March 2007

Analysis of the Mayor's Preliminary Budget for 2008

Economic Outlook

Taxes and Other Revenue

Capital, Debt, and Debt Service

IBO

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Overview

IBO projects the city will end 2007, the current fiscal year, with a surplus of $3.9 billion and 2008 with a surplus of just over $1 billion. These surpluses reflect the city's bright near-term fiscal picture as tax revenues continue to come in at better-than-expected levels. Indeed, IBO has now increased our 2007 tax revenue estimates by $1 billion over what we had projected just two months ago. But as our projected budget shortfalls for 2009 and beyond signal, revenue growth may not be sufficient to keep pace with expected spending increases.

The city's near-term fiscal strength allowed the Mayor to offer a number of new proposals in the 2008 Preliminary Budget, including several tax cuts that widen our projected out-year budget gaps. In addition to continuing the $400 per year tax rebate for homeowners, the Mayor proposed a 5 percent reduction in the property tax rate that would cost by his estimate $750 million in 2008. Although he presented it as a one-year measure to be considered for extension "if conditions permit," the tax cut is included in each year of the Financial Plan through 2011. He also proposed roughly $300 million in permanent tax cuts, including a child care tax credit for low-income working families, the elimination of the city's sales tax on clothing and shoes, and tax breaks for small businesses and S-corporations.

The large surplus expected in 2007, which will be used to prepay some of next year's expenditures, enabled the Mayor to also propose putting $500 million more in the Retiree Health Benefits Trust Fund in 2008. In addition, the Financial Plan assumes the 2008 surplus will be used to prepay some 2009 expenses, reducing the expected shortfall for that year to $2.8 billion based on IBO's projections.

IBO's estimated budget gaps for the remaining years of the Financial Plan are higher than in 2009, $3.3 billion in 2010 and $3.1 billion in 2011. The gap estimates in all three of these years assume the property tax rate reduction remains in place, reductions that comprise more than one-quarter of each year's gap.

Some key highlights of our analysis and reestimate of the 2008 Preliminary Budget and Financial Plan through 2011 include:

- IBO has increased its tax revenue estimate for 2007 by $1 billion more than we had projected just two months ago and now expect the city to end this year with a surplus of $3.9 billion.
- Higher than expected taxes from property sales and business income are responsible for most of the 2007 increase.
- Although a weaker real estate market and slower growth in corporate profits will dampen the growth rate of tax revenues over the next few years, IBO still expects a surplus of just over $1 billion in 2008.
- The budget plan includes a number of tax reduction proposals that will cost the city $1.3 billion in revenue in 2008, rising to $1.6 billion in 2011.
- With large surpluses no longer available to mask underlying shortfalls in the budget, IBO projects gaps of around $3 billion in 2009, 2010, and 2011.
- The same "big ticket" items that have propelled spending growth in the past—debt service, pensions, and health care and other fringe benefits for city

Total Revenue and Expenditure Projections

Dollars in millions

	2007	2008	2009	2010	2011	Average Change
Revenues	$58,144	$58,024	$59,451	$62,571	$64,762	2.7%
City-funded Revenues						
Taxes	*35,639*	*36,283*	*37,690*	*40,051*	*42,246*	4.3%
Tax Reduction Program	-	*(1,318)*	*(1,427)*	*(1,517)*	*(1,626)*	n/a
Other Revenues	*6,862*	*6,965*	*6,366*	*6,436*	*6,488*	-1.4%
Expenditures	58,144	58,024	62,282	65,828	67,833	3.9%
City-funded Expenditures	*42,501*	*41,930*	*45,460*	*48,227*	*50,179*	4.2%
IBO Surplus / (Gap) Projection	**$-**	**$-**	**($2,831)**	**($3,257)**	**($3,071)**	

SOURCE: IBO.
NOTES: IBO projects a surplus of $3.91 billion for 2007, $27 million below the Bloomberg Administration's forecast. The surplus is used to prepay some 2008 expenditures, leaving 2007 with a balanced budget. IBO projects a surplus of $1.05 billion for 2008, $328 million below the Bloomberg Administration's forecast. The surplus is used to repay some 2009 expenditures, leaving 2008 with a balanced budget. Estimates exclude intra-city revenues and expenditures.

Pricing Differences Between IBO and the Bloomberg Administration

Items that Affect the Gap

Dollars in millions

	2007	2008	2009	2010	2011
Gaps as Estimated by the Mayor	**$-**	**$-**	**($2,617)**	**($3,681)**	**($3,621)**
IBO Pricing Differences					
Revenues					
Taxes					
Property	15	(96)	(91)	(104)	116
Personal Income	(86)	154	20	248	164
General Sales	80	(25)	77	91	57
General Corporation	11	(91)	(63)	(85)	(100)
Unincorporated Business	108	146	248	288	288
Banking Corporation	(26)	(64)	96	83	79
Real Property Transfer	(17)	(71)	20	59	82
Mortgage Recording	(20)	(48)	(3)	43	51
Hotel Occupancy	1	18	23	27	27
Commercial Rent	(12)	(33)	(34)	(34)	(34)
Cigarette	1	1	1	1	2
	55	(109)	294	617	732
Tax Program					
Real Property Tax Rate Reduction	-	(8)	(10)	(11)	(24)
City Sales Tax Exemption- Clothing	-	(10)	(11)	(13)	(14)
Business Tax Reductions	-	(2)	(4)	(4)	(4)
	-	(20)	(25)	(28)	(42)
STaR Reimbursement	(39)	(44)	16	33	33
Total Revenues	**16**	**(173)**	**285**	**622**	**723**
Expenditures					
Public Assistance	(1)	5	9	9	9
Education	(17)	(55)	(102)	(104)	(104)
Campaign Finance	-	-	-	(25)	-
Overtime - Police	(25)	(75)	(75)	(75)	(75)
Buildings	-	(3)	(3)	(3)	(3)
Total Expenditures	**(43)**	**(128)**	**(171)**	**(198)**	**(173)**
Total IBO Pricing Differences	**(27)**	**(301)**	**114**	**424**	**550**
IBO Prepayment Adjustment 2007 / 2008	27	(27)	-	-	-
IBO Prepayment Adjustment 2008 / 2009	-	328	(328)	-	-
IBO Surplus/(Gap) Projection	**$-**	**$-**	**($2,831)**	**($3,257)**	**($3,071)**

SOURCE: IBO.

NOTE: Negative pricing differences (in parentheses) widen the gaps, while positive pricing differences narrow the gaps.

workers—continue to rise. But there is now also spending growth in some other areas of the budget such as education, the Mayor's new antipoverty programs, and the cost of exporting the city's trash to landfills.

- Despite the size of the planned increase in capital spending under the preliminary 10-year capital strategy, it will not have a significant effect on the future growth in city debt service because a large portion of the new projects are expected to be funded by water authority and state dollars.

ECONOMIC AND REVENUE ESTIMATES

IBO's economic outlook for the coming years, much like that of the Mayor's budget office, is generally cautious. On the national level, we expect a moderate and short-lived slowdown. The ongoing weakness in the national housing market and cuts in vehicle production will slow U.S. growth, particularly during the first half of the 2007 calendar year. Corporate profits have grown at an extraordinary rate over the past five years, a trend that most forecasters do not think can continue.

Locally, the residential real estate market has remained unexpectedly strong. Still, there has been a decline in the number of residential sales in the last six months of calendar year 2006 compared to the same period in 2005. Prices have continued to rise, but at a slower pace. Reflecting the slowdown in the national economy this year, IBO expects employment growth to slow in the city from 1.2 percent in calendar year 2007 to an average annual rate of 1.0 percent in 2008 through 2011. Likewise, the growth rate in local business profits and personal income is also expected to slow.

While tax collections for the rest of this fiscal year are projected to greatly exceed earlier expectations, our outlook casts a dimmer picture for 2008 and then begins to rebound in 2009 and beyond.

IBO now projects tax revenues to total $35.6 billion in the current fiscal year, 5.7 percent above last year. This new projection, fueled by the continued strength in real estate and financial markets, Wall Street bonuses, and the vigor of the city's broader economy, is $1 billion more than we estimated just two months ago, and $3.3 billion more than the Mayor expected when the budget was adopted last June. IBO projects that revenues from all sources (taxes, fees and fines, state and federal categorical aid, and other revenues) will total $58.1 billion in 2007.

2008 and Beyond. With the expectation that the real estate market will weaken and coperate profits grow more slowly, the tax revenue outlook for 2008 is quite different. Revenue from the real property transfer taxes will fall and collections from the business income taxes and sales tax will be relatively flat. Excluding the impact of the Mayor's proposed tax reductions, 2008 baseline tax revenues are expected to grow only 1.8 percent above their 2007 levels, to $36.3 billion. This projection is roughly $100 million *below* the level expected by the Mayor's budget office. With moderate growth (2.5 percent) expected from non-tax sources, total revenues, excluding the proposed tax cuts, are projected to equal $59.3 billion in 2008, an increase of 2.1 percent.

It is somewhat unusual for IBO's tax revenue forecast to be below the Mayor's, and it reverses in 2009 through 2011. We do not see the economy slowing as much nor as long as the Bloomberg Administration expects. IBO projects tax revenues will grow somewhat faster after 2008, with tax collections rising to $37.7 billion in 2009 (not including the proposed tax cuts) and reach $42.2 billion by 2011. Over the 2007-2011 period, annual baseline tax revenue growth will average 4.3 percent.

Property Tax Drives Growth. The real property tax accounts for much of the tax revenue growth in the years after 2007, when it is expected to grow by 7.9 percent annually. The strength of the property tax derives from the continued appreciation of property values and IBO's projection of a large pipeline of assessment increases in apartment and commercial buildings still to be phased in. This pipeline will help keep assessments for tax purposes growing briskly.

This growth comes despite IBO's assumption that some property assessments will be significantly reduced when the final assessment roll is released in May. A change in assessment procedure in order to spur the filing of required forms by the owners of income-producing properties sharply increased the assessments on certain residential and commercial buildings. While the Mayor's budget office apparently assumed that there would not be significant changes in assessments and the resulting tax collections, IBO assumed there would be. The finance department has indicated that if the forms are filed, many owners are likely to see lower assessments.

Tax Cut Proposals. The Mayor's budget plan contains a number of proposed tax policy changes that would reduce property, sales, and personal and business income taxes as well as provide a tax credit for child care for low-income working families. IBO estimates that if all of the proposals were enacted, the total cost of the tax program in 2008 would be $1.3 billion, rising to $1.6 billion in 2011. As a result, total tax revenues would be $35.0 billion in 2008 and $40.6 billion in 2011, reducing average annual growth over the 2007-2011 period by 1 percentage point to 3.3 percent.

The costliest of the proposals is the reduction in the property tax rate. IBO estimates the rate cut would reduce revenues by $758 million in 2008, growing to $941 million by 2011.

SPENDING TRENDS

IBO projects that under the Mayor's current Financial Plan total city spending will rise at an average rate of 3.9 percent annually, growing from $58.1 billion in 2007 to $67.8 billion in 2011. Despite this increase of $9.7 billion over five years, the level of services to be provided by most city agencies will remain relatively constant.

The same "big ticket" items that have propelled spending growth in the past—debt service, pensions, and health care and other fringe benefits for city workers—continue to rise. But there is now also spending growth in some other areas of the budget such as education, the Mayor's new antipoverty programs, and the cost of exporting the city's trash to landfills.

Education. IBO estimates that spending by the Department of Education will rise at an average rate of 5.0 percent annually under the Mayor's plan, growing from $15.7 billion in 2007 to just over $19 billion in 2011 (not including the education department's reserve fund for wage increases). This rise in spending is fueled by the new funds anticipated from the state—$723 million in 2008 growing to $2.3 billion in 2011— as a resolution of the Campaign for Fiscal Equity lawsuit as well as the normal year-to-year growth in the city's own share of education spending.

Our estimate of city education spending is somewhat higher than anticipated in the Financial Plan because of uncertainty over an assumption in how a portion of the recent contract settlement with the United Federation of Teachers will be funded. The Preliminary Budget included an assumption that a larger share of state and federal aid would be available to use for the settlement than may be the case. Because of this, IBO expects $55 million more in city education spending in 2008, $102 million more in 2009, and $104 million more in each of the ensuing years.

Capital Spending and Debt Service. Along with the Preliminary Budget for 2008 the Mayor also presented a $77.3 billion Ten-Year Preliminary Capital Strategy. This new strategy, presented biennially, is $14.9 billion more than the 2006 10-year strategy. Most of this new capital spending—$14.3 billion—is for school construction and water and sewer projects.

