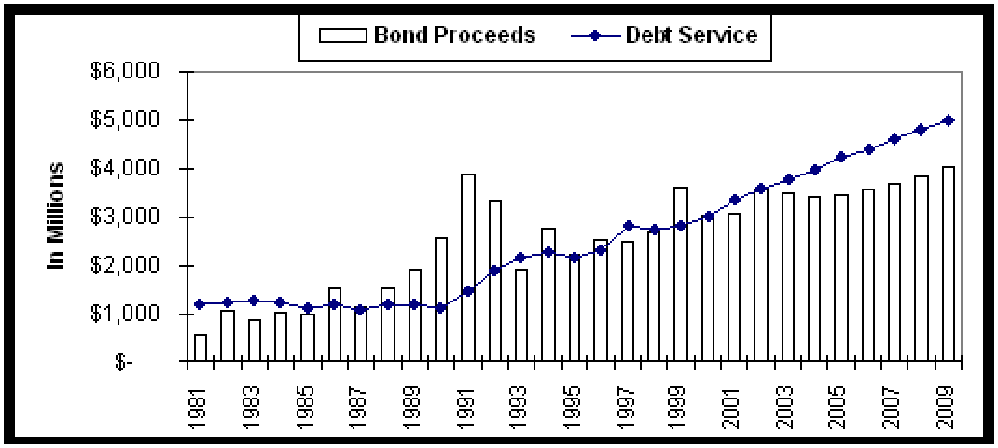



OCTOBER 1998

# *BUDGET NOTES*

## THE CITY OF NEW YORK

## OFFICE OF THE COMPTROLLER

**ALAN G. HEVESI, COMPTROLLER**

**1 CENTRE STREET**

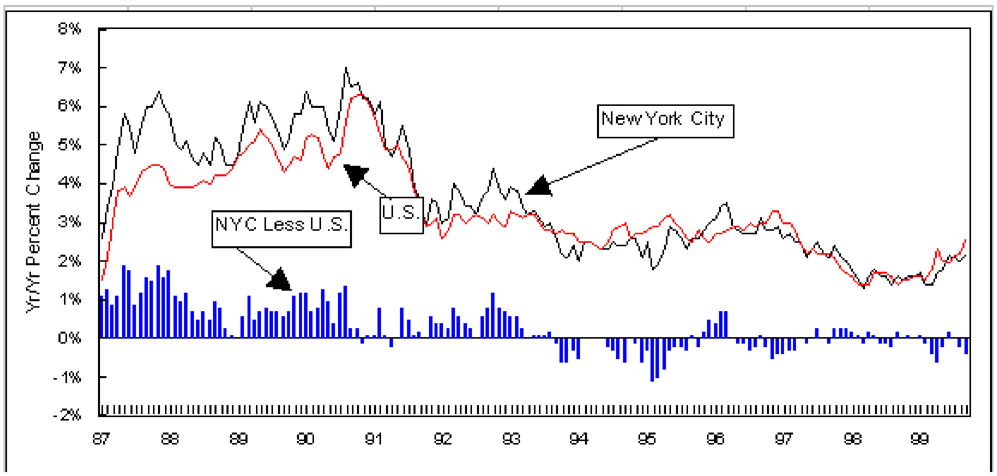
**NEW YORK, NY 10007**

**First Quarter Highlights:**

- **Tax revenues were $368 million above plan, led by property, sales, personal-income and real-estate-transaction taxes in the first quarter of FY 99.**
- **Major miscellaneous revenue collections were $12.7 million above plan.**
- **The public assistance caseload declined by 27,492 in the first quarter to 21,762 below plan.**
- **Pension contributions may be higher by $10 million.**
- **Overtime spending in the first quarter was $25.9 million more than planned, led by the Police and Corrections Departments.**
- **Since the beginning of FY 99 the City's work force has increased by 1,791 employees.**
- **Debt-service savings were $8.4 million in the first quarter.**

**<u>Tax Revenues</u>** For the first quarter of FY 99 (1QFY99), tax revenues, excluding audits, were $362.3 million above the June plan. (Revenues were $397.9 million higher than FY 98's first quarter, an increase of 6.6 percent.) Audit collections were $5.7 million greater than planned, making total tax revenues with audits $368.0 million above plan. (See Chart 1.)

