New York City Independent Budget Office Fiscal Brief

May 2014

### Reestimating the Mayor's Plan:

# An Analysis of the 2015 Executive Budget & Financial Plan Through 2018

When Mayor Bill de Blasio presented his Executive Budget for 2015 and financial plan through 2018 earlier this month, he characterized the plan as fiscally responsible, progressive, and honest: Fiscally responsible, in part, because it establishes and funds a pattern of labor settlements that had been the greatest source of uncertainty in recent budget proposals; progressive because of its investment in the new Mayor's priorities such as enhancing services for children and adolescents and providing affordable housing; and honest because it undoes the "budget dance" of past years in which Mayors routinely cut and the City Council regularly restored funding in an annual ritual affecting a variety of services.

While what constitutes a progressive budget is fundamentally a subjective matter, examining the Mayor's budget themes of fiscal responsibility and budget honesty fall more directly within IBO's role. But it is a role made more complicated for this report because of the tentative pact with the teachers' union and its possible extension to other unions. It is a highly complex agreement, reached just days before the Mayor released his Executive Budget, and has multibillion dollar effects on the city budget over seven years—beyond the four years covered in the financial plan.

The de Blasio Administration quickly built its estimated costs of the proposed labor settlement for all unions into the financial plan, but issued a revised plan on May 22 that addressed an accounting concern raised by City Comptroller Scott Stringer. In making the change in the revised plan, the amount in the Mayor has set aside to cover the cost of the tentative contract settlement has increased by $115 million. The revised plan was released as IBO was due to issue this report and we do not yet have a clear explanation of the increase. Even before this change, IBO had questions about other aspects of the proposed pact and their potential costs, questions that have prevented us from incorporating our own estimate of the settlement's cost into this review of the Mayor's Executive Budget and financial plan.

With this caveat in mind we project the city will end the current fiscal year with a surplus of $1.8 billion, $131 million more than the Mayor. Our estimate is based on IBO's latest economic forecast and projections of tax revenues and spending under the contours of the Mayor's revised Executive Budget and financial plan. We estimate that the upcoming fiscal year, 2015, will end with a surplus of $833 million, and that 2016 has a shortfall of $1.6 billion, $934 million less than projected by the Mayor. The budget gap IBO projects for 2016 is a manageable 2.9 percent of city generated revenues, particularly in light of the surplus we projected for 2015.

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## Economic Forecast

***U.S. Economy.*** Economic growth in the U.S. essentially stalled in the first quarter of 2014. (All years in this section on IBO's economic forecast refer to calendar years.) The primary reason was harsh winter weather in much of the country, which took its toll on output in many sectors, especially construction. Preliminary data reveal that real gross domestic product (GDP) growth dwindled to only 0.1 percent on an annual basis compared with 2.6 percent growth in the fourth quarter of 2013. Despite the disappointing first quarter, IBO continues to expect robust GDP growth in the remainder of the year, with much of the economic activity that would otherwise have occurred in the first quarter of 2014 shifted to the second quarter and beyond. Taking into account the first-quarter stagnation, IBO has reduced its forecast of real GDP growth for 2014 as a whole to 2.6 percent, down from 2.8 percent in the March forecast, but we have left our GDP forecasts for 2015 and beyond unchanged.

IBO projects that the U.S. economy will grow faster this year than in 2013, when contractionary fiscal policies and October's federal government shutdown together constrained real GDP growth to 1.9 percent. The fiscal drag attributable to last year's tax increases and spending cuts has been abating, and no new contractionary policies are expected in the near term. IBO forecasts faster economic growth after 2014, with GDP rising 3.5 percent in 2015 and 3.2 percent in 2016.

The U.S. economy's recovery from the Great Recession of 2008 and 2009 has been unusually slow, with modest private sector job growth coupled with declines in government sector employment. It has taken four years for the private sector to regain the 8.8 million jobs lost over 25 months of contraction, and total employment (private and government sectors) is now just shy of its pre-recession peak. However, these job gains have resulted in only a gradual decline in the nation's unemployment rate, from 9.9 percent at the recession's trough (fourth quarter of 2009) to 6.7 percent in the first quarter of 2014—still well above the average 4.6 percent unemployment rate in 2007.

Despite lackluster employment gains and GDP growth during the recovery, conditions favorable to a more robust economic expansion have been in place for some time. These conditions include a corporate sector flush with cash from record high profit margins and cost-cutting measures, a household sector with the lowest debt-to-income ratio in decades plus considerable pent-up demand for many consumer goods, and a banking sector well capitalized due to low interest rates and more stringent capital requirements in the wake of the financial crisis. Very low interest rates have increased access to mortgage financing, stimulated home sales, and reversed the long slide in home prices. The improving housing market and the strength in the stock market have created a wealth effect that has also boosted spending, especially by higher-income households.

The Federal Reserve's (Fed) policy of low interest rates, keeping the federal funds rate on overnight loans between banks near zero and continuing to buy up financial assets (albeit at a slowing pace) to put downward pressure on long-term interest rates (quantitative easing), has been a key ingredient fostering economic growth. Low rates have been vital to the turnaround of the housing market, which had been a major impediment to growth in the aftermath of the Great Recession. The Fed has indicated that it will continue its accommodative monetary policy until labor markets have substantially recovered from the recession or inflation appears to be taking hold. Based on our forecast of the U.S. unemployment rate averaging 6.4 percent this year, this suggests that the Federal Reserve will maintain a near-zero federal funds rate through most of 2014.

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

| | 2014 | 2015 | 2016 | 2017 | 2018 | Average Change |
|---|---|---|---|---|---|---|
| **Total Revenue** | **$75,108** | **$75,118** | **$78,016** | **$80,809** | **$83,490** | **2.7%** |
| Total Taxes | $47,304 | $48,428 | $51,004 | $53,330 | $55,843 | 4.2% |
| **Total Expenditures** | **$75,108** | **$74,286** | **$79,650** | **$81,367** | **$84,685** | **3.0%** |
| **IBO Surplus/(Gap) Projections** | **$–** | **$833** | **($1,634)** | **($558)** | **($1,195)** | |
| **Adjusted for Prepayments:** | | | | | | |
| Total Expenditures | $76,186 | $76,152 | $79,753 | $81,367 | $84,685 | 2.7% |
| City-Funded Expenditures | $54,775 | $55,604 | $58,781 | $59,920 | $62,708 | 3.4% |

NOTES: IBO projects a surplus of $1.8 billion for 2014, $131 million above the de Blasio Administration's forecast. The surplus is used to prepay some 2015 expenditures, leaving 2014 with a balanced budget. Figures may not add due to rounding.

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**IBO versus Mayor's Office of Management And Budget Economic Forecasts**

