New York City Independent Budget Office Fiscal Outlook

December 2012

From Superstorms to Labor Settlements:

# Despite Modest Budget Gap Projections, Significant Challenges Remain

When Mayor Michael Bloomberg introduced his first city budget plan, in the aftermath of Sept. 11 and the 2001-2002 recession, he stressed the need for the city to get its fiscal house in order. Eleven years later, looking at the bottom line of his most recent financial plan, it would appear he has made significant strides towards that aim. Based on IBO's tax and spending projections under the Mayor's November 2012 Financial Plan, the city faces a budget shortfall of $811 million in the upcoming fiscal year, a relatively modest 1.6 percent of our forecast for city-generated revenues. IBO's projected shortfall for the following year, fiscal year 2015, is $1.7 billion, 3.1 percent of expected city-generated revenues.

But just outside the revenue and spending projections presented by the Bloomberg Administration in last month's financial plan lie several important issues that could have major implications for the city's fiscal outlook. One issue is the lack of current contracts with nearly every union in the city. The contract with the teachers' union expired in October 2009, while contracts with the union for principals and other school administrators and District Council 37, the city's largest public employee union, expired in March 2010. Contracts with other large unions expired a year or more ago. There is little money set aside in the budget plan to fund contract settlements covering these past years.

The costs of rebuilding in Sandy's wake—and taking steps to lessen the effects of future "superstorms"—also have yet to be fully tallied. While it remains unclear how much of that bill will fall to the city, the financial plan assumes all costs will be shouldered by others. It is also unclear if there will be longer term economic and fiscal consequences. How will businesses and residents react to homes and buildings having to be vacated for long periods and major parts of the city's infrastructure being knocked out for weeks or months? How will this experience influence future decisions about location and job creation?

IBO's forecast for the local economy presents mixed signals from two key indicators. While we anticipate ongoing job growth, with an increase of more than 76,000 jobs this calendar year and nearly 51,000 next year, IBO's forecast for wage gains is relatively flat. Given these and other signals, our estimates for tax revenues for the upcoming years have been reduced slightly since our last forecast in May.

While projected budget gaps may currently appear modest—certainly when compared with gaps faced in some recent years—the next Mayor and City Council are likely to face significant budget challenges.

**Also available:** Additional Tables on Revenue, Expenditure, and Economic Projections @ www.ibo.nyc.ny.us

IBO
New York City
Independent Budget Office
Ronnie Lowenstein, Director

110 William St., 14th floor
New York, NY 10038
Tel. (212) 442-0632

Fax (212) 442-0350
iboenews@ibo.nyc.ny.us
www.ibo.nyc.ny.us

## Economy & Taxes

***U.S. Economy.*** Despite unexpectedly strong U.S. economic growth in the third quarter, IBO projects real gross domestic product (GDP) to rise at an annual rate of 2.1 percent in 2012, not appreciably better than last year's lackluster growth. (Unless otherwise noted, in the sections on the U.S. and local economies all years refer to calendar years.) Similarly, while the nation has continued to gain jobs this year, the pace is no faster this year than last. Monthly employment gains in 2012 have averaged 151,500 through November, compared with 153,300 per month in 2011. Although employment growth has been relatively modest, the unemployment rate has edged down. After ranging from 8.1 percent to 8.3 percent earlier in the year, since September the monthly unemployment rate has been below 8.0 percent—for the first time since January 2009. IBO projects 8.1 percent unemployment for 2012 as a whole.

IBO expects that federal tax increases and spending cuts stemming from an agreement to avoid the fiscal cliff will not be enough to send the economy into recession, but will constrain economic growth in 2013, particularly in the first half of the year. For the year as a whole, GDP growth is expected to remain 2.1 percent, the same as in 2012, with the annual unemployment rate declining only 0.3 percentage points to 7.8 percent. As the fiscal drag diminishes late in the year, the strength of the private sector will become more apparent, with increases in business investment, bank lending, and consumer spending. The housing market, which had been a major impediment to the recovery, has already turned around; the inventory of unsold homes nationwide has finally begun to decline and will shrink further, stimulating economic activity and boosting consumer and business confidence.

With less fiscal drag and more private sector economic activity, IBO forecasts GDP growth of 2.7 percent in 2014 and slightly faster growth in 2015 (2.9 percent) and 2016 (2.8 percent). Growth will be strong enough to reduce the unemployment rate substantially, from a projected 7.1 percent in 2014 to 5.9 percent in 2016. We expect inflation to hover around 2.5 percent throughout the forecast period, held in check by high levels of unemployment relative to that of past recoveries.

The differences between IBO's and the Mayor's Office of Management and Budget's (OMB) macroeconomic forecasts for 2013 are modest, with IBO projecting somewhat faster GDP growth (2.1 percent v. 1.8 percent) and a lower rate of unemployment (7.8 percent v. 8.0 percent). For subsequent years, OMB predicts slightly faster GDP growth than does IBO, reaching highs of 3.3 percent in 2015 and 3.0 percent in 2016. OMB also projects higher unemployment rates than does IBO after 2013, decreasing from 7.6 percent in 2014 to 6.4 percent in 2015—rates that are 0.5 percentage points to 0.7 percentage points higher than IBO's forecasts.

Near term, the biggest risk to IBO's forecast is that lawmakers in Washington fail to take decisive action to avoid the fiscal cliff, which would produce enough fiscal drag to endanger the U.S. economy's continued growth. Another major risk to the forecast is that Europe's current economic difficulties could become worse, leading to the threat of a global contraction.

**Total Revenue and Expenditure Projections**
*Dollars in millions*

| | 2013 | 2014 | 2015 | 2016 | Average Change |
|---|---|---|---|---|---|
| **Total Revenues** | **$69,450** | **$71,413** | **$74,053** | **$76,798** | **3.4%** |
| *Total Taxes* | *43,267* | *44,776* | *47,721* | *50,155* | *5.0%* |
| **Total Expenditures** | **69,450** | **72,224** | **75,709** | **77,788** | **3.9%** |
| **IBO Surplus/(Gap) Projections** | **$0** | **$(811)** | **$(1,656)** | **$(990)** | |
| ***Adjusted for Prepayments:*** | | | | | |
| *Total Expenditures* | *$71,611* | *$72,525* | *$75,709* | *$77,788* | *2.8%* |
| *City-Funded Expenditures* | *51,039* | *52,235* | *55,344* | *56,969* | *3.7%* |

SOURCE: IBO
NOTES: IBO projects a surplus of $270 million for 2013, $146 million above the Bloomberg Administration's forecast. The surplus is used to prepay some 2014 expenditures, leaving 2013 with a balanced budget. Estimates exclude intra-city revenues and expenditures. City-funded expenditures exclude state, federal, and other categorical grants, and interfund agreement amounts. Figures may not add due to rounding.

