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Speaker Miller, Committee Chair Weprin, honorable members of the Finance Committee, good afternoon.

Over the past three years the City has faced and surmounted its most daunting fiscal challenge in decades. The City Council and the Mayor deserve credit for helping to lead the City through a difficult fiscal period.

Yet, it is the people of the City of New York who merit the greatest recognition for the sacrifices they have made to return the City to fiscal balance.

I can report to you that the City's financial outlook now appears to have stabilized for the current fiscal year and Fiscal Year 2006. The out-years of the Financial Plan, however, continue multi-billion dollar deficits because the City's expenses continue to outpace the growth of its revenues.

The Fiscal Year 2006 Preliminary Budget appears on course toward balance assuming the risks it contains are expeditiously addressed.

These risks total 478 million dollars after accounting for offsetting revenues. The single largest risk stems from budgetary relief the City assumes will be forthcoming from Federal and State actions. The City relies upon an ambitious menu of such actions, and assumes enough will be realized to provide 750 million dollars in relief.

Many of the City's proposed actions have failed to materialize in the past, and it does not appear likely that they will receive legislative consideration in the near future. As in previous years, the Governor released a State budget that claims to provide the City with considerably more assistance than it requested. The City, however, has disputed most of the fiscal relief in the State estimates.

Although my office accepts that some additional State and Federal assistance will likely be realized, 550 million dollars of the City's agenda should be considered at risk.

Other risks to the Fiscal Year 2006 budget include an overtime risk of 150 million dollars and the assumption of 34 million dollars in savings from a reduction in the number of teacher sabbaticals.

This assumption has been maintained despite a ruling by the Public Employment Relations Board (PERB) that the City cannot unilaterally deny teacher sabbaticals in order to save money.

In addition, there are several major issues that are likely to be costly to the City, but whose precise costs and timing are difficult to predict. The City's approach to these issues has been optimistic.

First, the City has made no provision for wage increases for the next round of collective bargaining for civilian employees. This contract expires on June 30, 2005.

The City maintains its position that any wage increases for employees must be funded through productivity initiatives. In the absence of productivity savings, however, it will cost the City approximately 39 million dollars annually for every one-percentage point wage increase for these employees. This omission could result in significant cost to the City. Furthermore, the contracts of firefighters, police officers and teachers are

currently in mediation, the outcome of which could be costly as well. The City has funded these contracts based on the 2002-2005 agreement with civilian employee unions.

For every one percentage point above the civilian employee wage settlement, the City will incur an additional cost of 145 million dollars annually. Any increase in the wage level will also increase the baseline for overtime.

Second, the City faces risks with regard to education funding. As we all are aware, in February, the State Supreme Court ordered the State to increase the City schools' operating budget gradually over a four-year period until it has risen by 5.63 billion dollars a year from current levels. The Court also directed an increase of more than 9 billion dollars over five years in capital spending.

While the City has taken the reasonable position that the State should bear the costs for improving education, it remains unclear whether the City will be required to provide any of the increased education funding required by the court's ruling.

Third, the City must also confront the financial position of the Health and Hospitals Corporation. The City projects that the HHC will face budget gaps ranging between 485 million dollars and 636 million dollars in Fiscal Years 2006-2009, as receipts and disbursements diverge significantly.

While we recognize that the City's estimates may be on the conservative side because certain Federal and State actions may materialize in the outyears to help close these gaps, these actions would not solve entirely the Corporation's problem. In the current fiscal year, HHC appears to have averted a decline in its cash balance due in part to a 150 million dollar prepayment of the City's Fiscal Year 2006 subsidy. However, this results in lower projected receipts for Fiscal Year 2006. Therefore, unless a significant

improvement in HHC's receipts occurs, we should at least acknowledge the potential of a more permanent increase in the level of support that the City provides to the Corporation.

Our concern over these risks is heightened when we take into consideration the City's practice of relying on non-recurring actions to balance its budget. The use of an anticipated 2 billion dollar Fiscal Year 2005 surplus to prepay Fiscal Year 2006 expenses is emblematic of this approach. While the surplus provides one-time budget relief to Fiscal Year 2006, it does not address the central budgetary challenge: the fact that the growth of the City's expenditures outpaces the growth of its revenues over the financial plan period.

This year's projected surplus results from unanticipated revenues that have more than offset increases in this year's expenditures. The surge in revenue is due mainly to a recovering economy and a robust local real estate market driven by historically low interest rates that have together bolstered tax collections. The City has raised its tax revenue estimates for the current fiscal year by 909 million dollars, and is expecting an additional 224 million dollars from non-tax sources.

A surplus is not projected for Fiscal Year 2006. As a result, the City confronts multi-billion dollar deficits beginning in Fiscal Year 2007. The City projects budget deficits of 3.7 billion dollars in Fiscal Year 2007, 3.6 billion dollars in Fiscal Year 2008, and 3.2 billion dollars in FY 2009. This reliance on non-recurring revenues allows the City little margin for error in the event of increases in labor, education and health care costs or another economic downturn.

While the City's economy is projected to expand, my office projects that growth in 2005 will be slower than in 2004, and will lag that of the nation. In addition, rising interest rates may hamper economic growth.

Especially because the City's economic recovery remains tenuous, finding a way to address the embedded gap between revenues and expenditures is crucial to our long-term financial stability. While the City's budget situation is not nearly as dire as it was three years ago, we must work diligently to avert significant fiscal challenges in Fiscal Year 2007 and beyond.

Finally, I would like to discuss the issue of Payments in Lieu of Taxes, or PILOTS. I have serious concerns regarding the transparency and accountability in the process by which these revenues flow in and out of the City's general fund. For example, in Fiscal Year 2004, nearly 237 million dollars in PILOTs flowed into the City's general fund from a variety of sources. The question is, does that represent all the PILOTs the City received last year? We simply do not know, because at the moment the City has no central accounting source for these revenues.

What I have determined is that the Economic Development Corporation has an account that captures PILOTS that come to the City through Industrial Development Agency agreements.

As this revenue source is not a discreet line item in either the IDA's or EDC's budgets, one cannot discern that all of these funds are being transferred to the City's general fund. In that case, we are talking about close to 40 million dollars.

Therefore, my office will conduct an audit of the EDC accounts related to PILOTS to determine that all these funds have been received and expended appropriately. Providing we receive both cooperation and relevant documentation expeditiously, we hope to complete our audit within three months.

Thank you.