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| **National Economy** | | | | | | |
| Real GDP Growth | | | | | | |
| IBO | 1.9 | 2.6 | 3.5 | 3.2 | 2.7 | 2.4 |
| OMB | 1.9 | 2.5 | 3.1 | 3.2 | 3.1 | 3.0 |
| Inflation Rate | | | | | | |
| IBO | 1.5 | 1.8 | 2.1 | 2.4 | 2.6 | 2.5 |
| OMB | 1.5 | 1.6 | 1.9 | 1.7 | 1.9 | 2.1 |
| Personal Income Growth | | | | | | |
| IBO | 2.9 | 4.9 | 6.2 | 5.3 | 4.5 | 3.8 |
| OMB | 2.8 | 3.7 | 5.2 | 5.4 | 5.5 | 5.3 |
| Unemployment Rate | | | | | | |
| IBO | 7.4 | 6.4 | 6.0 | 5.7 | 5.5 | 5.4 |
| OMB | 7.4 | 6.4 | 5.9 | 5.6 | 5.2 | 5.0 |
| 10-Year Treasury Bond Rate | | | | | | |
| IBO | 2.4 | 3.2 | 4.1 | 5.0 | 4.9 | 4.7 |
| OMB | 2.4 | 3.3 | 3.9 | 4.3 | 4.6 | 4.6 |
| Federal Funds Rate | | | | | | |
| IBO | 0.1 | 0.1 | 0.3 | 2.3 | 3.6 | 4.1 |
| OMB | 0.1 | 0.1 | 0.4 | 2.2 | 3.8 | 4.0 |
| **New York City Economy** | | | | | | |
| Nonfarm New Jobs (thousands) | | | | | | |
| IBO | 83.1 | 75.7 | 63.8 | 60.0 | 51.5 | 50.2 |
| OMB | 83.0 | 58.0 | 51.0 | 58.0 | 55.0 | 50.0 |
| Nonfarm Employment Growth | | | | | | |
| IBO | 2.1 | 1.9 | 1.6 | 1.5 | 1.2 | 1.2 |
| OMB | 2.1 | 1.5 | 1.3 | 1.4 | 1.3 | 1.2 |
| Inflation Rate (CPI-U-NY) | | | | | | |
| IBO | 1.7 | 2.1 | 2.7 | 2.9 | 3.1 | 3.0 |
| OMB | 1.7 | 1.7 | 1.7 | 1.8 | 2.1 | 2.3 |
| Personal Income ($ billions) | | | | | | |
| IBO | 484.1 | 511.3 | 540.0 | 568.2 | 592.5 | 615.3 |
| OMB | 484.8 | 501.2 | 520.0 | 544.0 | 571.3 | 598.3 |
| Personal Income Growth | | | | | | |
| IBO | 2.8 | 5.6 | 5.6 | 5.2 | 4.3 | 3.9 |
| OMB | 2.7 | 3.4 | 3.7 | 4.6 | 5.0 | 4.7 |
| Manhattan Office Rents ($/sq.ft) | | | | | | |
| IBO | 68.4 | 67.8 | 68.9 | 71.1 | 72.5 | 73.8 |
| OMB | 68.9 | 68.0 | 69.9 | 71.7 | 72.7 | 74.2 |

SOURCE: Mayor's Office of Management and Budget
NOTES: Rates reflect year-over-year percentage changes except for unemployment, 10-Year Treasury Bond Rate, Federal Funds Rate, and Manhattan Office Rents. The local price index for urban consumers (CPI-U-NY) covers the New York/Northern New Jersey region. Personal income is nominal. For 2013, New York City personal income and growth rates are estimated, pending Bureau of Economic Analysis release.

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IBO assumes the Fed will be able to slowly wind down its asset purchases in a transparent and orderly fashion and succeed in avoiding sudden spikes in interest rates.

In addition to assuming that there will be no unintended consequences from monetary policy, IBO's economic forecast is premised on there being no significant external shocks to the economy and no additional drag from fiscal policy. The budget agreement approved in Washington at the end of 2013 removed the threat of a government shutdown or another round of sequestration cuts in 2014, and it is consistent with our assumption that the total dollar amount of deficit reduction in federal budgets will remain essentially unchanged through 2018, the final year of the city's financial-plan period. Also consistent with our assumption of no shocks to the economy is a Congressional agreement to temporarily shelve the political brinksmanship that had undermined consumer and business confidence through much of the recovery.

IBO forecasts some acceleration of personal income growth from a modest 2.9 percent in 2013 to 4.9 percent in 2014 and 6.2 percent in 2015—these increases are somewhat slower than the growth anticipated in our March forecast. Faster growth of income and output will bring a reduction in the unemployment rate, to an average of 6.4 percent in 2014 and 6.0 percent in 2015. It also will put upward pressure on prices. As the unemployment picture improves, we expect the Fed to begin increasing the federal funds rate towards the end of 2014 in order to start bringing monetary policy back to a more neutral stance and to contain potential inflation. IBO forecasts a rise in the inflation rate from 1.8 percent in 2014 to 2.1 percent and 2.4 percent in 2015 and 2016, respectively. After 2015, IBO expects growth to moderate, with real GDP growth dipping to 3.2 percent in 2016, and then falling further to 2.7 percent in 2017 and 2.4 percent in 2018. Although economic growth slows, we expect the unemployment rate to continue its gradual decline, reaching 5.4 percent in 2018.

Compared with IBO's macroeconomic forecast, the Mayor's Office of Management and Budget (OMB) projects somewhat less real GDP growth in 2014 (2.5 percent versus 2.6 percent for IBO) and 2015 (3.1 percent versus 3.5 percent). Despite OMB's expectation of slower growth, the two forecasts of unemployment rates are identical for 2014 and differ little for 2015 and 2016. With slower growth, OMB forecasts lower inflation (1.6 percent in 2014 and under 2.0 percent until 2018) than does IBO (1.8 percent inflation in 2014 and over 2.0 percent in subsequent years).

***New York City Economy.*** The number of jobs added to New York City's economy so far this year has continued to exceed expectations, and IBO has raised its forecast of 2014 employment growth to 75,700 (1.9 percent) compared with the 70,300 new jobs we projected in March. After 2014, however, we expect employment growth to diminish each year, with the city gaining an average of 56,400 jobs annually, slightly less than in the March forecast. In line with our expectation of more modest increases in local employment, IBO has also lowered its forecast of personal income growth to 5.6 percent in both 2014 and 2015 compared with our previous projections of 5.8 percent in 2014 and 6.3 percent in 2015.

Since the Great Recession, strong employment growth in New York City has been accompanied by income growth that is weaker than had occurred in the previous economic expansion. Over the last three years, New York City payroll employment grew by an average of 85,500 (2.3 percent) per year, with private-sector growth—90,300, or 2.8 percent per year—the strongest for any three-year period on record.[1] However, the growth in the number of jobs has been offset somewhat by a decline in average hours worked per private-sector employee—a decline that started in the recession and has continued through 2013. While total private employment increased 5.6 percent from 2008 through 2013, aggregate hours worked increased only 2.5 percent. We estimate that about four-fifths of this decline reflected shrinking work weeks within specific industries with the remainder resulting from change in the relative size of different industries in the city. In particular, employment in financial activities (where average work weeks are long) has been falling and the shares of employment in education and health care and in leisure and hospitality (where average work weeks are relatively short) has been rising.

The shift in employment growth from high-paying finance jobs to low-paying jobs in retail trade and leisure and hospitality has also had the effect of curtailing aggregate wage growth in the city, as have declining average wages within the securities industry, the most highly compensated segment of the financial sector. Real average wages on Wall Street have fallen in five of the past six years, though they remain five times higher than the average for jobs in other industries. [Click here for a set of graphs of New York City wage and employment growth by industry in the current expansion (2009-2013) and in the prior expansion from 2003 through 2008.] The bailout of the industry in the wake of the financial crisis and the plunge in firms' interest expenses due to near-zero federal funds rates helped securities firms earn a record-breaking $61.4

billion in profits in 2009. But total industry revenues collapsed during the recession and have changed little since, constraining firms' ability to maintain compensation levels while achieving profits. Since 2009, the continution of very low interest rates and reductions in compensation have enabled firms to earn healthy profits—averaging $18.9 billion a year through 2013.

Though the city's employment growth in the recovery has generally outpaced the rate of job creation in the nation as a whole, the city's annual average unemployment rate only declined from 9.6 percent in 2010 to 8.7 percent in 2013; over the same period the national unemployment rate fell from 9.6 percent to 7.4 percent. The U.S. unemployment rate would have been higher, however, had there not been a decline in recent years in labor force participation of working-age Americans—a decline which by itself causes the unemployment rate to fall since those not looking for work are not counted among the unemployed. In contrast, although New York City's labor force participation rate has been lower than the nation's, it has not been trending down as the nation's has.

IBO's economic forecast does not include any large shocks during the forecast period that would have a significant impact on the national or local economy, but a confluence of factors lead us to expect New York City job growth to taper off over the next five years. Total payroll job growth is projected to slow from about 75,700 in 2014 to 50,200 in 2018, averaging 56,400 (1.5 per percent) per year—moderate by recent standards, but still on par with "typical" expansions going back to 1950. Private-sector payrolls will grow by an average of 60,000 (1.7 percent) per year. IBO expects the deceleration in city job growth to become more pronounced after 2016, largely in line with the slower growth we project for the U.S. economy overall. Before that, however, the city economy will be boosted by rising labor force participation and the city's unemployment rate is projected to fall throughout the plan period, hitting 5.4 percent in 2018, just equal to the projected rate for the nation as a whole.

