TO: Lower Hudson Education Coalition
FROM: Ostroff Associates, Inc.
RE: NYS Mid-Year Financial Plan Update

On Thursday, October 30, the New York State Division of the Budget (DOB) released the FY 2026 Mid-Year Financial Plan Update. The update presents a picture of near-term stability—stronger receipts, robust reserves, and narrower budget gaps—while also underscoring a more challenging long-term reality. Structural growth in health care, workforce costs, and education continues to outpace recurring revenues, leaving the State fiscally solvent but not structurally balanced.

For LHEC members, this Mid-Year Update is important because it establishes the fiscal and policy baseline for the January 2026 Executive Budget and frames the administration's capacity and appetite for changes to School Aid, Foundation Aid, and other education funding streams heading into FY 2027.

Macroeconomic Backdrop: Tight Money, Volatile Revenues

DOB situates the plan within a late-cycle, high-rate environment:

- Interest rates remain elevated, raising borrowing costs for State capital projects, school district capital plans, and quasi-public issuers.
- Private-sector exposure to rate volatility is dampening business investment and wage growth, with implications for PIT and sales tax growth.
- Wall Street bonus income—a key driver of Personal Income Tax (PIT) receipts—is projected to grow by just 4.7% in FY 2027, well below historic trends.
- Equity markets remain concentrated in a small group of large tech companies ("Magnificent Seven"), so even a moderate 10–20% correction could translate into a meaningful PIT shortfall.

Ostroff Associates view: DOB is effectively assuming a "soft landing." That is an optimistic but not unreasonable planning posture. However, relying on stable markets and moderate inflation understates the risk that sustained high yields or a market correction could strain State receipts and, by extension, pressure School Aid growth and other education investments in the out-years.

What Changed Since the Enacted Plan?

High-Level Spending Shifts

Category	Mid-Year FY26 ($B)	First Quarter ($B)	Change	Key Drivers
State Operating Funds	147.513	146.103	+1.41	Medicaid, workforce, education, fringe costs
General Fund (incl. transfers)	126.482	125.512	+0.97	Health, School Aid, and workforce costs
Capital (State + Federal)	18.936	19.359	–0.42	Deferred bond reimbursements
Federal Operating Aid	91.938	88.916	+3.02	FEMA and Essential Plan adjustments

Compared to FY 2025 actuals:

- **Assistance & Grants** increased by **$10.98B**, driven primarily by:
  - **Medicaid** (+$4.21B), and
  - **School Aid** (+$1.747B).
- **Agency operations** grew by **$4.37B**, driven by correctional staffing, State Police retroactive pay, and rising pension and fringe benefit costs.
- **Debt service** declined by **$1.49B** due to prepayments—a one-time action that improves liquidity but does not change the underlying structural imbalance.

DOB attributes this growth to labor settlements, health care utilization, FEMA reimbursements, and pension accruals. Part of the increase in "All Other Grants" reflects a reclassification of local Medicaid costs from the Department of Health's Global Cap to other agency budgets—a technical shift that clarifies where costs sit, but does not reduce the overall burden on the State's financial plan.

Fiscal Cushion and Out-Year Gaps

Despite improved near-term gaps, the out-year picture remains challenging:

Fiscal Year	Projected Gap ($B)	Change vs. Enacted
FY 2027	(4.15)	+3.3
FY 2028	(10.03)	+2.1
FY 2029	(12.60)	+2.0

While the FY 2027 gap has narrowed, structural spending growth still outpaces recurring revenue by nearly 2:1 in FY 2028 and FY 2029.

Ostroff Associates view: This is not a short-term, cyclical imbalance; it is a structural challenge. For education, that means the State will be looking for ways to moderate growth in large, formula-driven programs—including School Aid—while preserving its stated commitments to equity and high-need districts.

Looking Ahead: January 2026 Executive Budget

The January 2026 Executive Budget is likely to be framed as a **stability and cost-containment plan**, not a period of broad new spending:

- Focus areas will likely include:
  - Medicaid and other health program reforms,
  - Administrative and workforce efficiencies,
  - Digital and procurement reforms, and
  - "Cost-bending" initiatives aimed at slowing baseline growth.
- New economic development or fiscal proposals, where advanced, are likely to be:
  - Targeted,
  - Short-term or pilot-based, and
  - Justified by clear return-on-investment (ROI) metrics.

Strategic state investments are expected to prioritize AI, clean energy, and workforce productivity—areas framed as essential to long-term competitiveness rather than near-term program expansion.

Implications for Education/LHEC:

- Large, across-the-board School Aid increases are less likely than targeted, formula-driven adjustments.
- Proposals that **modernize formulas, enhance accountability, or improve efficiency** (e.g., more accurate poverty measures, better targeting of Foundation Aid, improved transportation and BOCES aid design) will have a stronger footing than pure add-ons.
- Expect continued scrutiny of expense-based aids and capital-related programs where the State perceives cost growth to be running ahead of revenues.