***Local Economy.*** New York City's economy has been following the same path in 2012 as it traced in 2011: a very strong first quarter in terms of job creation followed by progressively slower growth as the year went on. Our forecast anticipates some weakness persisting in 2013 and then stepped up growth again in 2014 through 2016.

Very preliminary estimates of the impact of Hurricane Sandy do not change the broader shape of the forecast, but do have sharp near-term effects. Prior to Sandy, IBO expected real city gross city product (GCP) to grow at an annualized rate of 1.6 percent in the fourth quarter of 2012 and 1.2 percent in the first quarter of 2013. But we now estimate real city GCP to contract by 1.0 percent in the fourth quarter followed by a bounce of 1.9 percent in the next quarter spurred by businesses and homeowners replacing and rebuilding goods and property that were either damaged or lost. Similarly, there has been a hit to the employment growth IBO originally forecast for the last quarter of 2012, though we expect that in terms of the overall numbers the city will make up much of the lost ground in 2013. Recovery-related construction jobs will make up a larger part of the employment mix than previously projected.

These impact estimates are likely to be revised as the magnitude of the economic costs of Sandy come into better focus. For now we project annual average payroll job growth of 76,300 in 2012—even with Sandy, slightly stronger than the 72,700 in 2011—followed by a dip to 50,900 in 2013, and then a return to a robust 73,400 average per year from 2014 through 2016.

The 2013 lull and subsequent pickup in city employment growth are roughly in line with IBO's forecast for the national economy, and are subject to the same risks: the possibility that failure to negotiate a solution to the fiscal cliff will lead the U.S. economy to contract or that Europe's economic difficulties will worsen, resulting in a global downturn.

Barring shocks from these or other, less foreseeable, directions, IBO is forecasting seven straight years of growth, with a gain of nearly 480,000 payroll jobs from the end of the contraction in the last quarter of 2009 to the end of our forecast period in the fourth quarter of 2016. This would constitute the most robust city employment expansion since 1950, when these records begin.

Wall Street remains the city's most lucrative sector for firms and their employees but is playing a considerably smaller role in city economic growth post-financial crisis than it has in the past several decades. The securities sector's 2011 bonus pool, mostly paid out in the first quarter of 2012, shrank even more sharply (27.3 percent) than previously estimated, and securities employment contracted sharply in the second half of 2012. IBO anticipates a return to relatively modest job and wage growth from 2013 through 2016 as the industry continues adapting to the "new normal" of lower revenues and heavier regulation.

Broker-dealer profits of New York Stock Exchange member firms have been robust lately, totaling $17.6 billion through the first three quarters of 2012 and on pace to top $20 billion for the year—a large jump over the weak $7.7 billion earned in 2011. But this does not truly signal a return to pre-crisis norms on Wall Street. The recovery in the bottom line has been driven in part by an increase in broker-dealer revenues over 2011 levels, particularly revenues from member firm trading accounts. Yet even with this improvement, revenues are running at less than half the peaks attained in 2006 and 2007. Profits are still being realized because the expense side of broker-dealers' balance sheets have also been dramatically reduced. This is particularly true of interest expenses (largely the result of Federal Reserve policy), but compensation costs have also been reined in, and in 2012 are running even lower than the levels of 2011. This pattern of scaled back broker-dealer revenues and expenses and moderate profits averaging out to about $15 billion per year is projected to continue over the 2013 through 2016 forecast period. In line with this forecast, IBO expects the securities sector to account for just 1.9 percent of aggregate New York City employment growth and 26.1 percent of aggregate wage growth from 2013 through 2016. While the wage growth share is large, it is much lower than in the years leading up to the Great Recession, when securities generated nearly 60 percent of the city's total increase in wages.

Taking up the slack, education and health care are projected to add 22,300 payroll jobs in 2013 and average 19,300 jobs per year in 2014 through 2016; professional and business services, 11,700 jobs in 2013 and 18,400 per year in 2014 through 2016; leisure and hospitality, 8,100 jobs in 2013 and 7,100 per year in 2014 through 2016; and construction (boosted by hurricane recovery efforts) 6,100 jobs in 2013 and 5,700 per year in 2014 through 2016.

One of the mysteries of the city economy over the past two years has been the extremely low growth in resident household employment and stubbornly high unemployment rate, both contrasting sharply with the above noted strong pace of payroll job creation in the city. However, IBO expects increases in the number of residents employed to keep closer pace with local job creation over the forecast period, with the result that the city's annual average unemployment rate is projected to steadily decline from 9.7 percent in 2012 to 6.1 percent in 2016.

With wage and salary growth pulled down by Wall Street, IBO expects New York City personal income (PI) to grow at a rate of 3.8 percent per year over 2012 and 2013, considerably below the 6.4 percent annual growth over the previous two years. We forecast PI growth to ramp up to an average of 6.2 percent per year over the remainder of the forecast period. In inflation-adjusted terms, however, the slowdown in city PI growth has been sharper, with real growth dropping from 5.2 percent per year over 2010 and 2011 to just 1.9 percent per year over 2012 and 2013 and recovering to a still relatively lackluster 4.2 percent per year over 2014 through 2016.

One sector that it appears will not be buoyed much by the rising tide of city job creation is commercial real estate, in part because many of the jobs being created are in industries that are not housed in traditional office buildings. Moreover, with buildings at the World Trade Center site under construction, construction of several new buildings in midtown scheduled to get underway shortly, and with plans moving ahead for office development in Hudson Yards, additions to the inventory of Class A office space are expected to absorb some of the growth in office-using employment. IBO expects Manhattan office rents to rise from $65.60 per square foot in 2012 to $75.70 per square foot in 2016—after adjusting for inflation, just 1.6 percent per year.