The mix of industries IBO expects to add jobs over the next five years looks a lot like the mix adding jobs over the past four years. Again, most job growth will come from education and health care services (26.6 percent of total employment growth from 2013 through 2018), professional and business services (23.8 percent), leisure and hospitality (14.7 percent), and wholesale and retail trade (12.9 percent). The latter two sectors will continue to be substantially boosted by tourism. The securities sector is expected to pick up slightly, but will account for only 2.1 percent of projected city job growth and 15.2 percent of projected aggregate real wage growth—still a very far cry from expansions prior to the Great Recession.

With Wall Street adjusting to a new and still unfolding regulatory regime, IBO anticipates a moderate rise in New York Stock Exchange broker-dealer revenues, which in 2017 are expected to surpass $200 billion—still well below their $352 billion peak a decade earlier. But profits will remain fairly flat, averaging about $15 billion over the next five years, with the increases in revenue largely offset by the rising cost of interest.

IBO's forecast for the real estate market has changed little since March. The total value of taxable commercial real estate sales recorded in 2013 was $53.8 billion, an increase of 43.4 percent over 2012. Commercial sales recorded in early 2013 were unusually high, reflecting the rush of transactions initiated in late 2012 to avoid the 2013 increase in the capital gains tax. Residential sales were $40.7 billion in 2013, an increase of 23.5 percent above the prior year. Sales of coop and condo apartments have largely regained their pre-recession levels, particularly in Manhattan. However, the total value of one-, two-, and three-family home sales outside Manhattan is still substantially below their 2005-2006 peak prior to the housing downturn.

During the first four months of 2014, the value of commercial sales is down 8.3 percent compared with January-April 2013 and residential sales value is up 17.5 percent. For 2014 as a whole, however, IBO expects the total taxable value of commercial property sold to decline 17.9 percent, and the value of residential property sold to increase just 3.0 percent compared with 2013. IBO projects that the total value of residential and commercial properties will together increase at an average rate of around 7.0 percent annually in 2015 through 2018.

IBO projects a slight (-0.9 percent) decline in average Manhattan office rents in 2014, followed by modest growth (2.1 percent per year) through the rest of the plan period. This outlook reflects weakness in the office-using employment sector, particularly financial services, as well as the relatively large amount of Manhattan office space expected to come on line at the World Trade Center and Hudson Yards beginning in 2015.

There are considerable differences between the IBO and OMB forecasts with respect to the pace and timing of employment and income growth. In general, OMB forecasts slower New York City employment and income growth than does IBO and—consistent with the differences in the two macroeconomic forecasts—expects peak growth to occur later in the forecast period. IBO forecasts employment gains averaging 60,200 annually from 2014 through 2018 compared with 54,400 for OMB. While IBO expects increases in employment to taper off throughout the forecast period, OMB's forecasts of employment gains are as large in 2016 as they are for this year. Similarly, OMB's forecast of personal income growth from 2014 through 2018 is lower than IBO's, but peak income growth occurs in the last two years of the OMB forecast compared with peak growth in this year and next in the IBO forecast.

***Risks to the Economic Forecast.*** IBO's outlook for the U.S. economy is premised on there being no significant external shocks to the economy, and on monetary and fiscal policies remaining conducive to growth. The risks to the nation's economy from unforeseen events or policies also extend to the city's economy, which has significant exposure to the national and global economy in its role as a world financial center and major tourist destination.

The execution of monetary policy poses a major risk: unwinding quantitative easing as the economy strengthens without generating sharp increases in long-term interest rates will pose a challenge for the Fed. The risk of fiscal policy brinksmanship returns in 2015, as another showdown over the federal budget or debt ceiling could again undermine consumer and business confidence—essential ingredients to sustained economic growth—and potentially trigger another downgrade of U.S. debt.

A major shock to the U.S. economy, whether from a large rise in oil prices or economic disruptions elsewhere in the global economy, could derail the economic growth IBO is projecting. While potential geopolitical flash points such as the Middle East or, more recently, Eastern Europe could bring collateral economic disruptions, the economic problems of China—the world's second largest economy—may pose the greatest international risk. China's policymakers are just starting to confront the challenge of weaning the financial system and the broader economy from reliance on an unsustainable expansion of credit, but it remains to be seen if this can be accomplished without major disturbances to international trade and finance.

Given New York City's role as a global financial center, shocks to the U.S. economy from financial crises in Europe, China, or elsewhere would have a disproportionate impact on New York City's economy. In addition to harming the city's financial services industries, the shock would also be transmitted to the city's tourism and retail sectors. Finally, the city's economy could be challenged if additional capital requirements, other regulations, or rising interest rates affect the revenue and profitability of firms in the securities and banking sectors more than IBO has anticipated.

### Tax Revenue Projections

After better–than-expected tax revenue growth in the current fiscal year (a gain of 5.4 percent), IBO projects that tax revenues for 2015 will grow at less than half that pace and total $48.4 billion for the year. (All years in the tax revenue and following sections of this report are city fiscal years unless otherwise noted.) With the strongest economic growth during the financial plan period expected in calendar years 2015 and 2016, tax revenue growth is forecast to accelerate in fiscal year 2016 and total $51.0 billion (a gain of 5.3 percent). For 2017 and 2018, revenues are expected to grow more moderately—an average pace of 4.6 percent—and reach $55.8 million.

The current forecast for 2014 is over $1 billion higher than IBO's forecast in March with roughly half of the gain due to a surge in personal income tax payments during the spring filing season. IBO's projections for 2015 through 2018, however, are now lower in each year than in our March forecasts—the differences range from $199 million to $364 million.

While the outlook for the financial plan is slightly less optimistic than it was three months ago, IBO's current forecast is significantly above the outlook when the 2014 budget was adopted last spring. For 2014, tax revenues are now expected to be $2.8 billion (6.4 percent) better than the Bloomberg Administration assumed in June 2013, accounting for much of this year's budget surplus. For each year from 2015 through 2017, our current forecast exceeds the adopted budget projections by between 3.1 percent and 4.9 percent.

IBO's tax forecast exceeds OMB's in each year from 2014 through 2018, although the difference is quite small for this year. With the 2014 fiscal year largely complete and little time left for further revenue surprises, IBO's and OMB's forecasts have converged, with ours $196 million (0.4 percent) higher. The difference grows for 2015 to $779 million (1.6 percent) and continues to widen, reaching $2.3 billion (4.3 percent) by 2018. Much of the difference is found in the outlook for the business income taxes, although IBO's forecasts are generally higher than OMB's across each of the major tax sources.

**IBO Revenue Projections**
*Dollars in millions*

| | 2014 | 2015 | 2016 | 2017 | 2018 | Average Change |
|---|---|---|---|---|---|---|
| **Tax Revenue** | | | | | | |
| Property | $19,975 | $20,816 | $21,784 | $22,876 | $24,060 | 4.8% |
| Personal Income | 9,342 | 9,433 | 9,948 | 10,292 | 10,798 | 3.7% |
| General Sales | 6,436 | 6,729 | 7,114 | 7,455 | 7,771 | 4.8% |
| General Corporation | 2,923 | 2,928 | 3,095 | 3,231 | 3,355 | 3.5% |
| Unincorporated Business | 1,923 | 2,020 | 2,154 | 2,295 | 2,446 | 6.2% |
| Banking Corporation | 1,198 | 1,226 | 1,349 | 1,433 | 1,531 | 6.3% |
| Real Property Transfer | 1,467 | 1,375 | 1,508 | 1,578 | 1,635 | 2.7% |
| Mortgage Recording | 938 | 910 | 993 | 1,038 | 1,062 | 3.2% |
| Utility | 413 | 437 | 459 | 473 | 486 | 4.1% |
| Hotel Occupancy | 530 | 560 | 589 | 614 | 645 | 5.0% |
| Commercial Rent | 706 | 728 | 746 | 782 | 795 | 3.0% |
| Cigarette | 58 | 56 | 54 | 51 | 49 | -4.0% |
| Other Taxes, Audits, and PEGs | 1,394 | 1,211 | 1,211 | 1,211 | 1,211 | -3.5% |
| **Total Taxes** | **$47,304** | **$48,428** | **$51,004** | **$53,330** | **$55,843** | **4.2%** |
| **Other Revenue** | | | | | | |
| STaR Reimbursement | $838 | $889 | $880 | $885 | $891 | 1.6% |
| Miscellaneous Revenue | 5,571 | 5,268 | 5,174 | 5,162 | 4,794 | -3.7% |
| Unrestricted Intergovernmental Aid | – | – | – | – | – | n/a |
| Disallowances | (15) | (15) | (15) | (15) | (15) | n/a |
| **Total Other Revenue** | **$6,394** | **$6,142** | **$6,039** | **$6,032** | **$5,670** | **-3.0%** |
| **TOTAL CITY-FUNDED REVENUE** | **$53,697** | **$54,571** | **$57,044** | **$59,362** | **$61,513** | **3.5%** |
| State Categorical Grants | $11,735 | $12,453 | $12,906 | $13,407 | $13,953 | 4.4% |
| Federal Categorical Grants | 8,250 | 6,779 | 6,690 | 6,668 | 6,657 | -5.2% |
| Other Categorical Aid | 888 | 788 | 863 | 859 | 855 | -0.9% |
| Interfund Revenue | 538 | 527 | 513 | 513 | 513 | -1.2% |
| **TOTAL REVENUE** | **$75,108** | **$75,118** | **$78,016** | **$80,809** | **$83,490** | **2.7%** |

