



THE CITY OF NEW YORK
INDEPENDENT BUDGET OFFICE

110 WILLIAM STREET, 14TH FLOOR
NEW YORK, NEW YORK 10038
(212) 442-0632 • FAX (212) 442-0350 • EMAIL: ibo@ibo.nyc.ny.us
<http://www.ibo.nyc.ny.us>

**Testimony of Ronnie Lowenstein
To the New York City Council Finance Committee
On the 2009 Preliminary Budget and Four-Year Financial Plan**

March 4, 2008

Good afternoon Chairperson Weprin and members of the committee. My name is Ronnie Lowenstein, and I am director of the New York City Independent Budget Office. I am pleased to discuss our revenue and expenditure projections based on the Mayor's preliminary budget for 2009 and financial plan through 2012.

For the past five years, New York City's economy has grown steadily. But the losses experienced by the securities, mortgage, and banking industries during the second half of 2007 have put an end to that steady growth. IBO expects the city will lose a total of 2,000 jobs this year, after gaining more than 100,000 during the prior two years. This economic weakness leads us to project two consecutive years of declining tax revenues.

While the local economic downturn and the declines in tax revenue have dimmed the city's fiscal picture, our short-term budgetary condition may not be as dark as one might expect. One reason is that so far this fiscal year business tax collections have not declined as much as previously projected. In addition, despite Wall Street's huge losses, bonuses barely declined, bolstering personal income tax withholdings.

The strength of the past few years is also helping us weather the immediate effects of the economic storm. Last year's extraordinary surplus will help the city end this year with a similarly large surplus that can in turn be used to fill the shortfall in 2009. In fact, IBO's projections of revenues and expenditures suggest that the 2009 surplus will be big enough to fill a significant portion of the projected budget gap for 2010, leaving a shortfall of a relatively modest \$2.1 billion.

Still, broader economic events could quickly darken this near-term picture. IBO's latest economic and tax revenue forecast assumes a relatively brief and mild recession. If the problems affecting the financial and housing sectors worsen, or oil prices continue to surge, the recession will be deeper and fiscal pressures on the city will mount.

There are a number of other potential fault lines for the 2009 budget and January Financial Plan. For example, the Mayor's budget plan does not recognize the effects on the city of the Governor's proposed budget. Another example is the planned conversion of a merged GHI and HIP to a for-profit insurer, which could cost the city \$200 million or more a year in additional health insurance premiums for employees. A third example is stock market losses by municipal pension funds, which may force the city to substantially increase its annual contributions to the funds in the coming years.

I will turn now to a closer look at the economic and revenue outlook.

U.S. Economic Outlook. A combination of intensifying problems in the housing sector, financial market turmoil, and record high prices for oil have pushed the U.S. economy into recession. IBO is now forecasting a brief and relatively mild U.S. downturn through the first half of calendar year 2008. Inflation-adjusted gross domestic product will fall by less than half a percentage point over the first and second quarters, with a similar percentage decline in employment.

IBO projects that aggressive rate-cutting by the Federal Reserve and adoption of a fiscal stimulus package that includes tax rebates for low- and middle-income taxpayers will provide a lift to the economy during the second half of this year. With this lift expected to more than offset the earlier contraction, we are forecasting U.S. economic growth at an inflation-adjusted rate of 1.5 percent for 2008 as a whole, down from growth of 2.2 percent in 2007. Forecasting a strong rebound, IBO expects growth to reach 3.4 percent for 2009.

Local Economic Outlook. Problems in the U.S. housing market have spilled over into financial services—the industry that drives New York City's economy. The unprecedented surge in mortgage loan defaults has caused the value of mortgage and other asset-backed debt to plummet, eroding the capital position of institutions that own and insure these securities. With financial institutions writing off hundreds of billions of dollars of assets, they have been forced to sharply rein in lending and other activities. After near-record profits of \$20.9 billion in 2006, IBO projects that Wall Street profits totaled just \$3.2 billion in 2007, their lowest level since 1994. This year is not expected to be much better, with Wall Street profits reaching \$6.6 billion before rising to \$12.2 billion in 2009. Mirroring this weakness, employment in the city's financial services industry will fall by 12,600 jobs (2.7 percent) in 2008 and another 7,600 jobs (1.7 percent) in 2009.

As the financial sector's woes spread through the rest of the local economy, IBO projects that employment growth will stall this year and next. Losses of 8,000 private-sector jobs (0.3 percent) this year will be roughly offset by private-sector gains of 9,100 jobs (0.3 percent) in 2009. Reflecting this outlook for job losses in the high-paying financial industry and stagnant

employment growth overall, IBO expects that personal income growth in New York City will slow sharply from 7.8 percent in 2007 to just 2.9 percent in 2008 and 4.1 percent in 2009.

