New York City Independent Budget Office Fiscal Brief

May 2012

Reestimating the Mayor's Plan:

An Analysis of the 2013 Executive Budget & Financial Plan Through 2016

When Mayor Michael Bloomberg presented his Executive Budget for 2013 and four-year Financial Plan through 2016 earlier this month, he delivered two discordant messages. The Mayor trumpeted the city's improving economy, which has more than regained all the jobs lost during the recession as local employment reached an all-time high of 3.8 million. Yet the Mayor also voiced the need for austerity, warning that certain costs outside the city's direct control continue to grow and emphasizing that economic concerns have led the administration to lower its tax revenue projections for fiscal year 2013 by $277 million.

IBO expects the local economy to continue outpacing the U.S. recovery through calendar year 2013 and to sustain the growth in employment through at least 2016; after a pause in 2012, wages and incomes also grow from 2013 through 2016. Establishments in the city are expected to add nearly 70,000 jobs in 2012 and over 73,000 in 2013. Sectors such as business and professional services, trade, and leisure and hospitality are forecast to add jobs despite continued weakness in the financial services industry. For Wall Street firms, 2013 is expected to bring an increase in profits (and bonuses) as well as employment and average wages, but still leave them far below the pre-financial crisis levels.

While IBO's economic and tax revenue forecast also reflects the caution appropriate for current conditions, our projections are somewhat more optimistic than those of the Mayor's Office of Management and Budget (OMB). Based on our latest forecast of revenue and spending under the Mayor's Executive Budget for 2013 and Financial Plan through 2016, we expect the city to end this fiscal year with a surplus of $1.8 billion, $73 million more than the Bloomberg Administration's estimate.

To achieve balance in 2013, the Mayor is proposing $1.0 billion in recurring spending and revenue measures (called the Program to Eliminate the Gap, or PEGs), along with nearly $2.5 billion in one-shot (non-recurring) revenues, including; $1 billion from the Retiree Health Benefits Trust fund, $1 billion from the sale of new taxi medallions, and $466 million from the settlement of the CityTime scandal. Of these, the anticipated revenue from the taxi medallion sale is far from certain: the plan faces a court challenge and even if it is allowed to go forward it remains to be seen whether the medallions will sell for the expected price.

Assuming that the 2012 surplus is used to prepay some of next year's expenditures, the Mayor's plan for $1.0 billion in new PEGs is approved, and the proposed $2.5 billion in one-shots are realized, IBO projects that the city will end 2013 with a surplus of $570 million. The 2013 projected surplus is largely the result of IBO's tax forecast exceeding OMB's by $599 million.

Detailed Tables on IBO's Revenue and Expenditure Estimates @ 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

The Economy and Taxes

IBO's economic forecasts for the United States and New York City economies have changed little since we published our Analysis of the Mayor's Preliminary Budget in March. In the absence of any shocks, IBO forecasts moderate real U.S. gross domestic product (GDP) growth this year (2.4 percent) and next (2.8 percent), followed by a 4.0 percent peak in the growth rate in 2014. (All references to years in the economic forecast sections refer to calendar years. The nation's payroll employment is projected to continue its moderate expansion this year and next, with an annualized growth rate of 1.6 percent both years.

New York City employment growth is expected to outpace the nation's in 2012 and 2013 (1.8 and 1.9 percent, respectively) as it has in the last two years. Since March, IBO has raised its forecast of the number of jobs added each year, with projected near-term growth of 69,900 new jobs in 2012 and 73,200 in 2013—nearly the same as the 72,700 jobs added in 2011. Notably, Wall Street firms are expected to account for relatively little of the employment gains as their profits and revenues remain low compared with recent history. Instead, other sectors, including business services and leisure and hospitality—which are growing strongly despite weakness in the financial industry—are expected to account for many of the added jobs.

In its forecast accompanying the Executive Budget, OMB projects slower U.S. and local economic growth than IBO throughout the 2012-2016 forecast period.

U.S. Economy. GDP growth slowed to 2.2 percent (initial estimate) in the first quarter of this year, from 3.0 percent in the fourth quarter of 2011 (Unless otherwise noted, all monthly and quarterly figures are seasonally adjusted.) IBO expects the pace of growth to pick up in the remainder of 2012 and forecasts 2.4 percent GDP growth for the year as a whole. Though the economy is vulnerable to shocks, conditions favorable for sustained expansion and eventual acceleration of growth are expected to remain in place, with GDP growth of 2.8 percent forecast for 2013.

With strong profit flows and very low interest rates resulting in generally healthy balance sheets, businesses are able to expand production by adding workers and investing in new equipment and facilities. The banking sector is well-capitalized and more willing to extend credit. Consumer debt has been falling and credit-worthiness is improving, enabling more households to satisfy pent-up demand. Consumption spending rose in the first quarter of this year and IBO expects growth to accelerate, with consumption rising 2.3 percent in 2012 and 3.0 percent in 2013.

