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Honorable Michael R. Bloomberg
Mayor
City of New York
City Hall
New York, NY 10007

Dear Mayor Bloomberg:

The Executive Budget you will present next month is a critical juncture for New York City and for your mayoralty. This is the last budget you will propose and administer, and one of the last two you will formulate. With term limits forcing your tenure into its final period, this Executive Budget provides a key opportunity to build on your previous achievements and to address the fiscal challenges ahead. We offer specific recommendations for improving the City's fiscal health that we hope you will follow, and that will further shape your legacy as a mayor committed to sound fiscal policy.

Fiscal Policy Achievements

You have already accomplished a great deal. Many of the strategies and policies you have adopted demonstrate your commitment to the long-term prosperity and fiscal security of the City, and have been advocated or supported by CBC. For example:

- Upon entering office, you closed a $6 billion budget gap and helped steward the city's economic recovery after the tragedy of September 11, 2001. Since then, the City has achieved record-high bond ratings.
- You have used surplus resources in ways that yield long-term benefits, such as retiring $1.25 billion in debt in fiscal year 2007, beginning to pay for capital improvements with operating expenditures ("pay-go" capital), and creating and depositing $2.5 billion into the Retiree Health Care Trust Fund.
- In collective bargaining with public employee unions, you have pursued and achieved productivity-based settlements and other innovative arrangements, including productivity-linked compensation for sanitation workers, merit pay for teachers, performance bonuses for principals, and greater civilianization in the Police Department.
- You have integrated new technologies, such as 311 and ACCESSNYC (both of which were awarded the CBC Prize for Innovation), and performance data into agency management to promote more effective and efficient municipal service delivery. You have also worked with the City Council to begin organizing the budget programmatically and to link the budget with performance data.
- You have rezoned a large portion of the City, laying the groundwork for continued growth throughout the city and economic development in underdeveloped areas, such as Hudson Yards.

- You have put forward a plan to expand and rehabilitate New York City's infrastructure for the next generation in PLANYC. As you know, we share
- Your commitment to long-term planning for the City's infrastructure needs, which we addressed in a report released at a December event where you delivered the keynote address.

The Challenges Ahead

These are important achievements, but the City faces formidable challenges in both the short- and long-term. While the January plan for fiscal year 2009 is in balance thanks to the transfer of surplus revenues from the current fiscal year, economic indicators are being revised downward daily and threaten to undo this balance. Looking past 2009, the long-term challenges to the City's fiscal health are starkly apparent in the large looming out-year budget gaps. To confront these challenges, this budget should launch a larger agenda of fiscal reform that moves the City toward long-term fiscal health. This agenda should focus on:

Better Expenditure Control. Based on the January Financial Plan projections for the next fiscal year, municipal operating expenditures will have increased from $43.6 billion to $65.3 billion under your tenure, a total increase of 50 percent or 5.2 percent annually on average. At the same time, inflation has averaged 2.9 percent annually and Gross City Product has increased about 1.9 percent annually on average.

This relatively rapid growth is sometimes justified by distinguishing between so-called "uncontrollable" spending and "discretionary" spending, with the former category including items like pensions, fringe benefits and medical assistance. According to this distinction, "uncontrollable" spending has increased about 10.2 percent annually, while discretionary spending has grown just 4.4 percent annually. This, however, is a false dichotomy; the mayoral term provides opportunity to control all forms of spending through collective bargaining, advocacy for changes in state laws, as well as annual budget proposals. The State-mandated local Medicaid obligation provides a clear example: once considered "uncontrollable" with double-digit growth rates, advocacy efforts by you and county executives statewide (and the CBC) succeeded in enacting State legislation to cap local liability for increases to no more than 3 percent annually. As this successful effort demonstrates, there should be a counter strategy for contending with these so-called "uncontrollables" – instead of continuing to allow them to rise at rapid rates.

The items deemed discretionary could be better controlled also. One item clearly subject to annual control through the budget is the number of people on the City payroll. From the start of your first term to December 2007, the number of full time and full-time equivalent municipal workers increased by 3,000. Better deployment of police officers has allowed for the reduction of both the number of unformed police officers and crime, but similar efficiencies have not been recognized in other service areas; in fact, most agencies have expanded their workforce. Of the 70 agencies identified in the budget, fully 37 have more workers now than at the start of your term.

