New York City Independent Budget Office

Focus On:
The Preliminary Budget

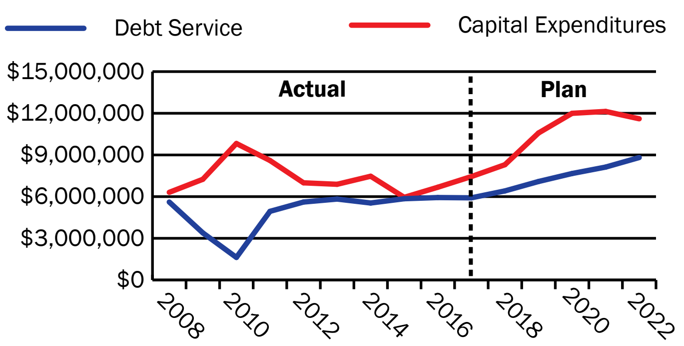
March 2018

Debt Service Costs to Grow as Planned Capital Spending Increases

Over the last five years the city has paid an average of $5.8 billion annually through its operating budget to service its outstanding debt, which as of June 30, 2017 totaled $86.3 billion. The preliminary budget assumes that over the next five years debt service will rise from $7.1 billion in 2019 to $8.8 billion in 2022 and cost the city an average of $7.6 billion annually (all years refer to fiscal years unless otherwise noted). New debt the city expects to issue from 2018 through 2022 is the main driver of increases in debt service over the plan period. While higher interest rate assumptions also account for some of the increase, most of the growth is primarily the product of the city's aggressive plan to sharply increase capital expenditures over the next few years. The current financial plan projects that capital expenditures will average $10.9 billion annually over the next five years, a nearly 58 percent increase over the average for the previous five years. IBO estimates that new debt issued from 2018 through 2022 will add a total of $4.6 billion to the city's debt service expenses during those years.

The planned increase in debt service spending—in terms of dollars as well as in the share of total city revenues—strains the city's ability to also fund other essential services. While the increase in planned debt service costs are a cause for concern, it should be noted that in recent years the city's actual debt service costs for any given year have often been much lower than the amount originally budgeted. The city has used the savings resulting from lower-than-expected debt service costs to help build up annual budget surpluses.

Annual City-Funded Debt Service and Capital Expenditures



SOURCE: Mayor's Office of Management and Budget
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The budget adoption process last June included the use of $4.2 billion of surplus 2017 resources to fund 2018 expenses. This surplus was generated over the course of 2017 primarily as a result of five actions: implementing a citywide savings program, drawing down of reserve funds that were no longer needed as a contingency against risks to the 2017 budget, recognition of lower debt service costs than originally budgeted, accounting changes regarding prior year expenses, and acknowledgement of additional non-tax revenue.

While the city routinely ends each year with a budget surplus, last year differed from the four preceding years in which the annual surplus was primarily comprised of higher than expected tax revenues; for 2017, tax revenues were actually lower than originally budgeted. For the current fiscal year, the preliminary budget projects that higher-than-budgeted tax revenues are on track to add about $700 million, or a quarter of the anticipated 2018 surplus, although $450 million of that is from tax audits rather than current tax year liabilities.

The preliminary budget includes $2.6 billion of surplus 2018 resources that the city plans to use to reduce 2019 expenditures. Debt service savings, which accounted for an average of nearly 11 percent of the annual surplus over the 2012 through 2017 period, accounts for only 3.4

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Debt Service Savings Expected to Have Little Impact on 2018 Surplus
Dollars in millions

	2012	2013	2014	2015	2016	2017	2018*
Debt Service Savings	$242	$97	$642	$449	$198	$379	$89
Annual Surplus	$2,462	$2,806	$2,009	$3,601	$4,037	$4,180	$2,584
Debt Service Savings as Share of Surplus	9.8%	3.5%	32.0%	12.5%	4.9%	9.1%	3.4%

SOURCE: Mayor's Office of Management and Budget
NOTE: *Forecast as of February 2018 financial plan.

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percent ($89 million) of the total surplus projected by the administration for the current year.

The city's reliance on savings from re-estimates of budgeted debt service costs may be in jeopardy as interest rates, which had hovered near historical lows for nearly seven years, have been rising since late last year and are widely expected to continue increasing through late in calendar year 2019. The city often accrues debt service savings on its portfolio of outstanding variable rate bonds. Each year the city assumes a certain interest rate that it will have to pay on its variable rate bonds, although in recent years the actual rates the city has paid are typically much lower than OMB anticipated in its financial plans. In recent years, the city has routinely assumed an annual interest rate for its variable rate bonds of over 4.0 percent. As the year progresses, these interest rate assumptions are lowered based on actual market conditions during the year. The actual annual interest rate for the city's variable rate bonds has been below 1 percent each year since 2009. IBO's economic forecast assumes that the federal funds interest rate will rise to nearly 4 percent by 2020 before declining slightly to approximately 3 percent in 2022. If market interest rates for variable rate debt rise similarly, potential savings from these instruments will fall sharply.

In addition, recent federal tax policy changes eliminating the tax exemption of certain advanced refunding bond issuances could affect the city's ability to utilize refundings to reduce financing costs. While the tax policy change may not eliminate the potential savings, it will likely delay any savings to future years.

Finally, for many years the city has budgeted millions of dollars to pay for the service costs on the issuance of short-term debt. Because the city has not needed to issue any short-term debt since 2004, the funds budgeted each year to service short-term notes were not spent and instead became part of the annual surplus. For the first time in decades, the adopted budget for 2018 does not anticipate the issuance of short-term debt, thereby eliminating one potential source of debt service savings.

The size and composition of the current year's surplus will continue to evolve until next year's budget is adopted. However, it seems likely that in the coming years the city will not be able to rely as much on savings from reduced debt service costs to generate surpluses as it has in the recent past.

Prepared by Jonathan Rosenberg

ENDNOTE

[1]Total debt outstanding includes debt from the sale of General Obligation bonds, Transitional Finance Authority bonds, Tobacco Settlement Asset Securitization Corporation bonds, Sales Tax Asset Receivable Corporation bonds, capital leases and other obligations.

Federal Funds Rate Projected to Rise
Annual Rates by Fiscal Year

	Actual					Estimated				
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Federal Funds Rate	0.1%	0.1%	0.1%	0.3%	0.6%	1.4%	2.6%	3.8%	3.5%	3.1%

SOURCE: Moody's Analytics

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