U.S. employment growth also picked up in the first quarter of 2012, when the nation added 700,000 jobs, compared with an average of 440,000 per quarter in 2011. The second quarter, however, has started poorly; it is possible that some of the strong growth in the first quarter reflected an acceleration of seasonal hiring due to the mild winter. IBO forecasts 2.1 million new jobs a year in 2012 and 2013—1.6 percent annual growth. This pace will gradually lower the nation's unemployment rate to 8.1 percent this year and 7.7 percent in 2013.

IBO projects the U.S. economy to grow more strongly after 2013. Our forecast assumes a sizeable decrease in excess housing inventories by 2014 so that the housing

Total Revenue and Expenditure Projections
Dollars in millions

	2012	2013	2014	2015	2016	Average Change
Total Revenues	**$67,681**	**$69,696**	**$70,628**	**$73,753**	**$77,016**	**3.3%**
Total Taxes	41,384	43,353	45,124	47,960	50,626	5.2%
Total Expenditures	**$67,681**	**$69,127**	**$73,072**	**$76,207**	**$78,205**	**3.7%**
IBO Surplus/(Gap) Projections	**—**	**$570**	**($2,444)**	**($2,453)**	**$($1,189)**	
Adjusted for Prepayments:						
Total Expenditures	$69,622	$70,804	$73,196	$76,207	$78,205	2.9%
City Funded Expenditures	49,082	50,955	53,168	55,877	57,381	4.0%

SOURCE: IBO
NOTES: IBO projects a surplus of $1.801 billion for 2012, $73 million above the Administration's forecast. The surplus is used to prepay some 2013 expenditures, leaving 2012 with a balanced budget. Estimates exclude intra-city revenues and expenditures. Figures may not add due to rounding. City funded expenditures exclude state, federal and other categorical grants, and interfund agreement amounts.

sector will no longer be a constraint on economic growth. GDP growth is projected to peak at 4.0 percent in 2014 and average 3.3 percent annually in the two following years. The economy is expected to add an average of 3.2 million jobs a year after 2013, causing the unemployment rate to fall to 5.4 percent by 2016.

A major risk to IBO's forecast for growth is "the fiscal cliff"—the drag to the economy at the beginning of 2013 that would result if the expiration of Bush-era tax cuts, the implementation of budget cuts agreed to when the Treasury debt ceiling was raised last summer, and the end of temporary payroll tax cuts and emergency unemployment insurance programs occur as scheduled in current law. If all three occur as scheduled, GDP growth would be reduced by more than 3 percentage points in 2013. However, IBO's economic forecast is based on the assumptions that Bush-era tax cuts for taxpayers with incomes under $250,000 will be extended and that some of the spending cuts will be delayed, limiting the fiscal drag to about 1.5 percentage points.

In addition to the potential for a steeper fiscal cliff than we have projected, political stalemate over fiscal policy and increasing the debt ceiling would likely damage consumer and investor confidence, much as it did last summer. Perhaps the most immediate risk to the U.S. economic outlook is the sovereign debt crisis in the euro zone, which could disrupt financial markets worldwide and significantly deepen European recessions, thus decreasing demand for U.S. exports. Another risk is an unexpected spike in oil prices due to possible disruptions of supply from the Middle East. The slowing of the Chinese economy, the world's second largest, would also constrain U.S. economic growth if it becomes more severe. Finally, if the U.S. government fails to lower its debt in relation to GDP as the economy expands, federal government borrowing could raise interest rates and crowd out private investment, compromising future growth.

Local Economy. The New York City economy has outperformed the national economy on several key measures for the past five years. In the first quarter of 2012 the U.S. was still well below its pre-recession peak in payroll employment. Meanwhile, New York City had recovered far more than the number of jobs lost in the recession and indeed reached an all time high (breaking a 43 year-old record) in employment.[1] The number of jobs is a critical economic indicator, but which industries are growing (or contracting) is also important. With the financial sector expected to continue a somewhat shaky recovery, IBO is forecasting continued employment gains for the city centered in other areas such as business services, hospitality, trade, and health. But growth in average wages and personal income is not as strong, particularly in 2012, (0.6 percent and 1.8 percent, respectively), reflecting the relatively small number of very high-wage securities sector jobs being added, and relatively tepid wage growth for those who are employed in this sector.

IBO expects the city's economic expansion to continue to outpace the nation over the rest of 2012 and 2013 and then to remain on a robust growth path (while the U.S. expansion accelerates) over the 2014 to 2016 period.

The city economy has weathered not only a record plunge in Wall Street wages in 2009, but also significant resident household deleveraging (debt reduction), which depresses spending (and related job creation) from the local economy. As a result, while real disposable personal income (DPI) in New York City was 4.0 percent higher at the end of 2011 than it was at the end of 2007, real DPI plus the change in real mortgage, credit card, and auto debt outstanding was 4.2 percent lower. For the U.S., the same measure was 7.3 percent lower suggesting that deleveraging has been an even larger weight on household spending outside New York. This is one clue as to why the recovery in the city has been better than in the rest of the nation.