IBO and OMB have similar city employment forecasts for 2013, but thereafter the two series increasingly diverge, with OMB projecting much weaker employment growth for the remainder of the forecast period. Concomitant with this, OMB anticipates both less nominal personal income growth in New York City and lower inflation over the plan period than does IBO. However, OMB does project higher Manhattan office rents.

***Tax Revenue Overview.*** With little acceleration expected in the pace of New York City economic growth, IBO forecasts $43.3 billion in city tax revenues for the current year—an increase of 4.7 percent over 2012 tax revenues. (Unless otherwise noted, all years in this and subsequent sections refer to New York City fiscal years.) The outlook for 2014 is for even slower tax revenue growth of 3.5 percent, with revenues totaling $44.8 billion. Revenues are expected to grow only moderately faster in 2015 and 2016 (averaging 5.8 percent annually) to reach $50.2 billion by the last year of the financial plan.

These growth rates are slower than those during the expansion following the recovery from the 2001-2002 downturn, reflecting the severity of the Great Recession in 2008 and 2009, the slow pace of U.S. economic growth since the downturn, and the continued weakness in the city's financial industry. After stagnating and then declining during the recession, baseline tax revenue growth resumed in 2010 and reached 7.2 percent in 2011 as the recovery took hold (growth rates adjusted to exclude the impact of changes in tax policy). But since then the city has seen weaker revenue growth of 4.3 percent in 2012 and growth is expected to average 4.1 percent this year and next. By comparison, in the three years that followed the recovery from the 2001-2002 recession, the city's tax revenues grew by 10.8 percent on average each year from 2005 through 2007.

IBO's current forecast of tax revenues is slightly below our forecast from last spring. One reason is slower growth in the local economy, particularly in the banking and securities sectors where profits and compensation gains are expected to be modest and where employment losses are expected to continue into 2013. Moreover, Hurricane Sandy has resulted in a near-term loss of local economic output. Reflecting this slower-than-expected growth, IBO has made small downward revisions in many of our tax forecasts from last spring, with the outlook for total tax revenue down by $86 million for this year and $347 million in 2014. Although our estimates of total tax revenues were revised downward for every year of the financial plan, the decline is less than 1.0 percent each year.

Collections so far this year are somewhat higher than had been expected when the budget was adopted, with the largest differences in the business income taxes, particularly the bank tax. OMB made only small adjustments to its adopted revenue forecast for the current year, essentially adjusting their projections for the year-to-date differences, but leaving the forecasts for the balance of this year and 2014 through 2016 unchanged. Although OMB's forecast was released in November after Sandy struck, their tax revenue projections do not yet account for the storm's economic impacts.

Even with the downward revisions in IBO's revenue outlook, our overall tax revenue forecast exceeds OMB's each year from 2013 through 2016 with the difference growing over time. For the current year, IBO's forecast is $251 million (0.6 percent) higher than OMB's. The difference is projected to double in 2014 to $512 million (1.2 percent). By 2016, IBO's tax revenue forecast exceeds OMB's by $2.0 billion (4.2 percent).

Federal fiscal policy is a major source of uncertainty in IBO's forecast of city tax revenues. The outcome of the fiscal cliff negotiations in Washington could potentially result in higher federal tax payments—and lower disposable incomes—for at least some New Yorkers. Moreover, given the concentration of high income households, households that derive a significant amount of income from capital gains and dividends, and households that claim large amounts of itemized deductions, the loss in after-tax income will be proportionally greater in New York City than in much of the country.

A full assessment of the economic impact of Sandy and the recovery from the storm is still not available, leaving the effect on New York City tax revenues uncertain. IBO's economic forecast incorporates some preliminary estimates of those impacts, but if recovery of commercial and retail activity is delayed, then the effects on business and sales tax revenues would be greater than we assume. It is also unclear how much of an effect Sandy will have on property values and hence property tax revenues.

Finally, the fate of the property tax abatement for coops and condos, which expired at the end of 2012, is still unknown. OMB's revenue forecast assumes that the abatement will be enacted, with benefits retroactive to the start of this fiscal year, although the legislation has not yet passed. If the abatement is not renewed, the city would have an additional $468 million in tax revenue this year from higher tax payments by apartment owners. Eliminating or amending the abatement beginning in 2014 could also result in hundreds of millions of dollars in additional property tax revenue in 2015 and 2016.

***Business Income Taxes.*** After growth in the city's always volatile business income taxes slipped to 1.2 percent in 2012—down from 17.6 percent growth in 2011—IBO projects that the combined collections for these taxes in the current year will be $5.6 billion (an increase of 5.4 percent) and $5.9 billion in 2014 (5.2 percent). The business income taxes include the general corporation tax (GCT), the unincorporated business tax (UBT), and the banking corporation tax (BCT).

Recent tax collections data tell a mixed story. In September 2012 (the first month of fiscal year 2013 collections for the business income taxes), GCT payments from the finance sector were off sharply from collections during the same period last year—down more than 26 percent. Payments from the information and other service sectors have made up some of this loss. BCT payments from commercial banks were up more than 180 percent over payments made during September 2011. Payments from noncommercial banks were also up, but only by 3.7 percent—due to a large drop (-24.5 percent) in collections from foreign banks. Overall, current fiscal year-to-date collections are up by 59.8 percent for the BCT while the UBT and GCT show small declines of 1.2 percent and 8.2 percent, respectively.

Following a drop-off in securities-sector employment in the second half of calendar year 2012, IBO is forecasting a decline in New York Stock Exchange member profits to $12.8 billion in calendar year 2013, a decline of 36.9 percent. These indications of weakness in the core of the local economy are expected to be offset by gains in other sectors including construction and business services, resulting in moderate growth for the business taxes in 2014. The GCT is expected to grow by 6.7 percent to $2.7 billion and the forecast for UBT revenues is 7.4 percent above the 2013 level; the BCT is expected to show virtually no change from 2013 to 2014.

