget was adopted, and January 2005, the projection for FY 05 tax collections increased by $1.5B. Most of this increase came in taxes related to real estate market transactions and to business income in the finance sector.

However, like the surge in real estate transaction taxes or the temporary income tax increase, many of these factors are non-recurring. In FY 05, $3.2B in non-recurring revenues needed to close the budget gap.

NYC structural budget problems persist: moderate tax growth, agency expenditures flat, but offset by continued high growth in what Mayor calls "non-discretionary" expenses

- While increase in property values will keep property tax collections growing, the scheduled end of the personal income tax increase dampens non-property tax collections. Collections from real estate transaction taxes (mortgage recording and real property transfer) forecast to drop off sharply in FY 06.

- Underlying economic projections call for moderate U.S. and NYC growth, with NYC adding 44,000 jobs (1.2%) in 2005, and an average of 36,000 jobs (1%) annually in 2006-2008. (It could be 2009 until NYC re-gains the peak 2000-01 employment level.)

- Combined "non-discretionary" expenses (mainly pensions, fringe benefits, debt service, and medicaid) total $20.7B in FY 2006, $5B greater than agency expenses. Growth in "non-discretionary" expenses of 8.6% in FY 06, while agency expenses, with continued agency budget actions, projected to decline 1.9% in FY 06.

- FY 2006 budget balanced with FY 05 $1.4B surplus, agency cuts, $750M in anticipated state and federal actions and $325M in pension and health insurance savings. FY 2007 gap projected of $4.1B and FY 2008 gap at $3.7B.

In his budget message, Mayor Bloomberg identified three major areas of "budgetary risk"

- The resolution of the Campaign for Fiscal Equity (CFE) lawsuit could call for the City to significantly increase its education spending to make up for the failure of the State to properly fund NYC schools.

- Since the Governor's Budget failed to sufficiently fund the $27.6B 2005-2009 MTA capital plan (and the MTA operating budget faces sizable deficits), the City might have to "bail the agency out".

- According to the Mayor, "labor settlements reached through the State PERB (Public Employee Relations Board) process that are above the pattern set for our workers who bargained with the City directly, could impose billions of dollars in additional costs and result in severe reductions in uniformed personnel". The Mayor's budget only provides for increases along the lines of the settlement reached last year with DC 37 (a $1,000 payment at contract signing, 3% wage increase in 2nd year, and only an increase in the 3rd year if funded entirely from "productivity".) (The change in the Consumer Price Index averages 3% annually from 2003 to 2005.)

NYC budget priorities should include:

- Continuation of personal income tax increase for top two brackets (above $150,000 and above $500,000 for joint filers) as set by the 2003 increase (rates of 4.25% and 4.45%). (These small increases more than offset by federal income tax reductions since 2000.)
- Establish a child care credit on the NYC personal income tax so that 130,000 NYC households (in which 230,000 children live) who owe no NYS income tax will not have a net NYC tax liability.
- Restore the $200M-$300M essential funding for child care slots, senior centers, libraries, and other social and cultural programs the Mayor cut from his preliminary FY 2006 budget.
- To adequately fund NYC schools and provide for long-overdue school construction needs, the City should work out a CFE settlement even if it involves an additional investment by NYC.
- Because the safety and reliability of the transit system is too important to leave in the hands of the Governor, the City should take the lead in building support for increasing the existing dedicated transit taxes or in identifying new dedicated revenue sources to adequately fund the MTA operating budget and 2005-2009 capital program.
- Any public subsidies granted as part of the Far West Side or other mega-developments should be negotiated as part of the City budget process. The financing plan for the Hudson Yards should not include an up-front tax subsidy to commercial developments.

The debt burden crisis in the MTA operating budget and the under-funding of the five-year capital program

(for a more detailed analysis of the MTA, see FPI's "Keeping NY's Transit System Safe and On-Track for the Future: the MTA Operating and Capital Budgets", Feb. 2005)

- Even with the fare increases from 2003 and as passed by the MTA Board in December 2004 (taking effect for NYC Transit at the end of this February), the nearly $8B MTA operating budget faces deficits of $600M for 2006, rising to $1B in 2008.
- The over-reliance on borrowing to fund the last two 5-year capital programs has created a debt service bomb that is blowing up the transit operating budget. Because the State dropped any capital subsidy to the MTA and failed to dedicate sufficient revenue streams to fund MTA needs, the bill for the 61% of the 2000-2004 capital program that was borrowed is now having to be paid for (and continues over the next 25 years).
- Increased debt service largely accounts for the operating budget deficits.
- Fares already cover a higher proportion of operating expenses than in any other mass transit system in the U.S. Transit riders in NYC pay 53% of operating costs; in Chicago, 42%, in Boston, 29%, and in Los Angeles, 27%.
- MTA has proposed a $27.6B five-year capital program that includes $17.2B for core "state of good repair" and replacement needs, $9.9B for expansion projects (2nd avenue subway, East Side Access, extension of the #7 line), and $500M for security needs.