Strategic Takeaways for LHEC

Sector	Opportunity	Strategic Lens for LHEC Members
Education	Foundation/Formula modernization; targeted School Aid; support for high-need and growing districts.	Frame proposals as improving **equity, predictability, and performance** rather than simply increasing spending.
Health & Human Services	Medicaid reforms, Essential Plan alignment, MLTC/CDPAP redesign.	Emphasize school-linked services (mental health, I/DD, early intervention) as **cost-avoidance** tools.
Infrastructure & Energy	Capital prioritization, school capital and energy retrofits, decarbonization incentives.	Position projects as **long-term cost savers** (energy, maintenance) and local job creators.
Private Sector/Partners	Stability of State incentives under H.R. 1 (OBBBA) timing changes.	Align partnerships with **career pathways, CTE, and regional workforce pipelines** for students.

From an advocacy standpoint, the most viable proposals in 2026 will be:

- **Budget-neutral or low-cost**,
- **Pilot-based or time-limited**, and
- Framed as **efficiency, modernization, or risk-reduction tools** that help the State manage structural pressures while still advancing key education outcomes.

The Ostroff Associates Perspective

The FY 2026 Mid-Year Update confirms New York's **near-term fiscal resilience** but also its **longer-term fragility**:

- Revenues remain **highly cyclical**, particularly PIT tied to Wall Street.
- Spending in major programs—including education—continues to grow faster than inflation.
- Reserves are strong but are being used to absorb baseline pressure, not to finance new, ongoing commitments.
- The next budget will need to **bend cost curves without stifling growth or undermining equity commitments.**

For LHEC and its members, this environment rewards proposals that:

- Deliver measurable **productivity and performance gains** for students,
- Enhance **targeting and fairness** within School Aid and related formulas, and
- Demonstrate **fiscal prudence** and risk mitigation for the State.

Quick Start Hearing: Reinforcing the Fiscal Baseline

On the heels of the Mid-Year Update, the Division of the Budget, Comptroller's Office, and fiscal committee staff from both houses held the **FY 2027 Quick Start Budget Plan** hearing. Budget Director Blake Washington, Deputy Comptroller Maria Doulis, and representatives of Senate Finance and Assembly Ways and Means majorities and minorities all largely agreed that the **economic and revenue outlook has improved relative to the mid-year forecast**:

- **Tax receipts** – particularly pass-through entity (PTET) and personal income tax – are running ahead of plan. DOB has revised projected tax revenues **upward by roughly $2.6 billion in the current year and $5.3 billion in the next year**, reducing out-year gaps by about **$7 billion** to a level Director Washington described as "completely manageable."
- The **Comptroller's Office** likewise projects higher revenues than the Mid-Year Update (about **$1.1 billion more in FY 2026 and $2.4 billion in FY 2027**), while urging continued **caution and growth of reserves**.
- Legislative fiscal staff generally concurred with the stronger outlook; Assembly majority staff project slightly higher revenues than DOB, and Assembly minority staff highlighted **stronger-than-expected gaming and mobile sports betting revenues** as an additional positive.

At the same time, the hearing underscored that **structural challenges remain**:

- **School Aid and Medicaid** were reaffirmed as the State's two largest and most persistent cost drivers. Washington characterized **post-pandemic Medicaid enrollment as "stubborn,"** with costs expected to continue rising before enrollment levels ease.
- **New state costs linked to federal changes** are expected to total about **$800 million this year and $3.4 billion next year**, putting added pressure on the financial plan even as revenues improve.
- All parties noted key risks: the **highly concentrated nature of economic activity** (heavy reliance on Wall Street and a small number of large tech firms), and a **fluid federal policy environment** that could alter both revenue timing and entitlement obligations.

From a political standpoint, the fiscal committees' positions point to a shared message of **cautious optimism rather than open-ended spending**:

- The **Comptroller** and majority fiscal staff stress the need to **continue building reserves** and to guard against over-committing new recurring spending.
- Minority members raised concerns about **ever-rising Medicaid costs** and signaled resistance to **additional broad-based taxes**, emphasizing the burden on New York taxpayers.

Concluding Observations

The FY 2026 Mid-Year Update functions as a **transition document**:

- It validates that New York can weather near-term volatility without immediate austerity.

- It also signals that **long-term sustainability will require restraining baseline growth** in large programs, including education.

In this context, advocacy influence will be strongest when:

- **Projects and proposals are reframed as productivity and equity enhancements, not simply added costs;** and
- **Advocacy is anchored in measurable outcomes, efficiency, and fiscal responsibility.**

Ostroff Associates will continue to monitor DOB updates and the development of the January 2026 Executive Budget and will work with LHEC to translate this fiscal context into concrete strategies that protect and advance education priorities in the Lower Hudson region.