The current year got off to a very strong start, with the survey of payroll employment showing 32,900 jobs gained in the first quarter. It is possible that some of that growth may have resulted from the speeding up of hiring due to the exceptionally mild winter, but that seems an unlikely explanation for the 10,300 jobs added in professional and technical services or the 6,800 added in health and social services in the first quarter. IBO expects the pace of job creation to cool somewhat for the remainder of the year, with projected growth of 12,600, 13,800, and 17,900 over the next three quarters, for an average annual gain of 69,900 (1.8 percent) for 2012 as a whole. For the following years, IBO forecasts payroll job growth of 73,200 (1.9 percent) in 2013 and an average of 78,000 (again 1.9 percent) per year over 2014 through 2016. The pace is even stronger for private sector employment, with an annual average growth rate of 2.2 percent forecast for 2012 through 2016.

Much of this job growth is expected in sectors that appear to be less driven by the vagaries of Wall Street than they have been in the past. Hospitality and trade, in particular, seem to be more closely tied to the city's booming tourism than to its embattled financial sector.

Leisure and hospitality is expected to add an average of 11,300 jobs from 2012 through 2016, (15.1 percent of the total increase in payroll employment in that period), and wholesale and retail trade has a projected annual average gain of 9,100 jobs (12.1 percent of the total). Professional and business services, which includes subsectors such as legal and accounting services for whom financial firms are important clients, is nevertheless also expected to see strong gains averaging 19,400 jobs annually, 25.7 percent of the overall 2012 through 2016 gain.

Health care and social services have long been nearly impervious to cyclical factors, and cost-containment pressures resulting from government policy initiatives have thus far not registered in the broader industry employment statistics. These sectors are expected to add an average of 14,100 jobs annually from 2012 through 2016. Education—which excludes public school teachers—has until recently been similarly immune, but it is now expected to shed 2,100 jobs this year for the first decline since 1991, and then grow at a slow pace, averaging 2,800 jobs added annually in 2013 through 2016.

Meanwhile, recent signals from Wall Street point to continued weakness. The broker-dealer revenues of New York Stock Exchange (NYSE) member firms in 2011 were nearly 60 percent below their pre-crisis peak and are expected to slip even further in 2012. As a group, the member firms lost money in the last two quarters of 2011 and finished the year with a total of $7.7 billion in profits, down from $27.6 billion in 2010. IBO expects member firm profits to recover only to $10.8 billion in 2012. Meanwhile, there was a sizable drop in the 2011 securities industry bonus pool (IBO's preliminary estimate is of a 19 percent decline from the prior year), and reports of new rounds of layoffs and restructurings planned or in process at major investment banks abound.

There are multiple economic and regulatory pressures behind all of this, few of which are expected to abate soon. As a result, IBO forecasts only relatively modest gains in securities and investment services employment over the next five years, adding an average of 2,400 jobs per year and accounting for just 3.2 percent of the city's 2012-2016 employment growth. Moreover, growth in average wages is expected to be a subdued—for this industry—3.0 percent per year after adjusting for inflation, far below the levels seen in non-recession years prior to the financial crisis (10.1 percent per year for 1995-2001 and 12.3 percent per year for 2004-2007).

Securities will account for 24.2 percent of the city's overall aggregate 2012 to 2016 wage growth, large relative to the sector's share of job growth but dwarfed by the 60 percent of aggregate wage change flowing from Wall Street over the prior decade.

With large swathes of the city economy growing, although Wall Street is contributing less than usual to demand for office space, commercial real estate has rebounded and IBO projects a further 20 percent rise in Manhattan office rents over the 2012 to 2016 period. The recovery in housing is more uneven but is strengthening. This is expected to translate into a notable pickup in construction employment starting in the latter part of this year.

One dimension where the city is lagging behind the U.S. overall is the unemployment rate. While payroll employment has been surging in the city, the resident unemployment rate has also been rising. It now stands at 9.5 percent, up 0.7 percentage points from a year ago. The rate is not going up because an improving economy is drawing more job seekers into the labor force. On the contrary, while payroll employment increased by 72,700 in 2011, the count of employed city residents went up by only 5,500, and the total resident labor force shrank by 19,100. The first quarter of 2012 was even more anomalous: as payrolls grew by 32,900, the number of city residents employed fell by 16,700, while the number unemployed rose by 17,200.

Some of this disjunction may be due to city jobs going to commuters, shifts from self-employment to payroll employment, and growth in the number of multiple job-holders, but all these factors appear to leave the bulk of the mystery unexplained. Our forecast does anticipate labor force and resident employment growth falling into step with projected payroll job growth. As a result we expect the unemployment rate to drop to 8.2 percent by the last quarter of this year and to be down to 6.0 percent by the end of 2016. This would still be above the 5.4 percent rate forecast for the U.S. and well above the city's pre-crisis low of 4.9 percent in 2007.