NOTE: Figures may not add due to rounding.

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***Personal Income Tax.*** IBO's forecast for personal income tax (PIT) revenue is up $559 million from our March projection, with the change due to unexpected strength in current year collections. The forecasts for 2015 through 2018 were reduced for each year by quite modest amounts ($25 million in 2015, $41 million for 2016, and an average of $109 million for 2017 and 2018).

For 2014, IBO now expects PIT revenues will total $9.3 billion, which is $174 million (2.6 percent) higher than in 2013. With continued gains in local employment, which was expected, and a better than anticipated Wall Street bonus season from December through March, collections from withholding this year are now projected to be 6.8 percent above last year. As a result, we have raised our withholding forecast by $130 million since March. Withholding growth during the months of December through March, which were the strongest months for withholding throughout the fiscal year, occurred despite a decline in the profits of New York Stock Exchange member firms. Some of the additional withholding revenue may have resulted from the exercise of stock options that had been granted in earlier years under deferred compensation arrangements.

Estimated payments, which include installment payments taxpayers with significant nonwage income are required to make on a quarterly basis and payments when filing for extensions, are the other large contributor to the upward revision in the 2014 PIT forecast. IBO had anticipated a sharp drop in estimated payments made with final and extension filings this spring. The decline was expected because of the ability of some taxpayers to shift the timing of certain types of income, such as capital gains realizations and bonus payments, in order to take advantage of lower federal income tax rates that expired at the end of calendar year 2012. These shifts in timing increased payments made with final returns or extensions last spring. It also meant that some income that would have otherwise been realized in calendar year 2013 and resulted in payments with final and extension filings this spring had instead already been realized in the prior year.

Taxpayers may not have fully adjusted their estimated payments to account for tax policy-induced shifting of income, preferring to overpay in order to avoid penalties and claim refunds later. Throughout 2014, quarterly installment payments for calendar year 2013 liability have been surprisingly strong, and for the current fiscal year IBO now projects a 9.9 percent increase in installments, compared with a 2.1 percent increase in the March forecast. Most extension payments are made in April, and collections this year indicate that there will be almost a 40 percent decline in extensions from 2013—far less of a decline that what had been expected in March. Taken together, IBO now expects total estimated payments to decline by 11.1 percent for the year as a whole, as compared with our March forecast of a 21.0 percent decline. This unanticipated revenue accounts for $285 million of the $559 million increase in IBO's PIT forecast for 2014.

For 2015, IBO expects PIT revenues to total $9.4 billion, 1.0 percent higher than in 2014. The growth in collections from withholding is projected to slow to 1.3 percent for the year in the face of slower employment growth and lower Wall Street profits and compensation, which will reduce bonus payouts. Estimated payments are expected to rise by a healthy 8.2 percent.

With local personal income growth projected to peak in calendar year 2015, IBO forecasts 5.5 percent PIT growth in 2016, with revenues reaching $9.9 billion. After 2016, PIT collections will grow more slowly—for 2017 much of the slowdown is in withholding and then in 2018 it shifts to estimated payments. On an annual basis, growth will average 4.2 percent in 2017 and 2018, with PIT revenue expected to reach $10.8 billion in 2018.

IBO's PIT forecast exceeds OMB's in each year, although the differences are relatively small. Like IBO's current forecast, OMB's Executive Budget forecast included a major increase in the outlook for PIT revenues in 2014, leaving only a $27 million difference between IBO and OMB for the year. The difference grows to $242 million (2.6 percent) in 2015, $331 million for 2016, and then widens further in the remaining years of the financial plan. By 2018, IBO's forecast exceeds OMB's by $578 million (5.7 percent). IBO's expectation of higher PIT revenue is attributable to our projection of faster employment and income growth for most of the forecast period.

***Business Income Taxes.*** Consistent with the changes to IBO's overall tax revenue forecast, we have increased our estimates of 2014 collections from the city's three business income taxes by a total of $158 million since our estimates in March. Although IBO's forecast for total business income tax revenues has increased for the current year, we have reduced our estimates in each of the subsequent years of the financial plan. The forecast for 2014 is now $6.0 billion, an increase of 3.2 percent from 2013. Combined business tax revenues are expected to grow, albeit at a slower rate of 2.2 percent, to $6.2 billion in 2015. With increases in local employment and output projected to be strongest in calendar years 2015 and 2016, business tax revenues are expected to increase by 6.9 percent, to $6.6 billion in 2016. By 2018, revenues will reach $7.3 billion.

The general corporation tax (GCT) is the largest of the business income taxes and is expected to show the strongest growth for 2014, increasing by 8.6 percent to $2.9 billion—$109 million higher than our March forecast. The upward revision was prompted by greater than anticipated collections, which through March were up by 10.1 percent over the same period last year. The latest available data on GCT payments over $1 million show that the strength in current year collections is concentrated in the finance and insurance industries.

GCT collections are expected to be essentially flat in 2015 but then pick up as stronger economic growth in calendar years 2015 and 2016 contributes to greater profitability, spurring revenue growth of 5.7 percent in fiscal year 2016. GCT revenues will reach $3.1 billion for the year, a level that finally approaches the 2007 peak in GCT revenue. IBO expects economic growth to moderate at both the national and local levels beginning in calendar year 2017, which leads us to forecast slower GCT revenue growth—averaging 4.1 percent annually—for fiscal years 2017 and 2018.

IBO's forecast for unincorporated business tax (UBT) revenues in 2014 is now $1.9 billion, 6.3 percent above the 2013 level. Robust growth in the professional and business services sector, which is expected to add another 60,200 jobs in the next four calendar years, and steady gains in receipts among firms in these industries will help drive UBT revenue growth at an annual average rate of 6.2 percent in 2015 through 2018. By the final year of the forecast period, UBT revenue is projected to reach $2.4 billion.

The banking corporation tax (BCT) is the weakest of the three business income taxes, with revenues expected to fall by 11.7 percent in 2014 and then increase by only 2.4 percent to $1.2 billion in 2015. Data on BCT payments over $1 million through March indicate that much of the decline in 2014 results from a decrease in payments by commercial banks. IBO expects BCT revenue growth to pick up beginning in 2016 and to average 7.7 percent annually from 2016 through 2018. BCT revenue is expected to total $1.5 billion in 2018.

IBO's revenue forecast for the combined business income taxes is $137 million (2.3 percent) above OMB's forecast in 2014 and $215 million (3.6 percent) above OMB's in 2015. For 2014, most of the difference comes from IBO's higher GCT and UBT forecasts; in contrast, IBO's 2014 BCT forecast is slightly below OMB's. The difference between IBO's and OMB's forecasts in 2015 is more evenly distributed among the three business taxes. After 2015, the difference between the two forecasts grows each year, reflecting IBO's expectation of higher local employment and output.

New York State recently enacted legislation altering its business income tax structure, most notably combining the general corporation and banking corporation taxes and moving away from physical presence as the standard for determining whether an entity is taxable by the state. These changes have not yet been adopted by the city and the de Blasio Administration has so far given no indication that it plans to do so. For now, IBO has assumed that the city will not conform its business tax structure with the state's.