Calendar year 2015 is expected to bring stronger local economic growth, with higher gains in employment and continued gains in Wall Street profits to $14.8 billion. IBO expects an additional 9,800 jobs in financial services industries in calendar year 2015. With faster local and U.S. economic growth, business income tax revenue is forecast to grow by 9.0 percent in 2015 and 9.1 percent in 2016. Collections are expected to total $7.1 billion by 2016. In the two years after 2014, growth in the UBT is expected to outpace the other income taxes, averaging 10.8 percent annually. The GCT and BCT are forecast to grow at 7.2 percent and 10.1 percent, respectively, over the same period. IBO's forecast of moderate business income tax growth over the next few years pales in comparison with the consistent double-digit growth that occurred during the period from 2004 through 2007. It is not until 2015 that we expect the combined business tax revenues to finally surpass the $6.0 billion collected in 2007. While the BCT has already surpassed its boom-era peak and the UBT is forecast to do so in 2014, the GCT is expected to remain below its peak through 2016.

For all years in the forecast, IBO's estimates of business income tax revenue are greater than OMB's. The difference starts small, $95 million, or 1.7 percent, in 2013 but it grows rapidly to reach $702 million by 2016, a difference of 11.0 percent.

***Personal Income Tax.*** IBO's forecast for personal income tax revenue this year is $8.6 billion, a gain of 8.0 percent from 2012. Growth this year is nearly double last year's rate. The outlook for 2014 is for much slower growth (less than 1 percent) with revenues expected to increase by only $72 million to $8.7 billion. This see-saw pattern is largely the result of expectations that many taxpayers will take steps to realize capital gains income this year to avoid likely increases in federal tax rates next year.

While employment growth in the city has been steady and is expected to result in moderate withholding growth of 2.9 percent for 2013, over half of the expected revenue gain this year (about $468 million) is attributable to estimated payments. Many taxpayers who are able to control the timing for realizing capital gains and other financial windfalls are expected to shift income realization into calendar year 2012 to take advantage of lower tax rates that may not be available in the future. This results in higher estimated payment collections in 2013 and lower estimated payments in subsequent fiscal years.

In 2014, withholding is expected to increase by 6.9 percent as compensation in the securities industry begins to pick up and personal income accelerates in the second half of calendar year 2013. But this withholding growth is offset by the loss of estimated payments that were shifted into 2013 and IBO's forecast for higher refunds in 2014.

After 2014, PIT revenues are projected to grow at an average annual rate of 7.5 percent, reaching $10.0 billion in 2016. The gains reflect strong growth in withholding, estimated payments, and other PIT revenue components, consistent with IBO's outlook for accelerating personal income and employment growth in calendar years 2014 and 2015.

IBO's forecast of 2013 PIT revenue is virtually unchanged from May, while the outlook for 2014 was reduced by 1.4 percent ($125 million). These changes leave IBO's forecast for PIT revenue slightly higher than OMB's for 2013 and 2014: $97 million (1.1 percent) and $141 million (1.7 percent), respectively. The differences stem from IBO's forecast of stronger estimated payments in 2013 and greater withholding—based on our expectation of higher personal income—for 2014. The difference between the forecasts widens in 2015 and 2016, with IBO's forecast exceeding OMB's each year by over $500 million.

***Real Property Tax.*** IBO expects real property tax revenues to total $18.5 billion this year, an increase of 3.0 percent over 2012, and reach $19.1 billion in 2014. Growth is expected to slowly accelerate in the last two years of the forecast, averaging 4.4 percent during 2015 and 2016 with revenues expected to total $20.8 billion in the latter year. The long lags built into the city's property tax system mean that changes in market values are not reflected in assessments and tax bills for several years; thus forecasts of revenues are heavily influenced by market changes that have already occurred.

Market values for one-, two-, and three-family homes (Tax Class 1), still affected by the overhang from the housing bubble, are forecast to grow by just 1.3 percent on the 2014 assessment roll that will be released in January 2013. IBO expects slightly stronger growth in 2015 and 2016, averaging 2.5 percent per year. While weak, these increases would outpace growth from 2008 through 2012, when Tax Class 1 market values fell and then remained depressed for several years. Total market value for Tax Class 1 in 2016 will still be slightly below the 2008 peak.

Market value growth for apartment properties (Tax Class 2) and commercial properties (Tax Class 4) has been stronger than for Tax Class 1 since 2008, averaging 2.1 percent annually for apartment buildings and 5.4 percent annually for commercial properties. IBO expects this pattern of faster growth to continue, with aggregate market value in Tax Class 2 growing by 4.8 percent in 2014, nearly matched by a 4.2 percent gain for commercial properties. During 2015 and 2016, the pace of market value increases in Tax Classes 2 and 4 will gradually accelerate, averaging 5.0 percent annually and 4.6 percent annually, respectively.

Property tax liability is based on taxable billable assessed value which is determined as a percentage of market value—the percentage varies by type of property—minus the value of any exemptions. Aggregate taxable assessed value is expected to increase by 3.8 percent in 2014, with increases across the board: 2.9 percent in Tax Class 1, 3.6 percent for Tax Class 2, and 4.2 percent for Tax Class 4. In Tax Classes 2 and 4, increases in assessed value are phased in over five years and the pipeline of assessed value still waiting to be phased in is estimated at $11.6 billion in 2013 (8.5 percent of billable assessed value in these two classes). This deferred growth contributes to the 2014 billable assessed value growth projected above. The pipeline is expected to grow in 2014 through 2016 with continued gains in market values.

Hurricane Sandy has introduced some uncertainty to the property tax forecasts. It is not clear how damage inflicted by the storm to office and residential buildings in Lower Manhattan and houses, apartments, and businesses in Staten Island, Brooklyn, and Queens will affect the property tax roll and eventual tax revenue. We expect the Department of Finance (DOF) to remove from the 2014 assessment roll all of the value associated with the building for homes that were destroyed. However, this is a small number of parcels relative to the size of Tax Class 1, so the overall fiscal affect is expected to be minimal.