Except for unemployment, this is a very positive New York City economic forecast, yet it comes with exceptional levels of risk. All the risk factors discussed previously in terms of the U.S. recovery—Europe, China, domestic policy—would disrupt the city's expansion as well, and New York City is particularly vulnerable to crises that batter the banking sector or international tourism. Even without another major shock in the next five years, it still remains to be seen whether other parts of city economy—especially business services, trade, and leisure and hospitality—will sustain strong employment growth while Wall Street remains relatively weak.

Tax Forecast. IBO's tax revenue outlook has darkened somewhat since the winter. While there is virtually no change for 2012, we have lowered our forecasts for each year from 2013 through 2016, although in each case the reductions are relatively small ranging from $100 million in 2015 to $397 million in 2016. (Unless otherwise noted, all years in this section refer to city fiscal years.) The reduction for 2013 was $287 million. Most of the forecast reductions are in the personal and business income taxes, partially offset by upward revisions to the hotel occupancy, real property, and property transfer tax estimates. Although OMB also reduced its tax forecast for 2012 and 2013, it increased its projections for 2014 through 2016.

While somewhat more pessimistic than earlier in the year, IBO continues to forecast steady tax revenue growth, averaging 5.2 percent from 2012 through 2016. Total tax revenues for 2012 are now expected to reach $41.4 billion (growth of 4.4 percent over 2011). In 2013, taxes are projected to grow by 4.8 percent to $43.4 billion, with most of the gains coming from the income taxes. By 2016, taxes will total $50.6 billion. IBO's tax forecast is considerably higher than OMB's each year from 2013 through 2016, with the difference growing from $596 million for next year to $2.5 billion in the last year of the financial plan. The differences are greatest on the business income taxes and the real property tax.

Business Income Taxes. The city's three business taxes—the general corporation tax (GCT), banking corporation tax (BCT), and unincorporated business tax (UBT)—are collectively expected to yield $5.5 billion this fiscal year, a 4.0 percent increase over 2011. IBO expects a strong increase in 2012 GCT collections to more than offset declines in BCT and UBT revenue. This year's increase follows much faster growth—17.6 percent—than last year and reflects the current difficulties in the financial industry. NYSE member firm profits fell from $27.6 billion in calendar year 2010 (the second-best year on record) to $7.7 billion in 2011, pulled down by losses for the group as a whole in both the third and fourth quarters. IBO projects that business income tax growth in 2013 and 2014 will be somewhat higher than this year (5.0 percent and 4.9 percent, respectively), and then accelerate late in the forecast period, reaching 9.4 percent in 2015 and 9.9 percent in 2016.

IBO projects that GCT revenues will increase 13.4 percent in 2012 to reach $2.6 billion, the second consecutive year of double-digit growth. For the current fiscal year through March, GCT revenue was up 13.8 percent over the same period in 2011, driven by a 6.7 percent increase in gross receipts and a 37.5 percent decrease in refunds. The growth is attributable to earnings of non-financial corporations, while tax receipts from financial firms have fallen 7.8 percent so far this fiscal year. GCT receipts are expected to grow more moderately in 2013 and 2014—3.3 percent and 4.7 percent, respectively—reflecting slower growth of corporate profits and a decline through the end of calendar year 2012 in total revenue of securities firms. In 2015 and 2016, more robust GCT growth is forecast to return, averaging 8.0 percent.

Banking corporation tax collections are especially volatile, and our BCT forecast for the 2012 through 2016 period is no exception. Consumer and business demand for bank services still weakened by the recession, tightened lending standards for riskier consumers, and uncertainty surrounding the effects of new regulation are all constraining profitability in the banking sector. A sharp decrease in refunds—67.9 percent through March compared with the same period last year—is limiting this year's decline in net BCT revenue to a projected 4.2 percent. Gross bank tax collections will pick up next year, but so will refunds, and net BCT growth is expected to be modest: 2.0 percent in 2013 followed by 1.4 percent in 2014. Beyond 2014, increased business and consumer confidence is expected to fuel stronger BCT increases—13.0 percent in 2015 and 12.2 percent in 2016.

IBO projects a 2.1 percent decrease in UBT revenue in 2012, but in 2013 the UBT is expected to lead the business taxes with growth of 10.1 percent. Reflecting our forecast of a steady expansion of the city's economy, UBT revenue is projected to show the most consistent growth of any of the business income taxes—averaging 9.5 percent a year from 2012 through 2016.

Overall, IBO's business income tax forecast for 2012 is $114 million higher than OMB's—almost all of which is explained by differences in GCT revenue projections. There are more substantial differences after the current year. IBO's forecast is $305 million higher than OMB's for 2013 and $249 million higher in 2014; the gap reaches $943 million (14.8 percent) by 2016. The widening gap is attributable to IBO's forecast of stronger economic growth, for both the U.S. and New York City, throughout the forecast period.

Personal Income Tax. IBO forecasts $7.9 billion in personal income tax (PIT) revenue this year, 3.7 percent ($280 million) greater than 2011. The acceleration of the city's employment and personal income growth in calendar years 2013 and 2014 will fuel PIT collections beginning in fiscal year 2013, and PIT receipts are expected to increase at an average annual rate of 5.5 percent in 2013 through 2016, when PIT revenue is projected to reach $9.8 billion. IBO's forecast assumes the expiration of federal tax cuts under current law will alter the timing of capital gains income and, by extension, the timing of federal, state, and local personal income tax liability. Although IBO's current-year estimate is slightly below OMB's, starting in 2013 our PIT forecasts are significantly greater, by as much as $393 million (4.3 percent) in 2015.

