June 29, 1984

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ANNUAL BUDGET REPORT

Section 3040 of the Municipal Assistance Corporation For The City of New York Act requires that the Board of Directors of the Corporation review the City's annual budget submission in order to determine whether "income is overstated or expenditures underestimated". In accordance with the Act, we have examined the Mayor's Executive Budget for fiscal year 1985 as presented on April 26, 1984 and as subsequently modified and finally approved by The Board of Estimate and The City Council on June 5, 1984. In addition, we have reviewed the reports of the Office of the Special Deputy Comptroller and the staff analysis of the Financial Control Board.

The budget as adopted (with total revenues and expenditures projected at $18.2 billion) is indeed balanced in accordance with generally accepted accounting principles for the fifth consecutive year. As in other years, there are uncertainties in the estimates of revenues and expenditures for fiscal 1985, and we are confident that as the year progresses there will be modifications made to the adopted City budget. We also are confident that the City will assure that the modifications result in a balanced budget, or even a surplus, at the end of the fiscal year.
The Fiscal 1985 Expense Budget

The fiscal year 1985 Expense Budget adopted by the City Council and the Board of Estimate provides for revenues and expenditures of $18.2 billion, an increase of $822 million, or 4.7 percent over the expected results for fiscal year 1984. This represents an increase of $1.2 billion in estimated revenue over the level projected one year ago and has contributed significantly to the elimination of the $582 million budget gap which had been projected at that time.

In general, the revenue estimates appear to be reasonable and consistent with plausible forecasts of future economic conditions in the City and the nation. Total funds generated by the City's own revenue sources are estimated to increase by 7.3 percent in fiscal 1985, compared to an expected increase of 8.4 percent for fiscal 1984 and an actual increase of 6.3 percent in fiscal 1983. Restricted and unrestricted aid from the Federal and State governments is estimated to change little, in the aggregate, in fiscal 1985, with reductions in Federal aid offsetting increases in State aid. In contrast, total Federal and State aid is estimated to have increased by 12.7 percent in fiscal 1984, after a negligible increase in 1983.
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The City's revenues are, of course, vulnerable to unpredictable changes in Federal policy. In addition, because so much of the City's own revenue stream is sensitive to economic conditions, even modest changes in the local and national economic outlook can have significant impacts on the City's revenue collections. The fiscal year 1985 budget deals conservatively with these areas of uncertainty.

Expenditures for fiscal year 1985 are projected to be $18.2 billion which is an increase of $822 million, or 4.7% over the forecast for fiscal year 1984. In general, the projections for expenditures appear reasonable and do not tend to understate actual requirements for the fiscal year. The adopted budget provides funding for a number of significant program enhancements including the addition of approximately 2,000 police officers. Overall, the adopted budget anticipates an increase of approximately 14,000 City-funded positions from the actual April 1984 level of approximately 181,000 City-funded positions.

There is one major area of uncertainty on the expenditure side of the budget. The budget provides for a 2 percent increase in wages and fringe benefits for municipal employees. The City and the various municipal unions are now negotiating new collective bargaining contracts. The
City estimates that each additional 1 percent increase would add about $68 million to 1985 costs. Settlements at any level other than 2 percent, therefore, will require significant modifications to the 1985 budget.

**Fiscal Years 1985 - 1988**

The City's proposed Financial Plan for Fiscal Years 1985-1988 (submitted to the Financial Control Board on May 10, 1984 and subsequently withdrawn) projected anticipated budget gaps of $323 million in fiscal year 1986 and $232 million in fiscal year 1987 and an estimated surplus of $36 million in fiscal year 1988. These projections assumed a 2 percent annual increase in wages in each fiscal year. The City has estimated that each additional one percent in the wage assumptions would add $154 million in 1986, $242 million in 1987, and $332 million in 1988. Obviously, the current round of labor negotiations will have significant implications for the viability of the City's Financial Plan.

In addition, two other major factors should be noted. First, a number of the program enhancements included in the adopted 1985 Budget are financed for only a portion of the fiscal year. The annualized cost of these enhancements will further exacerbate the projected budget gaps for 1986 and beyond. Secondly, the underlying economic assumptions of the City's Financial Plan anticipate sustained economic
growth through 1985, followed by a mild recession in 1986. While these assumptions appear to be reasonable at the moment, any number of developments are possible which might require a revision of the City's economic forecast. There is the danger that spending increases stemming from this year's labor settlements and program enhancements might peak at the same time as a deeper than anticipated recession reduces projected revenues, thus generating significantly larger budget gaps than those currently estimated.

Indeed, it is entirely conceivable that as a result of labor settlements reflecting projected rates of inflation and the annualized cost of the 1985 program enhancements, the City could be confronted with budget gaps approaching $1 billion for fiscal year 1986 and beyond. Prospective budget gaps of this magnitude have been estimated in previous City Financial Plans and have been closed subsequently with the help of exogenous developments such as better than anticipated economic growth and increased State aid. However, since reliance on these factors is uncertain at best, it would appear that strenuous actions by the City may be required if market credibility is to be maintained.

Capital Budget
During the course of the past several months, the City has been engaged in a major review of its capital program. In
conjunction with the presentation of the Executive Budget for fiscal year 1985, City officials outlined a revised ten-year capital needs assessment for the period 1985-1994. This program anticipates the raising and spending of $40.6 billion of which $20.7 billion would be financed through general obligation bonds, water and sewer revenue bonds, MAC capital program support and restricted cash reserves. Within the overall context of the ten-year plan, the City also presented a four year City-funded commitment plan of $6.7 billion for 1985-1988 with City-funded capital commitments projected at the level of $1.53 billion for 1985. This represents an increase of $226 million in projected City-funded capital commitments over the level estimated for fiscal year 1984. Estimated City-funded expenditures for fiscal year 1985 are projected at $1.440 billion which represents an increase of $270 million from the revised fiscal year 1984 expenditures level of $1.170 billion. In order to insure that capital commitment and expenditure targets will be achieved in the future, a total of 346 positions were added to various agency budgets to support the expanded capital program, including 85 positions funded through the expense budget.

During fiscal year 1984, the City continued to demonstrate substantial market access. At the outset of the year, the City had intended to raise $425 million in general
June 29, 1984
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obligation bonds and $150 million in proposed water and sewer revenue bonds. While the necessary legislation to authorize water and sewer revenue bond financing remained under consideration in Albany, the City was able to more than meet its financing requirements through the issuance of $775 million of its general obligations bonds. The fiscal year 1985 Capital Finance Plan calls for the City to issue $850 million general obligation bonds and $315 million in water and sewer revenue bonds.

A principal assumption of the Ten-Year Capital Plan is that the City's access to private credit markets will continue to improve and that by 1994 the City will be able to borrow $2.5 billion annually including water and sewer revenue bonds. This represents an extraordinarily ambitious program of financing. The implications of this capital financing assumption make it imperative that prompt consideration be given to permitting the City to take advantage of a greater variety of financing tools, such as the issuance of tax-exempt commercial paper and increased use of term bond financing.

Even more fundamental, however, to the successful implementation of the City's capital program is the need for the City to continue to achieve predictable and recurring budget balance. With the expiration of the Corporation's
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new money borrowing authority on December 31, 1984, the City will be on its own for the first time since 1975 in securing its capital funds. Clearly, the prospect of budget gaps for fiscal year 1986 and beyond has implications for the City's financing efforts. Accordingly, the City needs to maintain the policies and practices that have produced balanced budgets in each fiscal year from 1981 to the present.
Enclosed is still another draft of the Annual Budget Report. The principal change is the paragraph on page 5 concerning the prospect of $1 billion budget gaps in FY 1986 and beyond. In addition, I have enclosed a draft Report of the Office of the Special Deputy Comptroller. You will note that they are forecasting a prospective budget gap of $721 million in FY 1986 assuming labor settlements at forecasted rates of inflation. They arrive at this conclusion because they are estimating $171 million of increased net revenue over the City's current projections. It is my understanding that this Report will be made public a day or two before our meeting on June 26th.

TDS/dnd
Enclosures
15 June 1984

To: City Budget and Finance Committees

From: Dennis Sullivan

Re: Annual Budget Report

Enclosed is a second draft of the Annual Budget Report. You will note that the basic numbers have changed somewhat. The fiscal year 1985 Budget was finally adopted at a $18.219 billion level for revenue and expenditures, slightly lower than the May's submission of $18.252 billion. The approximately $150 million of increases which were added by the City Council and the Board of Estimate are being financed largely through the recognition of a greater surplus in fiscal year 1984 than had been anticipated previously. As a result, subsidy payments originally scheduled to be paid in FY 1985 will be paid in FY 1984 allowing room for the additional spending.

In addition, since many of the program enhancements have been financed for only a portion of fiscal year 1984, the City has increased its estimates of budget gaps for fiscal years 1986-1988:

<table>
<thead>
<tr>
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<th>May Estimate</th>
<th>June Estimate</th>
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<tr>
<td>1986</td>
<td>$(323)</td>
<td>$(392)</td>
</tr>
<tr>
<td>1987</td>
<td>(232)</td>
<td>(365)</td>
</tr>
<tr>
<td>1988</td>
<td>36</td>
<td>(88)</td>
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</tbody>
</table>

The text remains relatively unchanged although new paragraphs have been added on pages 5 and 7 concerning the deficit outlook for FY 1986-1988 and the implications of these prospective budget gaps for the City's capital program. I would appreciate receiving your comments on this draft.

TDS:dn
Enclosure
12 June 1984

To: City Budget Committee

From: T. Dennis Sullivan

Re: Enclosed is a preliminary draft of the Corporation's Annual Budget Report. I would appreciate greatly your reactions and comments as quickly as possible. In addition, I have enclosed two tables which chart recent revenue and expenditure trends. You will note that these tables for FY 1985 show revenues and expenditures of $18.252 billion, which is the level proposed initially by the Mayor. The adopted budget provides for revenues and expenditures of $18.4 billion. These tables will be updated as soon as more detailed information becomes available.

TDS:dnd
Enclosures
ANNUAL BUDGET REPORT

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The budget as adopted (with total revenues and expenditures projected at $18.4 billion) is indeed balanced in accordance with generally accepted accounting principles for the fifth consecutive year. As in other years, there are uncertainties in the estimates of revenues and expenditures for fiscal 1985, and we are confident that as the year progresses there will be modifications made to the adopted City budget. We also are confident that the City will assure that the modifications result in a balanced budget, or even a surplus, at the end of fiscal year.
The Fiscal 1985 Expense Budget

The fiscal year 1985 Expense Budget adopted by the City Council and the Board of Estimate provides for revenues and expenditures of $18.4 billion, an increase of $1.1 billion, or 6.4 percent over the expected results for fiscal year 1984. This represents an increase of $1.4 billion in estimated revenue over the level projected one year ago and has contributed significantly to the elimination of the $582 million budget gap which had been projected at that time.

In general, the revenue estimates appear to be reasonable and consistent with plausible forecasts of future economic conditions in the City and the nation. Total funds generated by the City's own revenue sources are estimated to increase by 8.8 percent in fiscal 1985, compared to an expected increase of 7.2 percent for fiscal 1984 and an actual increase of 6.3 percent in fiscal 1983. Restricted and unrestricted aid from the Federal and State governments is estimated to change little, in the aggregate, in fiscal 1985, with reductions in Federal aid offsetting increases in State aid. In contrast, total Federal and State aid is estimated to have increased by 12.6 percent in fiscal 1984, after a negligible increase in 1983.
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While this assumption appears to be reasonable at the moment, any number of developments are possible which might require a revision to the City's economic forecast. There is the danger that spending increases stemming from this year's labor settlements and program enhancements might peak at the same time as a deeper than anticipated recession reduces projected revenues thus generating significantly larger budget gaps than those currently forecasted.

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funded expenditures for fiscal year 1985 are projected at $1.440 billion which represents an increase of $280 million from the revised fiscal year 1984 expenditures level of $1.160 billion. In order to insure that capital commitment and expenditure targets will be achieved in the future, a total of 346 positions were added to various agency budgets to support the expanded capital program, including 85 positions funded through the expense budget.

During fiscal year 1984, the City continued to demonstrate substantial market access. At the outset of the year, the City had intended to raise $425 million in general obligation bonds and $150 million in proposed water and sewer revenue bonds. While the necessary legislation to authorize water and sewer revenue bond financing remains under consideration in Albany, the City was able to more than meet its financing requirements through the issuance of $775 million of its general obligations bonds. The fiscal year 1985 Capital Finance Plan calls for the City to issue $850 million general obligation bonds and $315 million in water and sewer revenue bonds.

A principal assumption of the Ten-Year Capital Plan is that the City's access to private credit markets will continue to improve and that by 1994 the City will be able to borrow $2.5 billion annually including water and sewer revenue
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## TABLE 1

<table>
<thead>
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<tr>
<td>General Property Taxes</td>
<td>$3,787</td>
<td>5.1%</td>
<td>$3,969</td>
<td>4.8%</td>
<td>$4,197</td>
<td>5.7%</td>
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<td>Sales Tax</td>
<td>1,515</td>
<td>7.1%</td>
<td>1,675</td>
<td>10.6%</td>
<td>1,806</td>
<td>7.8%</td>
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<td>Personal Income Tax</td>
<td>1,331</td>
<td>14.8%</td>
<td>1,511</td>
<td>13.5%</td>
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<td>6.1%</td>
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<td>General Corp. Tax</td>
<td>767</td>
<td>9.9%</td>
<td>830</td>
<td>8.2%</td>
<td>926</td>
<td>11.6%</td>
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<tr>
<td>Commercial Rent Tax</td>
<td>334</td>
<td>19.4%</td>
<td>387</td>
<td>15.9%</td>
<td>440</td>
<td>13.7%</td>
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<tr>
<td>Financial Corp. Tax</td>
<td>107</td>
<td>(47.8)%</td>
<td>166</td>
<td>55.1%</td>
<td>190</td>
<td>14.5%</td>
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<tr>
<td>Utility Tax</td>
<td>202</td>
<td>16.1%</td>
<td>200</td>
<td>(1.0)%</td>
<td>209</td>
<td>4.5%</td>
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<tr>
<td>All Other Taxes</td>
<td>714</td>
<td>(1.5)%</td>
<td>741</td>
<td>3.8%</td>
<td>749</td>
<td>1.1%</td>
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<td>Miscellaneous Revenues</td>
<td>1,516</td>
<td>7.1%</td>
<td>1,533</td>
<td>1.1%</td>
<td>1,612</td>
<td>5.2%</td>
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<td>Anticipated City Programs</td>
<td>0</td>
<td>-</td>
<td>0</td>
<td>-</td>
<td>228</td>
<td>*</td>
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<tr>
<td>Inter-Fund Revenues</td>
<td>81</td>
<td>8.0%</td>
<td>94</td>
<td>16.0%</td>
<td>107</td>
<td>13.8%</td>
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<tr>
<td>Less: Intra-City Revenues</td>
<td>(329)</td>
<td>3.1%</td>
<td>(356)</td>
<td>8.2%</td>
<td>(367)</td>
<td>3.1%</td>
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<tr>
<td>Total City Funds</td>
<td>10,025</td>
<td>6.3%</td>
<td>10,750</td>
<td>7.2%</td>
<td>11,700</td>
<td>8.8%</td>
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<td>Unrestricted Intergovernmental Aid</td>
<td>928</td>
<td>15.4%</td>
<td>993</td>
<td>7.0%</td>
<td>845</td>
<td>(14.9)%</td>
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<td>Federal Categorical Grants</td>
<td>2,201</td>
<td>(3.5)%</td>
<td>2,465</td>
<td>12.0%</td>
<td>2,351</td>
<td>(4.6)%</td>
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<td>State Categorical Grants</td>
<td>2,685</td>
<td>(0.6)%</td>
<td>3,077</td>
<td>14.6%</td>
<td>3,371</td>
<td>9.6%</td>
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<tr>
<td>Less: Disallowances</td>
<td>(25)</td>
<td>-</td>
<td>(15)</td>
<td>(40.0)%</td>
<td>(15)</td>
<td>-</td>
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<tr>
<td>Total Intergovernmental</td>
<td>5,789</td>
<td>0.5%</td>
<td>6,520</td>
<td>12.6%</td>
<td>6,552</td>
<td>0.5%</td>
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</tbody>
</table>

**Total Revenues**  
$15,814  
4.1%  
$17,270  
9.2%  
$18,252  
5.7%

*% is meaningless as increase over previous fiscal year far exceeds 100%.*
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<td>Personal Service</td>
<td>$ 7,746</td>
<td>8.8%</td>
<td>$ 8,583</td>
<td>10.8%</td>
<td>$ 9,134</td>
<td>6.4%</td>
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<td>Other Than Personal Service</td>
<td>6,601</td>
<td>2.0</td>
<td>7,176</td>
<td>8.7</td>
<td>7,684</td>
<td>7.1</td>
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<td>1,329</td>
<td>(10.7)</td>
<td>1,262</td>
<td>(5.0)</td>
<td>1,306</td>
<td>3.5</td>
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<td>MAC Funding</td>
<td>433</td>
<td>10.5</td>
<td>565</td>
<td>30.5</td>
<td>335</td>
<td>(40.7)</td>
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<tr>
<td>General Reserve</td>
<td>—</td>
<td>—</td>
<td>40</td>
<td>*</td>
<td>160</td>
<td>*</td>
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<tr>
<td>Subtotal</td>
<td>16,109</td>
<td>4.1</td>
<td>17,626</td>
<td>9.4</td>
<td>18,619</td>
<td>5.6</td>
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<tr>
<td>Less: Intra-City Expenditures</td>
<td>(329)</td>
<td>3.1</td>
<td>(356)</td>
<td>8.2</td>
<td>(367)</td>
<td>3.1</td>
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<tr>
<td>Total Expenditures</td>
<td>$ 15,780</td>
<td>4.2</td>
<td>$ 17,270</td>
<td>9.4</td>
<td>$18,252</td>
<td>5.7</td>
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</tbody>
</table>

* % is meaningless as increase over previous fiscal year far exceeds 100%
June 7, 1983

Honorable Mario M. Cuomo
Governor
State of New York
Two World Trade Center - 55th floor
New York, New York 10047

Dear Governor Cuomo,

The Board of Directors and the Staff of the Municipal Assistance Corporation are pleased to submit its review of the City of New York's fiscal 1984 budget.

This review highlights the significant improvements in the City's fiscal situation. Particularly noteworthy has been the commitment by the State, which provided key budgetary actions necessary to balancing the City budget.

We believe that the City's present situation is indicative of the considerable efforts by City and State officials since the time of the crisis. The forecasted surplus is a tribute to the economic possibilities of the metropolitan region and to the managerial policies of the City. The uncertainties that exist are manageable, and can be incorporated in this and future budgets.