Despite the size of the planned increase in capital spending, it will not have a significant effect on the future growth in city debt service. This is because borrowing for the water and sewer projects is paid with revenue from water and sewer fees and the capital strategy assumes that half of the school construction costs will be covered by the state

Debt service nonetheless continues to be one of the fastest growing portions of the budget. IBO projects that debt service will increase at an average rate of 7.7 percent annually, when adjusted for prepayments from the budget surplus, and excluding debt service on bonds issued by the Transitional Finance Authority (TFA) for school construction. The principal and interest payments on the money the city borrows for its capital projects will grow from $4.5 billion in 2007 to $6.2 billion in 2011. While debt service continues to grow, it is declining as a share of tax revenues—a common indicator of debt affordability.

Debt service for the TFA's bonds for school construction, Building Aid Revenue Bonds, or BARBs, is carried "off budget." With it included, debt service is projected to grow to $6.6 billion in 2011—an annualized growth rate of 8.7 percent. The debt service on these bonds is at least partially covered by an increase in state Building Aid.

Pensions and Fringe Benefits. The city's contributions for pensions for the municipal workforce also continue to climb at a fast pace over the Financial Plan period. Rising at an annual average rate of 6.4 percent, the city's pension contributions are projected to rise from $4.7 billion in 2007 and then level off at $6.1 billion in 2010. Part of the increase is due to anticipated changes in actuarial assumptions that will cost $230 million annually beginning in 2009.

The cost of health care and other fringe benefits for city workers (excluding those in the Department of Education) is growing at a slightly faster pace than pension contributions and is rising from $3.5 billion in 2007 to $4.6 billion in 2011, an average annual increase of 7.0 percent. This does not include the proposed $500 million dedicated for the Retiree Health Trust Fund in 2008.

Other Spending Changes. The Mayor has also added several

new ongoing spending commitments to the budget plan.
In response to the recommendations of his Commission on Economic Opportunity, the Mayor has proposed $65 million in new spending initiatives through a number of different city agencies. This effort includes $15.1 million in programs to provide out-of-school youth with internships and encourage other young people to remain in school funded through the Department of Youth and Community Development and $14.4 million in adult workforce training and job retention services funded through the Department of Small Business Services.

The Bloomberg Administration has also decided to incorporate in the Financial Plan roughly $60 million in spending that in prior years was part of the annual budget negotiations between the Mayor and the City Council. This includes $37 million in 2008 (and $35 million in the out-years) for cultural affairs programs, $14 million annually for parks services, and $10 million annually for child care subsidies.

In addition, the Bloomberg Administration has increased its estimate of the annual cost of exporting the city's trash to landfills as well as spending related to the closure of Fresh Kills. The cost is projected to rise by $15 million to total $312 million in 2008 and then grow more rapidly to reach $413 million in 2011, $115 million more than previously expected.

CONCLUSION

New York City's near-term fiscal picture remains bright, as tax revenues, particularly from the real estate and financial services industries, continue to exceed expectations. Because of this, IBO has increased its tax revenue estimates from just two months ago by $1 billion for the current fiscal year.

IBO, along with the Bloomberg Administration, the Congressional Budget Office, and the *Blue Chip* consensus of about 50 private economists, expects a moderate and short-lived slowdown of the national economy. Slower economic growth is expected to dampen the growth rate of city tax revenues in the upcoming years. With anticipated spending growth exceeding projected increases in tax collections, budget shortfalls of around $3 billion a year are expected to emerge in 2009 through 2011.

These gaps are smaller both in dollar terms and as a share of city-generated tax and other revenues—about 7 percent—than just a few years ago. Still, if IBO's economic forecast is correct, closing these gaps may require the kinds of actions—tax increases or spending reductions—the Mayor and City Council have largely been able to avoid in recent years. With the proposed property tax rate reduction comprising about one-quarter of the shortfall in each year, the rate cut may be particularly hard to maintain as represented in the Financial Plan unless spending reductions or other tax increases are used to offset the cost.

Economic Outlook

RECENT DEVELOPMENTS

The U.S. economy started calendar year 2006 strong, but then slowed down.[1] According to the latest reports from the federal Department of Commerce, real (inflation-adjusted) gross domestic product (GDP) grew at an annual rate of just 2.2 percent in the fourth quarter of 2006 and 3.3 percent in the year overall. The housing market weakened significantly, as interest rates rose sharply. Inflation remained above 3 percent for the second consecutive year, propelled in part by rising prices for energy.

Not all economic news for 2006 was bad, however. Payroll employment gained nearly 2.5 million jobs (1.8 percent) in its third consecutive year of growth.[2] The unemployment rate fell for the third year in a row as well to 4.6 percent, down from its 2003 peak of 6 percent. And corporate profits rose by 21.7 percent, the highest level in five years of double-digit growth.

New York City's economy continued to expand in 2006, with personal income up by 8.2 percent and payroll employment up 1.5 percent. The gain of 54,200 jobs represented more than a quarter of the 191,400 jobs lost between 2000 and 2003. Although manufacturing lost 3,900 more jobs (3.4 percent), other industries had job gains: financial activities, 9,300 jobs (2.1 percent), with a gain of 6,700 (4.0 percent) in securities; professional and business services, 8,100 (1.5 percent), although employment services, which includes temporary workers, lost jobs; leisure and hospitality, 8,200 jobs (3.0 percent); information, 2,000 jobs (1.2 percent); education, 4,900 jobs (3.4 percent); health, 8,600 jobs (2.3 percent); social services, 4,800 (3.1 percent); construction, 2,900 jobs (2.6 percent); and trade, transportation, and utilities, 6,200 jobs (1.1 percent). Retail trade gained 5,400 jobs (1.9 percent) in 2006, down somewhat from gains in the previous two years, but enough to rise above the 2000 peak in retail trade employment.

Even with this growth, total employment was still below the 2000 peak. Overall, there were 69,500 fewer jobs (1.9 percent) in the city in 2006 than in 2000, including 17,900 fewer jobs (9.1 percent) in the high-paying securities industry.

New York City's unemployment rate for the year was 4.6 percent. After declining throughout most of the year, the city unemployment rate averaged 4.4 percent in the last quarter, dipping below the national unemployment rate and reaching a local historic low. In a less favorable comparison, local inflation of 3.8 percent in 2006 exceeded the national inflation rate of 3.2 percent.

Wall Street had a great year in 2006, with profits reaching $16.9 billion. A broader and possibly more useful gauge of Wall Street's impact on the city economy may be the industry's net revenue—gross revenue less interest expenses. Net revenue includes earnings distributed as profits, regular wage and salaries, bonus compensation, and purchases of goods and services. With interest rates rising, the interest expenses of securities firms grew by about 50 percent from 2005 to 2006. Nonetheless, net revenue rose from $108.8 billion in 2005 to $127.9 billion in 2006.

New York City's residential real estate market has remained unexpectedly strong. Despite a decline in the number of residential sales in the last six months of 2006 compared to the corresponding period in 2005—the number of apartment sales fell by 11.0 percent and the number of conventional home sales fell by 26.4 percent—prices have continued to rise, albeit at a slower pace. The same holds for the commercial market. The office rental market has tightened substantially. Class A direct office vacancy rates fell to 3.8 percent in January for the midtown and midtown south sections of Manhattan and to 4.9 percent for downtown.

NATIONAL ECONOMIC OUTLOOK

IBO—along with the Bloomberg Administration, the Congressional Budget Office, and the *Blue Chip* consensus of about 50 private economists—expects a moderate and short-lived slowdown at the national level; the on-going housing correction and cuts in vehicle production will slow U.S. growth, particularly during the first half of the year. Real GDP is projected to grow just 2.6 percent in 2007, a slower pace than the last few years, but then grow 3.2 percent in 2008 and average 3.0 percent annual growth in 2009 through 2011.

Similarly, national payroll employment is expected to grow by just 1.0 percent this year (1.8 million jobs), but then build up to 1.4 percent in 2010-2011. Personal income (not adjusted for inflation) is expected to grow by 5.2 percent this year and next year, down from 6.4 percent in 2006, and then grow slightly more slowly in the later years of the forecast period. Inflation-adjusted personal income should show less of a slowdown, however, because inflation is expected to drop from 3.2 percent in 2006 to 1.8 percent this year and then stay just above 2 percent in 2008 to 2011. While the 10-year U.S.

IBO versus OMB Economic Forecasts

	2006	2007	2008	2009	2010	2011
National Economy						
Real GDP Growth						
IBO	3.3	2.6	3.2	3.1	3.0	2.9
OMB	3.3	2.2	3.1	3.4	3.3	2.8
Non-farm Employment Growth						
IBO	1.8	1.0	1.1	1.3	1.4	1.4
OMB	1.4	0.9	1.2	1.5	1.4	1.0
Inflation Rate (CPI-U)						
IBO	3.2	1.8	2.1	2.1	2.2	2.3
OMB	3.2	1.7	2.0	1.8	1.8	1.8
Personal Income Growth						
IBO	6.4	5.2	5.2	5.1	5.0	5.0
OMB	6.4	4.9	5.3	6.1	6.1	5.6
Unemployment Rate						
IBO	4.6	4.8	4.8	4.8	4.7	4.7
OMB	4.6	4.9	5.0	4.7	4.5	4.4
10-Year Treasury Bond Rate						
IBO	4.8	4.9	5.3	5.6	5.6	5.5
OMB	4.8	4.6	4.9	5.5	5.5	5.5
Federal Funds Rate						
IBO	5.0	4.9	4.7	4.7	4.5	4.5
OMB	5.0	5.0	4.8	4.9	5.0	5.0
NYC Economy						
Non-farm New Jobs (thousands)						
IBO	54.2	42.9	36.5	34.6	40.9	38.1
OMB	54.2	27.9	24.0	40.2	43.3	35.5
Employment Growth						
IBO	1.5	1.2	1.0	0.9	1.1	1.0
OMB	1.5	0.8	0.7	1.1	1.2	0.9
Inflation Rate (CPI-U-NY)						
IBO	3.8	1.7	2.2	2.4	2.6	2.6
OMB	3.8	2.1	2.2	2.0	2.0	2.0
Personal Income ($ billions)						
IBO	376.7	417.0	434.5	453.2	473.1	492.6
OMB	371.0	389.0	400.0	419.0	442.0	466.0
Personal Income Growth						
IBO	8.2	10.7	4.2	4.3	4.4	4.1
OMB	7.1	4.7	3.0	4.6	5.5	5.5
Manhattan Office Rents ($/sq.ft)						
IBO	55.95	66.96	69.71	71.95	74.54	77.36
OMB	53.59	61.31	63.29	65.89	72.66	77.83

SOURCES: IBO, Mayor's Office of Management and Budget.

NOTE: Rates reflect year-over-year percentage changes except for unemployment, 10-Year Treasury Bond Rate, Federal Funds Rate, and Manhattan Office Rents. The local price index for urban consumers (CPI-U-NY) covers the New York / Northern New Jersey region. Personal income is nominal.

Treasury bond rate is expected to jump significantly in 2008 and then again in 2009, and then stay at 5.5 to 5.6 percent, the federal funds rate is expected to decline gradually during the forecast period. IBO expects the national unemployment rate to rise slightly this year, but reach just 4.8 percent, and then drop to 4.7 percent in 2010-2011.

The national economic forecast of the Mayor's Office of Management and Budget (OMB) differs somewhat from IBO's forecast. OMB anticipates steeper declines in the growth rates for real GDP, personal income, and employment this year, but then slightly greater rebounds starting next year.

LOCAL ECONOMIC OUTLOOK

IBO expects New York City employment growth to slow down with the national economy this year, but not bounce back as quickly. IBO expects payroll employment to grow by 1.2 percent this year, and then by an average annual rate of 1.0 percent in subsequent years. The total gain projected for the 2007-2011 forecast period is 193,000 jobs. The 42,900 new jobs forecast for calendar year 2007, if realized, will bring the city close to its 2000 employment peak (3.723 million jobs); the 36,500 new jobs forecast for 2008 would take the city's total employment above its 2000 peak.

One-third of the new jobs projected for the forecast period—63,400 jobs—are expected to appear in professional and business services. Growth of 2.5 percent (14,300 jobs) is expected for 2007; growth of 2 percent or more is expected in all subsequent years.

The securities industry is expected to gain just 400 jobs in 2007 and then grow slowly but fairly steadily, averaging 1 percent growth per year through the rest of the forecast period. The total job gain projected for securities for 2007 to 2011 is 7,900, which will leave securities with about 10,000 fewer jobs (5.1 percent) than it had in 2000. This job outlook is consistent with IBO's forecast for Wall Street profits: a 15.0 percent decline to about $14.3 billion this year, followed by a climb to $16.8 billion in 2011. Revenue net of interest expense is expected to decline in 2007 and 2008, despite declines in interest expenses in both years, and then grow—although it is not expected to regain its 2006 level by the end of the forecast period. Overall, the financial activities sector is expected to gain just 10,000 jobs.