Most of the 2012 growth in PIT results from a $231 million increase in projected revenue from state/city offsets, an accounting adjustment that does not reflect employment and income growth in the city. IBO estimates only a 1.1 percent increase in withholding—by far the largest PIT component—despite 2.0 percent employment growth in calendar year 2011 and 3.5 percent annualized growth in the first quarter of this year. The estimated 19 percent decline in Wall Street bonus compensation has substantially offset the boost to this year's withholding from recent employment gains; withholding receipts through April have increased by only 0.7 percent over the same period last year, and the 2012 withholding forecast calls for just a 1.1 percent increase over 2011. Collections of estimated payments are expected to remain flat, and a 1.7 percent increase in refunds relative to 2011 more than offsets the 1.9 percent increase projected for payments with final returns.

Strong PIT growth of 8.2 percent is forecast for next year, when revenue is expected to reach $8.6 billion—$653 million above 2012 receipts. Employment and personal income gains of city residents will boost withholding receipts, though continued weakness in Wall Street compensation will limit withholding growth to 1.8 percent. Most of the projected 2013 PIT growth is expected to come from a 20.5 percent ($430 million) increase in estimated payments. The surge is largely a function of our assumption that preferential federal tax rates on capital gains income will expire at the end of December 2012, giving taxpayers a strong incentive to realize capital gains (and incur tax liability) by the end of the calendar year.

With employment and personal income growth accelerating from calendar year 2012 through 2015, PIT revenue is expected to increase at an average annual rate of 4.6 percent in fiscal years 2014 through 2016. But the growth will be uneven—2.4 percent in 2014, 8.4 percent in 2015, and 3.1 percent in 2016. In 2014, withholding growth is expected to be strong (5.8 percent), but a large portion of the added revenue from withholdings will be offset by a drop in estimated payments caused by the shift of capital gains realizations to calendar year 2012 from 2013. Absent the effects of federal tax policy, PIT growth in 2014 and 2015 would be more consistent. After 2015, we expect slower employment and income growth to also slow the increase in PIT.

IBO's PIT forecast for the current year is slightly lower than OMB's, by $42 million (0.5 percent). But beginning in 2013, IBO's forecasts exceed OMB's by increasing amounts, due to the stronger income and employment growth forecast by IBO. The difference between the two tax forecasts is $101 million in 2013, rising to $266 million in 2014 and $393 million in 2015, before declining in 2016.

Real Property Tax. While there has been no change since March in the levy for 2012 or our forecast of the levy for 2013, IBO has increased its real property tax (RPT) revenue forecast by $98.8 million for this year and $54.7 million for 2013 as a result of changes to the reserve, primarily collections from prior years and current year delinquencies. Both IBO and OMB forecast that RPT revenue will total $17.9 billion this year, a 6.1 percent increase over 2011.

For 2013 IBO expects RPT revenue to increase 2.3 percent to $18.3 billion. The decrease from the tentative to the final assessment roll for 2013 is expected to be greater than usual due to late renewals of tax exemptions for non-profit organizations. IBO is assuming that many of the non-profit exemptions that were removed because the organizations did not file the appropriate renewal applications will ultimately be reinstated, resulting in lower taxable assessed value. IBO's projection of the tentative to final roll adjustment is larger than OMB's and as a result, the revenue forecasts differ slightly, with IBO projecting $36 million less revenue.

IBO expects 2013 growth of 4.5 percent in assessed value for tax purposes in Tax Class 4 (commercial properties other than utilities), which is faster than the increases of 2.5 percent and 3.2 percent, respectively, projected for Class 1 and Class 2 (the residential classes). After 2013, Class 1 assessed value for tax purposes grows at an average annual rate of 2.6 percent, and Class 2 growth averages 4.1 percent. The annual growth rate for Class

4 properties is 5.5 percent. With relatively fast growth of Class 4 assessments for tax purposes, the pipeline of assessed value increases remaining to be phased in will expand throughout the forecast period, continuing a trend that began in 2012. The current value in the Tax Class 4 pipeline is estimated at $6.8 billion.

After 2013, projected RPT collections grow at an average annual rate of 4.9 percent to reach $21.1 billion by 2016—faster growth than OMB projects for the 2014-2016 period. IBO's 2014 forecast exceeds OMB's by only $80 million, but the difference grows to $854 million by 2016.

Transfer Taxes. The city's real estate markets are in their second year of recovery, and 2012 will be the second consecutive year in which there will be double-digit increases in revenue from the transfer taxes. IBO forecasts an 18.0 percent increase in real property transfer tax (RPTT) receipts, to $938 million, and a 21.5 percent increase in mortgage recording tax (MRT) receipts, to $528 million.