The City has made significant progress this year towards its goal of re-entering the public debt markets on a regular basis with approximately $450 million in bond sales in the first six months of the 1983 calendar year. Much work remains, however, if the City is to totally assume the responsibility for its capital financing by January 1985.

We believe the worst is over, but meeting the challenge of returning to financial independence requires a continuation of the same level of commitment and responsibility that the City has exhibited to date.

Respectfully submitted,

[Signature]

Felix C. Rohatyn
Chairman
ANNUAL BUDGET REPORT

As required by Section 3040 of the Municipal Assistance Corporation For The City of New York Act, the Corporation has reviewed the City's budget submission for the 1983 fiscal year. In accordance with the Act, we present our initial findings and determinations. This report reviews the Mayor's Executive Budget for fiscal year 1984 based on our own studies, the reports of the Office of the Special Deputy Comptroller and the staff analysis of the Financial Control Board. The budget as submitted reflects revenues and expenditures of $16.736 billion and is balanced in accordance with generally accepted accounting principles for the fourth consecutive year.

Moreover, there will be a substantial surplus in the fiscal year now ending, the third consecutive surplus. These are substantial achievements, at a time when city and state governments across the nation are grappling with deficits. In the mid 1970s, the City of New York was conspicuous for its fiscal weakness and deficient financial practices. In 1983, the City is conspicuous for its fiscal soundness.

The Budget Process

The fiscal 1984 budget was expected to require significant retrenchment. The City approached that prospect properly. Contingencies and options were clearly presented early in the year and periodically revised in light of current economic data which, for a period of time, were quite ominous. The regulatory reforms adopted during the fiscal crisis required officials to present plans which focused public debate on important budgetary issues. This forward planning process, which did not exist in the years prior to 1975, has proven to be of great benefit to the City.

The improvement in the managerial process of the City is an important factor in the projected surplus for fiscal 1983. The actions taken in January of 1983 represented responsible responses to a perceived problem, which in hindsight was not nearly severe as originally anticipated. In fact, most of the City's original revenue estimates proved to be on target; mid-year adjustments have proved to be too pessimistic.

The State budget process this year was markedly improved, as compared with the recent past. We welcome the State's return to an orderly and predictable budget preparation and adoption cycle. We also welcome increased State funding of
the Medicaid program, a measure we have advocated repeatedly as another positive step along the road to a more equitable sharing of the cost of government in New York.

The Fiscal 1984 Budget

The fiscal 1984 budget approved by City Council and the Board of Estimate appears to be in balance. Both revenues and expenditures have been conservatively estimated. Subject to the uncertainties noted below, we believe that the City will end fiscal 1984 with a surplus that exceeds the $100 million statutory requirement.

Nonetheless, there are a number of uncertainties and unresolved budgetary problems for fiscal 1984 and, even more, for the years beyond 1984. One of these is the future of the State's Medicaid funding program; the issue was resolved only for the 1984 fiscal year.

The City's fiscal 1984 budget is predicated on certain State actions that have not yet occurred. One is proposed State aid for "human service overburden." The City has included $120 million in its fiscal 1984 budget and $240 million in its fiscal 1985 budget which has not been appropriated by the Legislature. The City should secure stronger commitments from both the Executive and Legislative branches in Albany before including this proposed State aid in the budget.

The City has requested that the State legislature enact in additional taxes to yield an estimated $40 million to the City in fiscal 1984. The City has also requested the State to provide relief in the form of a reduction or exclusion from various state mandates. The Legislature does not appear likely to take these actions at this time.

Another area of uncertainty is savings attributable to productivity gains. Although productivity gains were included as part of the collective bargaining agreement and the City included $50 million in productivity savings as part of the fiscal 1984 budget, subsequent conversations with the unions and the City have revealed profound disagreements as to how the productivity gains should be achieved, if at all. We believe that a substantial commitment from both management and labor will be necessary to generate both present and future productivity increases. Any fiscal 1984 budget savings due to productivity improvements remain questionable at best.
As always, economic prospects are another area of uncertainty. From the beginning of the recovery in the New York economy in 1977 until last year, economic conditions, including high rates of inflation, were major contributors to the fiscal recovery. The City's taxes on sales, income and gross receipts all rose rapidly. But in fiscal 1983 the inflation rate subsided and is expected to stay low in the near-term future; the recession reached New York, with total employment declining during fiscal 1983 and an actual decline in retail sales (as measured by sales tax collections) for a period during the year. The national economy may be turning around, with positive effects on New York; indeed, City corporation tax receipts have grown sharply in the past few months. But we cannot count on economic recovery and the City revenue system is very sensitive to changing economic conditions. The next few years are unlikely to see a repetition of the 1977-82 experience of uninterrupted rapid growth in revenues.

The classic budgetary problem continues: how to maintain and enhance services while not damaging the local economy, if economic recovery does not provide the funds to do so. It is apparent that the Legislature is reluctant to raise tax rates at the State level to provide the City and other localities with more resources; there are serious questions about the wisdom of more rounds of tax increases at the City level.

On the expenditure side, the 1985 labor settlement is a major area of uncertainty. The fiscal 1984 budget includes provisions for rolling over any fiscal 1984 surplus into fiscal 1985 to help fund the 1985 labor settlement. If the present collective bargaining process does not produce stability with reasonable protection both to the City and its work force, a different process must be considered. We suggest the institutionalization of one-year contracts without a COLA provision, but incorporating a procedure for annual retrospective adjustments or bonuses based on actual economic performance.

In recent years, such a "floating rate" concept -- tying costs to relevant economic indicators -- has become commonplace in many types of financial transactions. The benefit of this approach is that all parties share the risk of uncertainty of events and actions beyond their control; both unjust enrichment and unnecessary pain are avoided. The same principles can and should apply to labor negotiations.
Capital Budget

For the first time in recent memory, it appears as if the City will achieve almost all of its capital spending projections. The Office of the Special Deputy Comptroller indicates that the projected City commitments will be reached. Non-City commitments, particularly the Transit Authority, are expected to miss the original commitment level by some $14 million.

Now that capital spending has finally reached the billion dollar level, the recommendations put forth in the Corporation's budget report of last year are all the more pertinent. The City must develop a much more refined method of establishing and implementing capital project priorities, both within departments and City-wide. Without a systematic evaluation of capital projects, it cannot be determined whether the City is spending its capital funds efficiently.

There is evidence that the City has recognized that reform of the administrative procedures governing construction is essential to a successful capital program. This year, the City re-established the Office of the Director of Construction to administer projects. However, much improvement remains to be achieved in the area of projection and timing of capital commitments. The City has failed to meet its own timetable for both commitments and expenditures of capital funds. As a result, the City has repeatedly delayed the private sales of its bonds to the Corporation.

The City projects capital spending to average $1.5 Billion per annum over the next four years. All but $500 million per year must be raised by borrowing in the market for long-term capital. In fiscal 1983, the Corporation and the City combined to raise more than one billion dollars in that market. However, after December 31, 1984, the Corporation will be authorized to sell bonds and notes only for the refunding of outstanding debt. The City must then be self-sufficient in the debt market.

In recent months, the City has made considerable progress in that direction, with the sale of $100 million in bonds in a competitive basis in May and total issues of $452 million in less than six months. However, there have been too few sales to demonstrate conclusively that the City can borrow when it needs to, in both weak and strong markets, and raise the entire amounts needed to finance the target levels of capital spending.
Therefore, alternative methods of funding the capital program should be considered, and considered with some urgency, rather than as low-priority issues. One alternative is partial "pay as you go" financing. The creation of a Water and Sewer Authority to issue revenue bonds for those purposes has been under consideration for some time; the issue should be resolved expeditiously.

One prerequisite to financing self-sufficiency is an investment grade credit rating from both rating services. To achieve this, the City must be prepared to exhibit the same planning techniques and disciplines on the capital budget as it has shown on the expense budget. We are confident that the City will continue to show improvement in its fiscal affairs and that this improvement will be recognized by the rating agencies.
MUNICIPAL ASSISTANCE CORPORATION FOR THE CITY OF NEW YORK

ANNUAL BUDGET REPORT

June 23, 1982
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As required by Section 3040 of the Municipal Assistance Corporation For The City of New York Act, the Corporation has reviewed the City's budget submission for the 1983 fiscal year. In accordance with the Act, we present our initial findings and determinations. Our report reviews the Mayor's Executive Budget for fiscal year 1983 based on our own studies, the reports of the Office of the Special Deputy Comptroller ("OSDC") and the staff analysis of the Financial Control Board ("FCB"). The budget as submitted reflects revenues and expenditures of $15.541 billion and is balanced in accordance with generally accepted accounting principles ("GAAP") for the third consecutive year.

THE BUDGET PROCESS

For the second year in a row (and the third in the last four years), the deadline for the Corporation's statutory report on the City's expense budget will expire before the process leading to an adopted budget and approved Four Year Plan is complete. The uncertainties surrounding the budget and Financial Plan are of particular concern this year because, after seven years of solid accomplishments and significant progress toward recurring budget balance, New York City now faces the most difficult budgetary test since 1975.

In his report dated June 15, 1982, the Special Deputy Comptroller has pointed to a remaining gap totalling $21 to $312 million for the 1983 fiscal year. Included in this estimate of the gap is the possible cost of a labor settlement, not yet concluded, at roughly $55 million per percentage point above the three percent settlement provided in the Mayor's Executive Budget. Contributing to the $21-$312 million estimated gap, OSDC believes that up to $124 million in projected City revenues are at risk. The City's planned expenditure level could be undercut even further during the year by uncertainties which might add to the gap: principally, the possibility of further Federal budget cuts, currently estimated by OSDC at $75 million, and possible shortfalls in State aid, worth up to an additional $193 million.
The budgetary process is made more difficult this year by actions and inaction at the Federal and State levels. Federal budget cuts in social programs have already reduced the resources available to both the State and City budgets and, equally important, the disposable income of the segment of our citizens least able to afford it. The delay in closure over this year's Federal budget raises the level of uncertainty with prospects of additional cuts.

The City is now jeopardized by the lack of an orderly and timely budget process in that it depends upon the Federal and State levels of government and is still in the initial phase of establishing the year-in and year-out fiscal credibility required to sustain and expand its access to the long-term capital markets.

The 1975 crisis taught two important lessons: First, that access to the public credit markets is linked to a predictably recurring balanced budget and, second, that the City and State are interdependent. It is the interdependency of the City and State which makes the issues faced in Albany relevant to the Corporation's examination of the City's 1983 fiscal year budget.

The central debate is over the extent to which the State's revenues will continue to grow at previous rates. The Legislature has enacted a series of programs, some for this fiscal year and others which will cost substantially more in the subsequent fiscal year, without adding new revenue streams to support these programs, thereby creating a new and much higher spending base for the State. One of these major programs, designed to provide relief from Medicaid cost increases for local governments around the State, including New York City, has been adopted but not funded in the State's current fiscal year. Rather, it is proposed to be funded sometime during the first quarter (April-June 1983) of the next (1983-84) State fiscal year, permitting those funds to flow into the City's fiscal 1983 budget.

It is the overlapping calendars of the State and City fiscal years which allow actions pertinent to a future State budget to fund the City's budget at hand. This use of the "Magic Window," which provides the promise but not the presence of State dollars, complicates our ability to judge the City's true fiscal position for 1983.
Beyond this manipulation of the funding cycle, the fundamental disagreement voiced by the Governor relates to the true condition of the State's finances. The Governor's position is that the programs enacted through the legislative process will produce a deficit this year, followed by a far larger deficit next year. If the Governor is correct, substantial new levels of taxation will be required next year to sustain the presently enacted programs, together with their built-in growth. This would reverse the seven year policy of reducing State personal income and certain business taxes. The alternative is to cut back expenditures, thereby jeopardizing the budgets of the City and of other localities throughout the State.

Resolution of these and related issues cannot be deferred too long. The sooner they are resolved, the better for all concerned: not only for the City's 1983 fiscal year expense budget, but also for the perceived creditworthiness of New York City and every tax-exempt borrower in the State, including the Municipal Assistance Corporation For The City of New York.

THE CITY'S 1983 EXPENSE BUDGET

City officials are committed to a GAAP-balanced budget, and we believe they will take such actions as are required to achieve that end. The FCB is in the process of reviewing the City's Plan submission and is expected to take action on June 29. Recent State actions, including the Legislature's approval of authority to enact $171 million in local taxes, promise revenues approximating those required to support the Executive Budget as proposed by the Mayor in May, assuming a 3 percent labor settlement.

As was pointed out in the OSDC report, there remains a series of uncertainties underlying the City's 1983 budget. It seems likely that the outstanding gap will be in a range which can be closed by the methods of expenditure control successfully employed by the City in recent years, that is, without resort to drastic cutbacks. There is no guarantee, however, that such controls will permit sustaining or improving the current level of services as planned. Nor will the accommodations yielding a balanced budget for fiscal 1983 represent any structural progress toward recurring budget balance. At best, as with the State
budget, many of the important issues will have been deferred until further events unfold.

In an environment made uncertain not only by the decisions of higher levels of government but also by the fragile state of the national as well as local economies, many actions affecting the budget are beyond the City's control. It is imperative that the City grasp the one variable which is clearly within its purview—the cost of labor.

Total revenue growth for fiscal 1983 is projected to be a mere 3.5 percent: one-half the growth experienced in fiscal 1981 and less than one-third the growth during 1979. The rate of increase in the cost of living has also slowed substantially. While the CPI increased for the region last month, the cost of living actually decreased by 1.1 percent between September 1981 and March 1982.

In the face of these budgetary and economic uncertainties, the labor settlement should be negotiated in a manner which takes into account actual changes in the cost of living and the final determination must take into account the City's ability to pay. Use of these criteria suggests that increases provided in the wage settlement should not be fixed for the entire length of the contract. Rather, the contract should provide a mechanism for periodically looking back at actual revenue growth and changes in the cost of living as a way of determining changes in compensation. The parties should agree to the development of a procedure which provides for the means of adjustment during the life of the contract.

The Corporation also supports the City's effort to continue the current Tier Three pension system. The establishment of Tier Three was a fundamental pension reform negotiated at the height of the fiscal crisis, and we believe the legislature should resist union efforts to undo this agreement.

CAPITAL NEEDS VERSUS MARKET ACCESS

The same external circumstances which call for continued austerity and caution with respect to the City expense budget demand more rigorous scrutiny of the City's capital spending priorities. Despite efforts in that direction, the City has yet to develop a comprehensive infrastructure
maintenance and rehabilitation program capable of identifying and accomplishing the highest priority capital projects, of spending available capital funds on such projects at projected rates, and of insuring construction is accomplished at the lowest unit cost.

It is perhaps understandable that, beginning earnestly in 1978, the City's initial efforts to re-start its capital program should have focused on the priority of gearing up the spending process using plans in hand. Indeed, the Corporation remains concerned that City capital spending and commitment rates, despite a large surge this month, will again become "stuck" at a plateau which falls short of the targets against which the Corporation and City jointly formulate the Four-Year Debt Issuance Plan.

The Corporation currently holds in escrow $812 million and is scheduled to borrow $1.25 billion more by December 31, 1984, when our statutory authority to issue new debt for the City's capital program expires. In this relatively short period, the so desperately needed renewal of the infrastructure is constrained by the City's capability to spend and not by the access of the Corporation or the City to capital.

To end there, however, is to take a fatally short-sighted view. Beginning January 1, 1985, the Municipal Assistance Corporation For The City of New York will be authorized to sell bonds and notes only for refunding outstanding debt. Otherwise, our task will be limited to payment of our bonds through 2008. The City will stand alone for raising capital under current plans at an average rate of $1.7 billion per year. Few are prepared to argue that even this projected capital spending level is "adequate" when compared with the true needs of the City's antiquated infrastructure.

The issue is two-fold: first, whether the City is putting its capital resources to the best possible use and, second, whether the City is prepared to make the kinds of difficult choices required if and when market access proves to fall short of current plans. As indicated in the attached memorandum from the Chairman of the Corporation's City Budget Committee, Dick Netzer, there are several areas in which we believe the City should assume a more aggressive posture: among them, in the establishment of capital priorities, the management of project costs, and wider
consideration of alternatives to borrowing for capital spending.

The Corporation and the City—whether separately or together—have yet to raise so much as $1 billion in long-term capital in the public markets since 1975. Moreover, we sell bonds today, in modern history's most adverse capital markets, at almost twice the cost per dollar borrowed, that the Corporation did in the depths of the crisis.

When tax-exempt rates were seven percent and we borrowed $1 billion, we paid back $1 billion in principal plus $1 billion in interest over the fifteen-year average life of the bonds. At tax-exempt rates approaching fourteen percent for the same bonds, we pay back $1 billion in principal plus $2 billion in interest. Notwithstanding legitimate arguments concerning the City's projected level debt service for this decade and the capacity of the real property base to sustain the level of debt service indicated, there is a point beyond which debt service at 14 cents or more per dollar borrowed is no longer affordable and "pay as you go" is the only alternative.

The City's accomplishments to date in reentering the public markets on its own account are impressive and heartening. Barring utter collapse of the markets, further significant progress will doubtless be made each year. But nothing in the immediate prospects for the national economy or the bond market, in the uncertainties underlying the City budget or the State's, suggests that the City can afford to be less hard-headed about its rock bottom capital priorities and standards of productivity than it has been forced to be on the expense budget since 1975.

Attachment: Memorandum from Dick Netzer to the Board of Directors (June 18, 1982).
18 June 1982

Board of Directors

Dick Netzer, Chairman, City Budget Committee

Reflections on the Problem of Financing the City's Capital Program

Intermediate and long-term economic and financial forecasts tend to be as highly colored by the short-term outlook as are short-term forecasts. That is, even the longer-term outlook, at any given moment, is heavily affected by the prevailing tenor of pessimism or optimism. This being a time of fairly deep pessimism, it may be that all of us are unduly gloomy about the ability to finance the capital program needed over the next decade to preserve and restore New York City's public infrastructure and other basic components of the public stock.

It would take a remarkable act of imagination, however, to contemplate seriously a scenario in which the local and national economies are in such good shape and the markets for long-term debt securities in general and tax-exempt bonds in particular are so buoyant that the financing of the City's capital program poses only technical, not substantive, problems. The more likely scenario is one in which economic and financial conditions external to the City government itself severely constrain the financing of the capital program.