MTA budgets, continued

- The Governor's budget provided a total of $19.2B for the 5-year MTA capital program: $14.7B for the core program, $2.5B less than the MTA core plan, and less than half of the funds needed for the expansion plans. While few details of the Governor's proposals have been provided, the general outline appears to be:

- Federal funds included in the Governor's budget could be as high as $8.2B, the amount the MTA indicated would be forthcoming in its $27.6B proposal, with $4.5B for core needs, and $3.7B for expansion plans. However, federal funding for expansion plans is at risk because it is contingent on matching dollars from the MTA.
- NYC is footing the $2B bill for the #7 extension (although the City says it will not be responsible for any cost overruns).
- The Governor is proposing increases in Motor Vehicle fees and to raise the Mortgage Recording Tax to generate new revenues of about $200M-$240M annually that will most likely be dedicated to repay debt service on roughly $3B in new borrowing.
- The Governor's budget also indicated that an additional $3.3B in funding would be provided for the MTA capital program through the existing dedicated taxes (this will probably involve new borrowing).

- Under-funding the Core Plan for maintenance and normal replacement potentially jeopardizes safety, system performance and ridership. The recent Chambers Street fire underscores the need to bring the "invisible infrastructure" (signals, trace, fans, pumps, etc.) of the system up to a "state of good repair". The MTA's target dates for achieving a SOGR for its signal system has been pushed from 2012 to 2020.

MTA budgets, continued

- The MTA will give priority to critical infrastructure over rolling stock or station repair.
- East Side Access and the Second Avenue Subway are jeopardized by the Governor's budget. The MTA may transfer remaining monies for these projects that is committed but not yet spent from the 2000-2004 capital program to help fund core program needs.
- It is not clear if the Governor is proposing the issuance of additional new debt for capital purposes that would have to be borne by the operating budget, including fares.
- Even if no new burden is placed on the fare box from borrowing for the 2005-2009 capital plan, the operating budget projects large deficits stemming from the debt service on bonds issued over the past 10 years.
- Operating subsidies from the state and the local governments in the 12-county MTA district (known as 18-b aid), have not increased since the early 1990s. The State Comptroller estimates that if adjusted for inflation, state and local 18-b assistance would increase by $210M from to $590M. NYC's share would increase by $87M to $245M.
- NYC used to reimburse the MTA about $135M annually to cover a reduced fare program for school students. In 1995, NYC reduced its reimbursement by $90M to $45M.
- With MTA takeover of private bus lines, NYC will continue and increase annual subsidy (about $180M).

MTA budgets, continued

What has to happen to adequately fund the MTA 12005-2009 capital program?

- MTA Chairman Kalikow proposed in a Dec. 3 letter to Transportation Commissioner Boardman that the taxes dedicated to the MTA, with the exception of the .25% portion of the sales tax, be increased by 50% to generate about $850M annually. The dedicated state transit taxes include: corporate taxes, petroleum taxes, motor vehicle fees, real-estate related taxes, and 1/4 of a percent on the sales tax in the MTA district.

- Chairman Kalikow reiterated the rationale that supported the initial imposition of dedicated transit taxes in the early 1980s. These taxes impact two groups who derive significant benefit from an effectively functioning mass transit system: (1) the business community and property owners because mass transit provides businesses with wider access to a high quality labor pool and higher density development both raises business productivity and property values, and (2) motor vehicle users since an efficient mass transit system relieves congestion and enhances their mobility.

- Adequately funding mass transit is a good investment for New York: good for the environment, supports and expands the state's tax base, and supports upstate manufacturing jobs.

- Public spending on mass transit has by far the highest economic multiplier among all industries in NYS. A billion dollars in spending on public mass transit in NYS yields, $3.4B in total economic output, 37,500 jobs and $1.8B in employee compensation.

Mayor Bloomberg's plans to redevelop Manhattan's Far West Side have significant implications for the NYC and NYS budgets.

The 3-part plan and the price tag of each:

- **Hudson Yards Re-Zoning:** Re-zone 60 acres from 28h to 42nd Streets west of 8th Avenue for high-rise commercial and residential development, extend the #7 Subway line and other infrastructure improvements. Price tag: **$3B**
- **Javits Convention Center:** Expand the Convention Center, connect it to the stadium and construct a convention center hotel. Price tag: **$1.4B**
- **New York Sports and Convention Center:** Build the New York Sports and Convention Center (aka Jets Stadium) on a platform over the LIRR Yards, use this as the Olympic stadium if NYC is chosen as the host for the 2012 Olympics. Price tag: **$1.6B+**

Common issues with all three economic development projects:

- Significant public subsidies and implications for future development projects
- Extensive use of off-budget authorities and public development corporations
- Significant new public borrowing, $5.4B out of total combined cost of $6.0B
- Creative financing techniques that raise questions about budget accountability
- In the case of Hudson Yards and the stadium projects, an RFP process was not used to solicit alternative plans

Status of each component of the Far West Side plan:

- **Hudson Yards Re-Zoning:** On January 19, NYC City Council approved re-zoning and also passed a resolution supporting a modification in the financing plan to borrow through a newly-created Hudson Yards Investment Corporation (HYIC) the $3B for the #7 extension and the other public infrastructure investments. The new financing plan calls for $1B in appropriations out of the City's operating budget over the next 10 years to pay the interest on HYIC debt until project revenues start flowing sufficient to meet debt service obligations. An unknown element is how much the MTA will receive for the development rights over the East Rail Yards.