The growth in RPTT revenue this fiscal year has come primarily through commercial real estate transactions. In contrast to 2011, when taxable sales of residential properties outpaced commercial sales, taxable commercial sales were greater than taxable residential sales in the first three quarters of this fiscal year—$27.8 billion compared with $22.1 billion. There were four taxable commercial sales valued at over $500 million during the first quarter of 2012 (July-September 2011), compared with just three during all of 2011. The highest value transaction was the August 2011 sale of the Starrett-Lehigh Building (601 West 26th Street) for $920 million. During the second and third quarters of fiscal year 2012 (October 2011 through March 2012), there were no taxable sales valued over $500 million. However, there were 28 sales valued at between $100 million and $500 million, compared with just 13 during the same period of 2011.

MRT revenues have been bolstered by the increase in property sales, as well as by a rise in mortgage refinancing. Though New York City-specific data is not available, national data from the Mortgage Bankers Association indicate that refinancing activity's share of the total value of residential mortgages rose to 78 percent during the October-December 2011 quarter, after hovering around 65 percent during the prior three quarters.

For the period 2012 through 2016, IBO projects an average annual rate of growth of 8.0 percent for RPTT, and 12.6 percent for MRT. IBO expects that mortgage rates will gradually increase from the unprecedented levels of recent months, but will remain low by historic standards. By 2016, RPTT revenues are forecast to reach $1.3 billion and MRT revenues $848 million. Still, the projected sum of collections from the two taxes is less than two-thirds the record amount of $3.3 billion collected in 2007.

IBO's 2012 forecast of combined transfer tax revenues is $40 million greater than OMB's—3.1 percent higher for the RPTT and 2.3 percent higher for the MRT. IBO forecasts faster revenue growth in 2013 for each tax than does OMB, and the difference in combined transfer tax revenue increases to $148 million. Beginning in 2014 the trend reverses and OMB forecasts faster RPTT and MRT growth than IBO does, and by 2016 OMB's forecast for RPTT is $25 million above IBO's, while the MRT forecasts are identical.

Sales Tax. IBO projects moderate growth of 3.9 percent in general sales tax collections in 2012, with receipts reaching $5.8 billion. Revenue growth will be stronger in 2013, with an increase of 5.5 percent to $6.1 billion. Revenue growth is expected to remain near that level for the remainder of the forecast period—averaging 5.7 percent on an annual basis through 2016, when sales tax receipts are forecast to total $7.2 billion.

Boosted by a mild winter and the continued influx of visitors, sales tax receipts through March were 4.3 percent greater than during the same period of 2011. But IBO projects increases in sales tax collections to moderate during the remainder of the fiscal year, due in part to an expected slowdown of personal income growth in the first half of calendar year 2012.

The city continues to benefit from growth in the number of business and leisure tourists: a record 50.6 million people visited the city in calendar year 2011 according to NYC & Company, the city's tourism bureau. Over 51 million tourists are expected in 2012—an increase of 3.2 percent. Tourists not only pay sales tax on their purchases in stores and restaurants, they also pay sales tax on their hotel rooms—in addition to a separate tax on hotel occupancy. Sales tax revenue growth for 2013 and later would slow considerably if the U.S. economic recovery falters or if the number of visitors from Europe declines and if those who do come curtail their spending.

IBO's sales tax forecast is 0.6 percent ($32 million) below OMB's for 2012, but is above OMB's forecast by $59 million (1.0 percent) for 2013 and by increasing amounts each year thereafter: $156 million in 2014, $251 million in 2015, and $386 million in 2016.

Hotel Occupancy Tax. Driven by record-level tourism and improving economic conditions nationally, IBO projects strong increases in hotel tax revenue this year and next. For 2012, IBO forecasts hotel occupancy tax revenue of $479 million—$57 million (13.5 percent) greater than 2011. The robust revenue growth projected for this year is based on IBO's economic forecasts and year-to-date collections, which through March are 13.1 percent greater than during the comparable period in 2011.

The demand for hotel rooms was robust in calendar year 2011, and occupancy rates hovered around 85 percent each month. Average daily room rates climbed 5.7 percent, from $261 in 2010 to $276 in 2011, even while the number of hotel rooms in the city increased by 5 percent. International tourists, who typically spend more money and stay longer in the city than domestic tourists, played a significant role in boosting demand for hotel rooms. Visitors from Europe account for 44 percent of foreign tourists, and their numbers increased 5.4 percent from 2010 to 2011 despite economic woes in the euro zone and the United Kingdom. Non-European countries also made strong contributions to the demand for city hotel rooms in 2011: according to estimates by NYC & Company, the number of visitors from Brazil grew 18.8 percent to roughly 700,000 and the number of visitors from Australia grew 11.3 percent to about 533,000.