The Office of Management and Budget's ten-year capital program, for the fiscal years 1983-1992, contained in the Mayor's 1983 Executive Budget contemplates capital expenditures averaging almost $3.5 billion annually, of which $1.7 billion is to come from City (including MAC) sources. Even this huge program is considered inadequate by some observers. For example, David Grossman (in a draft chapter for Setting Municipal Priorities 1983) concludes that the $750 million or so in City funds programmed for infrastructure (narrowly defined to include only water, sewer, roads and bridges) may be no more than is sufficient to match the current rate of deterioration, with an additional 50 percent required to make much of a dent in the huge backlog created by past undermaintenance. Grossman suggests that an overall $6 billion annual rate of capital spending could be justified easily. But, of course, there is nothing like an assured capacity to finance the much smaller program planned.

Are there ways to mitigate the probable severity of the financing problem? At least two come to mind.

First, there is serious question as to whether the City's capital program has been subjected to the kind of painful paring the operating expense budget has been subjected to
since mid-1975. The monitors quite correctly assert, at frequent intervals, that there are numerous opportunities for further economies and better management in the everyday operations of City government. But the fact is that there have been enormous economies in the operating expense budget, effected by lay-offs, attrition, declines in compensation in real terms and reductions in "expenditures for other than personal services." In some areas, services have been fairly well maintained in the face of expenditure restraint by dint of better management practices, resulting in lower unit costs in real terms. In other areas, services have been reduced but selectively—in other words, priorities were changed and services deemed "essential" before July 1975 became no longer essential. In still others, services were reduced more or less across-the-board.

In contrast, the capital program has gone through much more limited scrutiny. Capital spending was turned off almost completely, and pretty indiscriminately. The spigot was turned on again in 1978: rather abruptly, long lists of capital spending projects were at hand and included in the ten-year capital program.

Many of the departmental lists of capital projects that suddenly surfaced in 1978 were rather similar to the departmental lists that had evolved during the 1960s and early 1970s (and, in some cases, very likely had elements dating back before World War II) but were put into the file drawers in 1974, 1975 and 1976. Now, most of those old lists of capital projects did not reflect anything like a careful ordering of priorities, but instead a blend of narrow-gauge planning by old hands in the departments, passing fancies and fads of commissioners and community groups, and changing short-term policies of successive mayors. In some cases, there is considerable question about even the narrow technical competence underlying the old lists: it's hard not to question the capital program of a department that (a) has no inventory of the infrastructure for which it is supposedly responsible and (b) has a history of being unable to program everyday repairs in any rational manner.

So, it is most unlikely that the ten-year capital program is an up-to-date list of projects ranked by priority, with one department's list dovetailed with that of others, for example, in connection with work in the same streets. The operating expense budget has been subjected to a triage-type of scrutiny, imperfect and rough and ready though it may
have been. Surely, such a scrutiny is appropriate for the capital program; surely, it will result in a significant scaling-down of the lists.

Moreover, there is little evidence that there has been much attention paid to the unit costs of the projects on these lists, comparable to the management improvement efforts on the operating expense side. To be sure, the City lets contracts for construction work and the unit costs are set by the low bidders. But the bids are very much influenced by the conditions set by the City—the specifications for the projects (and in the good old days of ample capital budget funds, there was no great incentive to minimize capital costs by careful setting of realistic specifications), the required scheduling of the work (e.g., doing the work at off-hours) and similar conditions. In addition, the City must become an aggressive fighter against the bid-rigging, collusion and pay-offs that are said to be worse in the construction industry in New York than elsewhere. Here, too, it is likely that hard-boiled management can scale down the costs of the capital program significantly.

It would also be wise for the City to expand its consideration of alternatives to issuance of general obligation debt to support the capital programs. The City hopes to obtain—through the creation of a new State authority or otherwise—the capacity to issue revenue bonds for water and sewer commitments, supported by dedicated revenues. The expansion of the City's flexibility to do so in this area makes sense.

In addition, a second approach to mitigation of the financing problem could lie in greater reliance on current revenue, i.e. "pay as you go" financing of capital outlays, particularly in connection with activities amenable to user-charge support. If the City is going to be spending approximately $250 million a year for the next two decades on water and sewer lines, consideration should be given to funding all or a portion of this program directly through increased sewer and water charges.

By eliminating or reducing the need of a new water and sewer authority to issue $280 million of revenue bonds annually, other city needs might be more easily financed. The City could increase the water and sewer charges (FY 1982 revenues were about $270 million, so doubling them would produce roughly $250 million more annually) and appropriate that
18 June 1982
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additional revenue to the water and sewer capital program as an expense item.

Either approach—water and sewer revenue bonding or "pay as you go"—will result in higher water and sewer charges in the early years of the program. In the case of "pay as you go," however, overall project costs would be reduced. Moreover, increases in user charges which are unmistakably dedicated to capital improvements that directly benefit users are extremely unlikely to have the kind of negative impact on the local economy that increases in general taxes have.

If the external economic and financial conditions are indeed dreadful, then these approaches will be far from adequate to solve the financing problem. Even so, they will help. And if the external conditions are only moderately bad, these approaches may make it possible, by reducing significantly the amount of debt financing required each year, to create a reasonable adequate long-term City capital program.

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18 June 1982

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Rotten at the Core?
Surface Polish Hides the Big Apple's Deep-Rooted Ills

By MICHAEL BRODY

On one side of Manhattan, the West Side Highway is in ruins. On the other, sections of the FDR Drive are cordoned off, a number of that highway's landfill underpinnings are sliding into the East River. On Brooklyn and Queens streets, costly new buses are rudely jolted as they lumber into gangly potholes that reopen within months after hasty patch-ups. Ancient water and sewer mains crack open where soil shifts near construction sites. A cable snaps on the long-neglected Brooklyn Bridge. Subway tracks break down at the height of the rush hour—almost as if they're programmed for it. Derelict areas are no longer an anomaly. New York City may not be falling apart—but it's not giving a great imitation.

On the surface, at least, there's a certain polish to the Big Apple. The city balanced its budget according to generally accepted accounting principles in fiscal 1981, one year ahead of schedule—and theibus in practice of borrowing to cover operating deficiencies that had brought it near disaster in 1935. It also successfully returned to the public credit markets in March 1981, and during the current fiscal year, has sold $2.5 billion in general obligation bonds; most recently a $75 million issue for capital improvements. These, moreover, carried investment-grade ratings (albeit borderline, one) from Moody's and Standard & Poor's.

The decay of New York physically, however, threatens to infiltrate a financial wound as ghastly as any dealt by the mismanagement and whimsical accounting practices of years past. It is in its man who has struggled for decades to pay off a mortgage, finally reaches his goal, only to discover that the walls and roof and floors and basement of his home are collapsing.

Simply put, the Big Apple's core is rotting. That holds true on many scores. Not least is that poor services can prove the final straw, prompting a company to leave, taking jobs and tax dollars with it. In February, Harcourt Brace Jovanovich, the publisher, cited the sorry condition of the mass-transit system as one of the things that decided it to shift most of its operations to California and Florida.

Of course, many states and cities, pinched for funds, have cut maintenance work in recent years. But there are few places where the impact of such a policy has been as harsh as in New York. And worse may be coming. A recent study by the office of New York State Special Deputy Comptroller Sidney Schwartz, Albany's watchdog over the city's finances, found a backlog of over $20 billion in deferred maintenance work, beyond current tax needs, and new capital improvements. Meeting such a bill could double the city's $1.1 billion annual long-term projected borrowings over the next decade. The state's estimate, produced after lengthy discussions with city agency heads, has been denounced by budget officials as a "wish list" meant to provide opening ammunition in the infighting over the 1983 budget. Surprisingly, notes Deputy Budget Director Louis Friederich, "I'm sure that if we wanted to have commissioners go around in Cadillacs, we could triple that $1.1 billion figure."

Municipal officials have good reason to be irritable over higher borrowing projections. New York's books, though now in order, are burdened by an annual load of debt and related-service payments. Outstanding debt (including that of the Municipal Assistance Corp., MAC) now totals $14.1 billion—some even for a city whose declining population still numbers seven million or so. Of that, just over $10 billion is due during the next 10 years. Meanwhile, the arrangements that once allowed Gotham to shelter its offerings from the cold winds of the marketwatching diaspora... Last October saw the last private placement of MAC bonds under the terms of a deal with the banks and public employee pension funds—which became its lenders of last resort, at the height of the mid-Seventies fiscal crisis. And the final chunk of $600 million in federal guarantees also has been taken up...

In the four years through 1985, New York plans to issue $4.6 billion in city
And Now... Some Words From Chairman Koch

N O ONE has ever accused Edward Koch, mayor of New York City, of being a lover of words. And he won't, in a recent telephone interview with Barron's, Michael Readly Subject: the $3.7 billion the city hopes to spend on capital maintenance in the next decade.

B R A N D E R. The state's special deputy comptroller, Sidney Schwartz, argues that only about $3.5 billion of the money you've budgeted in your 10-year plan is in fact for deferred maintenance. The rest is essentially new construction.

Koch: I appreciate all of the analysis of the avant-garde, and they generally prove to be 50% right and 50% wrong. Sidney would be the first to tell you that, he hasn't always been right.

Q. Do you think there are any arguments for the city's postponing projects like the third water tunnel until it's done more of the stuff like replacing 75-year-old sewer lines?

A. I think it's a question of balance. If we have more money to put into the water tunnel and, at the same time, remove the sewer system and the water system, we could do both fast speed ahead. As it is, we're putting a lot of sewers, a lot of replacements of our existing water supply system, and we also need the water tunnel. It might have been a tragedy if we had not proceeded with the water tunnel for several reasons. One is that, simply to keep it from falling apart, you have to invest millions of dollars. You have to be able to to make it.

[A]nother is that you have to have it in the event. God forbid one of the outside water tunnels breaks down. We need to have this third tunnel available so that we can fix one of the other two that are that I think you're talking about 74 and 77 year old. The other is that there are parts of Staten Island where we do not allow any building because we don't have the ability to bring water out there. With our water tunnel ultimately completed, we will have the ability to provide the water to that area.

Q. Is there any danger? I mean, a steel beam cracked on the Manhattan Bridge [recently], going up subway traffic.

A. And we repaired it. The bridge is open.

Q. Is there a danger? Is it a question of how much of the work happened with the West Side Highway, that the number of things breaking down will run ahead of your ability to repair them?

A. I don't want to be one of those examples. We have a short-term and a long-term plan for the repair of the East Side Highway, which is I think about 40 years overdue. They should be done simultaneously. The highway is [Mayor Koch's] [Mayor's name is unclear] highway. It functions every day, tens of thousands of cars are on it. If you look at what we're doing with our capital budget and our interest rate structure, we're constantly looking on the capital budget.

Q. But people in the [financial] community express considerable uncertainty about whether the city will be able to borrow much as it is planning to do.

A. Well, those same people didn't believe that we would ever balance our budget. None of those people that talked to you would ever believe we would have balanced our budget in January of 1979. That, in fiscal '79, we would have an investment-grade [bond] rating. What we're talking about for the future should be examined on the basis of what we've done over the last four years. I think it's good enough.

Q. It sounds like what you're saying is that, in New York City, nothing is impossible.

A. Nothing is impossible when you get people working together. And I'm very proud that I have gotten people to believe that we can overcome. And if you don't mind the partisan aspect, the fact that I got 75% of the vote in the re-election last year would demonstrate that I've brought the city together.

Q. And if any hawks aren't believing they simply haven't gotten on board yet?

A. Or they haven't moved back to tears.

And More...

To which Friedrich angrily responds: "Sidney Schwartz is saying we have money come out there and cushioned the local cost of deferred maintenance. That is very important. If we don't give you a figure for the cost of deferred maintenance, but I have to know what the real problems are. The information might be some information to have doesn't change the ultimate decisions."

Schwartz admits that some of the estimates are shaky, but he still feels that the $7.2 billion he calculates has been budgeted to attack the backlog. And it's worth noting that New York's own capital plan was based in part on a study done by a state comptroller's office, whose engineers figure that the required investments in upgrading and expanding runs $40 billion.

"Say's Deputy Comptroller Martin [is] right. But we did have a good station on replacement cost for the water and sewer system [based on an estimate]. The 75-year useful life was $350 million. Capital expenditures that year to only about equal is the rate at which the city wears out. It probably isn't our backlog into the backlog of undone repairs."

And Washington Post Washington Post's article suggests that city officials have worked up on the possibilities of dealing with roads and highways by using a major facility. Groshans argues that the city has already shown it can handle much of the capital work with the money it already has. Let's assume the ultimate catastrophe, the Brooklyn Bridge falls apart. We can live with that. We can't afford to let the Brooklyn Bridge fall apart, without any one of those solutions we can afford to let it fall. It would cause major traffic disruptions and jams. But this is the city that weathered the 1970s, and it will weather any problems that come along.

Continued on Page 19.
Zweig reveals his #1 “Success Secret” and tells you why I’m getting ready to pull the trigger — AGAIN!... as soon as these potent indicators give the signal:

This is indeed an anniversary for me. It has not been exactly 10 years since I wrote the first issue of the Zweig Letter. Indeed, instead of a magazine format, I started publishing the Zweig Letter (in January 1973) to advise, to give advice, to better the performance of my New York City household — to make it less of a bear market. Today, the Zweig Letter is a full-fledged magazine that is published 12 times a year, and it is read by more than 17,000 people around the world. I have invested in my magazine with a hedge fund, Zweig Capital, which has grown to over $1 billion in assets under management. My magazine has become a household name, and I am proud to say that I have been a part of the Zweig Letter for over 10 years. I am looking forward to another decade of success, and I will continue to strive to provide the best possible service to my readers.
June 4, 1982

Ms. Heather Ruth
Municipal Assistance Corporation
for the City of New York
One World Trade Center, Suite 8901
New York, New York 10048

Dear Heather:

The discussion at the MAC Board meeting on June 3, about the gloomy prospects for the City's capital program, stimulated me to put down on paper some points that had been bothering me for some time. Hence the attached, which in essence calls for the same hard-headed approach that has been applied to the expense budget for the past seven years.

Sincerely,

[Signature]
Dick Netzer
Director

DN/sv

Encl.
Reflections on the Problem of Financing the City's Capital Program

Intermediate and long-term economic and financial forecasts tend to be as highly colored by the short-term outlook as are short-term forecasts. That is, even the longer-term outlook, at any given moment, is heavily affected by the prevailing tenor of pessimism or optimism. This being a time of pretty deep pessimism, it may be that all of us are unduly gloomy about the ability to finance the capital program needed over the next decade to preserve and restore New York City's public infrastructure and other basic components of the public stock. However, it would take a remarkable act of imagination to contemplate seriously a scenario in which the local and national economies are in such good shape and the markets for long-term debt securities in general and tax-exempt bonds in particular are so buoyant that the financing of the City's capital program poses only technical, not substantive, problems. The more likely scenario is one in which economic and financial conditions external to the City government itself severely constrain the financing of the capital program.

The ten-year capital program, for the fiscal years 1982-1991, contained in the fiscal 1982 Executive Budget contemplated capital expenditures averaging $3.0 billion annually, of which $1.6 billion was to come from City (including MAC) sources. Even this huge program is considered inadequate by some observers. For example, David Grossman (in a draft chapter for Setting Municipal Priorities 1983) concludes that the $750 million or so
in City funds programmed for infrastructure (narrowly defined to include only water, sewer, roads and bridges) may be no more than is sufficient to match the current rate of deterioration, with an additional 50 percent required to make much of a dent in the huge backlog created by past undermaintenance. Grossman suggests that an overall $6 billion annual rate of capital spending could be justified easily. But, of course, there is nothing like an assured capacity to finance the much smaller program planned.

Are there ways to mitigate the probable severity of the financing problem? At least two come to mind.

First, there is no evidence that the City's capital program has been subjected to the kind of painful paring the operating expense budget has been subjected to since mid-1975. The monitors quite correctly assert, at frequent intervals, that there are numerous opportunities for further economies and better management in the everyday operations of City government. But the fact is that there have been enormous economies in the operating expense budget, effected by lay-offs, attrition, declines in compensation in real terms and reductions in "expenditures for other than personal services." In some areas, services have been fairly well maintained in the face of expenditure restraint by dint of better management practices, resulting in lower unit costs in real terms. In other areas, services have been reduced but selectively--in other words, priorities were changed and services deemed "essential" before July 1975 became no longer essential. In still others, services
were reduced more or less across-the-board.

In contrast, the capital program went through no such scrutiny. Capital spending was turned off almost completely, and pretty indiscriminately. The spigot was turned on again in 1978: rather abruptly, long lists of capital spending projects were at hand and included in the ten-year capital program.

One has to be rather naive about the workings of complex organizations not to believe that the departmental lists of capital projects that suddenly surfaced in 1978 were not rather similar to the departmental lists that had evolved during the 1960s and early 1970s (and, in some cases, very likely had elements dating back before World War II) but were put into the file drawers in 1974, 1975 and 1976. Now, most of those old lists of capital projects did not reflect anything like a careful ordering of priorities, but instead a blend of narrow-gauge planning by old hands in the departments, passing fancies and fads of commissioners and community groups, and changing short-term policies of successive mayors. In some cases, there is considerable question about even the narrow technical competence underlying the old lists: it's hard to take seriously the capital program of a department that (a) has no inventory of the infrastructure for which it is supposedly responsible and (b) has a history of being unable to program everyday repairs in any rational manner. So, it is most unlikely that the ten-year capital program is an up-to-date list of projects ranked by priority, with one department's
list dovetailed with that of others, say, in connection with
work in the same streets. The operating expense budget has
been subjected to a triage-type of scrutiny, imperfect and
rough and ready though it may have been. Surely, such a
scrutiny is appropriate for the capital program; surely, it
will result in a significant scaling-down of the lists.

Moreover, there is little evidence that there has been
much attention paid to the unit costs of the projects on these
lists, comparable to the management improvement efforts on
the operating expense side. To be sure, the City lets
contracts for construction work and the unit costs are set
by the low bidders. But the bids are very much influenced
by the conditions set by the City—the specifications for the
project (and in the good old days of ample capital budget funds,
there was no great incentive to minimize capital costs by
careful setting of realistic specifications), the required
scheduling of the work (e.g., doing the work at off-hours) and
similar conditions. In addition, the City traditionally has
not been an aggressive fighter against the bid-rigging, collu-
sion and pay-offs that are said to be worse in the construction
industry in New York than elsewhere. Here, too, it is likely
that hard-boiled management can scale down the costs of the
capital program significantly.

A second approach to mitigation of the financing problem
lies in greater reliance on current-revenue financing of
capital outlays, particularly in connection with activities
amenable to user-charge support. If the City is going to be
spending, say, at least $250 million a year for the next two decades on water and sewer lines and if the state of the long-term bond market is going to constrain capital spending for years to come, it seems rather absurd to go through the process of creating a water and sewer authority to issue $250 million of revenue bonds annually to finance this element of the capital program, the bonds to be backed by drastic increases in water and sewer charges. Why not simply increase the water and sewer charges (FY 1981 revenues were about $270 million, so doubling them would produce roughly $250 million more annually) and earmark the additional revenue to the water and sewer capital program? There are parallels in other areas, as well. It is doubtful that increases in user charges with the revenue clearly and unmistakably earmarked for capital programs that directly benefit users have anything like the negative effects on the local economy that increases in general taxes have.

