Testimony on Hearing on the November Budget Modification

Testimony Submitted to the

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Chair Brannan and Members of the Committee: Thank you for the opportunity to appear before you today. The November mod makes it clear the city is facing tough fiscal times in the next few years, but nothing the city hasn't dealt with in the past. Overcoming these challenges will require that the city use all of the tools at its disposal: carefully chosen budget cuts; drawing down some of our reserves; lobbying state and federal partners for assistance; spending wisely; and considering tax increases.

Citing the continuing cost of providing services and shelter to tens of thousands of migrants, increased labor costs for municipal workers, and a slowdown in tax revenue growth, the Adams administration's November budget modification introduced $1.7 billion in budget reductions for this year and $2.0 billion for 2025 (years refer to city fiscal year unless otherwise noted). Even with the cuts, significant budget gaps would remain: $7.1 billion in 2025, $6.5 billion in 2026, and $6.4 billion in 2027. For 2025, the gap equals 9.0 percent of total city revenues.

While high, in percentage terms these are not record-high out-year levels. To help deal with these out-year gaps, the administration has already instructed most agencies to submit another round of budget savings that will be included in January's preliminary budget, followed by another round in April for release with the executive budget. (The Police, Fire, and Sanitation departments were excluded for the upcoming rounds.) So far, while some popular programs have been cut back or frozen, the cuts have largely consisted of vacancy reductions, personal service accruals, hiring freezes, and finding ways to tap federal reimbursements. As these options are exhausted, future rounds of cuts are likely to include more service reductions and perhaps layoffs unless the city can secure additional federal and state assistance or raise revenue.

Tax Revenue. Coming off three consecutive years of strong tax revenue growth, the outlook for 2024 is somewhat weaker, with OMB forecasting a decline from 2023 to 2024 of 1.7 percent, a drop of $1.2 billion. While tax revenue is likely to slow this year there are reasons to expect stronger performance than OMB is forecasting. Property tax revenue – the city's largest and most stable tax source – is forecast to grow by 3.5 percent this year, and several other major sources including sales tax and the withholding component of the personal income tax have been holding up better than forecast.

Notably, OMB's forecast for a decline in year-over-year tax revenue in 2024 occurred despite some upward revisions to the June forecasts for the personal and corporation income taxes due to current year collections exceeding OMB's forecasts. Consistent with OMB's usual practice, these changes totaling $592 million were not carried through to the remaining years of the plan. The one exception is an approximately $450 million increase to the real property tax forecast beginning in 2025.

The higher-than-expected collections so far this year are one indicator that there will likely be a larger budget surplus available this year to help balance 2025. More significantly, both the local and national economies look stronger today than they did last spring, allowing the city's tax base to grow and generate additional revenue. Last spring, most macroeconomic forecasters assumed very slow or negative growth in the national economy with better than even odds of a mild recession either in calendar year 2023 or 2024 as the Federal Reserve continued to raise interest rates to slow the economy enough to bring inflation under control. The failure of two significant regional banks last spring led forecasters to assume that the Fed's challenge to rein in inflation without bringing on a recession had grown even more difficult. Concerns about geo-political tension and a federal fiscal meltdown over the debt limit and the federal budget helped to ratchet up concerns about the economy even further. OMB's outlook for the local economy last April cited concern about the financial services sector, commercial real estate, and shrinkage of the city's labor force.

Today, there is growing optimism that inflation is finally slowing without the economy falling into recession. In the city, office occupancy has been slowly creeping up, tourism is once again a leading industry for the city, and the financial sector has seemingly weathered last spring's banking crisis without experiencing many of the anticipated job losses. The city has regained the number of jobs lost during the 2020 Covid recession, although the recovery has been very uneven among segments of the labor force, and poverty and public assistance rolls in the city have grown significantly. New evidence indicates that the increase in the exodus of high-income households at the height of the Covid pandemic was temporary and may be reversing. Income concentration has once again grown. Data from IBO show that the share of total income received by the city's top one percent of filers (those with incomes over $911,000 in 2021) rose to 44 percent of all income from 35 percent in 2019. These changes at the U.S. and local level portend a stronger city tax base which should generate some additional revenue above what was recognized in the November modification, although far from sufficient to close the gaps alone.