- **Javits Convention Center:** Legislation passed in December to allow Javits plan to proceed. $350M in the Governor's capital budget for the State's contribution. NYC will also contribute $350M (this was added to the City's capital budget and will be borrowed using G.O. bonds.) The Triborough Bridge and Tunnel Authority, which handled the financing for the construction of the original Javits Center, will borrow $500M to be repaid with a temporary $2 hotel room tax surcharge in NYC.

- **New York Sports and Convention Center:** ESDC Board scheduled to vote in February to approve a financing plan for the construction of the stadium and a platform over the West Rail Yards. Under the proposed financing plan, the City and the State would each borrow their $300M contributions to Stadium construction. A to-be-created joint State-City local development corporation would sell $400M in tax-exempt "Jets Bonds" on behalf of the Jets that are to be re-paid with payments-in-lieu-of-taxes (PILOTS) that the Jets otherwise would have paid to the city, the state or the MTA for the stadium. The stadium financing plan would have to be approved by the Public Authorities Control Board. A major unresolved issue is how much the Jets will pay the MTA for the development rights over the West Rail Yards. The lack of a competitive bidding process has complicated efforts to determine a fair value for the development rights.

From a budget perspective, a particularly troubling aspect of the Hudson Yards financing is whether massive property tax breaks will be given to commercial developers

Initially, Mayor Bloomberg had tried to maintain a fiction that the Hudson Yards project was "self-financing", i.e., that it would not come at the expense of the City budget, that the massive borrowing by the HYIC would not in any way jeopardize the City's credit standing, and that revenues generated by the project, e.g., through the sale of development bonuses and from PILOT payments received from commercial developers would be more than sufficient to repay the sizable up-front public investment. The PILOT mechanism built in substantial property tax subsidies to office building developers and promised to insulate them from property tax rate increases.

The PILOT arrangement was needed, it was argued, to provide a revenue stream negotiated by the City's economic development corporation outside of the city budget process that could be dedicated to debt repayment.

In its agreement with the Mayor to modify the financing, the City Council significantly increased the amount of affordable housing and agreed to the use of $1B from the City operating budget as a way to keep down the overall borrowing costs. The project is now clearly not "self-financing". The Council’s financing resolution did not address the issue of the PILOT mechanism or whether property tax breaks would be provided to commercial developments.

Far west side financing, continued

However, several Hudson Yards documents from the City have described the City’s intent to provide steep property tax subsidies to developers of commercial sites.   It is not clear if the subsidy component is still part of the financing plan. For a project that entails the construction of 24 million square feet of office space, building in property tax breaks from the start would permanently institutionalize property tax breaks for Manhattan commercial projects. This would likely seriously compromise the City's property tax base. Homeowners and other commercial property owners would then be forced to bear the property tax burden that will be lessened for office buildings on the West Side.

The property tax is by far the largest NYC tax and supplies nearly half of all City tax revenues.

The City would be far better off dropping the PILOT provision and instead making new office developers pay taxes on the full value of their property. The financing plan approved by the Council already permits the use of general tax revenues to pay the debt service on HYIC debt. Dropping the commercial property tax subsidies would prevent the erosion of the property tax base and could help wean Manhattan developers from an excessive reliance on public subsidies. At a minimum, the bond documents that accompany the sale of HYIC debt (which could occur as early as this spring) should not make reference to a subsidy-based PILOT mechanism for commercial properties. As the elected officials controlling the HYIC, the Mayor, the City Council Speaker and the City Comptroller should assure taxpayers now that commercial developers on the future West Side will pay their own way.

Mega-development projects raise questions regarding governance, fiscal accountability, and economic development vision that need to be addressed in this election year

In recent years, the people of NYC have been attempting to understand, react to, and shape 5 mega-projects:

- Rebuilding of Lower Manhattan
- Hudson Yards re-zoning (intensive commercial and residential development)
- NY Sports and Convention Center (aka Jets Stadium)
- Expansion of Javits Center
- Forest City Ratner's Brooklyn Atlantic Yards proposal (Arena, commercial, residential)

Much is at stake in these: housing, jobs, quality of life, sustainability, and city's fiscal capacity to fund essential services

Challenge is to shape developments in a way that broadly serves the economic and quality of life needs of NYC residents, current and future.

Do we have the right mechanisms to adequately and expeditiously evaluate these proposals given the challenges? People need to be able to raise these challenges without being cast as obstructionist.

Common problems shared by these mega-developments

- Proposals often top-down
- Objectives often distant from community needs
- Control by authorities dilutes accountability
- Public financing role poorly understood and often not accountable (use/mis-use of PILOTs for stadium, Hudson Yards, Brooklyn Atlantic Yards)
- Sizable public investments for mega-projects not balanced against other city infrastructure needs

Solutions ? Candidates for City offices this year need to pose and discuss possible solutions.