If the external economic and financial conditions are indeed dreadful, then these approaches will be far from adequate to solve the financing problem. Even so, they will help. And if the external conditions are only moderately bad, these approaches may make it possible, by reducing significantly the amount of debt financing required each year, to swing a reasonably adequate long-term City capital program.
June 10, 1982

Dr. Dick Netzer  
Director  
Urban Research Center  
New York University  
4 Washington Square North  
New York, New York  10003

Dear Dick:

Thank you for sending on to me your reflections on the Financing of New York City's Capital Program. I found the memorandum to be extremely constructive.

The applying of pressure to, but on a priority basis, on the capital needs of the City is something that has not been done. It must be done because the capital markets will never be able to provide incredible sums such as $6 billion annually for capital improvements. The problem simply must be sharply cut down to size. In addition, the City is totally incapable of carrying out billions of dollars of capital improvements annually. They do not have the necessary staffs or management expertise to successfully execute such an ambitious program.

Your thoughts on pay-as-you-go for such things as water and sewerage improvements are most sound. Ratepayers would be advantaged in the long run by being able to avoid interest charges in the 12 to 14% range.

In past years I had hoped that MAC would comment to a greater degree in its annual budget review on the City’s Capital Program. It seems to me that this is the year we must do this. The capital markets are far from robust. The chances of the City and MAC raising very much more than $1.5 billion annually over the next two years are not strong. After we go out of business at the end of 1984, the City would be doing quite well if it could do $1 billion a year in the capital markets—and all of this at outrageous interest rates.
Dr. Dick Netzer
Urban Research Center
New York University

I guess what I am really saying, Dick, is that MAC should take the lead, once again, by blowing the whistle on the capital program by calling for a hard-nose approach reflective of the capital markets we face today and probably be facing in the years ahead. The City has done well, in fact much better then I ever thought, in regard to the expense budget. Now it must turn its attention to putting their capital program in more realistic order. Your memo is the first step in that direction.

Kind personal regards.

Sincerely,

Edward M. Kresky
Managing Director

EMK:etc
cc: Felix G. Rohatyn —
    Heather Ruth
June 22, 1981

The Honorable Hugh L. Carey
Governor of the State of New York
The Honorable Edward I. Koch
Mayor of the City of New York

Dear Sirs,

You will find attached the Municipal Assistance Corporation's review of New York City's executive budget for FY 1982 which we find to be in balance, according to GAAP. The progress made by the City, both in the budgetary as well as the financing area, more fully described in our report, is quite remarkable. We do introduce, however, a cautionary note with respect to the trend of current expenditure growth which appears to be outstripping expected revenue growth. We fully support the City's decision to invest in service delivery and quality-of-life improvement. However, careful and continuous monitoring will be needed in order to avoid the recurrence of large budget gaps in the future which would require offsetting harsh cutbacks. We may be entering a generally less favorable economic climate for the City together with greater burdens caused by Federal budgetary cutbacks.

In addition, there are two issues of overriding importance to the City which must be singled out: Transit and Medicaid.

The degradation of New York's mass transit system can be just as lethal for the City as bankruptcy once threatened to be. A lingering death is, ultimately, no different from a sudden stroke. There is no rational reason to postpone the adoption of a long-range revenue and capital plan for the MTA; no miracles will occur in the next few months, and a piecemeal solution is no solution. Whether the Transit Advisory Panel's suggested plan is adopted or an alternative that is both long-range and comprehensive, we urge legislative action now.
Equally critical to the City's future is the State's phased and assured takeover of the City's share of Medicaid costs. Much of what has been accomplished over the last few years will be jeopardized if such a takeover does not take place, or if it takes place in such small increments and over such an extended period of time as to make it meaningless from the City's budgetary point of view. It is difficult to see how the City will be able to provide adequate funds for services and economic development in the future, unless its budget, simultaneously, is relieved of the cost of Medicaid.

We urge both Governor Carey and Mayor Koch to make the most of their combined leadership and cooperation to bring both these issues to a swift legislative conclusion. Failure on either one would be a sad way to end what has, up to now, been such an extraordinary achievement.

Very truly yours,

Felix G. Rohatyn
Chairman of the Board
MUNICIPAL ASSISTANCE CORPORATION FOR THE CITY OF NEW YORK

ANNUAL BUDGET REPORT

June 23, 1980
SUMMARY

The proposed New York City Executive Budget for FY 1982 is balanced according to generally accepted accounting principles (GAAP). Modifications made by the City Council and Board of Estimate in adopting the FY 1982 budget appear to be within the framework of a balanced budget.

The Executive Budget for FY 1982 represents the second consecutive budget which is balanced in accordance with GAAP. During FY 1981, the City made noteworthy advances toward self-sufficiency in the public credit markets. The City was able to meet its seasonal financing requirements entirely through the issuance of short-term notes backed by the City's revenues. In addition, the successful sale of $75 million of general obligation bonds in March, for which the City obtained an investment grade rating from Standard and Poor's Corporation, represents an initial step toward establishing full access to the long-term public credit markets.

With the submission of the Executive Budget, the City has eliminated a budget gap which, one year ago, was estimated to be $1 billion. The single most important factor in eliminating this gap was an increase in projected revenue of approximately $850 million during the past year, a substantially higher increase than was expected.

Based upon the trend of the local economy thus far during 1981, and the economic forecasts for 1982, revenue from the major economically-sensitive City taxes should grow moderately, at or close to the expected rate of inflation. This is in contrast to the very high growth rates experienced since FY 1979. Should the local economy perform more poorly than expected, it may be necessary to reduce the spending levels prescribed in the budget for FY 1982. This slackening in the anticipated revenue growth rate calls for close monitoring of tax receipts by the City.

As presented in the Executive Budget, the growth of City expenditures during FY 1982 is higher than the growth in preceding years, and exceeds the expected rate of inflation.
The projected expenditures grow at a rate which is significantly higher than the projected revenue growth. Annual City-funded expenditures in FY 1982 (exclusive of debt service) are projected to increase by over 10 percent, as compared with an increase in total annual City-generated revenues of only 6 percent. (See chart.) (It should be noted that debt service costs are excluded from the calculation of expenditure growth for FY 1982 because such costs have been reduced by the amount of prior years' real estate taxes collected in excess of debt service requirements. The growth rates calculated by the City differ in that debt service costs were included for FY 1982.) Nonetheless, budget balance will be achieved in FY 1982 because of the availability of funds from prior years' surpluses, higher real estate tax revenues generated through the use of accelerated debt redemption schedules and the City's ability to control the proposed new expenditure increases by restricting new hiring so as not to fulfill planned personnel levels. If not corrected, however, this imbalance will create ever-increasing budget gaps in the future.

It is appropriate that the City take advantage of the relative prosperity we have experienced recently by allocating funds for service improvements that can help to upgrade the quality of life for the people who live and work here. But it is also essential to maintain the balance between the levels of service it would like to achieve and the levels that can be afforded without adding to the burden of City taxation. If the local economy grows more slowly than it has in the recent past, then increases in City spending will have to be tightly constrained. This constraint has an obvious bearing on the City's labor negotiations next year.

* * *

As required by Section 3040 of the Municipal Assistance Corporation For The City of New York Act, we have reviewed the City's budget submission for the 1982 fiscal year. In accordance with the Act, we present our initial findings and determinations. Our report reviews the Mayor's Executive Budget for FY 1982 based on our own studies, the reports of the Office of the Special Deputy Comptroller ("OSDC") and the staff analysis of the Financial Control Board ("FCB"), as well as discussions with representatives of the City. The budget as submitted reflects revenues and expenditures of $14.690 billion and is balanced in accordance with generally accepted accounting principles ("GAAP") for the second consecutive year.
ANNUAL INCREASES IN CITY REVENUES AND EXPENDITURES
FROM FISCAL YEARS 1979 THROUGH 1982

% Change

11
10
9
8
7
6
5
4
3
2
1

FY

Locally-generated revenues

Adjusted City-funded expenditures (net of debt service)

Source: Office of the Special Deputy Comptroller. Revenues and expenditures for FYs 1979 and 1980 are actual from the Comptroller's Annual Reports; FY 1981 data from the forecast as of May 12, 1981; FY 1982 data from the Executive Budget.
The expected year-end results for FY 1981 indicate that the City was able to overcome a variety of obstacles throughout the year, including costs associated with the labor contract in excess of the funds originally provided, the potential need for increased City subsidies for certain covered organizations, and an unclear revenue outlook due to the unpredictable local economy.

Based on our analysis of the Executive Budget for FY 1982, we conclude that such budget is balanced, and the City may even achieve a modest surplus in that year. This represents an impressive achievement. However, areas of concern remain which will require careful monitoring.

I. Revenues

City forecasts for FY 1982 tax revenues assume a continued expansion of the national economy into calendar year 1982. Although local prices are still expected to rise more slowly than national prices, the disparity experienced in recent years has narrowed during calendar year 1981. Thus, for the near term, the local price outlook, as a measure of the City's competitive advantage, is less favorable than in the recent past because of the combined effects of higher mortgage rates, higher residential and commercial rents and the impending rise in the transit fare. These assumptions are based upon scenarios developed by the major economic forecasting services.

Many forecasters of City economic conditions expect that local tax receipts will exhibit moderate growth during FY 1982. The City's own forecasts reflect a lower growth rate than those experienced in recent years, primarily because of the assumption that local inflation will be somewhat lower than in the past.

Other factors affecting the City's FY 1982 budget will limit available revenues and inhibit surplus accumulation.

- The recently adopted State budget affecting the City's 1982 fiscal year maintains the previously enacted ceiling on State revenue sharing. With the exception of probable annual increases in State education aid, the State has made no commitment to provide new sources of budget balancing aid.

- The proposed State take-over of local medicaid costs is still being negotiated. While it is possible that the take-over, if enacted, will provide smaller incremental
savings than the City had assumed in the budget, the realization of any savings from the program remain uncertain.

- The completion of the phase-out of the stock transfer tax on October 1, 1981 will limit revenues from that source to a specified annual level.

- The retrenchment policies evident in the proposed Federal budget have not only reduced anticipated Federal aid but have also created pressures on the City to provide offsetting funds to lessen the burden on those most affected by the proposed spending cuts.

In the Mayor's Message submitted in conjunction with the FY 1982 budget, it was estimated that Federal aid in FY 1982 will be lower by $297 million as a result of the President's budgetary reductions proposed on March 10, 1981. The major portion of this spending reduction, $178 million, is attributable to the President's proposal to eliminate the CETA public service employment program. CETA employees had formerly represented a major component of the City's workforce - especially in certain municipal agencies such as the Department of Parks and Recreation in which CETA workers comprised 35 percent of the total personnel in FY 1981. Other Federal aid of $88 million which the City had anticipated receiving during FY 1982 was also eliminated from the City's Executive Budget. The City funds (totalling $193 million) provided to partially mitigate the impact of the proposed Federal budget reductions should prove sufficient to maintain the affected programs during FY 1982. However, the City will be hard-pressed to produce additional funds from local revenues in future years to continue these programs.

Recent developments in Albany have also affected the City's expectations of the aid levels to be provided by the State. It should be noted that the City's projections of State aid were developed prior to the adoption of the State budget for the State fiscal year which began April 1, 1981. The adopted State budget contains increases in education aid in line with the City's assumptions, as well as other categorical aid levels assumed in the City's budget. However, a total of $75 million of anticipated State aid, a portion of which is attributable to the proposed State takeover of local Medicaid costs, is not reflected in the State budget. While the savings which would accrue to the City from the proposed State action are not significant for FY 1982, the lack of a positive legislative resolution creates large potential shortfalls in the City's plans to eliminate budget gaps projected in FYs 1983 through 1985.
The City's Executive Budget has assumed a further action by the State legislature with respect to an expansion of the activities of the Off-Track Betting Corporation, which was anticipated to provide $50 million of revenues in FY 1982. This anticipated revenue is not included in the budget as adopted by the City Council and Board of Estimate. The receipt of $100 million from the sale of the right-of-way for the Westway project is assumed in the budget for FY 1982. The receipt of this nonrecurring revenue, included in the revenue budget for each fiscal year since 1978, continues to be subject to uncertainty.

By far the most significant assumption with regard to FY 1982 revenues is the rate of growth of City property values inherent in the estimates of real estate tax collections. Such tax collections in FY 1982 are projected to be $300 million greater than the forecast for FY 1981. This increase results from anticipated growth in assessed values of real property of more than $3 billion, as compared to FY 1981. The City had petitioned the State Board of Equalization and Assessment ("SBEA") to update the survey data then being used to determine the full value of real property within the City, in that City officials believed that such data significantly understated the growth rates of real property values from 1978 to 1980. The City estimated such growth to be approximately 18 percent, and computed real estate tax collections accordingly. Also included in the projected tax collections was the full year impact of a $.20 increase in the tax rate, now $8.95 per $100 of assessed value, which took effect on January 1, 1981.

Officials of the SBEA have indicated recently, however, that their preliminary findings point to an increase in property values of only 16 percent, which is below the City's assumption. Barring an increase in FY 1982 debt service (for which a municipality can levy real estate taxes without limit) or an upward revision of the SBEA's growth rates, OSDC notes that the City may exceed the constitutional tax limitation in FY 1982, indicating a need to reduce the tax rate.

The City does have a mechanism at its disposal, however, which could be used to increase debt service payments in FY 1982, and therefore maintain the current tax rate. This mechanism involves payments to the Corporation for certain City obligations (called bond anticipation note bonds) held by the Corporation. Accordingly, in addition to the scheduled maturity of some $122 million of such BAN-bonds during FY 1982, the proposed property tax levy had assumed a further call (prepayment) of $255 million (including a total of $137 million originally planned to be prepaid in FY 1981.
that was deferred until FY 1982). Based on the results of the SBEA's survey, the City could call an additional amount of such BAN-bonds in order to support the current tax rate for FY 1982. It should be noted that payments made to the Corporation by the City in this respect are returned to the City via a concomitant reduction in the amount of sales tax which would otherwise be required for payment of debt service on the Corporation's bonds.

In the foregoing, we have identified revenues totalling approximately $225 million which are not likely to be received as planned during FY 1982. Potential offsets for these uncertain receipts include $100 million representing the unallocated portion of the general reserve, and potential revenues in excess of the budget forecast, estimated by OSDC to be approximately $120 million, primarily from general corporation taxes and interest income. Therefore, it is likely that the City will realize the full amount of revenues projected in the budget for FY 1982.

II. Expenditures

The FY 1982 Executive Budget projects an overall expenditure increase of $527 million over the forecast for FY 1981. The vast portion of this increase, $434 million, results from the provision within the budget for the costs of the second year of the collective bargaining agreements negotiated in June 1980.

Not all of the second year costs of the labor settlement will be funded from FY 1982 revenues. A significant portion of such costs representing a nonpensionable cash bonus payment were funded in FY 1980. That year, approximately $200 million was set aside in a reserve in order to make such payments during FYs 1981 and 1982. This prepayment has the effect of both understating the costs of the negotiated labor settlement and overstating the City's ability, as represented in the budgets for FYs 1981 and 1982, to rely upon current revenues to fund current expenditures. The cash bonus payments, which become part of the wage base in FY 1983, will add approximately $165 million to expenditures in that year. The agency budgets for FY 1982 have been increased in the areas of essential services, including fire, police, sanitation, corrections and education. Overall City-funded personnel levels are projected to increase to 178,570 during FY 1982, representing the addition of 7,675 positions to planned personnel levels as of June 30, 1981. Included in this increase are 3,579 formerly CETA-funded positions which the City now anticipates funding. However, for several reasons, the
forecast personnel levels are unlikely to be achieved. First, headcounts of City-funded personnel are currently below planned levels for June 30, 1981. As a result, the actual City-funded workforce will be several thousand positions lower than planned at the beginning of FY 1982. Second, positions vacated through normal attrition during the year (about 13,500) are assumed to be replaced, so that the actual number of persons to be hired during FY 1982, according to OSDC's analysis, would have to be approximately 23,700 to meet the planned headcount figure at year-end. Hirings of this magnitude greatly exceed the City's past practices, and may in fact strain the City's hiring capacity.

Other significant expenditure increases over the forecast for FY 1981 contained in the Executive Budget include $83 million to fund City-wide energy costs, and $127 million for medical assistance payments. Projected public assistance costs only increase by $12 million. This slight increase assumes that the public assistance caseload will rise by 2,100 during the year. Though this assumption may prove optimistic in light of the potential impact of CETA employee terminations through October 1981, the City has provided an additional $45 million in its budgeted general reserve for FY 1982 to absorb any unanticipated effects of the proposed Federal budget reductions.

The Executive Budget for FY 1982 projects debt service costs which are $223 million lower than such costs forecast for FY 1981. The major portion of this net reduction - $178 million - comes from real estate tax revenue collections in excess of debt service requirements in prior fiscal years. (The State Constitution provides that such excess collections must be segregated for the payment of the succeeding year's debt service.) Of the $178 million, $137 million represents the deferral of the payment of the MAC-held City BANs from FY 1981 to FY 1982. As previously noted, the amount of sales tax revenue required by the Corporation for the payment of debt service in FY 1982 is reduced by the amount of the City payments on the BANs.

Actual total expenditures for FY 1982 may be less than the budget assumes if the pattern of underspending experienced in previous years continues in FY 1982. This potential underspending, which occurs primarily in the estimated expenditures for other than personal services ("OTPS"), has been estimated by OSDC to be $85 million, with perhaps another $15 million of underspending in personal services, based upon an analysis of FY 1981 spending.
Fiscal Years 1983-1985

While a surplus is expected for both FYs 1981 and 1982, the proposed financial plan for FYs 1983 through 1985 continues to include large budget gaps.

The City's financial plan for FYs 1982 through 1985 projects budget gaps of $739 million, $935 million and $963 million for FYs 1983, 1984, and 1985, respectively. The City has acknowledged that pressures from Federal budget reductions and increased agency expenditures have increased budget gaps in the later years of the plan. Compared with the gaps projected in the plan approved in February, the proposed plan now projects gaps which are greater by $167 million in FY 1984 and $157 million in FY 1985. The projected gaps are understated in that (i) the provision for a labor settlement of 3 percent annually will be inadequate, (ii) levels of State aid assumed in the gap projections are by no means assured, and (iii) shortfalls in other planned revenues may occur. It has been estimated by OSDC that the potential gap for FY 1983 could grow to $1.3 billion, assuming a labor settlement in line with the projected rate of inflation (8.7 percent) and shortfalls that are likely in certain revenues and State aid. Such assumptions for FYs 1984 and 1985 would result in budget gaps approximating $1.7 billion and $2.2 billion, respectively.