IBO projects hotel tax revenue for 2013 to grow 8.3 percent to $519 million based on the expectation that accelerating U.S. income and employment growth and further increases in the number of domestic and international visitors will fuel additional demand for hotel rooms. Growth in hotel tax revenues is expected to slow sharply in 2014 and 2015—to an average annual rate of 1.4 percent—due to the expiration of a temporary increase in the hotel occupancy tax, which will lower the tax rate to 5.0 percent on December 1, 2013 from the current rate of 5.875 percent. Projected revenues are $519 million and $533 million in 2013 and 2014, respectively. (If the higher rate were extended, hotel tax receipts would reach $558 million in 2014 and $602 million in 2015.)

With several euro-zone countries and the United Kingdom (the single largest source of foreign visitors to New York City) in recession, the major risk to the forecast is the possibility of a significant reduction in Europeans' spending on business and leisure travel to New York City.

IBO's forecast is nearly identical to OMB's for 2012. But in contrast to the strong revenue growth IBO forecasts for 2013, OMB projects a $5 million (1.0 percent) decline in hotel tax revenue, and our forecast is $46 million (9.7 percent) greater than their's. For 2014 through 2016, IBO's forecast is greater than OMB's each year by an average of $30 million.

Expenditures

While IBO's tax revenue forecast projects considerable—though not extraordinary—year-over-year growth averaging 5.2 percent from 2012 through 2016, city expenditures are also growing. The Mayor's budget plan for 2013 includes a $1 billion Program to Eliminate the Gap, or PEG, first introduced in the November 2011 Financial Plan. If not for the use of 2012's estimated surplus of $1.8 billion as well as nearly $2.5 billion in one-shot revenue sources—the sale of new taxi medallions, use of Retiree Health Benefit Trust funds, and the CityTime settlement—other cost-cutting or revenue-raising actions would be necessary.

IBO projects that spending in 2013 will total $69.1 billion, $409 million more than the Bloomberg Administration's estimate. When we adjust our 2013 estimate to account for the use of the 2012 surplus to prepay some of next year's expenses, total spending to meet 2013 needs is $70.8 billion, an increase of 1.7 percent from the current year.

Several factors drive the difference between IBO's and the Bloomberg Administration's forecasts of city spending in 2013. We estimate that the cost of health care and other fringe benefits will be $69 million more than projected by the administration, largely because of our expectation of higher medical inflation. Our estimate of homeless services spending is $27 million higher than the Mayor's because we anticipate higher family shelter costs due to longer length of stays as well as the assumption that two previously delayed cost–cutting measures will again be deferred. We also project that overtime in the police and correction departments will be a combined $40 million above the amount provided in the Executive Budget.

Conversely, IBO anticipates that maintaining current class sizes in general education classrooms will cost $37 million less than budgeted for 2013. In 2014 through 2016, though, we project that education is underfunded, mostly due to a shortfall in the budget for charter schools already slated to open—$122 million in additional funding is needed for charters in 2014, growing to $210 million by 2016.

The Fiscal Four: Pensions, Fringe Benefits, Medicaid, & Debt Service. For more than a decade, much of the growth in city spending has been attributed to just a few areas of the city budget. While some observers continue to cite pensions, fringe benefits, Medicaid, and debt service as still driving the increases in city spending, the dynamic is no longer the same, at least for two of these areas.

City pension contributions for municipal workers had been one of the fastest-growing portions of the budget. But this is no longer the case. Under the Mayor's budget plan the city's pension contributions have leveled off, albeit at a considerable cost of around $8.0 billion a year. With anticipated approvals of changes in actuarial assumptions and methods along with the state Legislature's recent creation of a new pension tier for future employees, pension spending is expected to rise at the modest annual average rate of 0.5 percent, growing from $7.9 billion in 2012 to $8.0 billion in 2016.

Growth in Medicaid spending has also slowed, largely because of caps on local annual increases enacted several years ago by the state, and an additional cap in the recently-adopted state budget. Again, although Medicaid spending may have leveled off with annual increases averaging just 0.6 percent, it remains a large cost that is expected to grow from $6.4 billion in 2012 to $6.6 billion in 2016.

Conversely, the cost of both fringe benefits for city employees and debt service on the money borrowed for capital projects, such as school construction and purchasing new sanitation trucks, continue to grow at a pace exceeding many other expenditures. Spending on fringe benefits is expected to grow at annual rate of 7.4 percent (excluding the use of the Retiree Health Benefit Trust funds), increasing from $4.6 billion in 2012 to $6.1 billion in 2016. This increase is largely driven by the rising cost of health insurance.

City payments of debt service on funds borrowed for capital construction and equipment purchases also continue to grow despite the expectation that interest rates will remain low in the near term. The Mayor's budget plan includes $152 million in savings in 2013 largely due to lower interest rates than previously anticipated. Still, debt service is expected to increase by $506 million next year to total $6.1 billion (adjusted for the use of prior-year surpluses to prepay these expenses). In 2016, debt service is projected to reach $7.5 billion, but if interest rates continue to remain low additional savings are likely.

Education Spending Rising. Over the past few years, city-funded spending on education has also risen substantially. The trend continues under the budget plan for 2013, though less dramatically than this year, when city spending grew by about $1.5 billion to replace expiring federal stimulus funds and other cuts in federal aid. Under the Mayor's budget plan, IBO projects total education spending to grow from $19.2 billion this year to $19.7 billion in 2013, with city funds comprising $154 million of the increase.