Revenue Outlook. Based on our economic forecast of a brief recession in the first half of this calendar year, IBO now projects that city tax revenues will decline both this fiscal year and next. To put this in perspective, in the downturn at the start of this decade, the only year in which revenues declined was 2002; in 2003 revenues would have increased even without the 18.5 percent property tax rate hike. Total tax revenues will decline by 2.6 percent to reach \$36.5 billion this fiscal year, and then fall another 2.9 percent to \$35.4 billion in 2009. Beginning in 2010, tax revenues will once again begin to rise as the U.S. and local economies rebound.

The biggest revenue declines—in both dollar and percentage terms—are in the property transfer and business income taxes. Property transfer taxes (the real property transfer tax and mortgage recording tax) are expected to end their explosive growth in 2008, with revenues falling by 18.8 percent and then by another 19.8 percent in 2009. These declines would still leave 2009 transfer tax revenues of \$2.1 billion, more than double their 2002 total. IBO’s property transfer tax forecast assumes that declines in the number of residential transactions will be followed by declines in price, and that the incidence of very large commercial transactions returns to more “normal” levels.

Similarly, 2007 is expected to mark the peak of a period of extraordinary growth in business income taxes (the general corporation tax, the unincorporated business tax and the banking corporation tax). IBO projects that total business income taxes will fall from \$6.0 billion in 2007 to \$5.6 billion in 2008 (a decline of 7.3 percent) and \$5.0 billion in 2009 (a 10.4 percent decline). This forecast is driven by financial firms’ huge losses, along with slower growth in U.S. corporate profits and the economy overall.

In contrast, revenue from the real property tax, the city’s single largest tax source, will continue to rise throughout the forecast period. IBO projects property tax revenue will grow 7.2 percent in 2009 and 7.3 percent in 2010—an increase of roughly \$1 billion each year. Although we are expecting market values for one- to three-family homes to decline, assessed values for many homes will continue to rise because limits on previous years’ assessment increases have left their homes well below the 6 percent target for the ratio of assessed value to market value. For larger residential buildings and commercial buildings, the pipeline of increases being phased-in from years of strong growth will keep assessed values growing faster than market values.

Comparison with OMB. Although both IBO and the Mayor’s Office of Management and Budget (OMB) are forecasting two successive years of tax revenue declines, IBO’s revenue forecast is significantly higher than OMB’s for each year of the financial plan. By far the biggest differences, in dollar and percentage terms, are in the forecasts for the business income taxes. In

the near-term, IBO—with the advantage of more recent information on current year collections—assumes that the strength shown so far this fiscal year will result in more modest business tax declines than OMB forecast in January. Looking further out, much of the difference between the two business tax forecasts is attributable to IBO’s projection of a strong rebound in the U.S. and city economies following the downturn, as opposed to OMB’s forecast of a more protracted period of slow growth.

Out-Year Gaps. Under IBO’s current economic and revenue assumptions, the risk of big out-year budget gaps is greater than in previous years. The large surpluses garnered over the past couple of years, including the surplus projected for 2008, are being used very much like a rainy day fund to fill the gap between recurring revenues and recurring expenditures in 2009 and even to remedy a large part of the 2010 shortfall. This is particularly striking given IBO’s forecast of back-to-back declines in tax revenues in 2008 and 2009. But the surplus will be exhausted in 2010, leaving expected gaps of \$4.8 billion in 2011 and \$5.1 billion in 2012 that will be difficult to close.

Thank you and I would be glad to answer any questions you may have.

Total Revenue and Expenditure Projections

Dollars in millions

	2008	2009	2010	2011	2012	Average Change
Revenues	\$61,267	\$59,790	\$62,711	\$65,195	\$66,712	2.2%
<i>City-funded Revenues</i>						
<i>Taxes</i>	36,457	35,409	37,603	39,605	41,065	3.0%
<i>Other Revenues</i>	7,875	7,151	7,059	7,115	7,169	-2.3%
Expenditures	\$61,267	\$59,790	\$64,779	\$70,017	\$71,804	4.0%
<i>City-funded Expenditures</i>	44,332	42,560	46,729	51,542	53,326	4.7%
IBO Surplus / (Gap) Projection	\$-	\$-	\$(2,068)	\$(4,822)	\$(5,093)	

SOURCE: IBO.

NOTES: IBO projects a surplus of \$4.83 billion for 2008, \$709 million above the Bloomberg Administration's forecast. The surplus is used to prepay some 2009 expenditures, leaving 2008 with a balanced budget. IBO projects a surplus of \$1.74 billion for 2009, \$1.39 billion above the Bloomberg Administration's forecast. The surplus is used to prepay some 2010 expenditures, leaving 2009 with a balanced budget. Estimates exclude intra-city revenues and expenditures. May not add due to rounding.