For damaged apartment and commercial buildings it is less certain how DOF will treat the damage when preparing the 2014 assessments. Such properties are generally assessed based on their income and expenses. Even in cases where buildings remain too damaged to be used, many tenants have continued to pay rent for now, thereby maintaining the building's income stream. Nevertheless, the disruptions will presumably result in lost building income and higher expenses, which will have at least a temporary impact on market values. Given the uncertainty as to the extent of the impacts and what adjustments DOF will make, we did not make any explicit assumption about these impacts in our forecast. Moreover, it is not clear whether the storm will have a long-term effect on the value of real estate along the waterfront, including parcels that were not damaged or destroyed in the storm.

The Bloomberg Administration and the City Council have announced two initiatives to help owners of damaged or destroyed properties. First, in designated areas of the city, owners will be able to defer their scheduled January property tax payment by three months without incurring penalties. This affects only the timing of revenue collections, rather than the total revenue for the fiscal year. The city is also considering a proposal to reduce 2013 tax liability for properties that were damaged or destroyed. This requires legislation in Albany, as current year tax liabilities are generally based on the status of the property at the start of the fiscal year even if conditions change after the taxable status date. Legislation to make this change has been introduced by the Speaker of the Assembly. If the proposal is enacted, the city would see a small reduction in tax revenue for 2013.

As part of the citywide program to reduce the budget shortfall, DOF expects to generate additional property tax revenue by examining the validity of tax exemptions previously granted and by closely reviewing new applications and renewals. The benefits under review include exemptions granted through various business incentive programs, exemptions allowed for properties owned by not-for-profit entities, and exemptions for religious organizations providing housing to clergy (parsonages). According to the city's financial plan, there has already been $12.5 million in revenue added this year as a result of these reviews and the department expects to generate more in the coming years: $13.5 million in 2014, $14.7 million in 2015, and $15.5 million in 2016. For now IBO has reflected the additional revenue in our 2013 revenue forecast. Until there is more information available about how exemptions for individual properties are being altered, we are not able to adjust our forecast of taxable billable assessments for later years.

The fate of the coop/condo abatement is the biggest uncertainty regarding the property tax revenue forecast. The abatement was established in 1997 as a temporary fix to begin addressing the differences in tax burdens between owners of conventional homes and apartments while a more comprehensive reform of all owner-occupied housing taxation was developed. The city has never introduced a long-term solution and instead the abatement has been extended a number of times. The latest version expired in June 2012 and the legislation needed to continue the benefit has not been enacted in Albany. The Bloomberg Administration is assuming that legislation to extend the abatement retro-actively to the start of the fiscal year will be adopted when the new legislative session begins in January. So far, tax bills sent to apartment owners this year are calculated as if the abatement is in effect. If it is not renewed before the end of the fiscal year, IBO estimates that apartment owners would owe a total of $468 million for 2013.

Both IBO's and OMB's property tax revenue forecasts assume the program will eventually be extended. The extender bill that almost passed last spring in Albany would have excluded owners whose apartments were not their primary residences while also increasing the benefit for some current recipients beginning in 2014. The net savings for the city from this proposal would have been at most $270 million by 2016. At the moment it is not clear what type of extension the city will pursue once the Legislature reconvenes; for now, the revenue forecast is based on a straight extension of the current abatement.

IBO's revenue forecast for 2013 is slightly higher than OMB's (by $28 million) due to minor differences in reserve items and estimates for collections of prior-year liabilities. IBO is projecting somewhat stronger growth in billable taxable assessments than OMB for 2014 through 2016, which results in higher revenue forecasts for those years. Our property tax forecast exceeds OMB's by $145 million in 2014, $247 million in 2015, and $562 million in 2016.

***Real Estate Transfer Taxes.*** After peaking in 2007 and declining sharply over the following three years, revenues from the real property transfer tax (RPTT) and mortgage recording tax (MRT) continued their recovery in 2012, a trend we expect to continue over the next four years. IBO forecasts RPTT revenue of $995 million in 2013, an increase of 9.1 percent from 2012. MRT revenue growth is expected to be even stronger in 2013, a gain of 13.8 percent to reach $611 million. RPTT revenue is forecast to increase an additional 6.2 percent in 2014, to $1.06 billion, while MRT revenue is projected to grow by 18.8 percent, to $726 million. The more rapid growth forecast for the MRT in 2013 and 2014 occurs as residential sales become an increasing share of the market for real estate, and more residential owners become eligible for refinancing.

During the first quarter of fiscal year 2013 (July through September 2012), taxable commercial sales ($8.0 billion) were less than taxable residential sales ($9.4 billion), reversing the trend over the previous four quarters. IBO still expects the value of commercial sales to exceed that of residential sales for this fiscal year as a whole, but starting in 2014, residential sales activity is forecast to be greater than that of commercial properties. There were 12 taxable commercial sales valued at over $100 million in the first quarter of 2013, compared with 17 during the same period of 2012. The largest transaction was the $720 million paid by RXR Realty for a 40-story office tower at 450 Lexington Avenue. This was the first taxable sale valued at over $500 million since the sale of 200 Lexington Avenue for just under $720 million in September 2011.

IBO projects continued gains in transfer tax revenue from 2014 through 2016, with RPTT growing at an annual average rate of 9.3 percent and MRT at 12.1 percent. In 2016, revenues are expected to reach $1.3 billion for the RPTT and $913 million for the MRT. The sum of revenues from these two taxes in 2016, roughly $2.2 billion, would be more than twice the level of 2010, when the market bottomed out. Still, the total would be nearly 34 percent below the 2007 peak of $3.3 billion.

IBO's transfer tax estimates have been revised downward since last spring. Together, the RPTT and MRT forecasts are $89 million (5.3 percent) lower for 2013, and $79 million (4.2 percent) lower for 2014. Despite the downward adjustment, IBO's combined transfer tax estimates remain slightly above OMB's for 2013 (4.3 percent) and 2014 (2.4 percent). Beginning in 2015, IBO's RPTT forecast is lower than OMB's, although our MRT projections continue to be higher.

***General Sales Tax.*** IBO projects that the city's general sales tax revenue will total $6.0 billion in 2013, an increase of 3.1 percent compared with growth of 4.1 percent in 2012. Through October 2012, sales tax revenue is 7.6 percent greater than it was over the same period last year but growth is expected to slow as the year progresses. In 2014, general sales tax revenue is projected to increase by 5.9 percent to $6.3 billion.

