New York City Independent Budget Office
Fiscal Outlook

December 2013

For the New Mayor and City Council:

A Big Budget Surplus and Even Bigger Fiscal Challenges Ahead

Through much of the summer and early fall, it was asserted with some frequency that New York's next Mayor and City Council would inherit a substantial budget shortfall for the upcoming fiscal year along with other fiscal challenges. Then in November Mayor Bloomberg released his quarterly update to the city's financial plan and a different story emerged: The Mayor projected a sizable surplus for the current year as well as a balanced budget for next year, fiscal year 2015.

Based on IBO's most recent economic forecast and tax revenue and spending projections, the city's near-term fiscal outlook appears even stronger than expected by the Bloomberg Administration. Under the contours of the Mayor's budget plan, IBO anticipates the city will end the current fiscal year with a surplus of $2.4 billion, $581 million more than projected by the Bloomberg Administration. We also project a budget surplus of $1.9 billion in fiscal year 2015, which starts on July 1, 2014.

But there are a number of challenges ahead that could quickly erode the city's fiscal condition. Largest among these challenges may be the cost of an eventual settlement with the city's municipal labor unions, all of which are working with expired contracts. The Bloomberg Administration's financial plan assumes the unions will settle for no back pay for the years without contracts or raises. A costless settlement for these prior years remains a long shot as part of an accord with the unions.

Ensuring the fiscal integrity of the city's public housing and public hospitals in the wake of diminishing federal subsidies and continued fiscal ills is also likely to strain city resources. Although the recent budget deal in Washington will lessen some cuts to federally subsidized programs, there will be pressure to replace lost federal aid with local funds to avert service cutbacks. And with a new Mayor and City Council taking office, there may be considerable expectations from issue advocates and the broader public for new initiatives from City Hall that could add to local spending.

U.S. and Local Economic Outlook

Economic Overview. Federal fiscal policy in 2013—the tax increases that took effect in January and the cuts to federal government spending under the sequester that took effect in March—created a drag on U.S. economic growth. (Unless otherwise noted, in this economic outlook section years refer to calendar years rather than fiscal years.) In the absence of further contractionary policies in the coming year, the drag will abate in 2014. With the Federal Reserve's (Fed) maintenance of low interest rates, IBO's forecast an acceleration of economic growth—to 2.8 percent growth in real gross domestic product (GDP) in 2014 and 3.4 percent in 2015. Even with this growth, the U.S. unemployment rate is not expected to fall below 6.0 percent until late in 2015.

With the addition of a projected 75,100 jobs to the New York City economy in 2013, employment in the city reached a new all-time high. IBO forecasts somewhat less employment growth in the coming years—the addition of 67,300 jobs in 2014 and an average of 68,400 new jobs in each of the next three years. However, increases in wages and earnings in the city have not kept pace with job growth. The composition of the city's work force has shifted, and is expected to shift further, towards lower paying industries.

U.S. Economy. The U.S. economy has continued to grow in 2013, but the pace has been sluggish in spite of momentum in the housing market and other conditions conducive to growth. Economic growth has been constrained by contractionary fiscal policies that took effect earlier in the year, and by uncertainty caused by the brinksmanship in Washington over the federal budget and debt ceiling that resulted in October's federal government shutdown. IBO projects a 1.7 percent increase in the nation's real gross domestic product for 2013—far less than the 2.8 percent growth in 2012. The fiscal drag attributable to this year's tax increases and spending cuts will begin to abate in 2014 and IBO expects consumer spending to increase. Barring external shocks to the economy, further contractionary fiscal policies or more budget and debt ceiling brinksmanship in Washington, IBO forecasts faster real GDP growth in the next two years: 2.8 percent in 2014 and 3.4 percent in 2015.

The U.S. economy has been slow to recover from the Great Recession of 2008 and 2009. By November 2013—after 44 months of near continuous employment growth—the economy had regained only 85 percent of the 8.7 million jobs lost over 25 months of contraction. So far this year (through November), employment has grown by an average of 189,000 each month, compared with average monthly employment gains of 179,000 per month during the same period in 2012. Modest job growth in the private sector coupled with declines in government employment for much of the period have resulted in only a gradual decline in the unemployment rate in the last four years, from 9.9 percent at the recession's trough (fourth quarter of 2009) to 7.0 percent in November—still well above the average 4.6 percent unemployment rate in 2007. Had the labor force participation rate of the 16-and-over population not fallen during this period—as discouraged job seekers left the labor market entirely—there would have been even less of a decline in the unemployment rate.

The recovery's lackluster employment gains and GDP growth have continued even as conditions favorable to a more robust economic expansion have been in place for some time. The recession was the start of a prolonged period of deleveraging by businesses, banks, and households that strengthened balance sheets. After-tax profit margins of the corporate sector have reached new highs in the last few years as businesses have reduced their operating costs. Banks are also better capitalized than at any point in the last 25 years—the result of more stringent capital requirements in the wake of the financial crisis and the high profit margins that low interest rates have enabled.