Closing the budget gap for FY 1983 appears to be more difficult now than six months ago because of certain changes which have occurred since the submission of the January financial plan. These changes include (i) the expectation that local economic activity will level off, (ii) the possibility of further reductions in Federal aid levels, (iii) the tentative nature of the proposed State Medicaid take-over, and (iv) the impact of proposed spending increases in FY 1982.

In the aggregate, these factors not only increase projected budget gaps during the plan period but also reduce the gap-closing options available to the City. For FYs 1983 through 1985 the City has proposed gap-closing programs consisting of various City, State and Federal actions which, if fully achieved, are sufficient to close the projected gaps in each of those years. In their report on the financial plan submission, OSDC raised serious questions regarding the proposed gap-closing actions.

Proposed City actions include expenditure reductions of $244 million, $313 million and $411 million in FYs 1983 through 1985, respectively. Of these actions, savings of $93 million in FY 1983, $117 million in FY 1982 and $153 million
in FY 1985 appear to be realizable. The proposed elimination of the budgeted general reserve, to be replaced by a cash reserve, may be precluded by the reference to such reserve within the covenants provided to holders of the Corporation's bonds. In addition, elimination of the reserve may negatively affect the marketability of the City's long-term bonds. Another $69 million of "other City actions" in FY 1983 have not been supported by sufficient detail.

The City has also proposed a revenue enhancement program anticipated to provide $143 million annually. In a recent report, OSDC has determined that only $58 million per year, from increases for water and sewer charges, CUNY tuition and other user charges, can be implemented by the City. The other proposals require legislation or other enabling determinations not within the City's control.

Intergovernmental aid levels assumed in the gap-closing program are also uncertain. These include undefined Federal aid of $50 million in each year, and savings from the proposed State take-over of Medicaid of $88 million, $256 million and $510 million in FYs 1983 through 1985, respectively.

Since the City's gap-closing program does not provide any assurance that the proposed actions will be sufficient to close the gaps projected for FYs 1983 through 1985, and even those projections may be significantly understated, we will look for more a definitive gap-closing program in the City's January modification of the financial plan. Access to the public credit markets, in the magnitude required to address the City's enormous capital needs, depends upon the City's ability to provide a plan to close the projected gaps through actions within the City's control to implement, combined with assured levels of intergovernmental aid. In the face of the withdrawal of Federal aid - especially for mass transit operating subsidies and for human services programs - it is essential that the City and the State come together to resolve two discrete problems affecting City life. The deterioration of the transit facilities poses a serious threat to the City's economic viability. Equally critical is the enactment of the proposed State take-over of local Medicaid costs, which will provide much needed budgetary relief. The swift resolution of these two issues through comprehensive, long-range programs will do much to insure that the City can continue its fiscal progress.
June 24, 1980

The Honorable Edward I. Koch
Mayor of the City of New York
City Hall
New York, NY 10007

Dear Mayor Koch:

Attached you will find our review of the City's budget for the 1981 fiscal year, as well as our assessment of the outlook for fiscal year 1982. The budget which you submitted, as modified in the adoption process, represents the most significant advance made by the City since this period began in 1975. That the budget is balanced according to generally accepted accounting principles a year before it is statutorily required is vital to obtaining access to the debt markets. The process of achieving full credit market acceptance will require a succession of such balanced budgets.

While we applaud its intent and believe that it can be implemented as adopted, there are several potentialities which place this ambitious plan squarely in jeopardy. One of these is the tentative labor settlement announced last week which includes wage increases at a level likely to match the rate of inflation over the term of the contract. While this agreement may in fact represent as reasonable a rate increase as could be negotiated, and while it may be a fair settlement given the level of the last two contracts, one thing is certain—the cost is clearly more than the City can afford, given the resources presently available.

In 1976 we started with a no-cost labor contract, moved to a limited-cost contract with productivity goals in 1978, and have now reached a full-cost contract with no productivity in 1980. The reality of the situation is a City still far from fiscal strength whose recovery will be hurt, not helped, by the trend of these settlements.
As it now stands, the tentative labor settlement and other expenditure decisions made by the City have resulted in a projected FY 1982 gap of $1 billion. That year has the clear potential for the kind of drastic actions not required since FY 1976, and there is an urgent need for a plan to deal with it.

The situation is exacerbated by the lack of any agreement on labor productivity measures in the proposed contract. If an impoverished city agrees to increase the wages of its employees at full market-rate levels, it requires a demonstrable increase in efficiency. The efforts of both the City and the Unions to date have not been successful in identifying areas of real savings and meeting productivity goals measured in dollars. For New York City, increased productivity is no longer a matter of choice, it is a matter of survival. It is a challenge which both the City managers and Union leaders should be expected to meet. The Productivity Council should be called upon immediately to develop a plan on an agency by agency basis.

Yet another threat to stability and balance over the next two years is the possible lack of Federal Guarantees. Should the Department of the Treasury fail to issue Guarantees in fiscal years 1981 and 1982, as outlined in our proposal to the Treasury dated June 6, additional costs in the range of $60 to $90 million will have to be borne by the City. In addition, without Guarantees, more of MAC's borrowing authority will be exhausted, making post 1982 financing more difficult.

These items, when added to the problems of intergovernmental aid which lags the Plan, expenditure reductions which have proven difficult to implement, and the effects of the recession on the City's revenues, creates a risk for FY 1981 balance, and reaffirm our deep concern about FY 1982. Indeed, as the Special State Deputy Comptroller pointed out, had the City adhered to its February Financial Plan, it would now be almost $200 million closer to true balance in 1982.

However, there is evidence that the City is moving in the opposite direction. A year ago this Corporation recommended a resumption of the attrition program as one way to gradually pare baseline costs. Instead, the City predicts that by the close of FY 1981, it will have 4000 more employees than were projected in its February Financial Plan. While externally imposed mandates may demand additional staff in selected areas, the idea of a larger overall workforce is not realistic.
The solution to this problem cannot await the arrival of the 1982 budget. In order to avoid substantial layoffs, significant new taxes and service cuts which further erode the quality of life, a plan of action must be chosen soon. No doubt it will require reliance on each of these to some degree but only by beginning now will it stay within tolerable limits.

The course which the City has chosen is clearly fraught with risk for FY 1981 as well as FY 1982. It is our judgement that it requires frequent review and early action should the City's assumptions fail to materialize. For this reason we will ask the Special State Deputy Comptroller to report to this Board at the close of the first quarter of fiscal 1981. We will then be able to assess more completely the operating results to that date, the provision by the Federal budget as adopted of funds for the City, the decision by the Department of the Treasury with regard to issuing Guarantees in FY 1981 and 1982, and the final labor settlements. By that time the City should adopt and the Control Board should approve a plan which assures budget balance in FY 1981 and completely funds the $1 billion imbalance which it currently projects for FY 1982. We would expect the Financial Control Board to assist the City in the formulation of any new actions which may be decided upon, and to provide support and direction as the City carries out any such plans.

Sincerely,

[Signature]

Felix C. Rubinstein
June 24, 1980

The Honorable Hugh L. Carey
Governor of the State of New York
1350 Avenue of the Americas
New York, NY 10019

Dear Governor Carey:

Enclosed is the Municipal Assistance Corporation's report on New York City's 1981 budget and my covering letter to Mayor Koch.

As I wrote to the Mayor, balancing the City's budget one year ahead of schedule is an extremely significant step but we remain concerned about the City's ability to keep the budget balanced in 1981 and repeat that feat in 1982. The difficult task of balancing the budget in 1982 has become more difficult by the recently concluded labor settlement with the non-uniformed employees and may be made harder still by future settlements with the uniformed employees, by failure to obtain federal guarantees, and by the continuing deterioration of the economy and the diminished prospect of inter-governmental assistance.

We believe the City must immediately prepare a plan to fund the budget gap it now projects for 1982, which totals approximately $1 billion. This plan should take account of the City's final labor settlement, the Treasury's decision on guarantees, and the latest trends of revenues and expenditures. This plan should be submitted to and acted upon by the Financial Control Board no later than September 30, 1980. Early development of the plan for 1982 is essential because the Control Board may determine that some of this plan should be implemented immediately in order to lessen the impact of drastic cuts made all at once at the beginning of the 1982 fiscal year.
It is obvious that, in the long run, the City will need additional streams of permanent revenues. Certainly part of those should come from Federal assumption of local costs, such as welfare and medicaid, that are national responsibilities. The shift of wealth to our oil producing states as a result of price decontrol will make the problem more acute. Economic development measures which benefit the Northeast and Midwest, including the creation of an RFC, will be required to prevent the further drain of industry away from this region and this country.

There is urgent need for coordinated political action throughout the whole Northeast-Midwest region if we are to succeed. I know that you recognize the urgency of this task and I will, as always, be delighted to assist you in your leadership of this effort.

Sincerely,

Felix G. Rohatyn
MUNICIPAL ASSISTANCE CORPORATION FOR THE CITY OF NEW YORK

ANNUAL BUDGET REPORT
June 25, 1980
The Municipal Assistance Corporation
For The City of New York

ANNUAL BUDGET REPORT: June 25, 1980

SUMMARY

The City's submission on May 11, 1980 of the 1981 Executive Budget is balanced according to generally accepted accounting principles (GAAP). Although the City is not legally required to balance its budget according to GAAP until 1982, the decision to accelerate this timetable to include fiscal 1981 is a positive step toward reentry to the long-term credit markets.

From FY 1976-1979 the City steadily reduced the accounting deficit from $1.8 billion in FY 1976 to $422 million in FY 1979. The City's greatest success during this period was in controlling its expenditure growth. It is commendable that the net expenditures for City operations only grew approximately 3% during fiscal years 1976 through 1979. In addition, there have been external factors which MAC has cited in previous reports which contributed to the City's accomplishments during this period, including significant growth in City tax revenues, increased Federal and State budget-balancing aid, nonrecurring revenues, reduced debt service costs and the availability of financing. These events combined to provide the City with a foundation for meeting its fiscal as well as statutory goals.
The budget for FY 1981 reflects a departure from the trends evidenced in budgets since 1976 in that those resources and events which have assisted the City in the past appear to be largely exhausted. The economic growth in City tax revenues will be restricted during the current recession and the upcoming years of recovery through 1983. Federal and State budget-balancing aid has been reduced from prior years' levels and remains constant throughout the financial plan period. The FY 1981 budget contains about $204 million of nonrecurring revenues, some of which are not even assured for that year, and there are few prospects for other such revenues to be identified for succeeding years. In addition, the use of year-end cash to prefund a portion of the labor settlement perpetuates the illusion that the City's revenue base can support these higher expenditure levels on an ongoing basis.

* * *

Based on our review of the FY 1981 budget we have concluded the following:

--The City has reduced the impact of expenditure reductions proposed in the February Plan by allocating increased revenues to fund greater expenditures. In some areas, expenditure cuts were actually restored. The use of greater-than-anticipated revenues and other available funds to offset expenditure increases may be a short-term expedient, but this practice only exacerbates the problem of a balanced budget in FY 1982 and beyond. As funds to offset new expenditures become more scarce, the City will not be prepared to address the reality of basic expenditure levels which exceed recurring revenue sources.

--The budget provides little margin to cover the potential revenue shortfalls and expenditure overruns that appear imminent. Indeed, the City will be several months into the 1981 fiscal year before the impact of these uncertainties can be accurately measured. Meanwhile, the City has no contingency plan to offset the substantial uncertainties already identified. The City's general reserve of $100 million may be depleted early in the year leaving the City to look elsewhere for savings.
The City's financial plan already reflects the fact that the recurring value of its FY 1981 budget-balancing actions, even with the addition of planned incremental actions, will not balance FY 1982. Further, even the estimated FY 1982 deficit assumes the receipt of Federal and State aid which is far from certain, and the attainability of savings from expenditure programs which have yet to be tested.

The tentative agreement recently reached by the City and the municipal unions adds substantially more costs than those provided for in FYs 1981 and 1982, without providing any savings from productivity measures. Assuming that the uniformed coalition, which is still in the process of negotiating, reaches a similar settlement, we estimate that approximately $141 million in additional costs will have to be funded in FY 1981, and over $459 million will be added to the gap in FY 1982. This tentative settlement, therefore, threatens the projected budget balance in FY 1981 and creates a gap in FY 1982 which now totals nearly $1 billion.

In the absence of increasing Federal and State aid, significant local revenue growth and debt service decline, which have contributed to the City's progress in the past five years, the City must take steps to reduce its expenditure base. The tentative labor settlement, coupled with the dwindling alternatives for closing the budget gap, may force the City to take drastic actions to balance its FY 1982 budget. The need for such additional fiscal retrenchment while continuing to provide services to the people of the City of New York will be extremely difficult and will require structural and institutional reforms that enable the City to maintain essential programs while achieving new levels of productivity.

Thus, the budget for FY 1981 aspires to, but does not guarantee, the goal of a GAAP-balanced budget. The City's operations must be closely monitored on a timely basis by the Financial Control Board. New programs must be designed in FY 1981 to strengthen the City's position for FY 1982. We look to the Financial Control Board to assist the City in the formulation of these plans, and to provide support and direction as the City carries out these actions.
As required by Section 3040 of the Municipal Assistance Corporation For The City of New York Act, we have reviewed the City's budget submission for the 1981 fiscal year. In accordance with the act, we present our initial findings and determinations. Our report reviews the Mayor's Executive Budget and subsequent modifications adopted by the City Council and Board of Estimate for FY 1981 based on our own studies and the staff analyses of the Financial Control Board ("FCB") and the Office of Special Deputy Comptroller ("OSDC"), as well as discussions with representatives of the City. Although the budget as submitted reflects a balance of revenues and expenditures in accordance with generally accepted accounting principles ("GAAP") there are a number of uncertainties which might threaten this delicate balance.

In reviewing the Executive Budget for FY 1979 last June, and in various reports since that time, we expressed concern regarding the impact of the following: a largely unpredictable economy on City tax revenues and related human services costs; a trend toward Federal and State budgetary retrenchment; a wage settlement in excess of that which is provided for by the City; the need to provide increasing City subsidies for certain covered organizations; and policy decisions on the part of the City to use additional revenues to either increase spending levels or to reduce the level of budget reduction programs originally proposed. In all of these areas, our concern continues and, in many cases, is heightened.

I. REVENUES

City forecasts for FY 1981 tax revenues assume that the mild recession in calendar year 1980 will be followed by a period of gradual recovery through FY 1983. Local prices are expected to increase more slowly than national prices, employment is expected to fall off slightly in 1981 and 1982, repeating the lag observed in the last recession, and the City's average inflation rate (8.4% from 1980-1984) is projected to be significantly lower (by 1.4%) than that of the nation as a whole. These assumptions are consistent with patterns experienced since the recession of 1974, and are comparable to scenarios developed by the major economic forecasting services.

Although the major economic indicators have recently reflected a more severe recession than economists had predicted earlier, the City's revenue projections are sufficiently conservative so as to be attainable even under these revised assumptions. Should the City's assumptions bear out, tax revenues may exceed the Plan slightly; however, the potential for substantial revenues in excess of current estimates along the lines of FY 1980 is vastly diminished. Thus, the City cannot
afford to depend on that potential in order to increase expenditure levels or to reduce the value of planned expenditure cuts.

Of particular concern is the City's inclusion of the anticipated receipt of $100 million of Federal aid and $72 million of State aid, beyond the levels already assumed in the estimates of Federal and State grants and unrestricted aid. These amounts had formerly been part of the City's program to eliminate the gap (PEG). The receipt of these revenues is far from assured. Currently, the Federal budget provides none of the anticipated $100 million, and there is a consensus that legislative, as opposed to administrative actions will be required to provide this aid. The prospects for successful legislative initiatives which would provide the bulk of this aid are doubtful at this time.

Conversely, while the State has proposed certain actions that it would be willing to take to provide aid in accordance with the City's expectations, there is an ongoing dispute between the State and the City regarding the treatment of certain State actions as gap-closing aid beyond that already reflected elsewhere in the City's Plan. For example, the State's share of the Medicaid rate appeal settlement recently negotiated by the Health and Hospitals Corporation ("HHC") (totaling $110 million, of which the State's share is $78 million) has been included in the HHC's financial plan for FY 1981, and, in large part, provided the additional revenues necessary for HHC's submission of a balanced plan for that year. While the State maintains that such payment would constitute gap-closing aid, the City contends that the payment should not be applied against the discrete additional State aid of $72 million which the City requires because the payment has already been reflected in the HHC plan. Similar disputes involve proposed State actions which would generate savings for the City, and have already been included within the estimates for State grants and related expenditures. Until the State and City reach an agreement on the treatment of the proposed actions, it will be difficult to determine how much of the $72 million will actually be received. Further, the City's estimate of State revenue sharing aid for FY 1981 includes $49 million of aid which has been rolled forward annually over the past few fiscal years. Since the State's five-year projection of General Fund expenditures calls for the continuation of this rollover, there may be a shortfall in State revenue-sharing aid assumed in the budget. Thus, it appears at this time that the City should be prepared to cover the potential shortfall of a significant amount of the $172 million in anticipated State and Federal aid.
Also included in the budget are additional anticipated revenues of $175 million resulting from new revenue proposals including increases in certain City taxes, transfers and charges. These proposals had previously been part of FY 1981 PEG, which has now been incorporated into the budget. In the closing weeks of the State legislative session, the City was granted the authority to obtain nearly all of the proposed increases requiring legislative approval. The City Council and Board of Estimate subsequently moved to adopt substantially all of the revenue proposals anticipated in the Executive Budget, thereby increasing City tax and miscellaneous revenues accordingly.

As in the budgets of several previous years, the FY 1981 budget estimate for miscellaneous revenues includes the receipt of two nonrecurring items: $100 million for the conveyance of right-of-way for the Westway project; and $55 million of proceeds from a bond issuance by the Educational Construction Fund ("ECF"). Both these items have appeared in the budgets for several fiscal years, and have later been postponed. Although the timing of bond issuance would be influenced by the prevailing market conditions, the City has discretion to obtain the ECF revenue. Whether or not the Westway revenue will be received, however, is not under the City's control, but rather a function of the outcome of various environmental studies and hearings. Because of the complexity of the environmental requirements, it is entirely possible that the $100 million will not be received during FY 1981.