***Real Property Tax.*** IBO expects real property tax revenue to total $20.0 billion in 2014, an increase of $189 million from our March forecast; OMB's forecast for the current year is essentially the same as IBO's. The change from our prior forecast is attributable to delinquencies, refunds, prior-year collections, and smaller technical adjustments. At this point in the fiscal year, there are no changes to the assessments or levy for the current year.

For 2015, we expect total revenue of $20.8 billion, which is $72 million less than we forecast in March. As in 2014, the changes in our revenue forecast relate to items in the property tax reserve, primarily a higher forecast for refunds.

IBO's property tax revenue forecast is $21.8 billion for 2016, $22.9 billion for 2017, and $24.1 billion for 2018; annual growth over the three years will average 5.1 percent. Each of these forecasts is slightly lower than in March, with most of the change once again due to our expectation of higher refunds and reductions in other components of the property tax reserve.

Our real property tax forecast reflects the recent change to the Senior Citizen Rent Increase Exemption (SCRIE), which raised the income eligibility threshold for the exemption to $50,000, at least for the next two years.[2] Qualifying seniors living in rent-regulated apartments are protected from rent increases and their landlords are compensated for the lost rental income through a property tax abatement. Although the income threshold was raised from $29,000 to $50,000, the state will reimburse the city for the increased cost of the SCRIE program in 2015 and 2016.

IBO reduced its forecast for 2014 and each year through 2018 for the school tax relief (STAR) exemption to reflect lower-than-expected payments from the state in 2014. STAR reduces individual homeowners' property tax through an exemption and localities across the state are made whole by compensating STAR revenue payments from the state to individual school districts and cities such as New York that finance schools as part of the general government.

IBO's property tax forecast exceeds OMB's by relatively small amounts in each year of the financial plan. The difference in 2015 is $137 million, with $41 million due to our slightly higher levy forecast. The difference widens in 2017 and 2018, when our forecast of the levy is higher than OMB's in each year due to our expectation of higher market values and assessments. The difference between the two property tax forecasts reaches $582 million (2.5 percent) in 2018, with $435 million attributable to IBO's higher levy forecast.

***Real Property Transfer Tax and Mortgage Recording Tax.*** Revenues from the real property transfer tax (RPTT) and the mortgage recording tax (MRT), often referred to collectively as the transfer taxes, have rebounded sharply since the financial crisis. IBO projects that receipts from these two taxes will reach $2.4 billion in 2014, an increase of 31.6 percent over 2013 and almost 2.5 times the level of just four years ago, when revenues hit bottom.

Transfer tax collections are projected to dip by 5.0 percent in 2015, as commercial sales return to trend levels and higher interest rates put a brake on all transactions. IBO expects growth to resume in 2016, and by 2018 the combined transfer tax revenue is projected to reach $2.7 billion, 18.1 percent below the 2007 peak of $3.3 billion.

The recovery in the real estate market has been especially notable in commercial sales, which are taxed at a higher rate than residential properties. Commercial sales were the main driver of the decline in sales and transfer tax revenues in 2008 through 2010. IBO projects that taxable commercial sales will reach $54.9 billion in 2014, a 32.4 percent increase over the total for 2013. Taxable residential sales for 2014 are forecast to reach $42.7 billion, a 23.5 percent increase over 2013. Large commercial sales, defined here as taxable commercial transactions valued at over $100 million, play an important role in the real estate market. There were 65 such sales in the first three quarters of 2014, compared with 52 during the same period in 2013.

IBO projects that total RPTT revenue for 2014 will reach $1.5 billion, an increase of 35.1 percent over 2013. With interest rates expected to rise, we forecast that RPTT collections will fall 6.3 percent in 2015, to $1.4 billion. RPTT growth is expect to resume in 2016 and by 2018 revenue is forecast to reach $1.6 billion, just 5.1 percent below its 2007 peak.

The forecast for MRT revenue in 2014 is $938 million, an increase of 26.4 percent over 2013. MRT collections are then projected to decline by 3.0 percent in 2015, to $910 million, in part due to our assumption that interest rates will rise. IBO expects moderate MRT growth to resume in 2016, with revenues reaching almost $1.1 billion by 2018. While this is almost three times the level of collections in 2010, it is still one-third below the 2007 peak of $1.6 billion.

IBO's transfer tax forecasts have changed little since March and the overall trends are essentially the same. Our forecast of RPTT revenues is slightly higher in each year. MRT revenues are higher in 2014 and 2015, and slightly lower in 2016 through 2018, than we expected in March.

IBO's RPTT forecast exceeds OMB's in each year by relatively small amounts. The differences are generally even smaller between the two MRT forecasts. For the combined transfer taxes, OMB's forecast follows the same trend as IBO's: a strong gain in 2014, a slight dip in 2015, and moderate growth through 2018.

***Sales Tax.*** IBO projects sales tax revenues of $6.4 billion in 2014 (a gain of 5.0 percent over last year) and $6.7 billion for 2015 (up 4.6 percent year-over-year). Revenue growth is expected to pick up somewhat in 2016, to 5.7 percent, generating $7.1 billion, before moderating in 2017 and 2018, with $7.8 billion in revenue expected in the latter year. Collections through the first nine months of the fiscal year are 5.9 percent higher than in same period last year, although they are expected to slow somewhat for the balance of the year. IBO's current sales tax forecast is only slightly changed from our March estimate, with very small reductions of $11.7 million and $35.1 million for 2014 and 2015, respectively. Conversely, our current forecast for the remainder of the financial plan period is somewhat higher than we projected in March, by $64 million in 2016 and $155 million in 2018.

IBO's sales tax outlook is premised on sustained consumer demand from residents and spending by visitors and tourists. Continuing employment and earnings gains are expected to enable consumers to satisfy pent-up demand for consumer durables and appliances, particularly from 2014 through 2016. In the last two years of the forecast period, with some of the backlog of spending exhausted, growth in consumer spending is expected to slow.

An estimated 54.3 million tourists visited the city in calendar year 2013, 3.0 percent more than in 2012. Over 11 million were international visitors (up 4.6 percent from the prior year), who are among the highest spending tourists. The strength in tourism has contributed to robust employment growth in retail, food service, and accommodations, which have added almost 87,000 jobs from 2010 through 2013 as tourists eat at local restaurants, purchase goods from local retailers, and stay at local hotels. (Hotel bills are subject to sales tax, in addition to the separate tax on hotel occupancy.)

IBO's sales tax forecast is very similar to OMB's, particularly for 2014 and 2015. The difference widens a bit beginning in 2016 with IBO's projection exceeding OMB's by between 2.4 percent and 2.8 percent each year.

***Hotel Occupancy Tax.*** IBO's forecast for hotel tax revenue in 2014 is $530 million (up 5.0 percent) and $560 million for 2015 (an increase of 5.7 percent). Hotel tax revenue growth is expected to moderate somewhat beginning in 2016 when revenues are forecast to be $589 million. For 2017 and 2018, growth will average 4.6 percent, with revenues reaching $645 million in the latter year.

IBO's current projection for 2014 is $11 million below our previous forecast because of lower-than-anticipated collections through March. Collections this winter were particularly slow because cold weather and snow hampered visitors' travel plans. According to the most recent tourism estimates by NYC & Company, both occupancy rates and airport arrivals were down this February as compared with

February 2013, although a 5.9 percent increase in room inventory also contributed to the lower occupancy rates. IBO expects the number of visitors to pick up significantly in the remainder of the year.

IBO's hotel tax forecast is approximately the same as OMB's in the current year. In 2015, IBO's forecast is $25 million (4.7 percent) higher. The difference grows each year thereafter and reaches $50 million in 2018.