Chart 1. *Difference between Actual and Projected Tax Revenues, 1QFY 99*




Note: PIT=personal income tax, GCT=general corporation tax, Bank=banking corporation tax, UBT=unincorporated business tax, CRT=commercial rent tax, RPTT=real property transfer tax, MRT=mortgage recording tax. 1QFY99=First Quarter of Fiscal Year 1999.

Source: Office of the Comptroller, The City of New York.

The Comptroller's Office, in July 1998, estimated that FY 99 tax revenues would be $531 million greater than planned. Based on first-quarter FY 99 tax revenues, the Comptroller's forecast appears to be on track. However, major downside risks stemming from the instability in financial markets and declining Wall Street profits pose a threat to tax revenues for the remainder of FY 99. While Wall Street profits in the first half of 1998 totaled $6.9 billion, many NYC-based brokerage houses and banks suffered major losses in the third quarter, and laid off some staff. These losses will affect taxes that are sensitive to the health of the financial sector, such as the real-estate-transaction taxes and the personal income tax.

The *personal income tax* will suffer from lower securities profits or losses. The large gains in personal income tax revenue that occurred during FYs 97 and 98 are not likely to be replicated in FY 99. The personal income tax was $42.8 million above plan for the first quarter FY 99. But the tax is likely to have slower growth, even decline, in the second half of FY 99 since lower profits are expected to lessen bonus payments, and layoffs in the financial sector, such as an announced cut of 700 people at Merrill Lynch's NYC office, will reduce withholding tax revenues.

The *real-estate-transaction taxes*, mortgage recording and real property transfer, were $142.2 million above plan for first-quarter FY 99. However, most of these gains were in July and August. Growth in September was still strong, but fell off from the prior months. Compared with 1997, July and August 1998 revenues for the real-estate-transaction taxes grew by 155 percent.

In September, the growth had fallen to 41.7 percent. This decline in growth is most likely caused by the hesitation of would-be homebuyers following the stock-market drop.

The *sales tax* was $63.2 million above plan during the first quarter FY 99, reflecting the continuing strength of the City's economy. However, the sales tax could suffer from curtailed spending on large-ticket items as people feel poorer because of the declines in stock values.

The *property tax* also performed well with revenues $78.6 million greater than expected. The property tax is a relatively stable and predictable tax due to its structure. The property tax is based on a five-year moving average of property assessments and year-to-year changes in assessments are subject to statutory limitations. The FY 99 property-tax roll has begun to reflect the relatively prosperous years of the mid-1990s.