The slower rate of growth projected for IBO for 2013 results from our forecast of slower growth in personal income and declines in Wall Street bonuses from last year. Preliminary estimates of the effects of Hurricane Sandy, including the shutdown of public transportation and power outages that disrupted business operations of many high-volume retailers south of 40th Street in Manhattan for days, also affect the forecast. To the extent that there was simply a delay in purchases, there would be limited effect on sales tax receipts. But some purchases will be forgone rather than delayed, such as those by out-of-town visitors with only a few days to shop.

New York City has welcomed a record number of domestic and international visitors each year since 2009. Looking forward, international tourism, one of the most significant drivers of taxable sales in New York City, is expected to contribute less than it has in the recent past due to the economic slowdown in Europe. Though visitors from South America, particularly Brazil, make up an increasing share of international tourists, Europe is still the largest source.

According to NYC & Company, in calendar year 2011 approximately 10 percent of the international tourists to New York City were residents of England and another combined 12 percent were from France and Germany.

Through September 2012, U.S. consumer spending had been increasing slowly, but data for October 2012 actually showed a small decline, which the U.S. Department of Commerce attributed to the effects of Hurricane Sandy. As the end of the year approaches, there is also concern that the looming fiscal cliff could dampen confidence levels and reduce holiday sales.

Calendar year 2013 is expected to bring a slowdown in hiring by retail sales establishments and only moderate growth in New York City personal income. IBO projects an increase of 3,700 employees in the trade sector—by far, the slowest growth since calendar year 2009 at the depth of the Great Recession. Similarly, personal income is expected to grow by just 1.9 percent in real terms. The IBO sales tax forecast beyond 2014 is for growth of 5.3 percent in 2015 and 4.0 percent in 2016, when revenue is expected to reach $7.0 billion. Gains in employment and personal income in the local economy in calendar years 2014 and 2015 contribute to this revenue growth.

IBO's 2013 sales tax forecast is $68 million lower than OMB's—a difference of 1.1 percent. After 2013, IBO's projections of faster employment gains and stronger income growth, relative to OMB's outlook, result in higher sales tax revenue forecasts. Our 2014 forecast is only $19 million greater than OMB's (0.3 percent) but the difference grows to $112 million (1.6 percent) by 2016.

***Hotel Occupancy Tax.*** After two years of double-digit increases in hotel occupancy tax revenue—16.3 percent in 2011 and 12.6 percent in 2012—IBO forecasts much slower growth in 2013, an increase of 5.0 percent to $500 million. The growth forecast for 2014 is similar, with tax revenue expected to reach $525 million—a 5.2 percent increase from 2013.

Collections through October 2012 show growth of 6.6 percent over the same period last year. In the third quarter of calendar year 2012, local hotels experienced a small increase of 2.5 percent in the number of hotel room nights sold. (Hotel occupancy declined slightly during the quarter but only because the inventory of hotel rooms continued to grow.) According to NYC & Company, average daily room rates also showed a modest decrease from $288 in the second quarter to $276 in the third.

The impact of Hurricane Sandy on hotel tax revenues is not yet clear. Tourist activity was disrupted as tens of thousands of flights across the U.S. were cancelled and some hotels had to be evacuated. But with many New Yorkers displaced from their homes, there was increased demand for hotel rooms from local residents.

IBO expects growth in tourist spending to moderate over the next few years as international tourism responds to the economic slowdown in Europe. However, as the U.S. economy recovers, increases in domestic business and leisure travel and non-European international visitors are expect to offset losses from this group.

Hotel tax revenue is projected to grow by 5.9 percent in 2015 and 4.8 percent in 2016. IBO's hotel occupancy tax forecast is higher than OMB's in every year of the forecast. The difference ranges from $23 million (4.7 percent) in 2013 to $47million (8.8 percent) in 2016.

### Spending & Savings

While IBO expects tax revenues will grow at a moderate rate, our projections for spending are for an even slower rate of growth over the 2013-2016 period of the financial plan. Growth in spending is tempered by the latest round of measures—worth nearly $1.6 billion over the next 18 months—to curb city-funded spending. These new initiatives by city agencies to cut costs and raise fee, fine, and other revenues come on top of a series of measures that began in fiscal year 2008 and have already cut expected city-funded spending by about $6.0 billion. Based on the November 2012 Financial Plan and adjusted for the use of last year's surplus to pay for some of this year's expenses, IBO estimates total spending, including state and federal dollars, will reach $71.6  billion in 2013. IBO expects that spending will grow by less than $1.0 billion in 2014, an increase of just 1.3 percent over 2013. Over the 2013-2016 period, total spending growth is expected to average 2.8 percent a year.

Although tax revenues are expected to rise at a faster pace than spending, this growth will not be enough to erase the underlying budget gap that has been covered in the past through the use of prior-year surpluses and one-time revenue sources. But the budget gaps IBO projects--$811 million in 2014 and $1.7 billion in 2015—are modest compared with gaps faced in recent years.

***Engines of Spending Growth.*** Just a few items in the budget drive a large share of the projected growth in city spending. For much of the past decade, spending on Medicaid, pensions, fringe benefits, and debt service were large and steadily growing parts of the city budget. This picture has changed.

Medicaid and pension spending, while still among the largest city expenditures, are no longer expected to grow rapidly. Medicaid is projected to grow by $83.0 million (1.3 percent) in 2014 and reach just under $6.6 billion. An increase of $71.0 million (1.1 percent) is expected in 2015. The city's pension contribution for its employees is also expected to level off, albeit at a high level of spending. Pension spending is projected to increase by $150.0 million (1.9 percent) in 2014 and reach just under $8.1 billion. In 2015, the city's pension contribution is projected to decline by $8.0 million.

Conversely, expenditures on debt service and health and other fringe benefits for city employees continue to grow steadily. Spending on debt service—the interest and principal the city pays on the money it borrows to build housing, repair schools, buy sanitation trucks, and meet other similar needs—is one of the largest and fastest growing parts of the budget. Debt service is projected to grow from $6.1 billion this year (after adjusting for the use of last year's surplus to prepay some of the 2013 cost) to $6.5 billion next year, a year-over-year increase of nearly 7.0 percent. By 2016, debt service is expected to reach $7.5 billion.