IBO Expenditure Projections

Dollars in millions

	2008	2009	2010	2011	2012	Average Change
Health & Social Services						
Social Services:						
Medicaid	\$5,841	\$5,646	\$5,800	\$5,959	\$6,133	1.2%
All Other Social Services	2,835	2,722	2,710	2,710	2,710	-1.1%
HHC	40	90	92	92	92	22.9%
Health	1,649	1,556	1,581	1,591	1,602	-0.7%
Children Services	2,751	2,702	2,709	2,709	2,709	-0.4%
Homeless	751	661	664	664	664	-3.0%
Other Related Services	677	522	519	518	518	-6.5%
<i>Subtotal</i>	14,544	13,900	14,075	14,244	14,428	-0.2%
Education						
DOE (excluding labor reserve)	16,801	17,726	18,868	19,672	19,684	4.0%
CUNY	601	547	549	553	553	-2.1%
<i>Subtotal</i>	17,401	18,273	19,418	20,225	20,237	3.8%
Uniformed Services						
Police	3,957	3,945	4,063	4,148	4,150	1.2%
Fire	1,550	1,536	1,537	1,545	1,546	-0.1%
Correction	985	989	994	990	996	0.3%
Sanitation	1,266	1,295	1,367	1,448	1,456	3.6%
<i>Subtotal</i>	7,758	7,764	7,960	8,132	8,148	1.2%
All Other Agencies	6,700	5,940	6,382	6,395	6,474	-0.9%
Other Expenditures:						
Fringe Benefits (excluding DOE)	3,599	3,633	3,912	4,231	4,543	6.0%
Debt Service	4,321	2,003	3,197	6,104	6,697	11.6%
Pensions	5,625	6,113	6,412	6,406	6,421	3.4%
Judgments and Claims	635	688	738	795	856	7.8%
General Reserve	100	300	300	300	300	n/a
Grant to TFA	546	-	-	-	-	n/a
Labor Reserve:						
Education	28	76	367	630	630	n/a
All Other Agencies	510	1,030	1,799	2,225	2,656	n/a
Expenditure Adjustments	(500)	70	219	331	413	n/a
TOTAL Expenditures	\$61,267	\$59,790	\$64,779	\$70,017	\$71,804	4.0%

SOURCE: IBO.

NOTES: Debt service expenditures, if adjusted for prepayments, would grow at an annual average rate of 10.5 percent from 2008-2012. Debt service includes Transitional Finance Authority (TFA) debt service expenditures. The city shifted Medicaid funds from HHC to HRA in 2008 and later years to consolidate all city Medicaid funding in a single agency. The shift is being carried out to simplify transactions with New York State under the new state cap on local Medicaid spending. Expenditure adjustments include energy, lease, prior year payable adjustments and non-labor inflation estimates. Estimates exclude intra-city expenses. May not add due to rounding.

IBO Revenue Projections

Dollars in millions

	2008	2009	2010	2011	2012	Average Change
Tax Revenue						
Property	\$12,920	\$13,852	\$14,861	\$15,774	\$16,699	6.6%
Personal Income	7,609	7,130	7,423	7,910	7,921	1.0%
General Sales	4,762	4,815	5,069	5,246	5,417	3.3%
General Corporation	2,953	2,726	3,021	3,293	3,447	3.9%
Unincorporated Business	1,692	1,636	1,736	1,843	1,933	3.4%
Banking Corporation	931	635	847	797	761	-4.9%
Real Property Transfer	1,482	1,178	1,194	1,216	1,247	-4.2%
Mortgage Recording	1,192	966	946	969	1,011	-4.0%
Utility	399	428	405	403	413	0.9%
Hotel Occupancy	375	412	447	483	519	8.4%
Commercial Rent	547	558	573	591	612	2.9%
Cigarette	126	124	122	120	119	-1.5%
Other Taxes and Tax Audits	1,468	950	958	959	968	-9.9%
Total Taxes	36,457	35,409	37,603	39,605	41,065	3.0%
Other Revenue						
STaR Reimbursement	1,256	1,315	1,356	1,387	1,439	3.5%
Miscellaneous Revenues	4,750	3,952	3,829	3,856	3,854	-5.1%
Unrestricted Intergovernmental Aid	340	340	340	340	340	0.0%
Anticipated Revenue (State & Federal)	-	100	100	100	100	n/a
Other Categorical Aid	1,079	1,026	1,027	1,030	1,034	-1.0%
Inter-fund Revenues	466	434	422	417	417	-2.8%
Disallowances	(15)	(15)	(15)	(15)	(15)	0.0%
Total City Funded Revenue	44,332	42,560	44,661	46,720	48,234	2.1%
State Grants	11,018	11,580	12,435	12,878	12,880	4.0%
Federal Grants	5,916	5,649	5,614	5,597	5,598	-1.4%
TOTAL Revenues	\$61,267	\$59,790	\$62,711	\$65,195	\$66,712	2.2%

SOURCE: IBO.