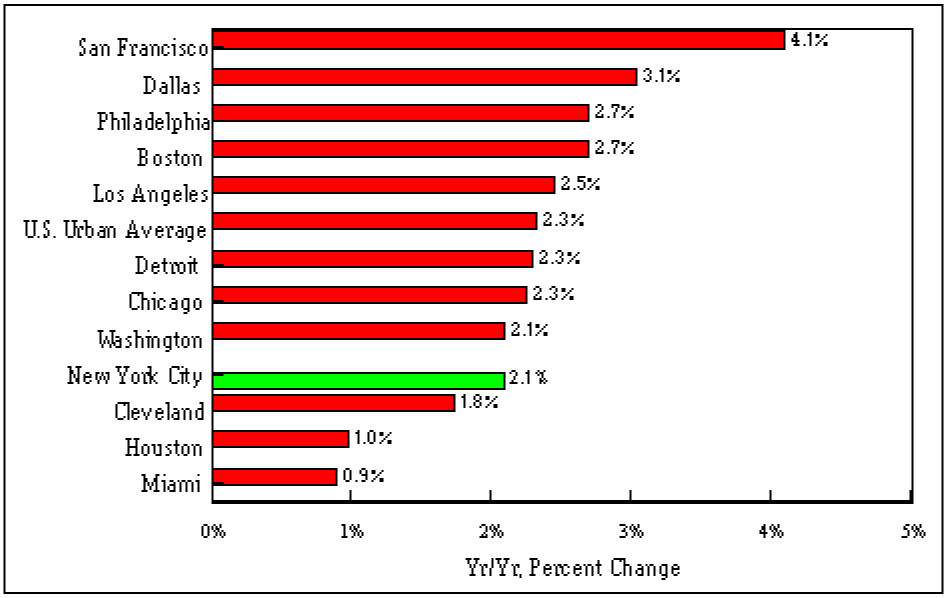
For first quarter FY 99, *general corporation tax* revenues were $35.5 million greater than expected, while *unincorporated business tax* revenues were $16.6 million greater than expected. However, the *banking corporation tax* was below plan by $17.2 million. Revenues from all of these three business taxes pose the greatest risk to the FY 99 forecast. The financial sector has already suffered substantial losses from investment in emerging markets and proprietary trading. The tax-revenue losses may worsen as the fiscal year progresses, especially since it is likely that many businesses are owed refunds from the high tax liability of previous fiscal years.

*Other taxes* were $1.4 million below plan while audit revenues were $5.7 million greater than anticipated.

**Major FY 99 Miscellaneous Revenue Initiatives** The City has budgeted $2.503 billion in FY 99 from non-tax miscellaneous revenues, of which $1.105 billion or 44 percent will be generated from major revenue initiatives. The remaining revenues, $1.398 billion, consist mainly of water and sewer payments ($813 million), City University tuition and fees ($134 million), and payments from the Health and Hospitals Corporation ($114 million) and other revenue sources ($337 million), such as fingerprinting and taxi inspection fees.

For the first quarter of FY 99, the City collected $298 million from the major revenue initiatives, about 4 percent or $13 million more than budgeted. The City has benefited during the first quarter from higher-than-projected earnings on overnight investments of cash balances, mainly as a result of higher-than-average cash balances. Interest earned on cash balances was $46 million, more than twice the budgeted amount of $22 million. The City projects interest earnings of $77.5 million in FY 99 from investments of daily cash balances. In FY 98, the City earned about $161 million in interest from these investments, about $84 million more than budgeted in the FY 98 Adopted Budget. (See Table 1.)

Table 1. *Major FY 99 Miscellaneous Revenues Initiatives, First Quarter Collections ($ millions)*




Source: NYC Integrated Financial Management System.

The City also collected higher revenues than projected from initiatives such as sales of City-foreclosed buildings, cable television franchise fees and park facility privileges. Collections from the sale of City-foreclosed buildings were $4 million, cable-television franchises ($14 million), and park-facility privileges ($10 million). Additionally, a FY 98 overpayment of $2 million in rental income for John F. Kennedy and LaGuardia airports was transferred to the FY 99 miscellaneous budget.

As a result of the faster-than-anticipated rate of transfer of cash from the Capital Proceeds Account to the General Fund, the City has had a lower level of funds for investment in its capital-proceeds account. This has resulted in lower-than-budgeted revenues of about $8 million. Collections from parking-violations fines were also $4 million lower than budgeted. The City has issued approximately 2.2 million parking-violation summonses through September, about 4 percent more than summonses issued during the same period in FY 98. Revenues generated from all other initiatives were $6.5 million lower than budgeted; for example, telephone-commission franchises were $2.6 million, $1.2 million less than projected.