Information is expected to grow steadily, adding a total of 12,600 jobs in calendar years 2007 through 2011. Adding this projected gain for information to the gains projected for professional and business services and financial activities produces a total projected gain for office employment of 86,000—about 45 percent of the total expected gain and just over the number needed to pass the 2000 office employment peak (1.3 million jobs) in the last year of the forecast period.

New jobs in education, health, and social assistance services are expected to account for another large share of the projected increase in city employment, both in 2007 and in subsequent years. The forecast for employment growth this year in this sector—which includes private education providers, social service agencies, and medical establishments like doctor's offices and nursing services—is 2.1 percent (14,600 jobs, with 6,800 in health, 3,100 in education, and 4,700 in social assistance). For the 2007 to 2011 period overall, the expected gain is 70,300 jobs, about 36 percent of citywide growth. These industries are important for the city's economic health because they generally are less sensitive to the business cycle and thus provide a more stable basis of employment growth than most other industries.

Leisure and hospitality industries have benefited greatly in recent years from the return of visitors to the city, particularly from abroad—at least partly due to the weak dollar. Employment growth in these industries is expected to continue, though at a more moderate pace. IBO projects a gain of 4,300 jobs (1.5 percent) this year, followed by gains of 1.1 percent to 1.3 percent through 2011. In retail trade, after a large employment gain this year of 5,000 jobs (1.7 percent), steady but significantly smaller gains of 0.3 percent to 0.5 percent are projected.

Manufacturing is expected to lose another 1,300 jobs this year, bringing the industry's total loss since 2000 to about 67,700 jobs (38 percent). IBO expects manufacturing employment to stay essentially flat during the rest of the forecast period.

In 2007, personal income growth is expected to be quite high—10.7 percent—in part due to extraordinary bonuses received by Wall Street employees early this year. For 2008 through 2011, IBO forecasts personal income growth will range between 4.1 and 4.4 percent.

Local inflation is expected to decline from 3.8 percent in 2006 to 1.7 percent this year, but then climb to 2.2 percent in 2008, 2.4 percent in 2009, and 2.6 percent in 2010. For 2008 to 2011, IBO's forecast for local inflation exceeds the forecast for national inflation.

IBO's local economic forecast differs from OMB's forecast in some important ways. Although both IBO and OMB expect economic growth to slow, OMB forecasts a steep drop in employment growth from 1.5 percent in 2006 to 0.8 percent this year, while IBO forecasts a more gradual slowdown. Overall, IBO's forecast of the total number of jobs to be added to the city's economy from 2007 to 2011 exceeds OMB's by about 22,100 jobs (12.9 percent).

IBO's forecast of personal income growth for 2007 is also much stronger than OMB's—10.7 percent, as compared to 4.7 percent. While both IBO and OMB forecast slower personal income growth in 2008, OMB projects a lower growth rate from a lower base. Thus, although OMB's forecast for personal income growth exceeds IBO's in 2010-2011, IBO's projected level of personal income in 2011 is still higher than that of the Mayor's budget office. IBO's inflation forecast starts the forecast period lower than OMB's, but exceeds it in 2009 through 2011. Finally, the two forecasts of Manhattan office rents end up at almost identical levels in 2011, but IBO expects office rents to grow faster than OMB does in 2007 and 2008, and slower from 2009 through 2011.

END NOTES

[1]Economic data and dates in this section refer to calendar years.
[2] IBO's forecast has been completed shortly before the March release of the annual benchmarking of payroll employment data by the New York State Department of Labor.

Taxes and Other Revenues

INTRODUCTION

The city's revenue outlook for the current fiscal year, particularly from tax sources, has greatly improved since the 2007 budget was adopted last spring, fueled by continued strength in real estate and financial markets, employment gains, and Wall Street bonuses. IBO projects that revenues from all sources (taxes, fees and fines, state and federal categorical aid and other revenues) will total $58.1 billion in 2007. Tax revenues are up 5.7 percent this year over last, but revenue from other sources is growing even faster. IBO's projection for total revenues in 2007 is 8.0 percent higher than the total for 2006.

Excluding the impact of the Mayor's proposed tax changes, 2008 baseline tax revenues are expected to grow only 1.8

IBO Revenue Projections

Dollars in millions

	2007	2008	2009	2010	2011	Average Change
Tax Revenue						
Property	$12,956	$14,131	$15,286	$16,402	$17,575	7.9%
Personal Income	7,498	7,773	7,765	8,342	8,688	3.8%
General Sales	4,618	4,619	4,813	5,043	5,271	3.4%
General Corporation	2,784	2,772	2,748	2,896	3,088	2.6%
Unincorporated Business	1,553	1,608	1,692	1,793	1,884	4.9%
Banking Corporation	786	749	754	776	808	0.7%
Real Property Transfer	1,466	1,193	1,183	1,237	1,289	-3.2%
Mortgage Recording	1,371	1,141	1,115	1,175	1,210	-3.1%
Utility	356	363	378	393	409	3.5%
Hotel Occupancy	333	350	361	377	389	4.0%
Commercial Rent	500	517	532	549	567	3.2%
Cigarette	121	118	114	112	111	-2.1%
Other Taxes and Tax Audits	1,297	949	949	956	957	-7.3%
Total Tax Revenue	35,639	36,283	37,690	40,051	42,246	4.3%
Tax Program						
Property Tax Rebate- Extension	-	(256)	(256)	(256)	(256)	n/a
Real Property Tax Rate Reduction	-	(758)	(820)	(879)	(941)	n/a
NYC Child Care Credit	-	(42)	(43)	(44)	(45)	n/a
City Sales Tax Exemption- Clothing	-	(120)	(128)	(132)	(136)	n/a
Business Tax Reductions	-	(142)	(180)	(206)	(248)	n/a
Total Taxes including Tax Program	35,639	34,965	36,263	38,534	40,620	3.3%
Other Revenue						
STaR Reimbursement	1,054	1,104	1,137	1,176	1,210	3.5%
Miscellaneous Revenues	4,005	4,103	3,474	3,499	3,522	-3.2%
Unrestricted Intergovernmental Aid	340	340	340	340	340	0.0%
Other Categorical Aid	1,062	1,027	1,042	1,049	1,045	-0.4%
Inter-fund Revenues	416	406	388	387	386	-1.9%
Disallowances	(15)	(15)	(15)	(15)	(15)	0.0%
Total City Funded Revenue	**42,501**	**41,930**	**42,629**	**44,970**	**47,108**	2.6%
State Grants	9,940	10,608	11,352	12,129	12,178	5.2%
Federal Grants	5,703	5,486	5,470	5,472	5,476	-1.0%
Total Revenues	**$58,144**	**$58,024**	**$59,451**	**$62,571**	**$64,762**	2.7%

SOURCE: IBO.

NOTES: Personal Income Tax includes Transitional Finance Authority (TFA) dedicated personal income tax revenue. Estimates exclude intra-city revenues.

percent from their 2007 levels. With moderate growth (2.5 percent) expected for non-tax sources, total baseline revenues are projected to equal $59.3 billion in 2008, an increase of 2.1 percent. IBO's forecast of baseline tax revenue growth from 2007 to 2011 (annual average of 4.3 percent) exceeds the annual growth from other city revenue sources (2.7 percent average).

Assuming the Mayor's tax proposals are adopted, total revenue for 2008 would be $58.0 billion, a decrease of 0.2 percent. Thereafter, total revenues resume growing, reaching $64.7 billion by 2011. Overall, revenues from all sources are expected to grow from 2007 to 2011 at an average rate of 2.7 percent annually.

The bulk of this section of the report presents IBO's forecast of tax revenues, which is built up from our forecasting models for 11 major tax sources. The section also includes a brief overview of the outlook for revenues from other sources.

TAX REVENUE FORECAST

Tax collections in 2007 have been soaring, thanks to the continued strength of the city's real estate and financial markets, high Wall Street bonus payments, and the sustained strength of the city's broader economy. IBO now projects that tax revenues will total $35.6 billion in 2007, $3.3 billion (10 percent) higher than anticipated by the Mayor's Office of Management and Budget (OMB) when this year's budget was adopted last June. The forecast for the two property transfer taxes—the real property transfer tax (RPTT) and the mortgage recording tax (MRT)—is now $1.1 billion (63.6 percent) higher than when the budget was adopted. The business income taxes are also up $981 million (23.7 percent) since last June's estimate.

Total tax revenues in 2007 are now expected to be 5.7 percent higher than their 2006 level, with much of the increase coming in the business income taxes (up 17.9 percent), RPTT (up 13.2 percent), and hotel occupancy tax (up 12.3 percent). The combined transfer tax revenues for 2007 are now expected surpass the record that was set last year.

IBO's outlook for 2008 is quite different, however. The number of real estate transactions has fallen, and growth in sales prices has slowed significantly. With these conditions expected to hold for the next 12 to 24 months, revenue from the transfer taxes is expected to fall by 18 percent from their 2007 levels, although they will still total $2.3 billion, higher than any year before 2006. With the growth in the local economy expected to slow towards the end of this calendar year and remain slow throughout most of 2008, and growth in corporate profits in the U.S. economy expect to slow from its recent torrid pace, revenue from the business income taxes is expected to be virtually the same as in 2007, ending several years of strong growth. Likewise, we expect little change in sales tax revenue from 2007 to 2008, while growth in the personal income tax will be moderate at 3.7 percent. Among the major taxes, the property tax is forecast to grow the most rapidly, increasing by 9.1 percent from 2007 to 2008. Overall, baseline revenues from all taxes are projected to grow by only 1.8 percent from 2007 to 2008. Excluding the recession year, 2002, this would be the lowest one-year growth in tax revenues since the mid-1990s.

Tax revenues begin to grow somewhat faster after 2008 with revenues expected to reach $42.2 billion by 2011. Over the 2007-2011 period, annual baseline tax revenue growth will average 4.3 percent. Note that this average annual growth would be much smaller than the rates that have prevailed in the last 10 years, again excluding 2002.

The real property tax accounts for much of the tax revenue growth in the years after 2007, when it is expected to grow by 7.9 percent annually. This growth comes despite IBO's assumption that there will be a significant downward revision in some assessments before the final assessment roll is released in late May. The strength of the property tax derives from the continued appreciation of property values and IBO's projection of a large pipeline of assessment changes in apartment and commercial buildings that remain to be phased in. This pipeline will help keep assessments for tax purposes growing briskly.

The Preliminary Budget contains a number of proposed tax policy changes. These include a 5 percent rate cut for the property tax, extension of the current $400 property tax rebate for homeowners, a new child care credit targeted at low income working families, elimination of the sales tax on clothing items costing over $110, and a series of proposals that would benefit small businesses and their owners. IBO estimates that if all of the proposals were enacted, the total cost of the tax program in 2008 would be $1.3 billion, rising to $1.6 billion in 2011. If adopted, the program would cut total tax revenues to $35.0 billion in 2008 and $40.6 billion in 2011, reducing average annual growth over the 2007-2011 period by 1 percentage point to 3.3 percent.

For 2007, IBO's tax forecast differs only slightly from the forecast presented by the Bloomberg Administration in the

Preliminary Budget. But the projections diverge in 2008 when IBO's tax forecast is $108 million lower than OMB's. Some of the difference is in the property tax forecast, where estimating the extent of the revisions to commercial and rental building assessments this year is particularly difficult. OMB apparently assumed that there would not be unusual changes, while IBO assumed there would be, as property owners respond to a change in assessment procedure.

IBO's 2008 outlook is also more pessimistic for the transfer taxes, sales tax, and the corporate income tax. Among the major taxes, there are only two (personal income and the unincorporated business taxes) where IBO's forecasts are higher than OMB's. For these two taxes, the difference between the two forecasts is probably due to differences in assumptions about the timing and extent of the economic slowdown that both offices anticipate. The Mayor's budget office expects growth to begin slowing sooner and is forecasting a more pronounced slowdown than IBO. Thus, IBO is expecting more modest impacts on employment and personal income, both important factors in our outlook for revenues from these taxes.

The unusual situation of having IBO's tax revenue forecast below the Mayor's lasts only one year, with IBO projecting somewhat higher revenues than OMB each year from 2009 to 2011, although the differences are somewhat less than in recent forecasts.