### Expenditures

While there are a number of new spending initiatives included in the Mayor's Executive Budget for 2015, the plan does not contain a set of spending reductions, or Program to Eliminate the Gap (often called PEGs), that had been a key portion of recent Bloomberg Administration budgets. By far the largest component of the new spending is the money allocated for new labor contracts. Based on the tentative agreement with the United Federation of Teachers, the revised budget includes about $13.7 billion for fiscal years 2014 through 2018 to cover the costs of the agreement with the teachers union as well as applying the relevant portions of that settlement to all the other municipal unions. Other new city-funded spending such as $70 million for the city's housing authority (only for 2015), more than $40 million annually to implement Vision Zero traffic safety initiatives, and $8.5 million annually for expanding the number of job slots in the Summer Youth Employment Program, are modest in comparison.

IBO estimates that under the Mayor's plan, spending from all revenue sources in 2015 will total $74.3 billion. When we adjust our 2015 estimate to account for the use of the 2014 surplus to prepay some of next year's expenses, total spending to meet 2015 needs is $76.2 billion. Looking just at spending using city-generated funds and again adjusting for the use of the projected 2014 surplus, 2015 expenditures will total $55.6 billion, about $830 million more than this year.

The Mayor's budget plan maintains some built-in cushion against unexpected expenditures. The balance in the Retiree Health Benefits Trust fund remains $1.0 billion and is untapped during the 2014-2018 period. Each year's budget for 2015 through 2018 includes a general reserve of $600 million, $500 million more than required and about $300 million more than the reserve the Bloomberg Administration typically included in its budgets.

***Contractual Matters.*** Although the Mayor has only reached a tentative labor settlement with the city's teachers, the Executive Budget and financial plan assumes that the teachers will vote to approve the contract and all other municipal unions will agree to the same fundamental terms. The de Blasio Administration's revised financial plan, released as this report was being completed, projects that the total cost of the proposed settlement with all unions is $13.7 billion through 2018, $115 million more than previously budgeted.

The financial plan adds $5.6 billion in new resources to cover the cost of the proposed labor settlement, while also drawing on $8.1 billion from reserves health offsets and projected savings to cover the full $13.7 billion cost of settling all of the expired contracts through 2018. The plan would use $3.7 billion that was already set aside in the budget for a potential labor pact, along with offsets of $3.4 billion in targeted health care savings and $1.0 billion from the health stabilization fund jointly controlled by the city and the municipal unions. The health care savings are part of the deal and have already been approved by the Municipal Labor Committee, which is comprised of all the city's unions.

Following the release of the financial plan, Comptroller Stringer sought a technical adjustment to one aspect of the accounting for the proposed contract. The change revolves around when the cost of lump sum payments for teachers expected to retire during the 2014-2018 period should be recognized as a liability. The revised plan shifts about $725 million into 2014 to cover these payments, which had previously been spread throughout the 2014-2018 period.

***Other Spending Factors.*** While the proposed labor settlement has dominated much of the public discussion of the Executive Budget since the Mayor presented the plan two weeks ago, there are a number of other points worth noting. The size of these other initiatives is small in dollars and cents compared with the costs of the potential labor agreement, but the initiatives clearly put the stamp of the de Blasio Administration on the plan in a way the Mayor's Preliminary Budget in February did not.

Two programs closely identified with the new Mayor, the expansion of pre-K and after-school programs, are being funded with state dollars, $300 million for pre-K and $145 million for after school. Vision Zero, the program to reduce traffic, bike, and pedestrian fatalities is funded with more than $45 million in city dollars in 2015 and somewhat lesser amounts in the ensuing years (an expense partly offset by ticket revenue expected from speeding drivers caught by new cameras). The largest shares of the funds would be spent by the transportation department ($29

**IBO Expenditure Projections**
*Dollars in millions*

| | 2014 | 2015 | 2016 | 2017 | 2018 | Average Change |
|---|---|---|---|---|---|---|
| **Health & Social Services** | | | | | | |
| Social Services | | | | | | |
| Medicaid | $6,547 | $6,628 | $6,597 | $6,597 | $6,597 | 0.2% |
| All Other Social Services | 2,987 | 3,066 | 3,018 | 3,011 | 3,009 | 0.2% |
| HHC | 81 | 81 | 81 | 81 | 81 | 0.2% |
| Health | 1,421 | 1,400 | 1,387 | 1,387 | 1,387 | -0.6% |
| Children Services | 2,793 | 2,799 | 2,824 | 2,824 | 2,824 | 0.3% |
| Homeless | 1,045 | 995 | 960 | 960 | 960 | -2.1% |
| Other Related Services | 651 | 587 | 540 | 540 | 540 | -4.6% |
| **Subtotal** | **$15,525** | **$15,557** | **$15,408** | **$15,401** | **$15,399** | **-0.2%** |
| **Education** | | | | | | |
| DOE | $19,713 | $20,631 | $21,309 | $22,007 | $22,695 | 3.6% |
| CUNY | 843 | 875 | 870 | 873 | 821 | -0.7% |
| **Subtotal** | **$20,556** | **$21,507** | **$22,179** | **$22,880** | **$23,516** | **3.4%** |
| **Uniformed Services** | | | | | | |
| Police | $4,761 | $4,692 | $4,674 | $4,667 | $4,667 | -0.5% |
| Fire | 1,976 | 1,876 | 1,852 | 1,833 | 1,796 | -2.4% |
| Correction | 1,098 | 1,083 | 1,082 | 1,081 | 1,081 | -0.4% |
| Sanitation | 1,460 | 1,482 | 1,536 | 1,515 | 1,515 | 0.9% |
| **Subtotal** | **$9,294** | **$9,133** | **$9,144** | **$9,097** | **$9,059** | **-0.6%** |
| **All Other Agencies** | **$9,474** | **$8,323** | **$8,360** | **$8,465** | **$8,639** | **-2.4%*** |
| **Other Expenditures** | | | | | | |
| Fringe Benefits | $5,007 | $5,229 | $5,662 | $6,129 | $6,663 | 7.4%** |
| Debt Service | 4,698 | 4,898 | 7,242 | 7,582 | 7,840 | 8.2%* |
| Pensions | 8,145 | 8,227 | 8,316 | 8,417 | 8,594 | 1.3% |
| Judgments and Claims | 663 | 674 | 710 | 746 | 782 | 4.2% |
| General Reserve | 50 | 600 | 600 | 600 | 600 | n/a |
| Labor Reserve | 2,095 | 139 | 1,950 | 1,873 | 3,282 | n/a |
| Expenditure Adjustments | (400) | – | 80 | 176 | 312 | n/a |
| **TOTAL EXPENDITURES** | **$75,108** | **$74,286** | **$79,650** | **$81,367** | **$84,685** | **3.0%** |

NOTES: *Represents the annual average change after adjusting for prepayments.
**Fringe benefits exclude DOE and CUNY expenditures, which are reported within DOE and CUNY budget amounts.
Expenditure adjustments include prior-year payable, energy, lease and non-labor inflation adjustments. Figures may not add due to rounding.

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million in 2015, $23 million in subsequent years) and the police department ($13 million each year). Other agencies such as the fire and sanitation departments and the Taxi and Limousine Commission each have about $1 million annually for driver training.

The budget also creates two new rental assistance subsidy programs for families in the city's shelter system. One program will be geared for families who have been in the shelters for at least a year and have one member working full time. A family could receive a rent subsidy for up to five years. The city is budgeting a total of $80 million over four years for the program, and seeking half of the funds from the state. About 800 families are expected to be subsidized each year. The other new rental subsidy program aims to assist families who have been in the shelter system more than once and are eligible for federal public assistance. Details are still emerging for this program, but the de Blasio Administration expects to generate $60 million a year to support it by capping the average monthly rent of $3,000 the city currently pays to the owners of hotels and groups of apartments used to shelter some families.

In addition to the rental assistance programs to help move people out of the shelter system, the budget adds just over $12 million in funds annually for homeless prevention efforts. Of this amount, $2.2 million is city dollars and the remainder federal grant dollars. Most of the new funding ($11 million) will go to expanding the Homebase Program, started under the Bloomberg Administration, in which community-based organizations work to prevent individuals and families from becoming homeless by linking them to job training, child care, and other services. The rest of the funding will be used to expand the city's anti-eviction legal services.

With the federal Environmental Protection Administration giving initial indications that it may hold the city liable for a large share of the remediation costs at the Gowanus Canal and Newtown Creek Superfund sites, the de Blasio Administration plans to undertake additional research to help support the city's contention that its liability is more limited. For this purpose, the Mayor has added $8.3 million to the budget of the city's Department of Environmental Protection for 2015 as well as $7.1 million in 2016 and $5.4 million in 2017.