**Public Assistance** The City's public assistance caseload fell again to 735,795 recipients in September 1998. According to caseload data compiled by the Department of Social Services, the public assistance caseload so far in FY 99 has declined by 27,492 recipients, 3.6 percent from the June 1998 caseload of 763,287 recipients. Since reaching a peak of 1,160,593 recipients in March 1995, the City's welfare caseload has experienced a significant decline of 36.6 percent. Monthly grant expenses have undergone an even steeper decline, falling by 38.8 percent to $151.7 million in September 1998 from $247.7 million in March 1995.

Compared with the City's caseload projection from the FY 99 Adopted Budget, the actual caseload is currently 21,762 recipients below forecast. The difference is comprised of 15,825 fewer recipients in the federally mandated Temporary Assistance to Needy Families category and 5,937 fewer recipients in the State-mandated Safety Net Assistance category. If the current pattern is maintained for the remainder of FY 99, the City may generate annualized savings of about $17.2 million that is not reflected in the plan.

**Pensions** *Market Volatility*: As the stock markets around the world display a higher-than-usual degree of volatility, some concern has been focused on pension fund investments. For the pension funds, while it is a time for the continued review of investment policies, it should not be a cause for undue concern. The pension funds, as long-term investors, expect such volatility and market corrections from time to time. Investment performance over the long run is the important criterion.

The City, on the other hand, is monitoring all developments very closely because investment returns in one year affect the level of its pension expenses in subsequent years. For example, a one percent investment return below the actuarial investment return assumption (which is used to project future employer contributions) in FY 99 will increase the City's pension costs roughly by $9 million in FY 00, by $22 million in FY 01 and by $39 million in FY 02. A better performance would similarly reduce the City's pension costs. Investment performance in each year, therefore, has a direct impact on the City's Financial Plan.

*Inflation Assumption*: Long-term interest rates have declined consistently, reflecting lower inflation expectations and a flight to safety. This is a mixed blessing for the City's finances. It is positive on three counts: (1) a low-interest environment provides a healthy business climate and generates steady tax revenues; (2) lower interest rates reduce the City's interest costs on new debt and provide for greater refinancing opportunities; and (3) the appreciation of fixed income investments in the City's pension funds will, at least partially, offset any declines in equity investments. However, offsetting some of these positive impacts is the possibility that the lower inflation expectation may lead to higher City pension expenses. The pension funds' long-term inflation assumption, currently at 3.5 percent, is a component of both the actuarial investment return assumption (AIRA) of 8.75 percent as well as the general wage increase assumption (GWIA) of 4.0 percent. If the inflation assumption is reduced, both the AIRA and the GWIA are reduced. A reduction in the AIRA increases the present value of liabilities for *both* active employees and retirees, while a reduction in the GWIA reduces the present value of liabilities, but *only* for active employees. Therefore, the net effect of a reduction in the inflation assumption is increased pension liabilities and, consequently, greater employer pension contributions.

Any change in the inflation assumption for the City's five major pension systems is not expected prior to FY 01, because an AIRA of 8.75 percent is written in law through FY 00. However, the City's Chief Actuary has indicated that he is contemplating reducing the inflation assumption, and as a result reducing the AIRA, for the Police and Fire Variable Supplements Funds (VSF) for FY 99. Since these funds are valued as liabilities of their parent pension funds, such an action would increase the City's contributions to the Police and Fire retirement systems. For the June 30, 1997 valuation, an AIRA of 8.5 percent was used for the Police and Fire VSFs. If the Actuary were to reduce the AIRA to 8.25 percent for the June 30, 1998 valuation, then the contributions to the Fire and Police pension funds would increase by about $10 million in FY 99

**Overtime** The City paid $99.6 million for overtime through the first quarter of FY 99, about $25.9 million (or 35 percent) more than budgeted and $15.1 million (or 18 percent) more than the first quarter of FY 98. Most of the overspending occurred in the uniformed agencies. The uniformed agencies paid $78.2 million during the first quarter of FY 99, outpacing both the plan ($57.7 million) and the first quarter of last year ($65.8 million) by 35.5 percent and 18.8 percent, respectively. (See Table 2.)