- IBO projects tax revenues for 2007 will be $35.6 billion, up 5.7 percent from the prior year and $3.3 billion from the level assumed when the budget was adopted in June.
- Revenue growth this year is fueled primarily by the business income taxes (up 17.9 percent from 2006), and real property transfer tax (up 13.2 percent).
- Although real property transfer taxes in 2007 are now expected to be slightly higher than last year's record level, this forecast is 63.6 percent above the amount the Bloomberg Administration anticipated when the budget was adopted.
- Baseline revenues will grow by only 1.8 percent in 2008, pulled down by a lack of growth in the business income taxes and a combined decline of 18 percent in the transfer taxes.
- Somewhat stronger revenue growth resumes beginning in 2009, with revenues expected to increase by 3.9 percent, followed by gains of 6.3 percent in 2010, and 5.5 percent in 2011.
- The Preliminary Budget contains a number of tax policy proposals, which in the aggregate would cost the city $1.3 billion in revenue in 2008, rising to $1.6 billion in 2011.
- For the 2007-2011 period, baseline revenue growth will be sustained by the property tax, which is expected to grow by an average of 7.9 percent annually due to a forecast of continued but more moderate growth in property values and the pipeline of earlier assessment increases still being phased in.
- Business and personal income taxes and the general sales tax are expected to grow at more modest rates (averaging 3.1 percent, 3.7 percent, and 3.4 respectively) over the 2007-2011 period, consistent with IBO's outlook for slower growth in the local and U.S. economies than in recent years.

REAL PROPERTY TAX

IBO projects property tax revenue to reach $14.1 billion in 2008, an increase of 9.1 percent over the 2007 level of $13 billion. From 2008 to 2011, strong growth in property tax revenue is expected to continue, with annual growth averaging 7.5 percent. IBO's forecast for property tax revenue is slightly less optimistic than OMB's forecast for 2008 through 2010; the difference is less than 1 percent each year.

Background. The amount of tax owed on real estate in New York City depends on the type of property, its value for tax purposes (as calculated by the city's Department of Finance from estimated market values), and the applicable tax rate.[1]

Under the property tax law, every parcel is assigned to one of four tax classes: Class 1, consisting of one-, two-, and three-family homes; Class 2, composed of apartment buildings, including cooperatives and condominiums; Class 3, made up of the real property of utility companies; and Class 4, composed of all other commercial and industrial property. Each tax class can have its own assessment ratio (the share of market value actually subject to tax). Tax rates also vary from class to class.

The tax classes also differ in how market value appreciation is reflected in assessments. In Class 1 and the portion of Class 2 consisting of apartment buildings with 10 or fewer units, annual assessment increases are capped, regardless of how rapidly market values are rising. In Class 1, increases are limited to 6 percent per year and no more than 20 percent over five years. For the small residential properties in Class 2, the limit is 8 percent in one year and no more than 30 percent over five years. In Class 4 and the balance of Class 2, there are no limits on annual assessment increases, but when computing the value for tax purposes assessment increases are phased in over five years.

While the city eventually captures the phased-in assessment increases in classes 2 and 4, much of the market value growth lost to the caps in Class 1 and the smaller residential buildings in Class 2 is essentially lost forever. When market value increases for capped properties exceed the assessment cap, assessed values fall further and further short of the maximum, or target, assessment ratio for the class (6 percent of market value in Class 1 and 45 percent in Class 2). Even in weak real estate markets, values rarely fall so far that assessments "catch up" to the target assessment rate for Class 1.

Although owners of rapidly appreciating properties benefit from a lower tax burden thanks to the caps, some of the benefit is offset when slower appreciating properties with increasing assessment ratios reach the target assessment ratio. Under the state law governing the city's property tax system, the shares of the tax levy borne by each class are based largely on each class' share of market value. When properties in Class 1 do hit the target assessment ratio, the tax rate for the class as a whole must be increased because the same amount of revenue must be raised from the class regardless of the total assessed value in the class. Thus, owners of properties that did not hit the target assessment ratio bear a higher burden than they would if the target ratio were higher.

With the process for determining assessed value in each class varying so greatly, there are wide differences between the classes in terms of shares of total market value, assessed values, and tax burdens (levies). On the 2007 assessment roll, Class 1 homes account for 54.5 percent of market value in the city, but only 11.6 percent of assessed value for tax purposes and 15.2 percent of the tax levy. In contrast, Class 4 properties account for 21.6 percent of the market value, but 45.9 percent of assessed value for tax purposes and 40.6 percent of the tax levy. The other two classes also account for greater shares of the assessed value than of market value, and therefore bear a disproportionately large share of the property tax burden.

Tentative Assessment Roll for 2008. In January, the Department of Finance released the tentative 2008 assessment roll. Because of the timing of the assessment process, the market values on the 2008 roll largely reflect economic conditions in calendar year 2006. Market values on the 2008 tentative roll showed an overall increase of 19.0 percent over 2007, with Class 2 showing the largest increase at 26.3 percent and Class 4 not far behind with an increase of 22.3 percent. Class 1 market values grew 16.3 percent. Assessed value for tax purposes (billable taxable assessed value) showed an increase of 8.9 percent, with growth for Class 4 at 12.0 percent and Class 2 at 9.7 percent. After taxpayer challenges and other finance department adjustments are processed, the values will be finalized in May and used for setting 2008 tax bills.

IBO expects changes from the tentative roll to the final roll to be larger than usual this year for both Class 2 and Class 4 because about one-quarter of the tentative increases in those classes result from a change in assessment procedure to spur filing of required information forms by owners of income-producing properties. The Department of Finance has announced that if the forms are filed, some owners are likely to see lower assessments based on the newly supplied information.

The Department of Finance usually estimates market values for commercial and rental apartment buildings using income and expense information, which building owners are required to report annually. In the past, if no report was filed for a property, the assessor would estimate the income and expenses or adjust the most recently reported income and expense information for intervening price changes. This year, for properties without income and expense statements filed (about 35,000 properties, according to the finance department Web site) assessors were told to use the highest income and lowest expense reported by owners who filed income and expense statements for the same property types to compute estimated net income. They then applied the lowest authorized capitalization rate for that type of property (the lower the cap rate, the higher the resulting market value) to the net income to calculate the new market value.

The results were staggering increases in market values for effected properties. For example, the citywide market value of Class 2 rental buildings rose 32.2 percent between the 2007 final roll and the 2008 tentative roll; in contrast, the increase between the 2006 final and 2007 tentative rolls was 1.6 percent for this building type. Outside Manhattan, where non-filing is more prevalent, the median increase for rental buildings that did not file was almost 100 percent.

The Department of Finance is encouraging property owners who did not file statements earlier to provide the information by May 1, 2007. IBO expects many property owners to take advantage of this opportunity, so that the expected decline in market values and assessments between the tentative roll and the final roll will be greater than usual this year. Note, however, that IBO still expects growth between the 2007 final roll and the 2008 final roll to exceed past growth, even with these larger than usual adjustments. Presumably, many owners who had not filed income and expense statements enjoyed lower tax liabilities in the past because of their inaction, and now their assessments will grow significantly, albeit less than as shown on the 2008 tentative roll.

Outlook for Market and Assessed Values in 2008. IBO projects that total billable taxable assessed value on the final 2008 tax roll will grow to $123.9 billion, 7.6 percent more than the 2007 roll. While Class 1 market value on the 2008 assessment roll is expected to grow by 16.3 percent, Class 1 billable taxable assessed value is expected to grow only 5.0 percent, largely because of the caps on assessment increases. In contrast to past years, the Class 2 difference between market value growth and billable taxable value growth—26.3 percent and 9.3 percent, respectively—exceeds the Class 1 difference. This is due to large market value increases in the Class 2 subcategory for small buildings with fewer than 11 units, where because of assessment caps, the assessment increases are generally much less than the market value increase. The difference for Class 4 is also very large. IBO projects that market value for Class 4 will grow by 11.7 percent and billable taxable assessments will grow by 9.4 percent on the final 2008 tax roll.

Outlook for Market and Assessed Values in 2009-2011. IBO expects market values to continue to grow strongly in 2009 through 2011 for classes 1 and 4. IBO projects that market values in Class 4 will grow at an average annual rate of 8.6 percent over the three years, while annual growth in Class 1 will average 4.8 percent. Growth in Class 2 is expected to slow in 2009, but then rise again.

This healthy growth in market values should translate into healthy growth in billable taxable assessments through 2011. Average annual growth of 4.7 percent is expected for Class 1, with little variation. Assessment growth in Class 4 is expected to average 8.6 percent over the same period. With coop and condo assessments, particularly in Manhattan, expected to continue their rapid increases, IBO projects growth of 9.7 percent for Class 2 billable taxable assessments in 2009 to be followed by slower growth; average annual growth is expected to be 7.9 percent. Overall, annual billable taxable assessment growth for all classes of property is expected to average 7.6 percent in the three years 2009 to 2011.

Revenue Outlook. After the Department of Finance has completed the assessment roll, the actual property tax levy is determined by the City Council when it sets the tax rates for each class. Before raising property tax rates by 18.49 percent in 2003, the City Council had observed an informal freeze in the average tax rate since 1992. IBO's baseline property tax revenue forecast assumes that the 2007 average tax rate, which includes the increase from 2003, will be maintained at 12.28 percent of the aggregate assessed value for tax purposes on the assessment roll. But as discussed below, the Mayor has proposed reducing the overall rate for 2008.

The amount of property tax revenue in a fiscal year is determined not only by the levy, but also by the delinquency rate, abatements granted, refunds for disputed assessments, and collections from prior years. Taking these other factors into account, IBO projects that property tax revenue for 2007 will total $13 billion, 3.9 percent above revenues for 2006. For 2008, revenue is forecast to grow by 9.1 percent to $14.1 billion. In 2009 through 2011, growth is projected to average 7.5 percent, with revenue totaling $17.6 billion by the last year of the forecast period.

IBO's property tax revenue forecast is quite similar to OMB's for 2007, differing by only $14.8 million. For subsequent years, OMB's property tax revenue forecast exceeds IBO's. The difference is $96 million for 2008, and then widens to $104 million by 2010. By 2011, IBO's forecast is slightly higher than OMB's, by $116 million. Much of the difference appears to be due to IBO's assumption that the adjustment to the 2008 final roll will be larger than normal. OMB's revenue forecast, which was released very shortly after the finance department released the 2008 tentative roll, assumed a more typical revision.

Tax Policy Changes. There are two Mayoral proposals that would affect property tax revenue. In addition, the Governor has proposed an enhanced state exemption

*Temporary Tax Rate Cut***.** The Mayor has proposed a 5 percent property tax rate reduction. IBO projects a cost of $758 million in foregone tax revenue for this cut in 2008; in 2011, the cost would be $941 million. The reduction would be applied to the overall tax rate rather than to assessed values; depending on how much a taxpayer's market value has grown, some, if not all, of the tax savings from the rate reduction would be offset by a higher billable taxable assessment. Moreover, because each class' tax rate varies under the complex structure of the property tax law, year-to-year changes in rates will differ with Class 1 owners likely to see a decrease of less than 5 percent compared to the final 2007 rate.

The Mayor has described this proposal as a temporary, one-year reduction in the rate. He has said that it is too early to know whether the city can afford the cut beyond 2008, implying that the rate would revert to the 2007 level again, beginning in 2009. (Of course, the property tax rates are set each year by the City Council making each year's rate in one sense "temporary.") Nevertheless, the Mayor's January 2007 Financial Plan projections for 2009 through 2011 assume that the lower overall rate will remain in effect.

Total property tax revenue with the 5 percent tax cut would be $13.4 billion in 2008, 3.2 percent above its 2007 level. OMB cost estimates differ slightly because of differences in projected total levies without the tax cut. In years that the OMB projected levy exceeds IBO' forecast, adoption of the 5 percent tax cut would reduce the size of the projected OMB-IBO gap in total property tax revenue, and vice versa.

*Homeowner Rebate***.** The Mayor's Financial Plan assumes that authorization for the $400 tax rebates for owners of houses and apartments, provided they reside in these properties, will be extended. Over 650,000 homeowners received the rebate in 2007, at a total cost of $256 million. IBO expects the cost of the rebate to be about $256 million again in 2008.

The Mayor's proposal to extend the rebate (initially authorized for only three years, 2005-2007) was first introduced in the November 2006 Modification of the 2007 Budget and is also reflected in the 2008 Preliminary Budget. In the current plan, it would be extended through at least 2011. The state law authorizing the rebate requires that any extension of the program beyond its first three years be accompanied by a reduction in the property tax burden for all taxpayers, not just the homeowners currently eligible for the rebate. OMB has argued that the Mayor's proposed cut in property tax rates for all tax classes satisfies this requirement.