The cost of health insurance and other fringe benefits for city employees is another major driver of city spending growth. Health insurance and other benefit expenditures (not including costs for education department and city university employees) are projected to rise from $3.8 billion this year to $4.0 billion in 2014, an increase of about 6.0 percent. Spending on benefits for municipal workers is expected to reach $5.9 billion in 2016, an average annual increase of 7.2 percent (after adjusting for the use of all of the funds set aside in the Retiree Health Benefits Trust in 2013 and 2014 to pay part of the costs for retired city workers).

The budget of the Department of Education is by far the largest of any city agency. Although spending by the education department will grow at a slower rate than debt service and health insurance, rising by an annual average of 2.9 percent from 2013 through 2016, the size of the agency's increases, in dollar terms, is considerable. IBO projects the education department budget will increase from $19.6 billion in 2013 to $20.2 billion in 2014, an increase of $567.0 million. By 2016, we expect education department spending to reach $21.3 billion—an increase of $1.7 billion over four years.

***Mayoral Under-estimates.*** IBO's projection of education spending exceeds the amount budgeted under the Bloomberg Administration's financial plan for two reasons. The Mayor's budget plan does not provide enough funding to cover the costs for new charter schools scheduled to open next year and scheduled expansion of existing charter schools. Nor does the Mayor's plan include enough funding to maintain the current level of classroom spending. IBO's expenditure projections add $177.7 million in 2014 ($101.7 million for charters, $76.0 million for classrooms), an amount that grows to $280.1 million in 2016 ($227.1 million for charters, $53.0 million for classrooms).

There are a number of other areas for which IBO's spending projections exceed the funds budgeted by the Mayor. One example is our estimate for health insurance costs, which is $73.0 million above the Mayor's for 2014 and $63.0 million in 2015. Our higher projection stems largely from differing estimates of the number of city university staff that will be eligible for health insurance as well the number of education department staff likely to retire.

Another example is IBO's estimate of higher costs for sheltering homeless families. With the number of homeless families growing and the length of time they are staying in the shelter system also increasing, the Bloomberg Administration added $42.9 million in November to the 2013 budget for providing families emergency shelter. Given recent trends, IBO estimates that the funds added by the Mayor will fall short and that providing homeless families with emergency shelter will cost $41.6 million more than the $466.5 million budgeted for this year and $77.7 million more than planned for 2014. The cost of providing emergency shelter for families is partially funded with state and federal assistance, so the additional cost in city-generated funds is $13.7 million in 2013 and $25.6 million in 2014. Our 2014 estimate also assumes that the plan to have some families share living quarters will again be delayed, eliminating a $9.0 million savings previously expected by the Bloomberg Administration (the Mayor dropped the shared housing proposal from the 2013 budget in the November plan).

***Gap-Closing Measures.*** The Mayor's latest financial plan includes $555.0 million in savings initiatives for the current fiscal year and just over $1.0 billion for 2014. These measures to close projected budget gaps include a combination of spending cuts, revenue from new or increased fees and fines, updated estimates of costs, and the supplanting of city dollars with revenue from other sources.

The November 2012 plan includes the elimination of about 1,340 municipal jobs over 2013 and 2014, predominately through attrition. The largest number of staff reductions is at the Department of Correction, which expects to eliminate nearly 395 positions over 2013 and 2014 through attrition. Much of this will result from the decision not to reopen the Queens Detention Center. The Human Resources Administration expects it will shed 385 positions in 2014 through attrition as the agency increasingly automates its interactions with clients in the food stamp and public assistance programs.

Some of the largest individual measures for savings are achieved with no effect on city services. The Bloomberg Administration expects to save $230.0 million in 2014 simply because interest rates for borrowing are lower than anticipated. The city will realize this savings in debt service payments on newly issued debt as well as by refinancing some existing debt. Because less waste is being generated for export out of the five boroughs as well as changes in contracts for these shipments, the Department of Sanitation will save $57.2 million in 2014. Another $18.6 million in refuse-related savings in 2014 results from continued delays in the construction and opening of marine transfer stations to handle the waste being shipped out of the city. The city's Department of Transportation is saving $19.2 million this year and $14.7 million next year by using federal and state funds to cover the cost of a variety of programs such as preventive maintenance of ferries and bridge inspections.

The transportation department also has a number of measures that seek to supplement—rather than supplant—city funds. For example, the transportation department anticipates raising $6.8 million (after deducting overhead costs) from the installation of 428 new multispace parking meters in Lower Manhattan. Similarly, the agency expects to garner an additional $4.8 million in 2014 by raising parking meter rates in Manhattan south of 96th Street by 50 cents to $3.50.

Other agencies also expect to bring in additional revenue. For example, the Office of Administrative Trials and Hearings projects that it will generate an additional $2.6 million in fine revenue in 2014; the Department of Consumer Affairs anticipates that it will collect $2.3 million more in fees in 2014 from sidewalk cafés.

Some of the gap-closing measures in the budget plan would have direct effects on city services. One example is the proposal to cut $10.0 million from the Out-of-School Time program in 2014. This would decrease the number of after-school slots available for children by more than 3,600 and reduce the number of currently budgeted slots to about 23,000. The health department plans to eliminate vision screening in schools for kindergartners and first graders in 2014 to save $2.8 million. The budget plan also proposes an 8.0 percent cut in the subsidy for the city's library system to save $16.7 million in 2014. The Mayor's budget office estimates that this cut would decrease the number of hours libraries are open each week by 2.4 hours.

For some of the services facing cuts in 2014, the reductions are even steeper than they appear in the financial plan. The libraries are one example. To offset a cut proposed for 2013, the Mayor and City Council agreed to add $89.5 million for the libraries to this year's adopted budget. But those funds were only put into the budget for this year. When coupled with the new cut proposed for 2014, the year-to year decline in the city's subsidy for the libraries is actually much deeper, enough to force the library systems to eliminate two days of service each week from their schedules.

Likewise, the proposed cut in 2014 for the Out-of-School Time program is steeper than it appears. To offset a proposed cut for the current year, the City Council added $50.7 million just for 2013. When coupled with the reduction proposed in the November 2012 plan, the number of slots in the after-school program would tumble from 56,000 this year to 23,000 next year.