The Mayor also proposes the addition of $8.5 million annually in 2015 through 2018 to maintain the number of work slots in the city's summer jobs program for youth. The funding enables the city to provide 36,000 work slots, the same level as last summer despite an increase in the minimum wage.

Two other de Blasio initiatives come in the form of revenue forgone. The city will forgo a $70 million reimbursement in 2015 from the New York City Housing Authority for providing policing in public housing projects. This extends a measure first included in the Mayor's Preliminary Budget that forgave part of the reimbursement for this year. By forgoing the payment, the de Blasio Administration is intending to help the housing authority complete its backlog of repairs. The financial plan assumes the payments to the city resume in the years after 2015.

The budget plan also anticipates less revenue from fines next year, in part because the Mayor intends to ease enforcement of some small business regulations. The Executive Budget anticipates revenue from fines will total $844 million this year and $789 million in 2015, a decline of $56 million. This is somewhat smaller than the decline noted by the Mayor when he introduced the budget and compared fine projections for 2015 with collections in 2012, highlighting what would be a 44 percent drop in health department fines over this period. When projected revenue is instead compared on a year-to-year basis, the decline is a more modest 17 percent, from $36 million to $30 million. Conversely, the drop in projected consumer affairs fines is a bit higher when 2015 is compared with 2014—a 28 percent decline from $13.5 million this year to $9.7 million in 2015 as compared with a decrease of 21 percent under the Mayor's formulation.

***School Spending.*** Based on the Mayor's plan, IBO estimates Department of Education spending will total $20.6 billion in 2015, an increase of $893 million, or 4.5 percent, over the current budget for this year. This estimate does not reflect the additional salary expenses that will be added to the education department's budget if the tentative settlement with the teachers' union is approved. (Funds for the labor settlement now sit in a separate line and would be reallocated to agency budgets as needed.) The bulk of the increases shown in the financial plan derive from state funds, which have grown by $522 million, or 6.3 percent. City funding increases by $195 million, or about 2 percent.

The new state funding is being used in part to support two initiatives that are hallmarks of the de Blasio Administration: the expansion of pre-K ($300 million) and middle school after-school programs ($145 million). State funding for charter schools in New York City, which flows through the education department's budget, is increasing by $77 million. Some of the additional city-generated funding is being used to expand arts education ($23 million) and to pay the rental costs for three charter schools as required under new state legislation ($5.4 million). The new state charter school funding is a supplement to the city's current share of spending for charter schools, which IBO estimates is $1.1 billion this year.

***Repricings.*** Much like with past budget plans, IBO has differing estimates of some costs as projected by the de Blasio Administration. The differences in these estimates are modest considering the scope of the $74.3 billion budget for 2015.

The single largest difference for 2015 is $45 million in IBO's projection of additional spending by the education department. Of that amount, $28 million is city funds that will be needed to meet our estimate of higher enrollment at charter schools than assumed under the Mayor's budget. We also anticipate that federal Medicaid reimbursements for certain special education services will be $17 million less than projected by the de Blasio Administration, requiring the city to make up the difference. By 2018, IBO estimates that the education department will need to spend an additional $326 million—$279 million for enrollment growth at charter schools (based only on schools already open or already approved for opening) and the remainder to cover a continued shortfall in projected Medicaid reimbursements.

IBO also projects the need for an additional $40 million in spending for overtime for the police ($25 million) and correction ($15 million) departments based on historical patterns. Given the uncertainty surrounding implementation of the cap on the rent paid to owners of certain hotels and apartments used to shelter homeless families, we project lower savings and the need for an additional $10 million in 2015.

The city may see a modest amount of savings based on our projections as well. We estimate the public assistance caseload will be lower than projected by the de Blasio Administration and require $7.9 million less in spending in

**Pricing Differences Between IBO and the de Blasio Administration**
Items that Affect the Gap
*Dollars in millions*

| | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|
| **GAPS AS ESTIMATED BY MAYOR** | **$–** | **$–** | **($2,568)** | **($1,879)** | **($3,105)** |
| **Revenue** | | | | | |
| **Taxes** | | | | | |
| Property | $6 | $137 | $70 | $273 | $582 |
| Personal Income | 27 | 242 | 331 | 344 | 578 |
| General Sales | (24) | 63 | 168 | 195 | 215 |
| General Corporation | 79 | 70 | 145 | 195 | 219 |
| Unincorporated Business | 77 | 87 | 138 | 209 | 278 |
| Banking Corporation | (19) | 58 | 166 | 243 | 305 |
| Real Property Transfer | 34 | 23 | 32 | 47 | 59 |
| Mortgage Recording | (12) | 36 | 2 | 8 | – |
| Utility | 20 | 22 | 46 | 52 | 55 |
| Hotel Occupancy | (4) | 25 | 33 | 41 | 50 |
| Commercial Rent | 9 | 13 | 1 | 4 | (17) |
| Cigarette | 3 | 3 | 3 | 1 | – |
| **Subtotal** | **$196** | **$779** | **$1,135** | **$1,613** | **$2,323** |
| STaR Reimbursement | – | 2 | 3 | 4 | 10 |
| **TOTAL REVENUE** | **$196** | **$781** | **$1,139** | **$1,617** | **$2,333** |
| **Expenditures** | | | | | |
| Education | ($46) | ($45) | ($149) | ($241) | ($326) |
| Police | (25) | (25) | (25) | (25) | (25) |
| Board of Elections | – | – | (20) | (20) | (20) |
| Correction | – | (15) | (15) | (15) | (15) |
| Homeless Services | – | (10) | – | – | – |
| Public Assistance | 5 | 8 | 8 | 8 | 8 |
| Small Business Services | 1 | 8 | (4) | (4) | (4) |
| Campaign Finance Board | – | – | – | – | (40) |
| **TOTAL EXPENDITURES** | **($65)** | **($79)** | **($205)** | **($297)** | **($422)** |
| **TOTAL IBO PRICING DIFFERENCES** | **$131** | **$702** | **$934** | **$1,320** | **$1,911** |
| IBO Prepayment Adjustment 2014/2015 | (131) | 131 | – | – | – |
| **IBO SURPLUS/(GAP) PROJECTIONS** | **$–** | **$833** | **($1,634)** | **($558)** | **($1,195)** |

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

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2015. We also expect the Department of Small Business Services' brownfield remediation and "clean heat" programs will, as in the recent past, underspend their 2015 budgets, and result in city savings of $8.1 million (after also accounting for some expected increases in agency spending, primarily for the Industrial Business Zones).

***Capital Considerations.*** Much as the labor contract overshadows any new spending initiatives in the expense portion of the Executive Budget, the Mayor's plan to create and preserve 200,000 units of housing over 10 years dwarfs other new capital spending initiatives.

After accounting for a shift in housing capital commitments from 2014 to 2015, about $1.2 billion has been added to the plan beginning in 2015 and continuing through 2018 for the Mayor's Housing New York program. Roughly $820 million of this additional planned spending is for new construction, $246 million for special needs housing, and $154 million to help preserve existing affordable housing. Nearly all of the $2.5 billion in the Department of Housing Preservation and Development's capital commitment plan for 2015 through 2018 is for the Housing New York initiative. The Mayor projects a total of $6.7 billion in city capital commitments to Housing New York over the next 10 years.

A number of other infrastructure projects have also been added to the commitment plan. The plan includes a combined $373 million in new funding for infrastructure improvements to support the Coney Island West project, the second phase of Hunters Point South, and second and third phases of the Homeport development. Other sizable new capital expenditures on infrastructure include $337 million in funding for bridge repair and maintenance. Bridges in the city's parks are also getting additional attention with a new commitment of $55.3 million for the upcoming year.

Among other additions to the commitment plan are increased funding for road repair ($57 million), construction of the Croton Filtration Plant ($20 million), and reconstruction of the Catskill Aqueduct ($17 million). The plan also has new funding for emergency sewer reconstruction ($16 million) and emergency water main reconstruction ($12 million).