Since the beginning of 2012, the household sector's debt as a percentage of its disposable (after-tax) income has remained lower than at any time since 1993. There is considerable pent-up demand for everything from appliances to cars to homes, much of it coming from the

Total Revenue and Expenditure Projections
Dollars in millions

	2014	2015	2016	2017	Average Change
Total Revenues	**$73,463**	**$74,574**	**$77,313**	**$80,455**	**3.1%**
Total Taxes	45,688	48,267	50,862	53,371	5.3%
Total Expenditures	**73,463**	**72,683**	**77,019**	**79,017**	**2.5%**
IBO Surplus/(Gap) Projections	**$-**	**$1,891**	**$294**	**$1,438**	
Adjusted for Prepayments and Transfers:					
Total Expenditures	$74,957	$75,133	$77,122	$79,017	1.8%
City-Funded Expenditures	$53,578	$54,903	$56,599	$57,976	2.7%

NOTES: IBO projects a surplus of $2.351 billion for 2014, $581 million above the Bloomberg Administration's forecast. The surplus is used to prepay some 2015 expenditures, leaving 2014 with a balanced budget. Estimates exclude intra-city revenues and expenditures. City-funded expenditures exclude state, federal and other categorical grants, and interfund agreement amounts. Figures may not add due to rounding.

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large number of young adults who during the recession deferred forming their own households. The improved financial position of households has stimulated consumer spending, particularly for autos and other durable goods. Very low interest rates have increased access to mortgage financing, stimulated home sales, and finally reversed the long slide in home prices. As a result, inventories of unsold homes have declined and housing starts have increased. 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 policy of low interest rates—keeping the federal funds rate on overnight loans between banks near zero and continuing to buy up financial assets to put downward pressure on long-term interest rates (quantitative easing)—has been an essential ingredient of 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.

In contrast to monetary policy, fiscal policy and Congressional brinksmanship have fanned economic headwinds, substantially reducing GDP growth in 2013. The elimination of the payroll tax cut and the increase in marginal tax rates for high-income taxpayers, each of which took effect on January 1, slowed growth early in the year. These actions were followed by the previously adopted across-the-broad spending cuts known as sequestration, which automatically took effect this March when Congress failed to agree on a new budget. Later in the year came the extended negotiations between the Congress and the White House over the federal budget and debt ceiling, which led to the partial shutdown of the U.S. government in the first half of October. In addition to interrupting government operations and pruning federal contracts with businesses, the shutdown and the brinksmanship that led up to it undermined consumer confidence. The Conference Board's Consumer Confidence Index (a widely used measure of consumer sentiment) plummeted in October and further declined in November to reach a seven-month low, negating most of its rise last spring. The political uncertainty created by the shutdown has also shaken business confidence and given firms more reason to postpone hiring and/or to expand capacity.

Despite unexpectedly strong growth in the third quarter, IBO projects just 1.7 percent real GDP growth in 2013—the lowest annual rate since the end of the recession. A spike in inventories—the highest in three years—accounted for nearly half of the 3.6 percent growth in third quarter GDP. IBO expects much weaker fourth quarter growth as inventories decline during the holiday shopping season and as a result of October's federal government shutdown. The modest pace of economic growth in 2013 has brought some improvement in the nation's unemployment rate, from an average of 8.1 percent in 2012 to a projected average of 7.4 percent in 2013. Personal income growth, however, has dipped to a projected 2.9 percent, down from 4.2 percent in 2012. With unemployment still high, relatively stable oil prices, and slow growth, the rate of inflation will decline from last year—1.4 percent, compared with 2.1 percent in 2012.

IBO's forecast beyond 2013 is premised on no external shocks to the economy, and no additional harm from fiscal or monetary policy. The Federal Reserve has indicated that it will continue its accommodative monetary policy until the unemployment rate falls below 6.5 percent or inflation appears to be taking hold. Based on our employment forecast, this suggests that the Fed will maintain a near-zero federal funds rate through most of 2014. When the Federal Reserve does decide to wind down its asset purchases, IBO assumes that it will be able to do so in a slow, transparent, and orderly fashion—successfully avoiding sudden spikes in interest rates. Although IBO's economic forecast was made before the recent approval of a new federal government budget, the new agreement is consistent with our assumptions about fiscal policy. We had assumed that lawmakers in Washington would avoid another showdown over the federal budget, coming to an agreement in time to avert the next round of sequestration. We had also assumed that any new budget agreement would not substantially change the current stance of fiscal policy, meaning that any loosening of cuts under sequestration would be offset by other changes that would leave the total dollar amount of deficit reduction essentially unchanged. Finally, the forecast also assumes that there will be no political brinksmanship when the nation's debt ceiling needs to be increased, sometime this spring.

With no new contractionary fiscal policies being adopted, IBO expects economic growth to pick up in 2014, as the impact of the 2013 tax increases and spending cuts gradually diminish early in the year. IBO forecasts 2.8 percent real GDP growth in 2014 and 3.4 percent growth in 2015—the latter growth would be faster than in any year since 2005. Personal income growth will accelerate from this year's modest gain of 2.9 percent to 6.0 percent next year and 7.0 percent in 2015. Faster growth will bring significant reduction in the unemployment rate, to an average of 6.7 percent in 2014 and 6.3 percent in

2015. It also will put upward pressure on prices. As the unemployment rate approaches the Fed's 6.5 percent target—likely towards the end of 2014—we expect the Fed to gradually increase the federal funds rate in order to contain inflation. IBO forecasts that the rate of inflation will remain in the vicinity of 2.5 percent in 2016 and 2017.