*Enhanced STaR Property Tax Exemption***.** Governor Spitzer's Executive Budget for the state's 2007-2008 fiscal year calls for a major three-year expansion of the STaR program. The main feature of his proposal is creation of a new Middle Class STaR program that would provide additional benefits based on income. Under the Governor's proposal, the value of the STaR property tax exemption would be increased by 80 percent for homeowners with incomes below $80,000 in the New York City metropolitan area and below $60,000 elsewhere. The exemption enhancement would decline as income increases, reaching zero at $235,000 upcoming year. In subsequent years, these brackets would be indexed for inflation.

Although this proposal, if adopted, would benefit New York City homeowners, it would not affect New York City property tax revenue because the state reimburses the city and other school districts across the state for the tax revenue lost to the STaR exemptions.

PROPERTY-RELATED TAXES

Mortgage Recording and Real Property Transfer Taxes. Revenues from the mortgage recording tax and the real property transfer tax (collectively referred to as the transfer taxes) will likely set another record in 2007. Overall real estate activity, as measured by the number of transactions, has slowed during the past year, and prices in some submarkets have been stagnant or slightly declining. In general, however, prices remain strong. Declining office vacancy rates in Manhattan have stimulated the purchase of office towers. A number of very large sales, including the Stuyvesant Town/Peter Cooper Village residential complex for $5.4 billion and the office tower at 1211 Avenue of the Americas for $1.5 billion, have been an important factor in keeping transfer tax revenues at high levels.

IBO projects that transfer tax revenues will decline by 17.7 percent in 2008, as fewer very large transactions occur. In addition, as residential sales prices realign with apartment rents it will reduce the differential currently favoring buying over renting. IBO expects revenues to inch down in 2009, and then begin to rise in 2010.

Even as revenues bottom out in 2009, however, they will still reach $2.3 billion, a level considered unimaginable just a few years ago. By 2011, IBO projects that RPTT revenues will reach $1.3 billion and MRT revenue $1.2 billion. For both taxes, 2011 revenues will be about 12 percent below their 2007 peak in nominal terms. Adjusted for inflation, the decline is expected to be 19 percent.

IBO and OMB project an almost identical decline in MRT and RPTT revenues between 2007 and 2009. But IBO expects over 90 percent of the decline to occur in 2008, while OMB projects that around one-third of the drop will take place in 2009. IBO projects a faster recovery beginning in 2010. By 2011 IBO's MRT forecast is 4.4 percent above OMB's, and our RPTT forecast 1.7 percent higher than OMB's.

Background. The MRT and RPTT are levied at opposite ends of residential and commercial real estate transactions. The RPTT is levied directly on the sale price and is typically paid by the seller. The MRT is levied on the mortgage used to finance the purchase (usually the sales price less the down payment) and is paid by the buyer. Sales of coop apartments are subject to the RPTT but are exempt from the MRT because coop financing loans are not technically mortgages.

Refinancing an existing mortgage also generates MRT revenue. The portion of a mortgage refinancing that involves new money ("cash out") is always subject to the MRT. Refinancing activity that involves a change of lender is usually subject to the MRT in its entirety, unless the first lender agrees to "assign" the mortgage to a second lender, in which case the tax is levied only on the new money. Refinancing is exempt from the RPTT, as no transfer of property is involved.

While sensitive to general business cycle changes, the two transfer taxes are also responsive to actual and anticipated changes in mortgage rates. Low mortgage rates effectively decrease housing costs, and thus increase incentives to purchase property. Low rates also provide incentives for mortgage refinancing. Conversely, higher mortgage rates deter mortgage refinancing, and discourage purchases by effectively raising property costs. During the past year mortgage rates rose and then fell, but were always at relatively low levels by historic standards. IBO forecasts the 30-year rate to remain below 7.0 percent until 2010, and then hover around 7.0 percent through the first part of the next decade.

MRT and RPTT revenues remained strong even through the local economic downturn of 2001-2003, but began an extraordinary takeoff in 2004. Even as property markets in much of the United States weaken, 2007 will be another record-setting year for transfer tax revenue in New York City. Bbecause of a falloff in mortgage refinancing activity, however, MRT revenue will increase only slightly (1 percent) over the 2006 level, while for RPTT the increase will be 13 percent.

Forecast. Revenues from these two taxes are expected to decline in 2008 and 2009, due to a drop in the number of very large transactions—mostly apartment buildings and office properties—and a return to conditions that are less frenzied and more consistent with market fundamentals. In recent years, sales prices for properties have increased much faster than household incomes or potential rental income, even after adjusting for the lower monthly payments resulting from favorable interest rates.

Although fewer properties were sold in the first half of fiscal year 2007 than in the first half of 2006, prices have generally continued to rise. For example, the number of Manhattan coops sold dropped 11 percent in the first half of 2007 compared with a year earlier. For Class 1 properties (one-, two, and three-family houses) outside Manhattan, the decline in the number of transactions was even steeper—a fall of 26.4 percent compared with the first half of 2006. In both cases, however, the average sales price continued to rise. For Manhattan coops, the mean sales price for the first half of fiscal year 2007 was $1,019,300, 14.1 percent above the average price of $893,027 for the first half of fiscal year 2006. For Class 1 properties outside Manhattan, the increase was a more modest 8 percent, from $543,441 in the first half of 2006 to $586,924 in the first half of 2007. (All of these calculations consider only "arms-length" transactions, and exclude sales made at prices far below market values.)

IBO is projecting a drop of roughly 19 percent in transfer tax revenues between 2007 and 2009 (in nominal terms), with virtually all that decline occurring in 2008. Revenues will increase moderately in 2010 and 2011, but a portion of this increase can be attributed to changes in the overall price level rather than a real rise in the value of real estate transactions. By 2011, revenues in nominal terms will be around 12 percent below their 2007 peak, but will still be above 2005 levels.

It seems clear that a new, higher baseline level of "normal" RPTT and MRT revenues has been established. One factor that leads to the higher baseline is that properties with a sales price over $500,000 are subject to a higher RPTT rate than are lower-valued properties. The same is true of the MRT: mortgages of $500,000 or more are taxed at a higher rate than smaller mortgages. Prices have now risen so much that even a major collapse in prices would leave many transactions above these $500,000 thresholds.

Commercial Rent Tax. IBO expects commercial rent tax (CRT) revenue to total $500 million in 2007, a 4.8 percent increase over 2006. Surging rents, particularly in midtown Manhattan, are responsible for much of the increase. We project a smaller increase for 2008, with revenues reaching $517 million.

Background. The CRT is paid by commercial tenants, with liability based on the amount of annual rent paid. Between 1994 and 2002, a series of tax policy changes significantly altered the incidence of the CRT and reduced the revenues from over $700 million in 1994 to $380 million in 2002. As of June 1, 2001, the tax is now only assessed on commercial tenants in Manhattan south of 96th Street, with annual rents over $250,000; liability is phased in for rents between $250,000 and $300,000. Tax liability is computed using an effective rate of 3.9 percent of the rent. Given the $250,000 threshold in place since 2001, many former CRT payers with lower rents have been removed from the tax rolls. In 2003, about 7,300 businesses (some with more than one lease) remained subject to the tax. The median rent for these remaining taxpayers was approximately $525,000 per year.

Despite the decline in commercial occupancy during the post-2000 downturn, CRT revenues remained surprisingly strong, with annual growth averaging 4.8 percent from 2001 through 2006. This was due in large part to the 18.49 percent property tax rate increase enacted in November 2002, which was passed through to many commercial tenants who have tax escalation clauses in their leases. CRT revenues grew from $377 million in 2002 to $477 million in 2006.

Beginning in 2006, additional targeted CRT cuts were enacted as part of the city and state aid package for lower Manhattan. These new benefits, which replaced some expiring benefits dating from the mid-1990s, have reduced 2007 CRT revenues by an estimated $6.7 million, with the cost expected to grow to $32.6 by 2011.

Forecast. With the impact of the property tax rate increase for most commercial tenants now fully reflected in existing rents and with rents for new leases expected to grow by about 6.7 percent annually in the next few years, IBO projects slower growth in CRT revenue. After 2007, CRT revenue growth will average 3.2 percent annually, with revenue reaching $567 million in 2011. By comparison, CRT revenue grew by 5.9 percent over the previous four years ending in 2007.

IBO's commercial rent tax forecast differs somewhat from OMB's, particularly with the outlook for 2008. OMB's forecast for the coming year is $550 million, which would be an increase of 7.2 percent over their 2007 estimate. After 2008 the growth rates for the two forecasts are fairly similar, leaving IBO's projections lower each year through 2011.

PERSONAL INCOME TAX

Personal income tax (PIT) receipts have continued growing this fiscal year and are forecast by IBO to reach $7.5 billion in 2007, a 2.5 percent increase over the previous year. (This and other figures for PIT collections in this section are net—gross collections minus refunds—and include PIT receipts dedicated to the Transitional Finance Authority.)

Though this modest increase is dwarfed by double-digit growth rates of the past three years, in large part it results from tax policy changes that reduce current year collections relative to 2006 revenue. Slower economic growth in the city, expected to begin later on this calendar year, will limit revenue in the coming fiscal year, though in the absence of any major tax policy changes, IBO forecasts a 3.7 percent growth in PIT collections in 2008. PIT collections are not expected to grow in 2009, but IBO forecasts a resumption of revenue growth afterwards. PIT growth in 2010 and 2011 is expected to average 5.8 to reach $8.7 billion.

IBO's current year forecast of PIT revenue is $86 million higher than OMB's. IBO and OMB both expect local economic growth to slow in the coming years, with IBO forecasting a later slowdown than is OMB. As a result, IBO's forecast of PIT revenue is somewhat higher than OMB's estimate for 2008 and about the same for 2009.

Background and Recent Changes. The personal income tax is levied on the incomes of city residents. PIT liability is generally determined by two components: a base with a progressive rate structure, in which income in higher tax brackets is taxed at higher rates, and a 14 percent surcharge. Currently, the combined tax rate (i.e., incorporating both the base rate and surcharge) is 2.907 percent for the lowest of the four brackets, compared with 3.648 percent for the highest bracket.[2] These rates have been in effect since January 2001, with the exception of calendar years 2003 to 2005 when two additional tax brackets were created at the top: a fifth bracket with a rates varying from 4.05 and 4.25 percent (depending on the year) and a top bracket for taxable incomes greater than $500,000 with a rate of 4.45 percent.

By fiscal year 2001, a number of tax cuts and credits enacted in the previous five years—including the 1998 expiration of the 12.5 percent "criminal justice" surcharge, the elimination of the commuter tax in 1999, the STaR program's PIT credit and rate cut beginning in 1999, and a temporary reduction in 2001 of the 14 percent surcharge—together reduced collections by almost a quarter of what they would have been in the absence of the cuts. In spite of this substantial loss of revenue, PIT collections grew by an average of 3.7 percent annually from 1998 to 2001, buoyed by the prolonged economic expansion and a soaring stock market that continually surpassed expectations. Stock market increases fueled PIT revenue by boosting both the capital gains realizations of city residents and the profits of securities firms that in turn increased their year-end bonus compensation to employees.

In the first half of calendar year 2001, however, the national economy weakened, Wall Street's bull market had ended, and local employment growth came to a halt. The September 11 attack on the World Trade Center was another blow to New York City's economy that—coupled with a loss of confidence in corporate accounting—had a particularly negative effect on employment and profits in the financial sector. As a result, PIT receipts plummeted 22.2 percent from 2001 to 2002, to $4.5 billion. And in 2003, as the local economy continued to lag behind the nation's anemic recovery and Wall Street's slump largely continued, PIT growth did not resume and receipts declined slightly to their lowest level since 1997.

PIT growth resumed in 2004, when receipts increased by 24.5 percent over the previous year. This strong upturn resulted from the resumption of local employment growth, the doubling of Wall Street profits from 2002 to 2003, and, most significantly, the three-year tax increase enacted in the middle of 2003, which added $701 million of revenue. PIT collections again grew strongly in 2005, by 17.6 percent, and then again in 2006, by 12.5 percent. Had the three-year increase continued after December 31, 2005, collections would have been roughly $300 million greater in 2006, resulting in almost the same percent growth of PIT revenue (17.1 percent) as in 2005. Revenue from withholdings has grown steadily, reflecting general economic growth plus a surge in the financial sector's bonus compensation. Collections from estimated payments soared 165 percent in three years to reach nearly $2 billion in 2006, fueled by the large increases in capital gains realizations that began in calendar year 2004.