There are numerous other programs that received funds just for 2013 and so the year-to-year drop in support does not appear as a cut in the budget plan. But some of the affected services are high profile and there is likely to be considerable pressure to restore funds. Some examples include maintaining the operation of 20 fire companies ($43.6 million), restoring aid for upkeep of parks and public pools ($19.2 million), and subsidizing cultural organizations ($11.8 million).

Even as the November 2012 plan proposes cuts in spending and increases in revenues, the plan also identifies new spending needs. One example is the increase in funds needed to provide shelter for homeless single adults—this is in addition to the increased funding for providing emergency shelter for families referenced earlier. The plan adds $26.6 million in 2014 to provide shelter for the rising number of single adults in the system and brings the total budget for adult shelter to $302.4 million. Additional funding of $8.9 million has also been added to provide for staffing at the new 121st Precinct in Staten Island. The Bloomberg Administration also plans to increase funding to improve the rate of recycling and lower the amount of waste exported to landfills outside the city. The November plan includes $6.7 million in new funding for 2014 for various initiatives to meet these goals.

***Small Gap, Big Questions.*** A budget gap of $811.0 million for 2014, as projected by IBO, is relatively minor—it can be closed with routine annual accounting measures and without the need for additional spending cuts or revenue increases. The budget shortfall expected for 2015 is somewhat larger and will take some additional gap-closing actions beyond the annual accounting changes. But these assertions are based on the contours of the Bloomberg Administration's November 2012 Financial Plan, which sidesteps some crucial issues that could substantially alter the fiscal outlook for the city and present significant budget challenges for the next Mayor and the City Council.

Mayor Bloomberg's budget plan assumes that the municipal labor unions will accept settlements with no wage increases for contracts that expired after 2010 and for those teachers, principals, and assistant principals who did not receive the two years of compounded 4.0 percent raises that were the pattern in the 2008-2010 round of contract negotiations. There is little money set aside in the budget for contract settlements covering years prior to 2013, and the Mayor's assertion that any wage increases covering those years would have to be paid for by productivity is impractical. This stance may well be untenable for the next Mayor.

If union members whose contracts expired in fiscal year 2010 or later settled for 2.0 percent compounded annual raises as the new wage pattern for the next two contract years (with the assumption that the teachers, principals, assistant principals, and members of a few small unions secure the prior wage pattern of two compounded 4.0 percent raises for two years), it would cost the city a cumulative total of $3.8 billion through June 2013. This estimate only covers the city-funded portion of wages for municipal union members and excludes from its calculation of a hypothetical wage increase the additional cost of city pension contributions, longevity pay, and some other forms of compensation.

If the annual raises were 4.0 percent for these same two contract years under the same assumptions, the total cost to the city through June 2013 would be nearly $5.4 billion. The Mayor's financial plan includes funding for raises of 1.25 percent in 2013 and 2014 for most civilian unions. There is also some funding at this rate for uniformed unions, based upon the expiration date of their contracts.

The Mayor's budget plan also effectively assumes that all of the costs associated with cleanup and recovery following Hurricane Sandy will be covered by state and federal aid. That may prove to be a risky assumption. Admittedly, at the time the Bloomberg Administration issued the plan the costs of the storm were still being tallied. To put a figure in the budget plan indicating how much the city expects to pay effectively tells Albany and Washington that the city anticipates having to carry this level of costs itself. Yet the $60 billion now being requested by President Obama for Congressional approval is less than the initial estimates of need presented by New York and other affected states. The possibility that the city will indeed have to shoulder some of the cleanup and recovery costs—as well as expenditures to mitigate devastation from future storms—remains very real.

It is also unclear if Sandy will have a longer term effect on the local economy. Nearly eight weeks after the storm, many buildings remain uninhabitable and thousands of telephones still do not work, and may not for months more. Electricity was knocked out in some locations such as Lower Manhattan for a week or more and the city's transportation network took many weeks to largely recover. The storm laid bare the fragility of New York's infrastructure, which may affect the decision of some businesses to locate, remain, or expand here.

Less theoretical but equally uncertain is the Mayor's plan to sell more taxi medallions. With the taxi proposal tied up in court, the Mayor has now pushed projected revenue from the sale back for a second time. As recently as May, the Bloomberg Administration anticipated $1.0 billion from the sale of new medallions in fiscal year 2013. That expectation was reduced in June to $635.0 million, and has now been reduced to zero for the current fiscal year. The Bloomberg Administration currently projects that the city will garner $790.0 million of the anticipated revenue from medallion sales in 2014, with additional revenue coming in 2015 and 2016 for a total of nearly $1.5 billion. Yet the projection of medallion sales for 2014 still harbors some uncertainty.

The city also faces the possible loss of $250.0 million in state education aid for the current fiscal year. In adopting the state budget, the Governor and Legislature tied the receipt of any increase in state aid to a district's ability to come to agreement with its teachers' union on an Annual Professional Performance Review by January 17, 2013. As of the publication of this report, no such agreement is in place for New York City and the United Federation of Teachers has announced it is breaking off talks with the Bloomberg Administration. Unless the two sides come together and produce a plan that is then approved by the State Education Department, the city budget will have to absorb this loss of $250.0 million.

In addition, the city's expectations for Medicaid reimbursements for certain special education services may also not meet projections. After the city and state had to repay the federal government millions of dollars for not being able to document claims for these services and foregoing most claims for several years as the city invested upwards of $55 million to create a computer system to aid in the reimbursement process, Medicaid payments continue to lag. The education department had expected to collect $117.0 million in reimbursements last year but received only about $37 million. The financial plan estimates Medicaid reimbursements for special education services will total $167.0 million annually, but it appears the city will continue to fall well short of this amount.

The questionable assumption of the taxi revenue, state education aid, and Medicaid reimbursements, along with other critical concerns renders the city's budget outlook less assured than it seems from the financial plan. Over the past few years the city has weathered a number of diverse challenges, from the economic storm of the deepest national recession since the 1930s to the post-Christmas blizzard that knocked out much of the city's transportation routes for days to the most recent superstorm. The fiscal difficulties that lay ahead for the next Mayor and City Council may be more prosaic than a historic recession or mammoth storms, but the potential challenges remain no less real.