During the first three months of FY 99, Police Department overtime payments were $12.4 million more than planned and $5.6 more than the first quarter of FY 98.

The variance from the plan is the result of such circumstances as: (1) intensified and enhanced anti-terrorism precautions; (2) a scaffolding accident in July that required a large area around Times Square to be cordoned off for an extended period; and (3) the expanded anti-drug initiatives throughout the City, which result in more arrests and, therefore, more arrest processing. In this context, it should also be noted that the Department has 2,210 more uniformed police as of September 1998 than September 1997.

The Department of Corrections has overspent its first-quarter FY 99 overtime budget by $5.2 million. DOC has also paid $3.3 million more during the first quarter of FY 99 than during the same period in FY 98. The City admits that DOC overtime was under-budgeted during the budget-preparation process. It is expected that the budget will be modified later in FY 99. The increased overtime is mostly attributable to higher prison populations that have resulted from increased anti-drug initiatives. The average daily prison population in the first quarter of FY 99 has risen to around 18,400 inmates, up from 17,500 during the first quarter of FY 98.

Table 2. *Overtime Spending (OT) for 1QFY99/1QFY98, $'000*

| | **Actual OT** | **Planned OT** | | **Actual OT** | |
|---|---|---|---|---|---|
| | **1st Quarter** | **1st Quarter** | **More/(Less)** | **1st Quarter** | **Inc/(Dec)** |
| **Agency** | **FY 99** | **FY 99** | **Than Plan** | **FY 98** | **From FY 98** |
| Police | $29,579 | $17,184 | $12,395 | $23,949 | $5,630 |
| Fire | 23,900 | 23,006 | 894 | 22,752 | 1,148 |
| Corrections | 12,453 | 7,279 | 5,174 | 9,109 | 3,344 |
| Sanitation | 12,262 | 10,231 | 2,031 | 10,032 | 2,230 |
| **Total Uniformed** | **78,194** | **57,700** | **20,494** | **65,843** | **12,351** |
| ACS | 4,351 | 4,381 | (30) | 4,529 | (178) |
| Social Services | 1,435 | 2,130 | (695) | 1,768 | (333) |
| Juvenile Justice | 913 | 94 | 819 | 351 | 562 |
| DEP | 3,634 | 2,882 | 752 | 3,194 | 440 |
| Transportation | 4,904 | 780 | 4,124 | 3,565 | 1,339 |
| All Other Civilian | 6,182 | 5,792 | 390 | 5,243 | 939 |

| | | | | | |
|---|---|---|---|---|---|
| **Total Civilian** | **21,419** | **16,059** | **5,360** | **18,649** | **2,770** |
| **Total City** | **$99,613** | **$73,759** | **$25,854** | **$84,492** | **$15,121** |