Revenue in the Current Year. PIT collections to date this fiscal year are about 10.8 percent greater than collections in the comparable period last year, reflecting continued employment and, especially, income growth in the city economy. To date in the fiscal year, withholding collections are 8.3 percent greater than the comparable period in 2006. This growth is impressive because in contrast to last year's withholdings, 2007 withholdings receive no boost from the 2003-2005 tax increase.[3] Reflecting the strength of Wall Street profits in 2006 and the resulting year-end bonus compensation, paid typically from December to March, withholding receipts in January were exceptionally high—$918 million, almost a third greater than any previous month's withholding revenue. Quarterly estimated payments of PIT liability by investors and the self-employed are also up so far in 2007, by 14.9 percent over the previous year, due to capital gains realized in real estate and, especially, financial markets, many of which have reached new record highs in the past year.

In spite of the strength in 2007 withholdings and estimated payments, the two largest components of PIT revenue, for the entire fiscal year IBO forecasts only a modest 2.5 percent growth of PIT collections, to $7.5 billion. For withholdings, strong revenue will continue in the remainder of the bonus period but then moderate in the final quarter of the fiscal year. More significantly, IBO expects estimated payments to be lower in 2007 than in 2006. Estimated payments reached a record high in 2006 in large part because of an exceptional surge last April in payments made by filers asking for extensions in filing their 2005 returns. This surge accounted for nearly $700 million of revenue, far more than in any previous year, and there is no expectation that this amount of extension payments will again be collected this spring.

Also limiting PIT growth in 2007 is an expected decrease in final return payments relative to 2006 and an expected increase in refunds. Because withholdings and estimated payments for liabilities in tax year 2006 have been strong, final returns payments accompanying 2006 returns (which are received mostly in the latter half of the current fiscal year) are not expected to be as large as last year, and refunds are expected to be greater. But most of the expected decline in net revenue from these two PIT components results from the near doubling of the per filer STaR credit that took affect at the start of calendar year 2006, thereby reducing 2007 final returns and increasing 2007 refunds. The increase in the STaR credit is reducing collections revenue by roughly $220 million—2.9 percent of the total PIT forecast for 2007.

IBO's forecast of 2007 PIT revenue is $86 million (1.1 percent) less than OMB's. While IBO expects more revenue from estimated payments than does OMB, we project lower withholding receipts and a lower level of payments with final returns.

The Forecast for 2008 and Beyond. After 2007, IBO expects PIT revenue growth to pick up only slightly, to 3.7 percent in 2008, with collections almost reaching $7.8 million. There currently are no enacted changes in tax rates or credits that would dampen 2008 collections. (See below for discussion of new proposed policy changes.) Rather, the modest revenue growth results from slower income and—to a lesser extent—employment growth IBO expects for this calendar year.

Withholding is expected to continue growing at a solid if not spectacular rate (a projected 3.9 percent), but much of this revenue growth will be offset by a fall in estimated payments and an increase in refunds. With a projected softening of both real estate and financial markets, realized capital gains are expected to decline slightly in 2008. Also, estimated payments will be affected by a slowdown in income growth from proprietor's incomes and from dividends, interest, and rents. Slower income and employment growth later on this year will result in some taxpayers overpaying their calendar year 2007 liabilities, which in turn will lead to a rise in refunds a year from now, in the second half of fiscal year 2008, when taxpayers file their 2007 returns.

IBO's forecast for 2008 is 2.0 percent ($155 million) greater than OMB's. The Mayor's budget office expects a sharper and earlier slowdown in the local economy, resulting in hardly any increase in PIT revenue from 2007 to 2008. OMB expects a small decline in withholding (1.8 percent), and the divergence of withholding projections accounts for most of the difference between the two forecasts. Although OMB's withholding forecast is considerably below IBO's, OMB's projections of both estimated payments and final returns revenue exceed IBO's, lessening the difference between the two PIT forecasts.

IBO projects no change in PIT revenue from 2008 to 2009. With the forecast for an economic slowdown that will persist into fiscal year 2009, withholdings are expected to grow even more slowly (1.9 percent), and estimated payments are not expected to increase at all. Also, a $100 million decline in 2009 in revenue from city/state offsets—an accounting component of the PIT collections flow from the state to the city—will offset whatever revenue growth is expected to occur. With a pick-up in the local economy coming sooner in its forecast, OMB expects PIT revenue to increase slightly in 2009, by 1.9 percent. As a result, there is little difference in IBO's and OMB's personal income tax 2009 projections. IBO's forecast is only $20 million (0.25 percent) higher than OMB's.

In the final two years of the forecast period, IBO expects PIT revenue to grow at an average rate of 5.8 percent, to reach $8.3 billion in 2010 and $8.7 billion in 2011. Revenue from withholdings is expected to increase at a faster pace as employment and income growth begin to pick up. Moreover, assuming that there is no change in current federal tax law, there will be a sharp increase in capital gains realizations in calendar year 2010 in anticipation of the expiration of many Bush Administration tax cuts, most importantly the preferential treatment of income from capital gains. Due to our higher withholdings and estimated payments projections, IBO's personal income tax forecasts are $249 million (3.1 percent) higher than OMB's in 2010 and $164 million (1.9 percent) higher in 2011.

Proposed Tax Policy Changes. The Mayor's Preliminary Budget includes several tax policy changes that would reduce PIT revenues if enacted. These include changes aimed at reducing tax burdens for operators of small businesses, as well as the creation of a city-level child care credit that would parallel similar federal and state credits. These proposals, and the impact of a proposed enhancement of the state's STaR credit available to city PIT payers, are discussed below.

Enhanced UBT-PIT Credit. The tax reduction program includes a proposal to enhance the existing PIT credit for unincorporated business tax (UBT) payments. Unlike most changes in city tax law, enacting this proposal would not require New York State legislative approval.

The Existing Credit. City residents who are sole proprietors or partners in businesses paying the UBT also pay taxes on their personal income that includes already taxed business income. Beginning in tax year 1997, however, these residents have been entitled to a partial credit against their PIT liability for UBT payments. The amount of the credit varies with residents' taxable income. Residents with New York State taxable incomes of $42,000 or less may claim 65 percent of their UBT payments as a PIT credit. The share of UBT liability allowed for the credit decreases by one-tenth of a percentage point for every $200 increase in taxable income until it reaches a minimum credit of 15 percent of UBT payments, for taxpayers with annual incomes greater than $142,000.

The state law authorizing New York City to establish the UBT-PIT credit enables the city to increase the credit without having to obtain state legislative approval. Thus, unlike most other local tax reforms, this proposal could be put into effect by the city itself.

Proposed Credit Increase. The proposal presented in the Preliminary Budget would enhance the credit by increasing the percentages of UBT payments allowed for the credit. The taxable income levels setting the maximum and minimum credit percentages would not change, but the percentages would become 100 percent of UBT liability for residents with taxable incomes of $42,000 or less, phasing down to 23 percent for residents with incomes over $142,000.

If this increase in the credit were to begin in the current calendar year, IBO estimates that PIT revenue would be reduced by $30 million in 2008, increasing gradually thereafter to $35 million by 2011. These estimates are $2 million to $4 million a year greater than OMB's. The estimates assume that the number of taxpayers who receive the credit would remain almost the same as the most recent data indicates—roughly 21,000. If the rise in the value of the credit induces more taxpayers to take advantage of it, the cost of the proposal would rise.

Because of its structure as a credit against the PIT, which is paid only by city residents, an increase in the UBT-PIT credit reduces the double taxation of city residents' business income without forfeiting the city's ability to tax (through the UBT) the incomes of commuters' unincorporated businesses.

Distribution of Benefits. In addition to establishing the PIT credit for UBT payers over 10 years ago, the city targeted reductions for small businesses directly through the UBT, eliminating liability for over 20,000 small business proprietorships and partnerships, resident and commuters alike. Given that many small businesses no longer pay the UBT, it is not surprising that the distributions of the UBT credit—and of the proposed increase—are heavily weighted toward UBT payers with high personal incomes. For calendar tax year 2004, 56 percent of all taxpayers claiming the UBT credit had taxable incomes above $142,000. These taxpayers also received 82 percent of the total value of the UBT-PIT credit, in spite of their being allowed only the minimum credit (15 percent of UBT). If this proposal were enacted, taxpayers with incomes over $142,000 would receive an estimated 86 percent of the benefits for calendar year 2007. Still, by providing UBT payers tax with taxable incomes of $42,000 or less a credit equal to 100 percent of their PIT liability, IBO estimates that the UBT liability of almost all taxpayers in this group—about 700 taxpayers—would be entirely offset by the enhanced PIT credit.

Subchapter S Corporation-PIT Credit. The tax reduction program renews a proposal to allow resident shareholders of subchapter S corporations a credit against PIT liability for their share of corporation taxes paid to the city. The proposed credit would provide tax savings to resident shareholders of many small businesses that pay city corporate income taxes.

Subchapter S-corps and Their Tax Treatment. Subchapter S corporations are a special type of small business eligible for certain tax benefits at the federal and state levels. In order to organize as an "S corp," a firm must meet several qualifications, the most important of which are that it have no more than 75 shareholders and that its shares not be publicly traded. Under federal law, the earnings of an S corp are exempt from the U.S. corporate income tax, though the earnings distributed to individual shareholders as dividends are subject to the federal personal income tax.[4] Under state law, S-corps can elect "New York S" corporation status and receive various tax benefits. The most basic benefit is that although S-corps are subject to the state's corporate franchise tax, they pay a much lower rate—0.825 percent of net income rather than the regular 8.0 percent rate for the current year.

Under city law, however, S-corps are treated like all other corporations and subject to either the city's general corporation tax (GCT) or banking corporation tax (BCT) with no preferential treatment. The city also taxes income received by resident shareholders of S-corps through the PIT.

The Proposed Credit and Its Cost. The current proposal would not alter the corporate taxation of S-corps on the city level, but it would benefit city residents who are shareholders in S-corps subject to the GCT or BCT. Specifically, starting in the current year these taxpayers would be permitted a credit against PIT liability for the portion of GCT and BCT payments attributable to the taxpayer's stake in the S corp. The proposal is patterned after the existing UBT-PIT credit and would be structured similarly, with the percent of business tax liability that could be claimed as a PIT credit decreasing as the taxpayer's personal income rises. The specific percentages and income thresholds being proposed are equal to those structuring the UBT-PIT credit under current law: from 65 percent of corporate tax liability for residents with $42,000 or less in New York State taxable income, phasing down as income increases to 15 percent of corporate liability to those with taxable incomes above $142,000.

In tax year 2003, the most recent year with available data, 123,000 S-corps paid an average of $5,400 in business taxes to account for 42 percent of all corporate tax liability. The proposed credit would be based only the portion of aggregate S corp liability attributable to resident shareholders. The Bloomberg Administration estimates that the proposed credit would reduce PIT revenue by $70 million in 2008 and $78 million by 2011—a somewhat greater impact (by $15 million-$20 million) than the current UBT-PIT credit.

To be enacted into city tax law, the New York State Legislature would need to pass enabling legislation. This is not the first time an S corp-PIT credit has been proposed and considered. When the budget for 2002 was adopted, the City Council and Mayor agreed to establish the credit, but the proposal subsequently failed to get legislative approval in Albany.

Policy Goals of the Credit. The proposal to give city residents a PIT credit for their share of S corp-related GCT and BCT payments serves goals related to both personal and business income taxation. The proposal would reduce double taxation of business income for city residents, who alone among owners of local S-corps are subject to the city's PIT in addition to corporate income taxes. The new proposed credit would also make the treatment of resident shareholders in local S-corps more similar to the treatment of city residents who are business partners and proprietors paying the UBT. Also, the credit, like the already existing one for UBT payers, targets benefits specifically to city residents while retaining the city's ability to tax business income generated in the city by S corp shareholders who do not reside here.

Finally, the proposed PIT credit would benefit owners of small, New York City-based businesses, because S-corps—like most unincorporated businesses—are relatively small entities. To the extent that the credit encourages existing S-corps to remain or expand in the city, the credit would increase local employment.

Child Care Credit. The tax reduction program includes a proposal to establish a city credit for child care expenses against PIT liability. The proposed credit would be based on already existing federal and New York State child and dependent care credits, but only low-income filers with children under the age of 4 would be eligible for the new city credit.

A Piggybacked Credit. Several times in recent years, both the Council and the Mayor have presented child care credit proposals, each calling for a credit that would have equaled a certain percentage of either the existing federal child care credit or the comparable New York State credit. (The state credit is itself defined as a certain percentage of the federal credit.)