In the foregoing, we have identified a number of significant revenues, the receipt of which must be considered to be uncertain at this time. Failure to receive even a relatively small portion of these revenues will have to be offset elsewhere in order to preserve a balanced budget.

II. SALARIES AND WAGES

Salaries and wages have been estimated in the budget based on a projected work force as of June 30, 1981 which is approximately 4,000 positions greater than the estimated work force for FY 1981 in the Plan approved in February 1980. This increase comes about because of the City's identification of about 3,000 positions required to meet new needs within the agencies (of which over 2,000 positions were added for the Board of Education ("BoE")) and a reduction of about 1,000 in the number of positions proposed to be eliminated during FY 1981 in the City's PEG Plan approved in February 1980. (About 875 positions originally planned to be cut were reinstated for the Board of Education, primarily as a result of increased State funding for mandated programs in special education.) The significantly higher estimate for the
FY 1981 work force represents both an increase in expenditure levels as well as a reduction in the level of savings from the PEG. In the past, the City has consistently increased expenditures and abandoned planned attrition programs as offsetting revenues became available. The FY 1981 budget reflects a continuation of this pattern.

The Executive Budget for FY 1981 incorporated within the agencies amounts sufficient to pay salary increases of 4% on October 1, 1980 based on employee salary levels as of June 30, 1980. In addition, the reserve for collective bargaining in FY 1981 included $21 million which will fund a similar wage increase for employees of the HHC. The adopted budget includes an additional $90 million in the reserve for collective bargaining in order to provide funding for additional labor costs pursuant to recent City wage offers. Furthermore, the City has set aside a substantial portion of the projected surplus for FY 1980 to increase the reserve for collective bargaining to $301 million for that year. This would be sufficient to continue the payment during FYs 1981 and 1982 of nonpensionable cash bonuses of $750 per annum, which had been included as part of the labor settlement in prior years. With approval of the City's outside auditors, this reserve will fund the full cost of the cash bonuses for FYs 1981 and 1982 ($150 million annually).

On June 19, 1980, it was announced that the City had reached a tentative wage settlement with the non-uniformed municipal employee unions. The wage increase that had been negotiated is double the wage increase provided for in the May 12 financial plan. The agreement also provides for the continuation of the annual cash bonus payment of $750 during FYs 1981 and 1982. Under these assumptions, we estimate that the City will have to fund additional labor costs in FY 1981 of about $141 million and over $459 million in FY 1982. These estimates assume that the uniformed City employees, still negotiating at this time, will reach a similar agreement.

The terms negotiated in the tentative wage agreement are very costly for the City. By 1982 the wage agreement will have increased the City's budget gap to approximately $1 billion which will have to be closed through very substantial expenditure reductions or tax increases. In addition, the agreement also calls for converting the current $750 annual nonpensionable cash payment into a pensionable base wage cost for fiscal 1983. This will significantly increase salary costs in that year before the effect of any settlement that will have to be negotiated between the City and the municipal unions in June 1982. In addition to the significant budget impact of the wage agreement, particularly in 1982, we are very concerned that no productivity savings are contained in this agreement that could offset
some the cost impact of the settlement. If the City is
going to maintain adequate service levels without large
expenditure reductions, the City work force must become more
efficient. In the absence of significant productivity
savings in the tentative wage agreement, the City faces
having to take drastic actions to balance its 1982 budget as
required by law.

III. OTHER EXPENDITURES

The City's estimated pension costs for FY 1981 reflect a
number of revised actuarial assumptions to effect compliance
with GAAP. Chief among these is the City's inclusion of
$126 million to properly accrue pension costs (largely
attributable to the Fire Department Pension Fund).

The City has also changed the method of calculating pension
costs so that such costs for a current fiscal year are
computed based on salary levels as of June of the preceding
fiscal year. Thus, the pension costs estimated for FY 1981
do not reflect the added pension costs resulting from the
wage settlement. (This method saves the City about $20
million in FY 1981 assuming a 4% wage settlement.)

The City's projection of administrative other than personal
services ("OTPS") expenditures, appear reasonable. During
FY 1981, the City may continue to benefit from underspending
in this category which occurred during FYs 1979 and 1980.
The City's projections for public and medical assistance
costs during FY 1981 assume a levelling off of the decline
experienced in recent years and are considered reasonable
and consistent with the City's economic assumptions.

IV. COVERED ORGANIZATIONS

Board of Education

For FY 1981, the appropriation contained in the Executive
Budget for the Board of Education (BoE) is $344 million greater
than the amount provided in the FY 1980 modified budget.
The primary reasons for this increase are (1) collective
bargaining costs ($92 million at 4%), (2) program enhancements
and register increases for special education ($117 million),
(3) energy costs ($31 million), and (4) increased fringe
benefits ($19 million). In order to fund these additional
needs, the City has increased its funding of the BoE by $96
million (not including pensions and debt service which are
accounted for elsewhere in the budget), State aid for educa-
tion will increase by about $131 million, and the BoE will
offset $98 million of these new needs through attainment of
the planned PEG. Federal aid, estimated to be $281 million,
has decreased from the FY 1980 level, largely due to the
elimination of impact aid and reductions in other entitlements.
A significant portion of Federal and State aid is designated to help offset the rapidly rising costs of providing Federally mandated programs such as special education. Full-time personnel levels in FY 1981 are projected to increase by over 1,000 positions from the FY 1980 level, chiefly for the special education program. In addition, the incidental costs of providing education for handicapped students, such as transportation, escort services, and contracts with private schools for services that the BoE cannot provide, have increased rapidly in keeping with greater enrollments in the program. Although intergovernmental aid has grown, the escalating costs of providing the mandated educational programs create an ever-increasing strain on City-funded expenditures.

The Board of Education faces major uncertainties in the coming years. As with other City agencies, the BoE's budget probably will have to be increased to fund a labor settlement in excess of the costs currently provided for in the budget. The BoE's PEG for FY 1981 includes savings to be derived from declining enrollments ($21 million), cutbacks in administrative staffing ($54 million), elimination of pedagogical employees through attrition ($8 million), and from other areas for a total agency savings of $98 million. This represents the largest portion of PEG savings assigned to any one City agency. It is important to recognize that City-funded support for the Board of Education is $96 million higher than the level of support contained in the FY 1980 modified budget, even after considering the impact of the BoE's PEG plan. The reason for the increased funding is that the Board of Education's PEG plan was reduced from $111 million contained in the February plan, to the currently proposed $98 million, and new needs were increased from $55 million to $69 million. Net savings to the BoE resulting from PEG are now expected to provide only $30 million for FY 1981. Moreover, the adopted budget now includes additional City funding of $22 million for the BoE in FY 1981. The experience has been, therefore, that new needs for the BoE continue to be identified while PEG savings are reduced, causing ever-increasing City support. Thus, the BoE's potential to substantially increase the projected FY 1982 deficit has been well established.

In looking ahead to FY 1982, the BoE's budget will continue to grow due to the lag inherent in achieving savings from enrollment declines, mandated educational programs and increasing salary costs from the new labor contract. While some savings can be achieved from the proposed expenditure reductions, long-term plans that will effect tangible reductions in the basic expenditure pattern of the BoE do not appear realizable at this time. Even if such plans were to be developed, the semi-autonomous nature of the BoE makes it
difficult for the City to impose expenditure reductions and savings programs, and to insure that the targets are met. A system of financial controls is currently being formulated by the City and the BoE to improve the monitoring capacity and enhance the prospects of attaining savings goals, but such controls are not yet in place. At best, the urgent need to redirect the policies of both the City and the BoE toward tighter fiscal control and concrete, far-sighted fiscal planning has not yet been fulfilled.

Health and Hospitals Corporation

Another covered organization which has been receiving increased City funding to offset looming budget gaps is the Health and Hospitals Corporation (HHC). For FY 1981, however, the HHC is projected to have a balanced budget. The improved financial condition of the HHC is primarily the result of higher revenue collections stemming from the State's recent approval of greatly increased rates for Medicaid, Blue Cross and skilled nursing facilities. In addition, the HHC's budget is dependent upon the receipt of $110 million of nonrecurring revenue in FY 1981 from a rate appeal settlement related to prior fiscal years. Of this total, approximately $70 million represents the State's share and, at this time, it is not definite that the State will make the full payment in FY 1981, as assumed in the HHC's budget. (As mentioned earlier, it is also not clear as to whether this State payment would be an offset to the $72 million of State gap-closing aid for FY 1981.) In anticipation of the receipt of this revenue as planned, however, the City has reduced its funding of the HHC from the FY 1980 modified budget level by about $116 million. Should the appeal settlement revenue not occur as planned, additional City funds will probably have to be allocated to the HHC to cover any shortfall.

Other uncertainties in the HHC's Plan for FY 1981 include an estimated $38 million from revenue enhancement programs and savings of $25 million from the hospital closing and reorganization plan. The revenue enhancement programs developed for HHC by outside consultants have not been materially productive to date; therefore, the planned revenues may not be fully achieved. The estimated value of the savings from the hospital closing and reorganization plan was reduced in the current plan for HHC by about $12 million from the February Plan for FY 1981. The savings estimate now assumes only that Sydenham Hospital will close by June 1, 1980. Savings from closing Metropolitan Hospital were reduced, as were estimated savings from reorganizations of clinics and contracting for outside management for the other municipal hospitals, because plans for the implementation of such actions have been delayed.
It must be stressed, however, that if the HHC achieves a balanced budget for FY 1981 it will largely be the result of the infusion of a substantial "one-shot" revenue and in no way signals the end of the chronic imbalance of revenues and expenditures inherent in the HHC. Although the substantially increased reimbursement rates for Medicaid, Blue Cross and skilled nursing facilities will continue through FY 1982, these revenues will not be sufficient to meet costs in FY 1982, when HHC deficits are once again projected, ranging from $35 million to as much as $125 million.

Transit Authority

The Transit Authority (TA) has a projected budget gap of $293 million in FY 1981, increasing to $415 million in FY 1982. Unlike the City's other covered organizations, however, the TA has the ability to take revenue-generating actions which include raising the fare. In this regard, the TA has already undertaken certain actions such as eliminating the half-fare program for the elderly during morning rush hours and for weekend bus and subway rides and increasing the tolls for certain bridges and tunnels. While the TA is currently conducting hearings on proposals to increase the subway fare, without additional outside aid, the TA would require a minimal increase of $.25 for FY 1981, and a greater increase for FY 1982. Recent developments, however, indicate that gap-closing actions are likely to be comprised of some intergovernmental aid as well as a slight increase in the fare. Given the size of the projected TA gaps, and the limitations of the gap-closing proposals, however, there appears to be serious questions as to the prospect of balanced TA budgets for the upcoming fiscal years.

V. PEG

The Financial Plan for FYs 1980-1983, approved in February 1980 for FY 1981 included $507 million of City actions to close the projected budget gap. In addition, the PEG included $170 million of Federal ($100 million) and State ($70 million) gap-closing aid. The Executive Budget for FY 1981 includes $502 million of City PEG actions.

Certain changes in the composition of the program were made by the City in preparing the Executive Budget. These changes include a decrease in agency budget reductions of $22 million (including $13 million which was added back to the BoE's budget) from $248 million to $226 million, and an increase in other expenditure reductions (primarily involving subsidies to covered organizations) of $22 million from $51 million to $73 million. The net change in the PEG also includes a reduction of $5 million (from $33 million to $28 million) for the estimated impact of improvements in City revenue collections for fees, licenses and other City charges.
The City's incorporation in the budget of substantially all of the proposed PEG for FY 1981 is a positive action on the City's part to attempt to restrain the growth of expenditures while seeking to enhance revenue collections in a way that would not be detrimental to the City's economic base. The program, however, is largely dependent upon revenues that are far from certain, and upon expenditure and subsidy reductions which may prove difficult to accomplish.

As noted in the discussion of FY 1981 revenues, the City includes as anticipated revenue a total of $172 million of Federal and State gap-closing aid. The extent to which this expected revenue is achievable will not be known until several months into the fiscal year, and the City currently has no back-up plan which would provide additional revenues or expenditure reductions to cover any shortfalls that may occur. Similarly, the attainability of the planned expenditure and subsidy reductions will only be known as the year progresses, and because such reductions are reflected in the agencies' budgets, the PEG actions will be difficult to monitor.

A disconcerting development in the process of preparing the FY 1981 budget was the City's identification of new needs requiring City funding of $164 million over projected expenditure levels contained in the February 1980 Plan. Thus, few of the PEG expenditure reductions will actually result in a net decrease in agency expenditure levels, but rather, the PEG reductions will serve to offset the size of the spending increases which have been projected. In this regard, then, the PEG Plan acts as a City-wide cost containment program as opposed to a cost reduction program. While cost containment is a worthy goal, it does not accomplish the necessary objective to actually reduce City-funded expenditures in a period of economic decline, State and Federal budget policies which merely maintain or even reduce aid levels, and inflationary pressure on fixed expenditure levels. As the City approaches FY 1982, realizable savings from expenditure reductions must become an integral part of the City's plan to achieve a balanced budget; cost containment—or even cost control—will not address the basic imbalance between revenues and expenditures. The City's identification of new needs which more than offset planned PEG reductions of FY 1981 expenditures implies that City policy has not yet been redirected toward true retrenchment.
VI. THE CAPITAL PLAN

During the years since 1975, monitors of the City's budget have focused their oversight activities on the City's expense budget. The City has made substantial progress toward fiscal recovery since 1975 and with the submission of a GAAP-balanced budget for fiscal 1981, the City has taken a major step toward reentry into the long-term credit markets. During the past five years, the constant pressure and the more immediate problems of balancing the expense budget often obscured the underlying purpose of the City regaining market access. It is critical to the long-term habitability of the City that it be able to finance and rebuild its rapidly deteriorating physical plant. Therefore, both the City's Expense Budget and Capital Plans for 1981-1984 should be viewed together as both are inexorably tied to the future viability of the City.

An analysis of the City's FY 1981-1984 Capital Plan must include both the current status and recent history of the City's management of the capital program. While there are encouraging signs that the volume of capital construction will begin to approach targeted levels in the future, the underlying management of the capital program has yet to produce a reasonably predictable and controlled capital plan.

Recent History

During the three year period from 1976 through 1978, new capital construction was halted as a result of the lack of available financing, and agencies with capital programs did not continue to design capital projects. When these constraints were lifted with the advent of the Four Year Financial Plan which provided the City with $2.3 billion in long-term financing for the 1979-1982 period, the City had no pipeline of capital projects ready for construction. As a result, needed capital construction did not get started and capital cash flow has not approached targeted levels. In both fiscal years 1979 and 1980, the City underspent their original cash flow targets (City dollars) for those years by 37% and 32%, respectively.

In an effort to reach its $2.3 billion capital spending target for the 1979-1982 Financing Plan, the City has begun scope and design work on a large number of capital projects in order to expand the capital pipeline for future construction. This has had a positive effect on the level of capital commitments in 1980 which will be double the value of 1979 commitments. The pressure on City agencies to generate a large pipeline of projects, however, has not been matched by the development of a central system that would enable the City to track and manage the capital plan.
The most fundamental problem that continues to impact the City's capital budget is the lack of effective central control of the capital process or the formulation of the annual Capital Plan. There are no common assumptions used by both OMB and the agencies to formulate a project-by-project capital program. After two years of underspending capital targets, City agencies continue to grossly overestimate annual commitment and cash flow forecasts for a fiscal year. OMB, in turn, has made little effort to reconcile differences between agency targets and their City-wide Capital Plan. For example, in the City's January 1980 Financial Plan, City agencies estimated that they would commit $905 million in City-funded projects by the end of fiscal 1980 as compared to the OMB target of $814 million for the same period. With only 6 months remaining in the fiscal year, OMB could not determine a project breakout that supported their estimate. Capital cash flow targets for fiscal 1980 were estimated by the agencies in May 1979 as totalling $576 million. In June 1979, OMB lowered this estimate to $440 million and finally in January 1980 OMB lowered the target again to $393 million. In both cases the OMB estimates are far closer to being accurate than those of the agencies; however, OMB could only formulate estimates on an aggregate basis without documentation of the specific capital projects that were involved.

A major cause for the continuing disparity in capital commitment and spending targets is the lack of a capital management information system that reflects reasonable assumptions regarding agency work speed and work capacity for a fiscal year. Neither OMB nor the agencies have developed realistic models of the length of time it takes to move a project from scope to construction, which forms the basis for the timing of future capital liabilities. While some attempts have been made to model work speed, in the case of the two agencies with the largest capital programs, Sewers and Highways, these models have not proven to be realistic. For example, the Department of Highways estimated in January that on an average project it takes approximately 21 months to complete the pre-construction process; OMB estimated it took 24-28 months; and we have found from tracking Highway projects, that it can take as much as 32-34 months to complete the pre-construction process. Clearly the timing of capital commitments and cash flow is affected dramatically by which assumption is used to formulate the agencies' capital plan. The current capital information system reports are not based on realistic appraisal of work speed and they have been produced, after the fact, to reflect the City's Financial Plan rather than becoming the basis for the Plan.
As a result, it has been difficult for the City to control the capital program. For example:

-- The City has underspent available capital financing to date, and may still underspend their 1979-1982 Financing Plan target, although capital cash flow has been increased greatly by inflation.

-- Inflation-driven cash flow masks the continuing problem of project work speed in some agencies. For example, in the Department of Highways, approximately 45% of the projects originally planned for construction between 1979 and 1982 are no longer in the Plan for those years, although cash flow targets for highways are still as originally targeted as a result of inflation. Project slippage is clearly extremely costly for the City and may cause many of these projects to be dropped from the Plan altogether.

-- The pressure to spend available financing during the Four Year Financing Plan period has created a large pipeline of capital projects which are in the initial pre-construction phases. At current work speed, many of these projects will not be ready for construction by 1982, but will begin in 1983/1984; years in which the capital budget may have to be constrained due to uncertainties in available financing levels.

The 1981-1984 Capital Plan

The 1981-1984 Capital Plan represents a departure from past capital plans in many respects. The Plan reflects a genuine effort on the part of OMB to analyze the relationship between capital commitments and cash flow and the Plan allows flexibility during the fiscal year to allocate resources between agencies as it becomes clear which agencies will not meet their annual targets. However, the absence of a good information or program management system has created real problems for the City in constructing the current Plan. Absent a reasonable model of agency work speed or an accurate tracking system, OMB has not been able to estimate project commitment dates even for FY 1981. As a result, the Capital Plan contains arbitrary annual commitment and cash targets which are substantially reduced by OMB (prior to the start of the fiscal year) to take into account assumed project slippage.
Consequently, aggregate commitment and cash flow targets for the City as a whole are not supported by agency specific annual capital targets. For example, in FY 1981 commitment and cash flow targets for City agencies total $1,367 million and $1,072 million (City dollars), respectively. Yet the City-wide planned commitments and cash flow for FY 1981 are $1,153 million and $669 million. The difference of $300 million in commitments and $400 million in cash represents "unidentified slippage". While this Plan allows OMB to allocate resources between agencies as well as substitute pipeline projects for planned projects during the fiscal year, the Capital Plan in its current form is extremely difficult to monitor. Consequently, the FCB and MAC have requested that OMB provide a quarterly commitment plan broken out by project for FY 1981 as supporting documentation for the City's Capital Plan. The City has agreed to provide this information, which will greatly assist in identifying project slippage as it occurs during the year.