Although school spending is rising, much like last year the increases are driven by a few discrete portions of the education department's budget. Spending on charter schools and nonpublic schools (largely tuition for special education and foster care students placed in private schools) is expected to grow by $243 million next year and total nearly $2.9 billion

In contrast, spending on traditional public school classrooms is again expected to decline. The budget for general education classrooms would edge down next year by $83 million to just over $6.0 billion.

Spending Cuts, Revenue Raisers. Although the Executive Budget did not present a new set of agency measures to cut costs or raise revenues, the plan includes a substantial number of PEGs that had been previously proposed. By the Mayor's count, 11 rounds of proposals since 2007 have reduced the budget for city-funded spending in 2013 by $6.2 billion. Included in this are the just over $1 billion in initiatives proposed in the November 2011 Financial Plan—$874.9 million in budget cuts and $137.5 million in revenue measures.

Among the more controversial cost-cutting proposals is a $96.1 million reduction in the subsidy for the city's library systems; a $43.0 million savings from the closing of 20 fire companies; a $9.0 million reduction in after-school programs including the elimination of seven Beacon Centers and 2,300 Out-of-School Time slots; and a $7.3 million cut to programs for runaway and homeless youth. About one-third, or $46.5 million, of the new revenue proposed in the November plan would come from the finance department through more sophisticated audits and other measures. Other revenue measures are also anticipated such as increased commercial parking rates (to raise $4.0 million) and increased restaurant inspections ($3.8 million).

A Precarious Budget Balance. In addition to the proposed $1.0 billion in revenue and spending measures, the Mayor's budget plan for 2013 relies on nearly $2.5 billion in one-shots. Two of these sources are relatively secure, the use of $1 billion from the Retiree Health Benefits Trust fund and the payment from the $466 million CityTime settlement. Far less certain is the $1 billion budgeted in expectation of revenue from the sale of new taxi medallions. The taxi medallion revenue is less than assured for at least two reasons: the plan is now tied up in court and even if approved, it is not guaranteed that the medallion sale will net the revenue estimated by the Bloomberg Administration.

Another stumbling block for the Executive Budget could be expired contracts with the city's labor unions. Contracts with some of the city's largest unions expired two or more years ago. The most immediate problem for the Bloomberg Administration may be the teachers' union contract, which expired in 2009. It is a problem for both fiscal reasons and policy reasons. There is no money in the budget for retroactive increases for teachers covering a period in which other unions received 4 percent wage hikes. Moreover, the union has been at loggerheads with the Mayor over issues such as teacher evaluations and school closings; a lawsuit filed by the United Federation of Teachers could derail the school closing plan and the lack of agreement on teacher evaluations could cost the city $300 million in state aid.

Although the Mayor declared when presenting the Executive Budget that retroactive pay raises are off the table, reaching a contract settlement with the union could enable the Mayor to advance some of his education initiatives but open new gaps in the city budget. The City Comptroller estimated that a retroactive raise for teachers (and principals) covering the period other unions received 4 percent increases would cost $1.7 billion.

As noted, there are a number of risks that threaten the economic assumptions underlying IBO's tax forecast. These include the possibility of a deeper recession in Europe, the spill-over of problems with European sovereign debt on financial markets, and the potential for stalemate in U.S. fiscal policy. Closer to home, it remains to be seen if local employment growth can be sustained if Wall Street profits, employment, and earnings continue to grow at a slower pace than in the recent past. Finally, if market forces or regulatory policy caused Wall Street profits and earnings to again decline, rather than just grow slowly, the economic and revenue outlook for the city would be much more negative.

A Cautionary Tale

While the Mayor is correct to warn that the new jobs the city is now generating do not pay as handsomely as the Wall Street jobs that drove the city's extraordinary economic growth in 2003-2007, his budget plan may be especially cautious. Some of this caution may be in response to continued national and international economic uncertainty, particularly in the euro zone, but some of it may also be the result of doubts about the viability of a key budget proposal for 2013. At risk is the assumption of $1 billion in revenue from the sale of new taxi medallions.

Although IBO projects that tax revenues will grow at a faster pace than city-funded expenditures over 2012 through 2016, the use of one-shots to keep 2013 in balance (and help reduce the projected 2014 shortfall) simply postpones the hard work of bringing the city budget into balance. Add to that the many expired municipal labor contracts for which no funds have been set aside (the 2010-2012 round of negotiations), and the city's budget problems potentially deepen. So while IBO's tax revenue projections may be higher and budget-gap estimates in the out-years smaller than the Mayor's, the city's fiscal landscape remains challenging.

Endnotes

[1]These numbers are still subject to revision, and when the Current Employment Statistics estimates are rebenchmarked again next March, some of the exceptionally sharp upward adjustments to 2011 New York City employment in the last benchmarking may be pared back.

Detailed Tables on IBO's Revenue and Expenditure Estimates

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