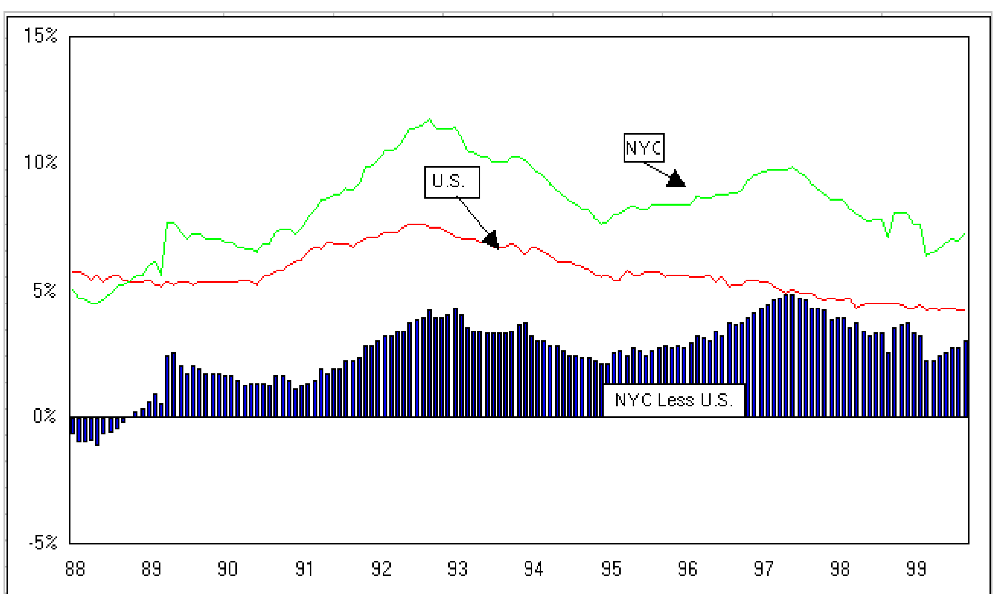
Source: NYC Integrated Financial Management System.

Among civilian agencies, the Department of Transportation's spending shows the largest variance from its overtime budget. DOT paid $4.9 million for overtime for the first quarter against a budget of only $800,000. DOT's overtime payments during the first quarter of FY 99 were $1.3 million higher than the same period in FY 98 as a result of an increased workload involving security measures— specifically, barricading government offices— to guard against potential terrorist strikes. According to the City, the low budget for the first quarter was an under-calculation that will be rectified in future plans.

Based on the first-quarter FY 99 data, overtime expenditures for FY 99 will be far higher than FY 98 and will exceed the plan. As mentioned in prior reports, some of the budget differences are attributable to under-budgeting by the City. At this stage, however, the drastic increase in overtime costs over last year is of most concern. If the trends in the first quarter continue for the rest of the year, then FY 99 overtime expenditures will exceed FY 98 overtime expenditures of $469 million by more than $80 million, and the FY 99 budget of $376 million by $173 million.

**Work Force** As of September 30, 1998, the City had a work force of 244,240 employees, 602 more than planned and 4,902 more than the same time last year. Since the beginning of FY 99 the City has increased its work force by 1,791 employees. (See Chart 2.)

Chart 2. *Work Force September 1997-September 1998*




* Work force data for August 1998 and September 1998 are preliminary, as final data are not yet available from the City.

Source: NYC Integrated Financial Management System.

Compared with the June Plan, the City had 926 more civilians in the Police Department. The City is expecting Federal funding for approximately 600 of these employees, which would leave the Police Department with 300 more civilians than planned.

The City work force has been growing, driven mainly by the Police Department and the Board of Education. The Police Department, since September of 1997, has increased the uniformed workforce by 2,210 federally funded officers. The Board of Education has approximately 2,600 more teachers in September 1998 than at the same time in 1997. The civilian work force has remained unchanged with a slight decrease of 47 employees over the previous 13 months.

**Debt Service on Variable Rate Bonds** The lower-interest-rate environment has yielded debt-service savings from the City's outstanding Variable-Rate-Demand Bonds (VRDB's). Including the City's Series 1999 C & D bond sale, the City's total general obligation debt outstanding is $27.7 billion of which $3 billion are VRDB's including $2 billion of tax-exempt and $1 billion of taxable long-term debt. Interest rates used to determine debt service for VRDB's in the first quarter of FY 99 have been substantially lower than those assumed in the Budget. The one-day, seven-day and 30-day tax-exempt interest rates have averaged 3.37 percent in the first quarter of FY 99 lower than the 5.0 percent assumed in the Budget. The concomitant taxable interest rate has averaged 5.61 percent in the first quarter of FY 99 compared with 7.0 percent projected in the Budget. Debt service on VRDB's totaled $32.4 million in the first quarter of FY 99, $8.4 million below the debt service in the Budget for the period of $40.8 million.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