Cost of migrants. The November modification assumes that the city will spend $3.6 billion this year in services to migrants, $5.5 billion in 2025, before tapering off to $1.0 billion in 2027. In 2025, the city cost is 6.0 percent of city-funded revenue. If the federal or state government were shouldering half of these costs, the city's projected gap for 2025 would be cut nearly in half to $3.3 billion. Lacking support from the state and federal governments, the city has begun taking steps to reduce costs by imposing time limits for shelter stays and ordering a 20 percent reduction in spending for migrants. Whether these actions withstand the opposition they face will play a role in determining the scale of future budget cuts. The Governor has already pledged to provide more aid for the city in her Executive Budget. The state is in much stronger fiscal shape than the city and should be able to provide more assistance to help deal with the migrant crisis.

Fiscal cliff remains. While the costs of migrant services are highlighted, other costs the city is likely to face are not mentioned in the modification. These include city funds that are needed to maintain a number of programs that have until now been funded with temporary Covid-era federal fiscal relief funding that expires in September 2024. If city funds do not replace the federal funds programs such as the partially-expanded PreK-3, Summer Rising, or the provision of special education services to all Universal Pre-K children requiring them, the initiatives would almost certainly be scaled back. The city is also facing a new mandate from the state to reduce class sizes, although no funding has been provided. While estimates vary, the mandate would require the city to hire thousands of teachers and build classrooms with tens of thousands of seats.

PEG Program. In September when the Mayor and Budget Director announced that there would be a new Program to Eliminate the Gap (PEG) that would be incorporated in the November modification, agencies were instructed to come up with budget actions equal to five percent of their city-funded expenditures. According to OMB's classification of the PEGs in the November modification, $72 million resulted from service reductions in the current year, which grow to over $300 million each year in 2025 through 2027. Spending re-estimates which occur when assumptions about costs or numbers served are adjusted to account for actual operations were the largest contributor in each year of the PEG program. Savings resulting from greater efficiency in agency operations accounted for nearly one-third of the total $1.7 billion in 2024, rising to 41 percent in 2025. By growing the share of cuts generated from efficiencies the city could avoid or limit cuts that reduce current services.

Reserves. Both the city and especially the state have been adding to their budget reserves and could provide some temporary fiscal relief by tapping them, particularly if the alternative is cutting services. The easiest source for the city to draw on is the so-called "general reserve" and "capital stabilization reserve" in the city budget. The former is required under the City Charter with an initial appropriation of $100 million, although the city has been routinely starting each fiscal year with $1 billion or more – this year it is $1.2 billion with another $250 million in the capital fund. These are appropriated funds with no assigned use.

If needed during the fiscal year, money can be transferred from these reserves and used where needed. In most years the money is not used and is gradually drawn down over the course of the fiscal year to help build up the surplus to be rolled into the next fiscal year. In 2020, the state legislature granted the city the right to establish the "revenue stabilization fund" which will function like a traditional rainy day fund, which has accumulated a balance of $2 billion. The city has yet to define the size or set rules for deposits and withdrawals from the fund. Finally, the city has access to the Retiree Health Benefit Trust which has $4.6 billion, although withdrawals must leave sufficient funds to cover the annual cost of retiree benefits.

Time to Raise Revenues? It is clear that the city is facing tough choices. It has taken on most of the burden of providing services and shelter to tens of thousands of migrants, must decide whether to use city funds to replace expiring federal Covid relief funds to keep some popular and important programs in operation, and is facing slower tax revenue growth this year, albeit, likely higher than currently projected by OMB. A question for city leaders to answer is whether it is better to solve the shortfalls solely by cutting the budget or perhaps use a combination of prudent cuts and tax revenue hikes as was done in the wake of 9/11.

Ideas to consider include rescinding the Madison Square Garden property tax exemption, or adding a new top bracket and rate to the city's income tax. The income tax is currently not very progressive, with the top bracket beginning at $90,000 for a married couple. Another option would be to either negotiate or assess a payment in lieu of tax (PILOT) from private universities and hospitals that are currently exempt from property tax under state law. Such institutions benefit from city services that are funded in part through the property tax paid by others. There are many examples of cities receiving PILOTs as an alternative to bringing hospital and university property directly onto the tax roll, usually at some discount from their liability if not exempt. In New York, over $28 billion in market value is currently exempt for such properties according to Department of Finance data. If taxed as regular property they would owe about $1.4 billion.

Thank you again for the opportunity to testify and I look forward to answering any questions you may have.