NOTES: Personal Income Tax includes Transitional Finance Authority (TFA) dedicated personal income tax revenue. Estimates exclude intra-city revenues. May not add due to rounding.

Pricing Differences Between IBO and the Bloomberg Administration

Items that Affect the Gap

Dollars in millions

	2008	2009	2010	2011	2012
Gaps as Estimated by the Mayor	\$-	\$0	\$(4,224)	\$(5,598)	\$(5,324)
IBO Pricing Differences					
Revenues					
Taxes					
Property	(79)	(67)	(88)	(83)	40
Personal Income	111	127	51	70	(290)
General Sales	58	173	174	104	(26)
General Corporation	200	59	171	237	177
Unincorporated Business	156	170	172	176	143
Banking Corporation	235	138	234	118	34
Real Property Transfer	7	60	94	132	118
Mortgage Recording	38	17	14	49	52
Utility	39	53	14	(4)	(6)
Hotel Occupancy	9	25	26	36	48
Commercial Rent	(3)	(8)	(10)	(10)	(11)
Cigarette	5	6	7	8	10
	777	752	860	833	287
STaR Reimbursement	1	(3)	(3)	(2)	(0)
Total Revenues	778	748	857	831	286
Expenditures					
Public Assistance	4	19	23	23	23
Campaign Finance	-	-	(25)	-	-
Overtime - Police	(65)	(65)	(65)	(65)	(65)
Overtime- Corrections	(8)	(20)	(20)	(10)	(10)
Buildings	-	(3)	(3)	(3)	(3)
Total Expenditures	(68)	(69)	(90)	(55)	(55)
Total IBO Pricing Differences	709	680	767	776	231
Prepayment Adjustment:					
IBO prepayment Adjustment 2008 / 2009	(709)	709	-	-	-
IBO prepayment Adjustment 2009 / 2010	-	(1,389)	1,389	-	-
IBO Surplus/(Gap) Projection	\$-	\$-	\$(2,068)	\$(4,822)	\$(5,093)

SOURCE: IBO.

NOTE: Negative pricing differences (in parentheses) widen the gaps, while positive pricing differences narrow the gaps. May not add due to rounding.

IBO versus OMB Economic Forecasts

	2007	2008	2009	2010	2011	2012
National Economy						
Real GDP Growth						
IBO	2.2	1.5	3.4	3.5	2.8	2.7
OMB	2.2	1.8	2.7	2.8	3.0	2.6
Non-farm Employment Growth						
IBO	1.3	0.4	0.9	1.7	1.4	0.8
OMB	1.3	0.8	1.1	1.2	1.3	1.1
Inflation Rate (CPI-U)						
IBO	2.9	2.7	2.0	1.9	1.9	2.2
OMB	2.9	2.6	1.7	1.9	1.8	1.7
Personal Income Growth						
IBO	6.2	4.0	4.9	5.3	4.9	4.5
OMB	6.2	4.6	4.8	5.1	5.2	5.2
Unemployment Rate						
IBO	4.6	5.4	5.8	5.4	4.9	4.8
OMB	4.6	5.1	5.2	5.1	4.9	4.8
10-Year Treasury Bond Rate						
IBO	4.6	4.2	5.4	5.7	5.5	5.5
OMB	4.6	4.0	4.6	5.3	5.3	5.3
Federal Funds Rate						
IBO	5.0	2.6	4.5	4.9	4.5	4.5
OMB	5.0	3.6	3.9	4.7	4.7	4.7
NYC Economy						
Non-farm New Jobs (thousands)						
IBO	54.5	-2.0	9.8	44.9	37.1	34.6
OMB	54.5	5.2	14.6	25.2	29.0	24.4
Employment Growth						
IBO	1.5	-0.1	0.3	1.2	1.0	0.9
OMB	1.5	0.1	0.4	0.7	0.8	0.6
Inflation Rate (CPI-U-NY)						
IBO	2.9	2.3	1.4	2.2	2.4	2.7
OMB	3.0	2.9	1.9	2.1	2.0	2.0
Personal Income <i>dollars in billions</i>						
IBO	417.8	430.3	448.8	470.3	491.7	513.6
OMB	398.0	402.0	413.0	432.0	452.0	473.0
Personal Income Growth						
IBO	7.8	2.9	4.1	4.6	4.4	4.3
OMB	7.5	1.0	2.7	4.5	4.7	4.7
Manhattan Office Rents (\$/sq.ft)						
IBO	72.56	78.98	81.57	85.76	90.50	95.49
OMB	71.91	78.85	78.31	81.21	81.54	81.96

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.