### Hurricane Sandy: Federal Aid, City Spending

The de Blasio Administration's financial plan anticipates receiving a total of $1.2 billion in federal aid in the city's operating budget in response to Hurricane Sandy in 2014 through 2017. The vast majority of this revenue, $1.1 billion, is budgeted for the current fiscal year. Comparatively modest sums of $30 million in 2015, $12 million in 2016, and $5.9 million in 2017 are included in the budgets for the upcoming years. These amounts are likely to grow substantially because nearly $2 billion out of the $3.2 billion in federal Community Development Block Grant-Disaster Relief funds allocated to the city have yet to be included in the financial plan.

Substantial federal Sandy relief funds are also expected to be used for capital projects such as repairing Sandy-damaged schools, parks, and roads. There is now a total of $2.4 billion in the capital commitment plan for 2014 through 2018 for Sandy-related projects that the city expects will be reimbursed by the federal government. The city now plans to commit nearly $1.5 billion of these funds this year—$577 million previously planned for this year has been shifted into other years, mostly 2015.

The commitment plan now includes a $143 million project to repair fire alarm box wiring damaged during Hurricane Sandy. Funding has been increased for some previously planned projects and reduced for others, and in a number of cases projects that had been planned for commitments this year have been shifted to next year. For example, the commitment plan has reduced funding for street reconstruction projects by nearly $72 million, to a total of $337 million. There is $246 million for specific street reconstruction projects such as Beach Channel Drive and Front Street as well as almost $91 million for other unspecified street reconstruction.

Among the other changes are allocations of $200 million in 2015 for repairs at Coney Island Hospital and $106 million at Bellevue Hospital (shifted primarily from an unspecified allocation of funds in the prior capital plan). All of the nearly $40 million in funding for repair of the Battery Park underpass has been shifted to 2015. Likewise, about $58 million in planned commitments for repair projects on Rikers Island have been rescheduled for 2015, in addition to the $21 million planned for this year. All the nearly $30 million in funding for reconstruction at the Brooklyn Navy Yard has also been moved to 2015. For more details on Sandy-related federal funding and spending, see IBO's April 2014 testimony to the City Council.

Overall, the May 2014 Capital Commitment Plan for 2014-2018 totals $48.9 billion. City funds comprise $37.1 billion of the total. Even with the additional commitments for housing construction and preservation, the largest shares of the commitment plan continue to be allocated to school construction and repair, water and sewer projects, and bridge and road repair. The de Blasio Administration has also started an initiative to better align the timing of projects in the capital commitment plan to when those projects will likely get underway. In the past many projects—and billions of dollars in planned commitments— routinely "rolled" from one year to the next.

***Paying for the Capital Plan.*** The de Blasio Administration has also realigned its plan for borrowing to finance the capital plan: reducing the volume and changing the mix of new debt it will issue in 2015, and sharply increasing borrowing expected for 2017, 2018 and subsequent years. Much of the cost of the new borrowing does not rise rapidly until 2019 and beyond—the years after the current financial plan.

The city has reduced the new debt it plans to issue in 2015 by a total of $450 million (7.9 percent) and will shift the composition of its bond offerings to rely less heavily on general obligation debt. While the city had planned to issue $1.4 billion in new general obligation debt in the first half of 2015, it will now sell none; however general obligation borrowing in the second half of the year will increase by $325 million, bringing total general obligation issuance for 2015 to $1.8 billion. Instead, the de Blasio Administration will sell $650 million more in Transitional Finance Authority bonds than previously planned, bringing total finance authority borrowing in 2015 to $3.5 billion. With interest rates on debt issued by the Transitional Finance Authority typically slightly below that on the city's general obligation debt, the changing composition of city borrowing will provide savings on debt service, the interest and principal paid by the city on its borrowing.

The overall reduction in planned borrowing next year is offset by increased general obligation and Transitional Finance Authority borrowing in the subsequent years: $120 million more in 2016 ($5.2 billion total), $680 million more in 2017 ($5.2 billion total), and $1.0 billion more in 2018 ($5.0 billion total). While some increased interest expenses show up in 2017 and 2018, the cost of this new borrowing does not rise rapidly until 2019 and beyond.

***New Steps to the Budget Dance?*** While the annual ritual of cuts and restorations that dominated budget negotiations between the Mayor and Council for years—the budget dance—may well have ended, the City Council will likely still want to leave its imprint on the budget that is passed. The Executive Budget provides funding for some of the priorities presented in the Council's response to the Preliminary Budget such as $6.0 million for antigun violence programs and $2.6 million to expand case-management services for seniors, although only in 2015. But many other City Council priorities have not been addressed.

City Council Speaker Melissa Mark-Viverito has recently expressed her intention to continue to press the de Blasio Administration on at least two proposals that were included in the Council's response to the Mayor's Preliminary Budget. One proposal is to hire an additional 1,000 police officers to bolster precinct staffing at a cost of $94 million in 2015, as estimated by the Council. The Speaker also intends to urge the Mayor to support the Council's proposal to provide free lunch to all students regardless of income. The Council estimates this would cost an additional $20 million to $24 million a year.

The Council has also suggested that the de Blasio Administration could better meet its goal of an honest or more transparent budget by revamping some units of appropriation—the basic level of detail in the budget. The City Charter says a unit of appropriation should reflect a clear program and goal. But many agencies' units of appropriations lump together many programs. A prime example: Units of appropriation 401 and 402 in the Department of Education contain more than $6 billion in general education spending. The Council's budget response presents suggested changes for about a dozen agencies.

***Taking Measure of the Plan.*** In the days after the Mayor released his Executive Budget some fiscal observers were highly critical of the plan, in particular noting the costs of the tentative contract settlement has caused projected budget gaps to balloon. Based on IBO's analysis of the Mayor's spending plan and our latest projections for tax revenues—projections that have been reduced a bit since our prior forecast—we anticipate that budget shortfalls through 2018 will be smaller than expected by the de Blasio Administration.

Both in dollar terms and as a share of city-generated revenue, IBO's projected budget gaps are relatively modest. The $1.6 billion gap we project for 2016 is 2.9 percent of city-generated revenues. The projected gap of $558 million in 2017, 1.0 percent of city-generated revenues, is even smaller and both gaps are unexceptional as compared with gaps projected in past financial plans. It is also worth noting that the budget plan contains a $600 million general reserve in each year and that the $1.0 billion in the Retiree Health Benefits Trust fund remains untouched.

Still, there are ample reasons for caution. Numerous questions remain about details of the proposed labor pact, details that could significantly alter estimates of just how much the settlement could cost in the coming years. Nor is it clear that all of the unions will accept the terms. The city's police and firefighter unions have publicly expressed their displeasure with the terms, in particular the zero wage increase in the first year. Both the police and firefighters can opt for arbitration.

There are also potential risks to IBO's economic forecast and our estimates of higher tax revenues than those presented by the de Blasio Administration. Perhaps the greatest risk is whether the local economy can continue to add jobs at the pace we project without being led by growth on Wall Street.

There are other potential risks as well. A sharp jump in interest rates as the Fed pulls back from its very accommodative monetary policy stance could slow economic growth and depress local tax revenue. Another showdown in Washington over the federal budget or debt ceiling next year could undermine growth we expect in the national economy and lead to a downgrade of U.S. debt. And given New York City's role as a global financial center, financial problems in China, Europe, or elsewhere would have a disproportionate effect on the local economy, weakening the city's financial services and tourism industries.

Risks can also emerge on the spending side of the budget plan. While the Mayor has provided a fiscal helping hand to the city's public housing authority, it is only for one year. Moreover, the Health and Hospitals Corporation remains mired in red ink. The hospitals corporation projects operating losses of $535 million this year that—absent measures to close these shortfalls—grow to $1.6 billion in 2018. Pressure may well mount for additional aid from the city.

Although IBO projects a surplus in 2015 and relatively manageable budget gaps in the future years of the revised Executive Budget and financial plan presented by the Mayor, there is no shortage of potential fiscal hurdles in the years ahead.

## Endnotes

[1]These growth rates reflect the March 2014 benchmark revisions of employment data.
[2]The state legislation only increased the annual income threshold for two years, after which it is slated to return to $29,000. As with many legislative changes containing sunset provisions, it is likely that the higher threshold will eventually be extended for additional years.