The federal credit currently equals 35 percent of eligible child and other dependent care expenses for households with adjusted gross incomes of up to $15,000. For incomes greater than $15,000, the rate is reduced by 1 percentage point for each $2,000 of additional income up to $43,000, and remains constant at 20 percent for all incomes above that level. Eligible expenses are capped at $3,000 for one dependent and $6,000 for two or more dependents, so that the maximum amount of federal credit per dependent allowed under current law would be $1,050 (35 percent of $6,000). In addition to children under 13 years of age, expenses for the care of certain adult dependents, such as a disabled spouse, are eligible.

The state credit equals 110 percent of the federal credit for filers with incomes no greater than $25,000. Above $25,000, the percent phases down to 100 percent of the federal for filers with incomes above $40,000. The state credit remains equal to the federal credit for families with incomes from $40,000 to $50,000. From $50,000 to $65,000, the percent again phases down, more steeply than before, to 20 percent of the federal credit for all filers with incomes over $65,000. The state and federal credit are each refundable, meaning that taxpayers whose credits exceed their pre-tax liabilities receive the amount of excess credit as tax refunds.

The current proposal is to define a city child care credit as a certain percent of the state credit, but only for families with children up to 3 years old. Families with incomes of $25,000 or less would be eligible for a city credit equal to 75 percent of the state credit. From $25,000 to $30,000, the credit percentage phases out and there would be no credit for filers with incomes over $30,000. Like the state and federal credits, the city child care credit would be refundable. Like most changes to the city's PIT, the state Legislature would need to approve this credit before it could be enacted into city law.

Estimated Fiscal Costs and Benefits. The maximum city credit under this proposal would be received by a family with an income up to $15,000 whose eligible child care expenses reached the maximum. It would equal $1,155 per dependent ($3,000 x 35 percent x 110 percent x 100 percent). The Bloomberg Administration estimates that 49,000 city families would have received the credit were it established for calendar year 2006.

If the proposal were enacted for the current calendar year, the Bloomberg Administration projects the revenue loss in fiscal year 2008 would be $42 million, an estimate consistent with available data on New Yorkers receiving the existing state and federal credits. After 2008, the estimates grow slowly to reach $45 million by 2011. The Mayor's projections also assume that the enrichment of the credit's benefit would induce more eligible families to take the credit. But over time this increase in the number of filers taking the credit would be in part offset as more filers' incomes to exceed the $30,000 cap. Thus, the projection of only a minimal expansion of the credit's cost is warranted.

IBO estimates that the proposed credit would eliminate PIT liability for about 11,500 taxpayers. Almost all of these are among the 210,000 families with incomes low enough to avoid state and federal income taxes but not, under current law, the city PIT.

Enhanced STaR Credit. While not part of the Mayor's Preliminary Budget, there is another tax proposal that would reduce PIT burdens: an increase in the per-filer STaR credit against PIT liability. This reform is a component of a package of enhanced STaR tax benefits that the Governor has proposed in his state budget.

In addition to property tax benefits for homeowners under STaR, since 1999 city residents have received a refundable credit against PIT liabilities, as well as a cut in PIT rates. Only the credit would be affected under this proposal. The credit currently equals $230 for married couples filing jointly and widows, and $115 for all other filers. The proposal is to increase the credit amounts by 30 percent—to $300 for joint filers and widows and to $150 for others.

Though increasing the STaR credit would reduce the city's PIT revenue by roughly $140 million each year, under the STaR program the state reimburses the city for the forgone revenue. Thus, increasing the STaR PIT credit would not affect the city's finances.

BUSINESS INCOME TAXES

IBO expects business tax revenues to total $5.1 billion in 2007, $951 million (23 percent) higher than the amount anticipated when the budget was adopted last summer, and 18 percent above the revenues from the prior year. Revenues are expected to be nearly flat in 2008 (growing just 0.4 percent) and 2009 (growing 1.3 percent) before resuming annual growth in the 5.5 percent range over the remainder of the Financial Plan.

Background. New York City levies three entity-level taxes on business net income, the general corporation tax (GCT), the banking corporation tax (BCT), and the unincorporated business tax. About 55 percent of total city business tax revenues are derived from "flow-through entities" (S-corporations taxed under the GCT; and limited liability corporations, partnerships, and proprietorships taxed under the UBT) whose net income is for the most part subject only to personal income taxation at the federal and state levels. Conversely, insurance corporations are subject to federal and state but not city taxation.

In 2006, business income taxes, excluding audit revenues, generated over $4.3 billion, 13.2 percent of total city tax revenues. The business income taxes differ from the city's other tax sources in that audit revenues account for a significant portion of revenues. With audits included, business taxes yielded over $5.0 billion in 2006, 14.9 percent of total tax revenues. (Note that all the revenue figures below exclude audits.)

After declining by 23 percent in the two years following the 9/11 attack, business tax revenues rebounded to post unprecedented back-to-back gains of 25 percent in 2004 and 30 percent 2005. This was followed by another 17 percent gain in 2006, and we expect to more than match this in 2007. By the end of the current fiscal year the *increase* in business tax revenues since 2003, over $2.8 billion, will be nearly equal to the pre-9/11 peak in *total* business tax revenues.

Year-to-date actual net collections are running 32 percent ahead of last year's pace through January. (Note that because July and August business tax transactions are accrued to the previous fiscal year, the business tax fiscal year effectively starts in September.) We expect markedly slower growth over the remainder of the current year—a little over 6 percent—and then, as noted above, very low growth in the coming two years. But the timing of the anticipated slowdown must be viewed with caution: a year ago we also expected it in the spring of 2006, and it did not come; likewise two years ago we thought that it was just around the corner, and it still did not come.

IBO's total business tax forecast is $94 million higher than OMB's in 2007, $9 million lower than OMB's in 2008, and an average of about $280 million per year higher over the out-years of the Financial Plan.

General Corporation Tax. New York City's GCT is unusual in two respects: it is one of the few locally levied taxes on corporate profits, and nearly half of the tax liability is borne by S-corporations (a type of firm required to pass essentially all net earnings directly through to stockholders). Over three-fourths of the tax is collected through an 8.85 percent tax on entire net income allocated to New York City; the remainder is collected through alternative tax bases: income plus compensation, capital allocated to the city, and a $300 minimum tax. (Almost 60 percent of GCT filers pay only the minimum tax.) Finance, real estate, and professional and business services account for about half of GCT liabilities; manufacturing and trade generate another quarter.

From 2004 through 2006 GCT revenues increased $1.1 billion (92 percent), the gains far outweighing the cumulative declines ($541 million) of the previous three years. The current fiscal year has also started out strong, with revenue up $304 million (30 percent) through January. But IBO projects growth to slow to 7.4 percent over the remainder of the year, resulting in a $405 million (17 percent) increase in revenue for 2007 as a whole. Our forecast of $2.8 billion for the current year is $11 million higher than OMB's January forecast. IBO projects $75 million more than OMB in gross collections, but this is largely offset by $64 million more in IBO's forecast of refunds.

In the following two years a sharp slowdown in GCT collections growth combined with jumps in refunds is expected to yield slight declines in net revenues: a decline of $12 million (0.4 percent) in 2008 followed by a decline of $24 million (0.9 percent) in 2009. These baseline forecasts do not include the impacts of proposed corporate tax relief (small firm filing simplification and partial phaseout of the income-plus-compensation base for calculating corporate liabilities), which OMB estimates will cost a combined $26 million in 2008 and $64 million in 2009. (The proposed city personal income tax credit against the GCT liabilities of resident S-corporation filers, would not affect GCT revenue.)

A year ago GCT collections were thought to be vulnerable to the impact of rising interest rates, especially on the city's pivotal securities industry. But as it turned out Wall Street firms weathered the rate increases well, posting strong profits in 2006 even in the face of surging interest expenses. Now what we expect to finally put the brake on GCT revenue growth is simply a slowdown in corporate profits growth, both nationwide and in the city. Five years of double-digits profits growth has brought the share of profits in national income to the highest point since official records have been kept (1929). Most forecasters do not think that profit shares can go much higher.

IBO forecasts a resumption of GCT revenue growth in 2010 and 2011, albeit at a more moderate pace (5.4 percent followed by 6.6 percent). If the currently proposed corporate tax relief is enacted, however, these growth rates would be reduced.

Unincorporated Business Tax. New York City imposes a 4 percent tax on the income of partnerships, proprietorships, and (since 1994) limited liability corporations, which are entities structured and taxed like partnerships, although the members/partners have the same liability protection enjoyed by officers and shareholders of regular corporations. As with the GCT, entity-level taxation of unincorporated businesses by a city is unusual. Because all of the firms' earnings are passed through to the partners or proprietors and subject to individual income taxes, the city's entity-level UBT subjects the same income to double taxation. New York City somewhat attenuates double-taxation by providing a partial credit in its personal income tax for UBT liabilities of city residents. Legal and business services account for about half of the tax.

UBT revenues grew 23 percent in 2005 and 17 percent in 2006, and have increased by another 29 percent through January of the current fiscal year. IBO expects growth to slow to 9.5 percent for the remainder of the current year, resulting in 18.7 percent growth for 2007 as a whole. IBO's $1.6 billion forecast for 2007 is $108 million above OMB's.

IBO expects UBT revenue growth to dip to 4.6 percent in 2008 before picking up slightly to average about 5.4 percent in the out-years of the Financial Plan. Our 2008 forecast of $1.6 billion is $162 million higher than OMB's. By 2010 and 2011 our forecast has grown to $305 million higher than OMB's. This is because OMB projects declining UBT revenues over the remainder of 2007 (down 6.2 percent compared to the February-August totals for the previous year) and then little UBT growth over the course of 2008 and 2009. IBO forecasts a much softer landing for this tax. (Note that neither the IBO nor OMB projections include the impact of the proposed doubling of the UBT partnership deduction, which OMB estimates would cost $16 million per year starting in 2008.)

Banking Corporation Tax. New York City taxes banking corporations separately from other corporations, but the structure of the BCT base and rate is similar to that of the GCT. Over four-fifths of collections are derived from a 9 percent tax on entire net income allocated to the city, the remainder from alternative net income, asset base, capital, and minimum tax bases. Generally somewhat over one-third of BCT liabilities are generated by foreign banks and a bit under one-third each by domestic commercial banks and thrift institutions. These shares, however, may vary considerably from year to year.

BCT net revenue is highly unstable. This volatility is exacerbated by large fluctuations in refunds, the result of adjustments for overpayments and underpayments based on losses and gains not recognized until a year or more after they are incurred. Relatively low refunds contributed to the strong growth in BCT net revenues over the past three years. BCT net revenues doubled in 2004, and then reached successive new highs in 2005 and 2006.

IBO expects refunds to more than double from 2006 ($53 million) to 2007 ($118 million), but a projected big jump in collections from $709 million to a record $903 million will yield a nearly 20 percent increase in overall net revenue. IBO's $786 million net revenue forecast for 2007—another all time high—is $25 million below OMB's, the difference being due to our higher refunds forecast.

For 2008 IBO projects a slight dip in BCT collections (to $878 million) and a slight rise in refunds (to $130 million), resulting in a 4.7 percent decline in net revenues, to $749 million. This is $64 million below OMB's forecast. Over the rest of the Financial Plan period (2009-2011) both collections and refunds are expected to grow, resulting in modest increases in BCT net revenues each year.

GENERAL SALES TAX

IBO's forecast for sales tax revenue in 2007 is $4.6 billion. This is an increase of 4.5 percent from the 2006 level. In 2008, revenue is expected to remain essentially unchanged from their 2007 level. The slowdown in 2008 reflects IBO's forecast for sluggish growth in disposable income and employment, beginning in the last months of calendar year 2007. The growth in sales tax revenue is expected to regain momentum in later years with annual growth projected to average 4.5 percent in 2009 through 2011. By 2011, IBO expects that sales tax revenue will reach $5.2 billion. With the exception of 2008, when the two forecasts are nearly equal, IBO's sales tax revenue estimates are slightly higher (about 1.5 percent on average) than those of OMB through 2011.

Background. Sales in the city of most retail goods, utility charges, and a variety of personal and business services are subject to a combined sale and use tax rate of 8.375 percent. The tax is composed of a 4.0 percent city tax, a 4.0 percent state tax, and a 0.375 percent Metropolitan Commuter Transportation District surcharge.

City sales tax revenue is broadly a function of household spending of city residents along with consumption expenditures by businesses, commuters, and tourists. Household spending, in turn, is primarily determined by disposable income and the level of consumer confidence.

Recent Trends. In 2005 and 2006, after accounting for tax policy changes, sales tax revenue grew at an annual average of about 9 percent. A confluence of factors explains this healthy growth. In recent years, the level of consumer expenditure rose in conjunction with higher profitability in the financial industry and record-breaking Wall Street bonuses. Sales tax revenue was further bolstered by the stellar performance of the tourist industry. As the number of domestic and foreign visitors increased, the city has reaped the economic benefits—evident from near capacity hotel occupancy rates, increasing room rates, and strong Broadway ticket revenue.