More Disciplined Debt Policy. The City's extensive and increasingly diversified debt has not been well-targeted. To finance an ever-growing capital program, debt has grown tremendously: 40 percent since fiscal year 2002. This has resulted in a debt service burden that has also grown consistently and quickly, 5.4 percent annually on average since you entered office, and which will continue to grow at a pace faster than other expenditures in the financial plan.

As troubling as the rapid growth of debt are its forms and uses. Gone are the days when most, if not all, of the City's debt was general obligation debt used to finance capital projects. Today, City debt has morphed into a variety of forms, including some used to provide operating budget relief. This includes $2 billion in borrowing by the Transitional Finance Authority for operating purposes made necessary after September 11th, but also the refinancing of the debt of the Municipal Assistance Corporation into the 30-year debt of the Sales Tax Asset Receivable Corporation.

The City now finances substantial portions of its capital program through the Municipal Water Finance Authority and the Transitional Finance Authority (TFA). The TFA originated under Mayor Rudolph Giuliani to bypass the City's debt limits, and is an off-budget entity. Since then, reliance on it has increased, even though the City is now well below its debt limits. This dependence is apparent not just in the repeated increase of the debt cap on the TFA, but also by the new TFA Building Aid Revenue Bonds (BARBs) that are financing school construction with dedicated State aid. When all forms of local debt are accounted for, the CBC projects that total debt outstanding will be over $100 billion by fiscal year 2012, compared to $56 billion when you assumed office.

What this debt burden is achieving for the City is questionable. The Asset Information Management System (AIMS) report released by the Office of Management and Budget in January discloses $5.3 billion in state of good repair and maintenance needs for the assets covered by the report – and this estimate excludes housing, the water and sewer system, and the East River bridges, among others. Agencies are not required to fund AIMS recommendations, and if the past few years are any guide, they will not: total citywide funding will be less than half the total recommendation – leaving a shortfall of $2.7 billion.

This suggests that the City's capital investment priorities are misdirected. The Ten-Year Capital Strategy released last year plans for $83.6 billion– $86.6 billion when including Hudson Yards – in capital improvements; however, less than half of that will be directed towards state of good repair work. A substantial portion, close to $23 billion, will be dedicated toward expansion projects. Some of these projects, particularly in environmental protection, are necessary and justified; for most other projects, however, it is unclear what the City will be gaining from its investment in terms of improved services. Particularly for economic development projects, there is little attempt to justify investments with rigorous analysis that demonstrates benefits or a rate of return.

Better Tax Policy. New York City's tax burden remains too high and discourages economic development. At the beginning of your administration, in fiscal year 2002, the City tax burden was $71 for every $1,000 of personal income. At that time, the City was unsettled by the events of September 11th and faced enormous budget gaps; to close these gaps, you enacted several tax increases, the largest of which was an 18.5 percent increase in the citywide property tax rate. Most of the others were temporary measures that aided the City's recovery and have already expired. Nevertheless, at the end of fiscal year 2007, the City's tax burden surpassed $100 for every $1,000 of personal income. New Yorkers pay local taxes that are more than double the national average.

Last year, you enacted tax cuts worth $1.5 billion in their first year. These measures included a 7 percent property tax rate cut, the elimination of the sales tax on clothing and footwear, various tax cuts for small businesses, a child care credit, and the extension of the $400 annual rebate for owners of one- to three-family homes, condominiums and cooperatives. According to current forecasts, these measures will assist in lowering the City tax burden to $90 for every $1,000 of City personal income. This is a move in the right direction, and one that CBC supported, but New Yorkers still have a higher tax burden than at the start of your administration.

The structure of local taxes, especially the property tax, is harmful to economic investment and job growth. Due to numerous protections for small residential property in New York property tax law, the effective tax rate for small residential property was $0.52 per $100 of market value in fiscal year 2007. In contrast, the effective tax rates for larger rental buildings and commercial properties are $3.29 and $3.97, respectively. The commercial rate was lower – $3.65 per $100 of market value – at the start of your administration, and the disparity between commercial and small residential property grew in this period from a ratio of 5.6:1 to the current 7.6:1.

Last year's 7 percent property tax rate cut benefits all property taxpayers, but the $400 rebate program in effect since 2005 exacerbates the disparate tax burden between small residential property and commercial and rental property. High property taxes for commercial and rental property detract from the City's ability to attract and retain business and place undue burden on the two-thirds of City residents who are renters.