* * *

For the first time since 1978, the City faces a four year capital program (1981-1984) that will approach currently anticipated annual financing ceilings, at least in FYs 1983-1984, when the projected capital spending program could be restricted by the financial capacity available to the City.

The level of financing for capital projects depends upon a number of factors. For example:

--The amount of MAC financing available.

The Municipal Assistance Corporation has been granted in the last week, through legislation, an extension of its borrowing authority beyond 1982 as well as an increase in the amount of debt that can be issued to approximately $10 billion.

--The amount of debt which the City can issue on its own.

The City may be able to return to the long-term credit markets in 1983-1984, but the amount of debt that the City can issue will be limited during the first years of market reentry.

It is consistent with the Federal Loan Guarantee Act that the U.S. Treasury authorize issuance of guaranteed City bonds. If these bonds were issued in 1981-1982, it would allow MAC to issue capital debt to prefinance a portion of the City's capital program for 1983-1984 when the capital requirements will be very substantial.

The use of the Federally guaranteed bonds provided for in the adopted Federal legislation is critical to providing full financing for the City's capital program in 1983-1984. With the U.S. Treasury's approval, the current legislation would allow the City to issue up to $900 million in guaranteed bonds for capital purposes. Without this capacity, it is likely that the City's capital program would have to be constrained in 1983-1984 as a result of financing limits of both the City and MAC. With the alarming rate of deterioration in the City's infrastructure, a constrained capital program in the near future would be a costly alternative for the City.

As the spectre of possible financial limitations on the City's capital program looms in the near future, it is becoming increasingly important that OMB and City agencies develop and maintain a capital information system which can produce realistic estimates of the timing of agency capital commitments and cash flow. In a constrained environment the City will have to carefully prioritize the capital program, and control of the timing of this work is critical to being able to finance major areas of needed construction.

This problem begins to emerge in the City's capital plan for fiscal 1981-82. It is evident from our analysis of agency work speed that some agencies have been allocated a greater level of resources than they have the capacity to deliver in fiscal 1981 while others will be restricted by their targeted resource level. For example, it is highly likely that the Department of Sewers could commit as much as $100 million more in fiscal 1981 than the target commitment level of approximately $120 million currently contemplated in the City's plan. On the other hand, other agencies such as the Departments of Highways, Corrections and Education will probably not be able to meet the full value of their commitment targets in fiscal 1981. In fiscal 1982, on the other hand, it is likely that the Department of Highways will far exceed their commitment target and the Sewers program will have to be held back as the City's bridge rehabilitation program emerges in 1982-1983 as a major funding priority. The City will have to correct these allocation problems in the Capital
Plan during fiscal 1981 if the City-wide commitment and spending targets are to be achieved. The danger of not being able to realistically anticipate agency capacity relative to the planned volume of work is that in a constrained financial environment the City may face the prospect of having to severely reduce the capital program of an agency that has largely completed pre-construction phases of their projects in order to fund an alternative priority or simply not be able to shift funding for priorities at the time they are needed.

A potential solution to many of these continuing problems with the capital information system could result from the Mayor's appointment in January 1980 of a full-time Director of Construction. This office could greatly assist agencies in expediting the capital process as well as establishing and maintaining performance levels and responsive information systems. As yet, however, the Office of the Director of Construction has had little impact in these areas. This is in part because clear jurisdictions have not been established between this office and OMB and the role of the construction office has not been established with City agencies.

It is evident, therefore, that the City is progressing to the point that it will have a substantial annual capital program in the near future. This positive development, however, has not been paralleled by the development of a capability to plan, forecast, and control the capital program. A sustained emphasis on setting priorities and establishing a capital management information system will be required on the part of the City in the face of difficult times ahead.
11 June 1979

Honorable Edward I. Koch,
Mayor
CITY OF NEW YORK
City Hall
New York, New York 10007

Dear Mayor Koch:

As required by Section 3040 of the Municipal Assistance Corporation For The City of New York Act, we have reviewed the City's budget submission for the 1980 fiscal year. In accordance with the Act, we present our initial findings and determinations.

Our report reviews the Mayor's Executive Budget. It is based on our own studies and the staff analyses of the Financial Control Board (FCB) and the Office of the Special Deputy Comptroller (OSDC). We have met with both offices on the issues raised by these reports and have had discussions with the City on these matters as well.

The revenue and expenditure projections in the Executive Budget assume a modest economic downturn in the first half of FY 1980, and a gradual recovery in the second half of the fiscal year. If a more serious economic slump were to occur, the City's ability to achieve its FY 1980 targets could be significantly affected. Several of the City's major revenue sources -- the sales tax, personal income tax and stock transfer tax -- are economically sensitive, and revenues from the real property tax may decline, as well, if delinquency rates increase as a result of an economic decline coupled with increases in fuel and utility costs. The City's expenditures can be expected to increase if there is an economic downturn more serious than projected, as a result of increases in the public assistance caseload and related human services costs and potential increases in the number of housing units held by the City as a result of in rem housing proceedings.
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Nonetheless, we have determined that, as of now, the budget for FY 1980 is balanced within acceptable margins for error and conforms with the requirements of Section 3038 of the MAC Act, as amended, as it applies to FY 1980. Among the reasons for this conclusion are the following:

-- the general agreement among all parties on the core revenue and expenditure estimates after staff reviews by the OSDC and the FCB. In fact, the revenue estimates of both these agencies suggest that City projections for certain economically sensitive taxes -- stock transfer and personal income -- remain potentially conservative, if the City's economic assumptions regarding FY 1980 prove correct.

-- the size of the remaining uncertainties for FY 1980 in light of the City's successful performance in responding to larger uncertainties in previous years. The City has taken all the steps necessary to achieve the budgetary requirements of each year since FY 1976. The present City administration has committed itself to take whatever actions are necessary to continue its compliance with those requirements.

There are a number of areas of uncertainty, however, with respect to FY 1980 which warrant concern and which MAC will continue to review:

I. UTILIZATION OF NEW REVENUES

According to the OSDC, the Executive Budget reflects approximately $340 million in additional available revenue and State and Federal aid for FY 1980, compared to the Financial Plan approved in February. The City proposes to allocate $15 million of this amount to improve its basic long-term fiscal position (increased phase-out of capitalized expenses) and to use the rest either to increase spending levels or to reduce the level of budget reduction programs originally proposed.

One significant manifestation of this policy decision is the increase in the number of full-time City-funded employees as of June 30, 1980 by 2,900 positions above the February 1979 Financial Plan level. This will constitute a small net increase in the number of City-funded positions during FY 1980, rather than the 3.6 percent attrition program adopted in February 1979 or the original 4 percent attrition program adopted in November 1978.
This decision was made possible by increases in local revenues, the movement of anticipated revenues (proceeds from a bond sale by the Education Construction Fund) from FY 1979 to FY 1980, increases in State aid, and reductions instituted by the City through its Level I reduction program. These increases will enable the City to "buy-out" a portion of the CETA positions for which Federal funds will not be available as of October 1, 1979, to increase personnel in several agencies, and increase support for programs the City deems essential.

While these goals are not without merit, the result of this action is to once again postpone until later years -- when budget gaps are greater -- the implementation of an attrition (reduction of payroll) program. The OSDC, in its draft report, points out that, as a result of this decision, a substantially smaller percentage of the actions to reduce budget deficits for FY 1982 will be implemented in FY 1980 than was originally contemplated. Based on the January 15, 1979 Financial Plan, 25 percent of the actions necessary to close the FY 1982 budget gap were to have been taken in FY 1980. This has now been reduced to 11 percent. This decision implies that the City is not only reluctant to re-establish a program of retrenchment -- absent since 1977 -- but also that given a short-term increase in revenues the City will spend the bulk of those revenues rather than use them to improve its debt position or to ease longer-term expenditure problems.

II. HEALTH AND HOSPITALS CORPORATION

The staffs of the FCB and the OSDC report continued concern with the finances of the Health and Hospitals Corporation (HHC). The Budget proposes (a) the elimination of a $10 million City reserve for Medicaid which was used to meet HHC revenue shortfalls in FY 1979 and (b) a program to close a projected baseline deficit of $37.7 million.

The OSDC and FCB question both the baseline deficit and the program to close the gap.

The OSDC report of a proposed budget gap for HHC between $46 and $116 million is based on an analysis of revenue shortfalls, administrative problems in billing for Medicaid, the absence of programs to insure increased collections from self-pay patients,
potential costs relating to Social Security changes, and an evaluation of the proposed attrition program for HHC, which appears to require a 9 percent reduction in the HHC workforce between April 1, 1979 and June 30, 1980, with no corresponding decrease in revenue levels.

While the City is not legally mandated to eliminate gaps in the budget of HHC, past practice has been for the City to use its revenues to do so. In FY 1979, more than $45 million of City funds are being used to balance the HHC budget; if similar action is required in FY 1980, it would markedly reduce the City's reserves and could jeopardize its ability to respond to unforeseen events.

The City administration is scheduled to outline a program to control HHC costs on June 15.

I. SOCIAL SERVICES PROGRAM COSTS

The City's FY 1980 Budget projects a decline of $66 million for Public Assistance from the FY 1979 level. A portion of this program depends on welfare caseload reductions (a 3 percent decline projected for FY 1980), continued removal of ineligibles from the welfare rolls and a general stabilization of income redistribution programs.

Certain questions remain regarding these assumptions:

Caseload Projections

OSDC reports that the baseline caseload projections for the end of FY 1979 appear to be low. If the OSDC estimates are accurate, baseline costs will increase.

Economic Downturn

If the region were to suffer a serious economic downturn, the ability to maintain a shrinking caseload would be jeopardized. Depending on the depth and length of an economic slowdown, increases in applications for both Aid to Families of Dependent Children (where the City is responsible for 25 percent of the cost of each recipient) and Home Relief (where the City and State each pay 50 percent of the program) could be expected. Proportional increases in costs would also occur in the Medicaid program.
Increases in the Basic Welfare Grant

New York State has not increased its basic welfare grant since 1974, with its standard of need computed on a 1972 base. Both the Speaker of the New York State Assembly and the Majority Leader of the New York State Senate have indicated their support for a grant increase. City officials support the concept of a grant increase, but take the position that the State should assume the full cost of the added amount, including any incremental Medicaid costs that might be incurred. Under present statutes, the City would be required to pay 25 percent of an increase in AFDC costs and 50 percent of an increase in Home Relief costs.

IV. PROGRAM TO ELIMINATE THE GAP

A substantial factor in the Executive Budget is the assumption of successful implementation of $153 million of cost reduction actions. The OSDC reports that "...many of these [cost reduction] programs, however, have as yet not been well defined," and that "...shortfalls in any of these areas will impact negatively on the City's plan." Among those areas of expenditure cited for particular concern by the OSDC are the Board of Education, the Board of Higher Education, and the uniformed services (Police, Fire, and Sanitation). This lack of definition is of particular concern to MAC, as the City has already offset $119 million of new expenditures against these projected savings, leaving a net expenditure saving of $34 million.

V. FIRE DEPARTMENT PENSION FUND

The continued underfunding of the Fire Pension Fund threatens the solvency of that system. The OSDC report points out that if the City begins to fund the system based on up-dated actuarial assumptions -- a plan reported to be under consideration -- the City's costs for such funding could increase by between $65 and $85 million in FY 1980.

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Given the uncertainties discussed above, we believe it is imperative that the City implement a system of periodic reporting to the FCB, OSDC and MAC of information necessary to assess the developments affecting the City's revenues and expenditures during the coming year. Accordingly, we support the FCB's February 1979 resolution calling for the City to furnish monthly reports which would enable those agencies charged with oversight responsibilities to monitor the City's progress toward its budgetary goals.

We understand that the City has agreed to provide a series of reports in several critical areas which MAC will review in accordance with its statutory oversight responsibilities.

* * * * *

FINANCIAL PLAN -- FISCAL YEARS 1981-1983

The Financial Plan projects substantial budget gaps for each of the 1981 through 1983 fiscal years. The City projects a budget gap of $406 million for FY 1981, $793 million for FY 1982 and $814 million for FY 1983. These projections assume the Level I reductions contemplated for FY 1980 and take into account the reduction in the City subsidy for the HHC which is discussed below. The City has proposed a variety of programs to close those gaps. Some of the programs are within the control of the City administration while others are dependent on actions by other levels of government.

In analyzing the proposals for subsequent years, we remain cognizant of the fact that the City met or exceeded its goals with regard to balancing its budget and achieving the targets established in its financial plans from FY 1976 through FY 1979. This achievement is the product of several factors:

-- City actions to reduce expenditures, beginning in FY 1976, continue to have an effect on spending levels. Despite the fact that neither the FY 1978 nor FY 1979 budget was truly a "retrenchment" budget (see MAC Reports for FY 1978 and 1979) the actions taken in FY 1976 and 1977 have held City spending (in the FY 1980 budget) at a level approximately 7 percent above that of FY 1975.

-- The new City financial information and management systems have given City administrators better control over spending.
11 June 1979
Honorable Edward I. Koch
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-- Labor settlements between the City and the municipal labor unions have remained moderate during the period since 1975.

-- A general increase in the level of economic activity in the State and City and high inflation rates have produced steadily increasing revenues in economically sensitive taxes such as the personal income tax, sales tax and stock transfer tax.

-- Increases in levels of State and Federal aid during this period have been substantial, although this pattern -- at least with regard to Federal aid -- is now changing.

While the accomplishments of the City in meeting its budgetary targets must be considered when analyzing the programs to close the budget shortfalls for FY 1981 through 1983, it must be noted that the future gaps remain significant. Any major change in the precarious balance that has been established between revenue and expenditure patterns could easily jeopardize the impressive achievements of previous years. Projections for future years will be affected by national economic conditions which differentially affect the City's revenue and expenditure patterns. For example, while certain revenues (e.g., the real property tax) do not grow with inflation, high inflation rates put substantial upward pressure on all of the City's expenditures. Additionally, any prolonged recession tends to slow revenue growth without similarly reducing the need for increased expenditures.

In this context we feel it important to point out that the City's program to close projected budget gaps for FY 1981 through 1983 leaves numerous unanswered questions.

I. WAGE SETTLEMENTS

The Financial Plan states that, aside from a reserve of $82 million of potential new revenues to be derived from sale of property for Westway, no funds have been earmarked for a labor settlement. However, the Plan also states that a "no-cost" labor settlement during the present inflationary period is not likely.

The rates of inflation which resulted in steadily increasing local revenues during the past few years are likely to result in pressure for a wage rate increase in the contract to be negotiated for FY 1981 and 1982
larger than the one negotiated in 1978. The City must also negotiate a second labor settlement during the Financial Plan period, to take effect in FY 1983.

For each 1 percent increase in wages and fringe benefits, the cost to the City is approximately $44 million per year. In addition, beginning with FY 1982, the City must accrue an additional $8 million per year for pension costs for each 1 percent wage increase. No provisions for these costs have been made.

The Financial Plan reports that a wage rate increase comparable to that negotiated in 1978 (approximately 4 percent annually) could add approximately $43 million, $295 million and $465 million to the projected FY 1981, 1982 and 1983 budget gaps, respectively. For FY 1981, this amount assumes receipt of the $82 million mentioned above. Thus, based on the City's own estimates, the projected budget gaps for FY 1981, 1982 and 1983 are $449 million, $1,088 million and $1,279 million, respectively. For FY 1982 and 1983, these estimates do not include amounts which the City will be required to accrue under GAAP, resulting from pension costs attributable to future labor settlements. The OSDC has estimated these costs at $59 million and $89 million, respectively, for a wage rate increase comparable to that negotiated in 1978. Moreover, other uncertainties, some of which are discussed in this report, could further increase these gaps.

As we pointed out above, the City has committed itself to maintain a 1980 City-funded workforce level higher than that projected in February 1979, thereby retaining a base cost for personal services at a higher level than was projected in February 1979.

II. EXPENDITURE INCREASES IN THE COVERED ORGANIZATIONS

Health and Hospitals Corporation

While the City is not mandated to close the budget gap of the HHC, during each year of the financial emergency the City provided funding from its own revenues to insure a balanced budget for the HHC.

The Financial Plan calls for the City to reduce its subsidies to the HHC by $10 million in FY 1980, $40 million in FY 1981 and an additional $20 million in FY 1982. Analysis of the budget of the HHC by the staffs of the
OSDC and the FCB indicates that the deficit for the HHC for FY 1980 appears to be well above the amount projected in the Executive Budget. The OSDC estimates a gap ranging from $46 million to $116 million for FY 1980. There are no programs currently proposed to reduce this deficit for FY 1980, nor is there evidence that the problems for subsequent years will not be greater. Presently, there is no basis for the assumption that the subsidy reduction program for HHC is possible. In fact, it remains to be demonstrated that the City will not be forced to increase subsidies in subsequent years. However, the City is scheduled to outline a program to deal with future HHC deficits on June 15.

**Transit Authority**

The Transit Authority (TA) has projected an operating deficit for FY 1981 of approximately $75 million. This projection does not include the cost of a labor settlement for the TA. The cost of such a settlement is approximately $9.5 million for each 1 percent increase in wages and fringe benefits. While the City is not obligated to increase its subsidy to the TA -- which has the statutory authority to meet deficits by raising the fare -- both the City and State administrations have pledged to maintain the 50-cent fare through 1982. Moreover, as part of the 1978 labor settlement with the TA, the City agreed to increase its operating subsidy to the TA to fund a portion of the wage settlement. The City's position is that any future increases in the level of operating subsidy for the TA should be funded by the State.

**Board of Education**

The single largest proposed reduction among the City's Level I actions to close the budget gap for FY 1981 through 1983 is a proposed reduction in personal service costs for the Board of Education. These reductions are based on the City's projections of declining pupil enrollment. However, the historical precedent has been that it remains difficult to implement major reductions in the budget of the Board of Education. For the remaining years, reductions are scheduled at the following levels:

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
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<tr>
<td>1981</td>
<td>$ 52 million</td>
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<tr>
<td>1982</td>
<td>101 million</td>
</tr>
<tr>
<td>1983</td>
<td>148 million</td>
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III. INTERGOVERNMENTAL AID

The Financial Plan for FY 1981 through 1983 looks to both the State and Federal governments for additional aid to close succeeding years' budget gaps. While the amounts of aid being sought appear reasonable in light of Federal and State patterns in recent years, they may prove to be unattainable, given the political and economic climate which currently prevails.