Tax Policy Proposal. As a part of the tax reduction program, the Mayor has proposed changes in the sales tax on clothing and footwear. Currently, clothing and footwear purchases that cost $110 and more are subject to the city, state, and transportation district sales taxes.

The Mayor has proposed the elimination of the city portion of the sales tax on all clothing and footwear. IBO estimates the loss of city sales tax revenue would be $120 million in 2008, $128 million in 2009, $132 million in 2010, and $135 million in 2011, although these losses would likely be partially offset by some modest growth in new economic activity resulting from the cut.

The Mayor's proposal would increase the city's competitiveness with neighboring states by lowering tax rate differentials and—assuming other New York State jurisdictions do not follow suit—by creating new rate differentials within the state. The city's retail clothing industry is likely to see a direct positive impact as more shoppers find prices in local stores more attractive. This improvement in turn results in higher employment in the broader retail sector that would produce additional economic gains.

The Mayor's proposal would also provide tax relief to consumers, particularly to households in lower- and middle-income brackets that spend a larger share of their income on clothing and footwear items. With clothing items priced under $110 already exempt from all sales tax, however, the benefit to households would depend on how much of their clothing expenditures are for higher priced and luxury items.

HOTEL OCCUPANCY TAX

IBO expects hotel tax revenue to reach $333 million in 2007 and $350 million in 2008. From 2007 to 2011 annual revenue growth is expected to average 4.0 percent. IBO's estimates are above OMB projections, particularly in the later years of the Financial Plan, with the difference reaching more than 7 percent in 2011 when IBO expects the city to collect $389 million in hotel tax revenues.

Background. Since 1970, New York City has imposed a hotel occupancy tax, which is levied in addition to the combined city, state, and transportation district sales taxes. The hotel tax is currently 5 percent of room charges plus a flat fee of $2.00 per night for rooms renting for $40.00 or more, with lower fees for less expensive rooms.

Recent Trends. The recent robust hotel tax revenue growth reflects the recovery in the city's tourism industry from a sharp contraction in the wake of September 11. Both domestic and foreign visitors continue to flock to the city as it remains a relatively cheaper destination when compared to Paris or

London, combined with a greatly improved reputation for safety. The number of international and domestic visitors totaled 44 million in 2006, up 3.3 percent from the prior year and 7.8 million more than the number of visitors the city hosted in 2000.

This increase in the number of visitors is reflected in the growth of airport arrivals and Broadway gross receipts. Annual passenger volume at the local airports in 2006 grew by 7.6 percent over 2005, to a record high of 107.3 million passengers. During the most recent holiday season Broadway theaters sold 10 percent more tickets than in the previous season, with total revenue increasing by 20 percent.

In 2006, the influx of visitors, accompanied by the conversion of several hotels into condominiums, led to record-low hotel vacancy rates. This in turn has allowed hotels to continue raising room rates. In the last quarter, Manhattan hotels were at or near full occupancy and average room rates were up well over 10 percent from the previous year.

OTHER REVENUES AND CATEGORICAL GRANTS

Other Revenues. IBO's estimate of revenue from sources other than taxes for 2007 totals $6.3 billion. Other revenues include funds from unrestricted intergovernmental aid, STaR reimbursements, other categorical grants, inter-fund capital transfers, and miscellaneous revenues from recurring and nonrecurring sources. Some of these sources, particularly miscellaneous revenues, can fluctuate due to unusual or one-time transactions. Other revenues are expected to increase slightly next year to $7.0 billion and then fall to $6.4 billion in 2009 and remain near that level through 2011.

Categorical Grants. Categorical grants received from the state and federal governments to fund specific programs account for approximately 30 percent of all funds spent by the city each year. IBO projects that state and federal categorical grants will total $10.6 billion and $5.5 billion, respectively, in 2008. For some types of categorical grants, such as education and welfare, IBO has developed forecasts based on changes in programs and caseloads. IBO's forecast of categorical grants in other parts of the budget is based on a methodology that takes the grant level in the current year and adjusts for historical trends and programmatic changes.

END NOTES

[a] When IBO refers to market values and assessments, the reference includes only taxable property. The assessed value for tax purposes (also referred to as billable taxable value) reflects the required phase in of assessment changes for apartment, commercial, and industrial buildings. In this report the billable taxable values are net of STaR exemptions.

[b] For example, for a married couple filing jointly, the lowest bracket ends at $21,600. The highest bracket begins at $90,000. For other types of filers, the income thresholds are lower.

[c] The three-year increase provides only a negligible revenue boost (of $10) million in the form of final returns payments from a small number of taxpayers who had not yet finalized their calendar year 2005 liabilities by the end of fiscal year 2006.

[d] The federal treatment of S-corps is thus similar to the treatment of partnerships. Earnings are exempt from tax for the business as a whole, yet the income is taxed only after it has been distributed to either the partners or shareholders. While receiving similar tax benefits, partnerships and S-corps differ significantly in terms of structure and liability.

Capital, Debt, and Debt Service

THE PRELIMINARY TEN-YEAR CAPITAL STRATEGY

Concurrent with the release of the Mayor's Preliminary Budget, the city also released its Preliminary Ten-Year Capital Strategy for the period 2008 through 2017. The 10-year capital plan is prepared every other year, and is intended to provide a long-term framework for the maintenance and development of the city's extensive infrastructure and capital assets. Following a public hearing held by the City Planning Commission, the final version of the strategy will be released with the Executive Budget.

The preliminary strategy totals $77.3 billion over 10 years—by far the largest capital program ever proposed, and a 24 percent increase over the previous long-term strategy for 2006-2015. Even accounting for the recent rapid growth in construction costs, if realized, this would represent a further significant expansion in the city's capital program, which has averaged over $6 billion in capital commitments every year since 2001.

Whether or not this ambitious capital program will actually come to fruition is uncertain, however. The increase is largely driven by a doubling of the School Construction Authority's capital plan—to $28.2 billion. The draft 10-year plan assumes that the state will provide over half the funding—$15.0 billion—over the next 10 years. The state and the city agreed in 2006 on a school construction financing plan that was intended to fulfill the requirements of the court decision on the Campaign for Fiscal Equity lawsuit. The agreement provided for $1.8 billion in aid from bonds issued by the state, and then gave the city the authority to issue, through the Transitional Finance Authority (TFA), a total of $9.4 billion in special bonds backed by increased state building aid. The city describes plans to use a total of $4.76 billion in this authority through 2010 to finance the Department of Education's 2005-2009 capital plan. The remaining $4.6 billion in authorized TFA Building Aid Revenue Bonds would provide, however, less than half of the amount of state aid the 10-year plan assumes after 2010.

Most of the rest of the increase is driven by investment in the city's water and sewer system, which is funded with debt issued by the Municipal Water Finance Authority, repayment of which is backed by water system user charges, rather than by city general revenues. Debt service on water authority bonds is rising rapidly and is the principal cause of rising water and sewer rates. Rates were increased 9 percent for fiscal year 2007.

Further details on agency capital programs are provided in the agency preliminary budget analyses.

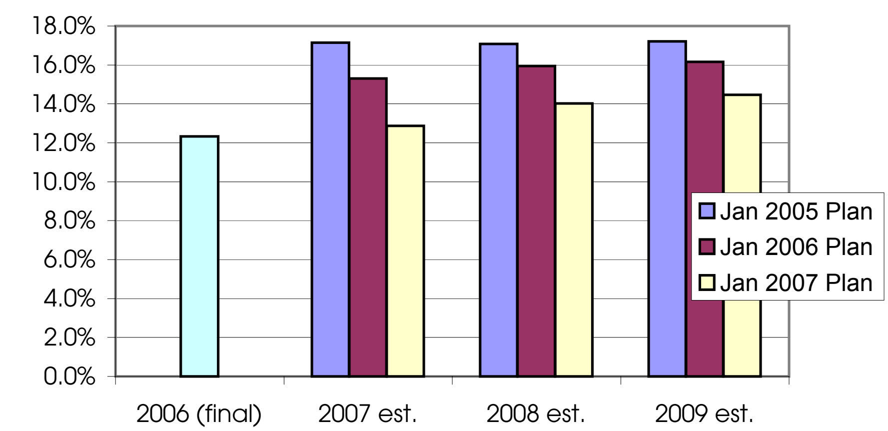
IMPLICATIONS FOR DEBT AND DEBT SERVICE

Because the growth in the capital program is concentrated in the education and environmental protection programs, as discussed above, that part of the capital program that will directly impact future expense budgets through debt service is actually projected to grow by only $3.1 billion, to a total of $40.5 billion in city tax-supported debt, compared to the previous 10-year plan for 2006 through 2015.

Debt service continues to be one of the fastest growing portions of the budget. IBO projects that debt service will increase at an average rate of 7.7 percent annually, when adjusted for prepayments with the budget surplus, and excluding debt service on TFA education bonds, from $4.5 billion in 2007 to $6.2 billion in 2011.

Despite the growth, the burden of debt service on the budget has been declining due to a combination of lower than projected debt service spending, and higher tax revenues. Debt service, which we projected to consume 17 cents of every 2008 tax dollar two years ago, and 16

Projections of Debt Service as a Percentage of Tax Revenues



SOURCES: IBO; Office of Management and Budget.

2008-2017 Ten-Year Capital Strategy, by Program Area And Investment Category

Dollars in millions

Program Area	Agency/Program	State of Good Repair	Programmatic Replacement	Program Expansion	TOTAL
Education					
	Department Of Education	$18,679	$109	$9,397	$28,185
	CUNY	131	19	83	232
	Education Total	$18,810	$127	$9,479	$28,417
Environmental Protection					
	Dept. of Environtmental Protectio	998	14,015	4,499	19,512
	Environmental Protection Total	$998	$14,015	$4,499	$19,512
Transportation & Transit					
	Department of Transportation	$8,789	$171	-	$8,961
	NYC Transit & S.R. Railroad	-	767	-	767
	Transportation & Transit Total	$8,789	$938	$ -	$9,728
Housing & Econ. Development					
	Housing Preservation & Dvlpmt.	$588	-	$3,611	$4,199
	NYC Housing Authority	229	-	-	229
	Economic Development Corp.	-	70	1,042	1,113
	Housing & Economic Development Total	$817	$70	$4,653	$5,540
Public Safety					
	NYPD	-	$824	-	$824
	FDNY	455	358	-	813
	Correction	576	165	1,095	1,836
	Courts Program	-	333	783	1,116
	Juvenile Justice	-	1	23	24
	Public Safety Total	$1,031	$1,681	$1,901	$4,613
Health & Social Services					
	Admin. for Childrens' Services	$71	$92	-	$163
	Dept. for the Aging	43	-	-	43
	Dept. of Homeless Services	-	20	269	289
	Dept. of Health & Mental Hygiene	184	21	57	263
	Health & Hospitals Corporation	157	538	-	694
	Human Resources Admin.	36	149	-	185
	Health & Social Services Total	$492	$820	$326	$1,638
Parks, Libraries & Cultural Affairs					
	Dept. of Parks and Recreation	$1,457	-	$101	$1,558
	Library Systems	82	2	13	97
	Dept. of Cultural Affairs	210	-	186	396
	Parks, Libraries, and Cultural Affairs Total	$1,748	$2	$300	$2,050
General Government					
	Sanitation	$1,032	$1,250	$503	$2,785
	Citywide Equipmt	-	1,789	-	1,789
	Public Buildings	958	200	-	1,158
	Real Estate	51	-	-	51
	General Gov't. Total	$2,042	$3,239	$503	$5,784
	GRAND TOTAL	**$34,728**	**$20,892**	**$21,662**	**$77,282**

SOURCES: IBO; Office of Management and Budget.
NOTE: Totals by investment category differ slightly from totals presented in the Ten-Year Capital Strategy.

percent one year ago, is now projected to consume 14 cents on the tax dollar. This will rise to slightly under 15 percent by 2011.

Actual debt service spending has been lower than previously projected this times last year—by $320 million in 2007 and by $350 million in 2008, with continuing savings in the out-years of the plan—because of continuing favorable interest rates. These savings arise from both the lower cost of new debt issuance and from refundings. At the same time, tax revenues are now projected to be higher by almost $3.6 billion this year and $2.2 billion in 2008, compared to our projections from a year ago. The combination of lower than projected debt service and higher than projected revenues means that the ratio of debt service to tax revenues is expected to fall to its lowest level in more than 10 years.