Priority Action for the Executive Budget

Tackling these challenges requires immediate and sustained effort. In the Executive Budget, you should build on the momentum of your prior efforts and make the tough decisions that are necessary to leave the City in a position of fiscal strength.

The CBC recommends the following actions as a priority for the Executive Budget:

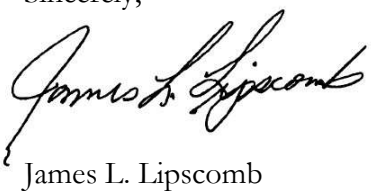
- **Use surplus revenues prudently.** In recent years, the City has benefited from extraordinary surplus revenues, and despite an economic slowdown, this year is no exception: the surplus is estimated to be over $4 billion dollars. The January plan calls for using nearly all these resources to cover operating expenses in fiscal year 2009. In the past, you have wisely devoted significant portions of any surplus revenues to purposes with long-term benefits; you should continue that practice in this year's budget by retiring more debt, retaining pay-go capital payments, or contributing to the retiree health insurance trust fund. Although this would create a gap in the fiscal year 2009 budget, it is more responsible to address this gap now – and not to postpone action for when the problem is even greater in fiscal years 2010 and 2011, when gaps are now projected to be $4.2 billion and $5.6 billion, respectively.
- **Promote efficiency in city services.** City agencies should be working to optimize their efficiency. A few weeks ago, targets for the agency program to eliminate the gap were increased by 3 percent. It should be made clear to agencies that they should be identifying cuts, especially in headcount, that will produce recurring savings. Headcount for the rest of the fiscal year is projected to grow to 312,571 positions from 307,956 in December 2007. This growth should be reversed; in fiscal year 2009, the municipal workforce should be lowered by an additional 1.5 percent, or 4,500 positions, to return the size of the workforce to one comparable to that which you inherited. It should be kept at that level, or lower, for subsequent years with a goal of sustaining planned services with fewer workers.
- In addition, you recently announced a Charter Revision Commission to conduct a top-to-bottom review of city government and recommend ways to make city operations more efficient and transparent. CBC supports this aim, and urges it be made concrete by identifying an overall savings target– perhaps $1 billion annually– that can guide the

Commission's agenda. One area ripe for reform that will also generate savings is procurement. More extensive implementation of the recommendations in the CBC's 2002 report, *No Small Change: Opportunities for Streamlining Procurement in New York City*, which you endorsed at the start of your administration, should be a meaningful part of this program.

- **Renew efforts to control employee fringe benefit costs.** In years past, you identified a new tier in the pension system for new employees as a way to control the growth in pension expenses. You should renew that call and work with State leaders toward that goal. Similarly, you should continue current negotiations with the municipal employee unions to change health insurance arrangements to achieve larger savings than indicated in the January Financial Plan and even greater long-term savings. Such a restructuring will be critical as part of a long-term strategy to address the projected $58.7 billion liability the City faces for retiree health insurance and other post-employment benefits.
- **Trim and reshape the capital budget**. As detailed in the CBC's December 2007 report *Capital Budgeting for 2030: Achieving the Goals of PLANYC,* the City's capital planning and budgeting should be improved. More should be done to assess the condition of the City's assets and to develop a comprehensive plan for achieving a state of good repair citywide. The City also should better justify expansion projects, particularly those in economic development. Finally, capital spending for the regular replacement of assets should be gradually shifted to the operating budget; this could begin in the next budget by designating some surplus revenues for pay-go capital investments as part of a regular replacement cycle program.
- **Restructure the property tax**. Last year's 7 percent reduction in the property tax rate eased the burden for all property tax payers, but the property tax rebates exacerbate the drastic inequity in the effective tax burden between small residential property and all other classes. The $256 million annual homeowner rebate program should be repealed, or, if economic conditions allow, reconfigured; redirecting these savings would allow a cut in the citywide property tax rate by another 2 percent, or would allow more targeted tax relief to renters or business that bear the brunt of this tax.

We commend you for all you have accomplished in the past 75 months, and look forward to helping to promote actions that will enhance your legacy even further over the remaining 21 months. Our suggestions are made in this context; we hope they are helpful as you prepare the Executive Budget. We would be pleased to discuss them with you and your staff.

Sincerely,



James L. Lipscomb
Chairman