Federal Actions

Unlike the 1974-75 period when the Federal government was expanding its support for localities with programs such as CETA and counter-cyclical revenue sharing, there are few new Federal initiatives on the horizon. With the exception of the President's modified welfare program, which would provide limited assistance to New York City, the Federal government appears determined to reduce programs rather than expand them. The counter-cyclical revenue sharing program has expired, CETA has been reduced, mass transit aid is being funded at well below the authorized level, and the Federal revenue sharing program is under attack. While it is difficult to speculate on the outcome of the legislative process in Washington, the most vulnerable portion of the revenue sharing program appears to be the grants to states. Any reduction in that program, which currently provides the State with approximately $250 million annually, would severely limit the State's ability to provide additional assistance to the City.

State Aid

During the period of the fiscal crisis the State has continued to increase its commitment to assist the City. For FY 1980, for example, the City estimates that the State will provide increased budget balancing assistance of approximately $180 million. However, continued growth in State assistance will be shaped by several factors, in addition to the Federal activities mentioned above. In particular, the City makes no provision for certain new expenditure needs, such as increased public assistance grant levels or an increase in the mass transit subsidy, and maintains that any such increases should be funded by the State. To the extent that the State provides additional funding in these or other areas, it may be unable to increase substantially its unrestricted aid to help the City close its budget gaps.
The City's Contingency Programs (Level II Cuts)

The City's proposals for additional reductions in the event of failures to obtain Federal and/or State assistance fall into two categories:

Program Dependent on State Legislative Action

The single largest specified program in Level II is the elimination of the remaining portion of the Increased Take-Home Pay program, which requires the City to pay a portion of its employees' pension contributions. The State Legislature has thus far steadfastly refused to consider this item.

Unspecified Actions

The Level II program proposes additional attrition in FY 1981 through 1983 with the amount of projected savings growing from $16 million in FY 1981 to $72 million in FY 1983. This is primarily an unscheduled and unallocated attrition program.

Additionally, the Level II program calls for "other actions" of $38 million in FY 1981, $140 million in FY 1982, and $35 million in FY 1983, which the City will institute to close the gap. Since these amounts are not listed in the "Revenue Changes" portion of the program, they would appear to be expenditure reductions and could entail deeper personnel cuts.

IV. POTENTIAL REAL ESTATE TAX LIABILITY

Pending litigation challenges the City's practice of assessing different categories of property at different proportions of full value. Several judicial decisions in other jurisdictions have held this practice to be a violation of existing State law. State legislation which makes resolution of these cases in the City's favor more likely has been enacted but is being challenged in court. The Financial Plan provides approximately $80 million annually to pay settlements based on pending real property tax claims. The City's most recent estimate of its potential liability for real property tax claims, in the event that plaintiffs ultimately prevail on the proportional assessment issue, is approximately $2 billion.
V. CAPITAL FINANCING

Capital Budget

Essential maintenance of the City's physical infrastructure has been deferred for several years due to the lack of funds to support an on-going capital spending program. Significant portions of the existing physical plant are in dire need of major repair, and there are some additional new projects which should be commenced. The City has not been able to restore its capacity to implement needed construction; as a result, the level of capital spending in 1980, as in 1979, will be well below that which is projected.

Since the physical condition of the City is a key element of its attractiveness in the future to both families and businesses, the success of this program is critical to the City's long-term economic vitality.

Market Re-Entry

The City's ability to meet the statutory requirements for balanced budgets and to achieve other financial reforms resulted in public credit market acceptance of its short-term securities in 1979. The balancing of the FY 1980 budget should allow the City to finance its short-term needs in the public markets during the coming year.

This achievement demonstrates the distance the City has come since the crisis of 1974-75 and is evidence of the City's growing capacity to manage its fiscal cycles and near-term problems.

However, the event which will signal the fact that the City has restored a sound fiscal base for the long term will be the marketing of its bonds on a regular basis (currently scheduled to begin in FY 1981). We believe that the City will only be able to achieve this goal after it demonstrates not only the ability to manage its day-to-day operations but also that it has permanently in place a program which insures that the City's future budgets will be balanced in the face of pressure for increased expenditures and fluctuations in revenues. The City will be required to show that it possesses the will to use short-term gains to improve its long-term position, and has responsibly anticipated and provided for those events which predictably jeopardize the Financial Plan.

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The success of the City's Financial Plan depends on a pattern of events which cannot be assured, particularly since the City has decided to put off that portion of planned reductions that is under its sole control -- reductions in the workforce. The City program requires:

-- moderate wage settlements, comparable to the 1978 settlement;

-- increasing levels of Federal and State aid for both City programs and the covered organizations;

-- avoidance of a prolonged and serious recession;

-- costs and revenues consistent with Financial Plan levels.

In the event that the City's assumptions are incorrect on more than one of these points, the levels of service cut-backs and personnel reductions required within a short period of time could be severe. Early actions to reduce the City's expenditures would increase the City's flexibility to respond to adverse changes in assumptions, should they occur.

* * * * * * * * *
12 June 1978

The Honorable Edward I. Koch
Mayor
THE CITY OF NEW YORK
City Hall
New York, New York 10007

Dear Mayor Koch:

As required by Section 3040 of the Municipal Assistance Corporation For The City of New York Act, we have reviewed the City's budget submission for the 1979 fiscal year. In accordance with the Act, we hereby present our initial findings and determinations.

Our review is of the Mayor's Executive Budget as modified by the City Council and Board of Estimate on June 5, 1978. It is based on our own studies and the preliminary analyses prepared by the staffs of the Emergency Financial Control Board and the Office of the Special Deputy Comptroller; it also takes into account the City's initial response to these analyses. We have met with the staffs of both offices on the issues raised by these reports and have had preliminary discussion with the City on these matters as well.

Based on our analysis of the available information, it appears that the City's budget for Fiscal Year 1979 as adopted on June 5 is in substantial conformance with the requirements of Section 3038 of the MAC Act, as amended and as it applies to FY 1979.

There are a number of areas of uncertainty in which a reversal of current expectations could alter this conclusion. Most important of these are:
Federal and State actions assumed in the Budget that remain to be implemented.

Some of these, such as revenue sharing, countercyclical aid and repeal of certain statutory tax exemptions require legislative action as well as administrative approval.

The labor settlement between the City and the coalition of municipal unions.

In the absence of a final written memorandum of agreement, it is impossible to make an accurate estimate of the cost of the new contracts in FY 1979. Moreover, at this time, there is no agreement at all with the Patrolmen's Benevolent Association, Uniformed Firefighters' Association, and certain other unions.

Unspecified and/or unitemized measures to be used by the City.

It is impossible to evaluate the probability of success of such measures without further information. Similarly, the standby program being prepared by the City puts substantial weight on gross, undetailed expenditure reduction categories.

Debt service.

Until action in Washington on the proposed Federal legislation is complete, the true cost of debt service in next year's budget cannot be ascertained.

Inability to review actual experience in FY 1978.

This necessitates evaluating next year's projections on the basis of this year's estimates rather than this year's actual results.

Future economic trends.

The City's budget estimates are based on projections of the future economic climate that may not be accurate given the recent jump in the inflation rate. If this rise should lead to a recessionary movement in the local economy the City would be faced with lower than expected revenues from its economy-sensitive taxes and higher than estimated expenditures in the social services area.
Nonetheless, we have determined that, as of now, the budget is balanced within acceptable margins for error. Among the reasons for this conclusion we note, in particular, the following:

-- the City's general performance over the past three years in responding to the exigencies of the financial emergency relative to the size of the gap-closing measures necessary for FY 1979;

-- the general agreement among all parties on the core revenue and expenditure estimates after reviews by the staffs of the Special Deputy Comptroller and the EFCB;

-- the proposed contingency program which provides flexibility needed to deal with unforeseen events. This flexibility is enhanced by the fact that the City has relied on only a fraction of actual attrition to reach its 1979 goals;

-- the possibility of favorable developments, including additional Federal aid and a continuation of the general pattern of underspending by the City during the past two fiscal years;

-- the continued existence of the EFCB as a viable and forceful monitor.

Our focus in this report is on the City Budget for Fiscal Year 1979, as this is our immediate statutory responsibility. The City has also presented a four-year Financial Plan which we will evaluate and report on in a month's time. However, our analysis of the present budget raises issues which have important consequences in future years. Of particular concern in this area are the following:

1. The future costs of the labor settlement.

Though there is yet no written memorandum of agreement to be evaluated, it is clear that much of the cost of the agreement is obscured by delay of the implementation dates of various benefit provisions. The contract requires the City to use three years of revenue (the 1978 "surplus" together with 1979 and 1980 revenues) to pay for a two-year agreement. The effects of the scheduling of benefits (shifting the costs to the end of the contract) therefore do not become fully apparent until FY 1981-82, exacerbating the City's future fiscal problems. At that time the City will have to find savings to cover personal service costs at the higher rates in addition to whatever new benefits will be negotiated for the second part of the Financial Plan period.
The absence of a final contract between the Transit Authority and the Transport Workers' Union combines with the absence of any agreement with some of the uniformed services to further heighten our concern over future cost implications.

2. **The failure to recognize the need for future retrenchment.**

Though the City is still projecting sizeable deficits for the following three years of the Financial Plan, the current budget makes little effort at continuing the reduction in scope and cost of government necessary to meet these challenges. An understanding of the need for continued retrenchment and the ability to plan for it with a minimum disruption of City services has not yet been manifested in the City's current financial plans. For example:

--- The City has heavily back-loaded its long-range attrition plans, changing from the original pattern of reductions of 4%, 3%, 2%, 1% for the respective Fiscal Years 1979-82 to one calling for 1% attrition in FY 79 and 3% in each of the three succeeding years. This costs the City heavily both in the loss of personal service savings over the four-year period and also in loss of flexibility to meet future budgetary needs.

--- Heavy reliance on CETA and other non-tax levy means of funding personnel costs will lead to a net increase in size of the City's workforce next year. Should Federal/State funding be lost or eligibility requirements substantially modified in future years, as proposed by the Federal administration, these additional employees will prove difficult to either sustain or dismiss.

--- The concept of productivity has been divorced from the issue of wage and benefit increases.

3. **Increased State assistance.**

The City's FY 79 Budget depends upon increased State assistance payable from two successive State budgets. This is possible because the City's fiscal year overlaps with two State fiscal years. Traditionally, the benefits from a State surplus have been shared in this manner. The Financial Plan, however, counts on the continuance and growth of State assistance, despite the lack of a legislative commitment to such recurrence and the problematical nature of future economic stability necessary to generate continued State surpluses. A failure in either of these two areas in the future will leave the City with a significantly larger problem.

Pending Federal action it remains unclear at this time whether the City will be able to finance itself after July 1, 1978, what the terms of this financing (if any) will be and what impact these terms will have on this and future budgets.

We will continue to review and update this report over the coming year. Part II of this letter indicates in greater detail elements of uncertainty in the budget which we, together with other oversight agencies, will be monitoring throughout the year.

Part II

REVIEW OF THE BUDGET FOR THE CITY FISCAL YEAR 1979

The following is a more detailed discussion of our analysis of the compliance of the adopted City budget with the requirements of Section 3038 of the MAC Act. Section 3038 requires the City to adopt and maintain an expense budget in which the total of all income items equals or exceeds the total of all expenditure items as calculated in accordance with the accounting principles set forth by the State Comptroller pursuant to the Act (except as modified in connection with the phase-out of capitalized expenses and except for pensions, which are budgeted on a cash rather than an accrual basis).

The City's budget for FY 1979 as adopted on June 5, 1978, appears to be in substantial conformance with these requirements within a reasonable margin for error. However, the achievement of a balanced budget is contingent on several actions by the State and Federal governments that are not yet in place. Moreover, there are major uncertainties underlying parts of the budget which could result in additional budget problems later in the year. Following are some of the major unresolved issues which will require monitoring during the upcoming year. To the extent that developments occur with an adverse impact on the City's budget, the City must be prepared to take prompt, effective steps to deal with these problems.
A. Required Action by the State and Federal Governments.

The adopted budget assumes State and Federal government actions that have not yet occurred. Though the City feels it has reliable commitments in these areas, the possibility remains that these commitments may go unfulfilled. The major items still to be accomplished are:

1. Repeal of the Amtrak and Conrail General Property Tax Exemption.

The adopted budget includes $12 million in property tax revenue that will be uncollectible unless the State Legislature acts to remove this exemption. To date such legislation has not been introduced.

2. Timing of Recognition of State Revenue Sharing and the Pass-through of Federal Countercyclical Funds.

The State's FY 1979 budget appropriation includes payments to the City of $16 to $29 million in State revenue sharing and $20 million in pass-through of Federal countercyclical funds for which no legislative payment date is set. The City's adopted budget counts these funds as FY 1979 revenues, but the City's outside auditors have recently concluded that such payments must be accrued as FY 1978 revenue unless clarifying changes are made in the enabling State legislation. The City has indicated it will seek the required legislative action.


The adopted budget assumes the State will assume the City's share of SSI costs effective October 1, 1978, reducing City expenditures by approximately $50 million. Current State legislation, however, makes this action contingent on State participation in a renewed Federal Countercyclical Aid Program after that date.

The President's current proposal for continuation of the countercyclical program after October 1 does not include participation by the states. Nevertheless, the Governor has publicly committed himself to foster the SSI takeover or provide alternative funding in an equal amount.
4. Other Federal Actions.

The budget, as adopted, includes approximately $18 to $27 million in revenue attributable to other Federal actions, but only $5 to $10 million has been identified with specific projects. The City is currently working with Federal representatives in a variety of areas and feels confident its goals will be reached. The lack of specific information, however, indicates this area is a potential problem. The Emergency Financial Control Board has estimated the potential short-fall here at $10 to $20 million.

B. Other Major Uncertainties.

The adopted budget's estimates of anticipated revenues and projected expenditures include other significant areas of uncertainty which will be unresolved before the start of the fiscal year and which, therefore, will require close monitoring during the year. Most important of those with the potential for major impact on the budget are:

1. Westway.

The City's inability to complete the sale of the Westway right-of-way during FY 1979 would create a revenue shortfall of $80 million. The City and the Governor are firmly committed to this project but there remains the possibility of delays brought about by court action and/or the permit procedures of the relevant State and Federal agencies. The City appears confident the sale will be timely, and is also optimistic that Federal reappraisal of the properties involved will lead to revenues in excess of the budgeted amount.

2. Interfund Agreements.

The adopted budget includes a transfer of $62 million ($79 million including items reimbursable by Federal or State grants) from the capital budget for support of engineering/architectural staff costs associated with capital projects. The City is still implementing the controlled-time distribution system that will enable it to assign personnel costs to specific projects as required by the State Comptroller's Accounting Systems Directives. The OSDC staff has expressed doubts regarding the City's ability to have this system fully functional for FY 1979. It appears the potential problem is in the range of $18 to $35 million (EFCB estimate).
3. **Health and Hospitals Corporation.**

The Special Deputy Comptroller's report notes the potential for a budget deficit of $11 to $95 million. The City has recognized the problem and has prepared new programs to generate additional revenues and savings totalling $59 million. It appears the possibility of a significant deficit in HHC (EFCB estimate $10 to $30 million) is sufficient to warrant careful monitoring of compliance to the original budget and the development of the new programs.

4. **Fire Department Pension Fund.**

The adopted budget does not provide money to amortize any of the unfunded accrued liability in the Fire Department Pension Fund. The OSDC staff estimates the cost of full amortization to be $23 million in FY 1979. At this time, however, it is unlikely an agreement will be reached with the union requiring the City to provide this full amount.

5. **Medicaid Management Information Systems.**

The City has budgeted $18 million for its share of savings from the implementation of MMIS. Given the usual problems associated with the start-up of a new program, there appears to be a potential shortfall here (EFCB estimate $0 to $12 million). The City, however, feels it has been more conservative than the State in estimating MMIS savings and is confident of meeting or exceeding the $18 million figure.

6. **Labor Settlement.**

On June 5, 1978, the City reached agreement on a basic wage package with the coalition of major municipal unions (excluding Fire and Police). Though the City assures us the costs of the agreement, as applied city-wide, will be within the $262 million budgeted for this purpose in FY 1979, there is as yet no written Memorandum of Agreement between the parties. Until a written document is produced it will be impossible to analyze fully the cost of the package as major elements may remain unknown. The Executive Director of the EFCB and his staff were present during the labor negotiations. We expect them to report on the settlement cost relative to amounts available in the Financial Plan and any guidelines which may be established by the Control Board. We will review the written labor agreement and the reports of the Control Board staff and OSDC when they are available.
In addition, it remains unclear how the City intends to fund the costs of increments and COLA I for Board of Education employees not included in the budget. The potential liability here ranges up to $46 million.

7. **MAC Debt Service.**

There is significant uncertainty about cost in this area which cannot be resolved until final action in Washington on proposed Federal legislation. The adopted budget assumes full bonding of the capital reserve funding requirement and a substantial reduction in the magnitude and cost of seasonal financing. These savings can be achieved with enactment of a Federal guarantee program but are uncertain if Washington action is limited to a seasonal loan extension. Indeed, in the absence of a guarantee program, the City's ability to obtain any long-term financing is uncertain. MAC and the City are currently evaluating the budgetary impact of alternative financing assumptions.

8. **Ability of the City to Use Certain Federal Grant Funds Under its CETA and Community Development Programs to Supplant Tax Levy Expenditures.**

The adopted budget includes increased revenue from the Federal government in the amount of $10 million attributable to improvement in indirect cost allowances under CETA and $14 million attributable to the substitution of Federal CD funds for tax-levy support of certain existing programs. Applications for these changes have not yet been submitted and it appears there may be some conflicts with existing Federal regulations and administrative policies. The City feels confident, based on initial discussions with the relevant Federal agencies, these applications will be approved.

9. **Renewal of the Federal Countercyclical Aid Program**

The existing countercyclical legislation expires on October 1, 1978. The City's projection of $120 million in revenue from this program in FY 79 assumes renewal of the legislation in its present form. However, adoption by Congress of any alternative proposals also under consideration could result in the City's receiving
as much as $30 to $50 million less than presently budgeted.

Very truly yours,

MUNICIPAL ASSISTANCE CORPORATION FOR THE CITY OF NEW YORK

Felix G. Rohatyn
Chairman

Dick Netzer
Chairman, Budget Committee

Eugene J. Keillin
Executive Director

Stephen Berger
Budget Consultant