IBO expects growth of both personal income and output to moderate after 2015, with real GDP growth dipping to 2.9 percent in 2016 and 2017. Despite slower economic growth, we expect the unemployment rate to continue its gradual decline, falling below 6.0 percent late in 2015 for the first time since 2008.

Compared with IBO's macroeconomic forecast, the Mayor's Office of Management and Budget (OMB) projects slightly slower real GDP growth in both 2014 (2.6 percent versus 2.8 percent for IBO) and 2015 (3.2 percent versus 3.4 percent). In line with a forecast of slower growth, OMB forecasts higher unemployment than does IBO in 2014 and 2015—7.1 percent and 6.5 percent, respectively, compared with 6.7 percent and 6.3 percent. With slower growth, OMB also forecasts lower inflation than IBO in these years–1.5 percent in 2014 and 1.6 percent in 2015. After 2015, the OMB forecast of real GDP growth remains above 3.0 percent, while IBO's falls to 2.9 percent in each year.

Risks to the Economic Forecast. Monetary policy poses a major risk to IBO's economic outlook. Unwinding quantitative easing without generating sharp increases in long-term interest rates will be tricky, as was demonstrated last summer—interest rates rose when investors (mistakenly) believed that the Fed was about to reduce its asset purchases. While the rise in interest rates was temporary and the higher rates were still quite low by historical standards, it had a measurable negative impact on consumer spending and home sales—strength in both these sectors is necessary for more robust U.S. economic growth.

Another risk is the possibility of a new Congressional showdown over the federal debt ceiling—which looms again in the spring. This would again undermine consumer and business confidence, and potentially trigger another downgrade of U.S. debt. The ability of Congress to come to a timely agreement in recent budget negotiations is a hopeful sign that a showdown can be averted.

IBO's economic forecast is premised on there being no external shocks to the U.S. economy, whether from oil prices or economic disruptions elsewhere in the global economy. Though the current glut of oil on the market has made the disruption in the supply of oil less an immediate threat than it has been in recent years, any sudden increase in the price of oil could greatly harm economic growth.

A worsening of economic problems in the European Union countries—which together make up a substantial share of the global economy and a major U.S. trading partner—could have a major impact on global trade and financial markets including those in the U.S. Slow growth or recession still plagues most European Union countries, and the current institutional underpinnings of the euro may not be able to sustain the currency in the long run.

Finally, economic problems in China, the world's second largest economy, could also have a major impact on international trade and finance. The rapid growth of the Chinese economy in recent years risks becoming unsustainable, and has resulted in fiscal imbalances that have only recently been acknowledged. Economic reforms are on the agenda of Chinese policymakers, but it is not clear if they can be carried out without major disruptions. Given New York City's role as a global financial center, shocks from financial crises in Europe or China would have a major impact across all sectors of the city's economy.

New York City Economy

New York City's economic expansion is now four years old, and in that time the city has added 312,000 (corrected number) payroll jobs and established new all-time highs. in employment. The job gain is more than double the number of jobs lost during the 2008-2009 crisis and recession. The city's forward momentum was only briefly interrupted by Hurricane Sandy, and has not been checked (at least in terms of overall jobs growth) by prolonged duress in the city's financial sector.

IBO forecasts an only slightly diminished pace of growth over the next four years, with the city economy projected to add another 67,300 jobs (1.7 percent) in 2014 and an average of 68,400 jobs (1.7 percent) per year from 2015 through 2017.

Average Wages and Salaries Since 2010

	2010	2013	Percent Change
All Jobs	**$82,382**	**$82,752**	**0.4%**
Securities Sector	376,605	342,529	-9.0%
Other Finance and Management	134,474	135,821	1.0%
All Other Private	62,344	65,760	5.5%
Government	61,126	61,918	1.3%

NOTE: In real 2013 dollars.

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Private Sector Employment and Hours Worked in New York City			
	January-October Averages		
Year	**Employment,** *thousands*	**Weekly Hours**	**Aggregate Weekly Hours,** *thousands*
2008	3,224.3	35.6	114,625
2013	3,394.9	34.5	117,060
Percent Change	5.3%	-3.0%	2.1%

SOURCE: Bureau of Labor Statistics
NOTE: Hours worked not available for government.
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This forecast incorporates projections for very modest growth in employment and wages in the banking and securities industries, but it is also possible that regulatory changes and other shocks would result in more profound restructuring of the industries.

The strength in the city's jobs numbers does not extend to all measures of the economy. Real per capita personal income has grown by a meagre 2.6 percent per year over the past four years, a markedly poor performance compared with the 4.5 percent average growth from 2003 through 2007 and the 3.6 percent average from 1996 through 2000 (another period of strong employment growth). The underlying cause of the lackluster personal income growth is weak wage and salary growth. Even as city job creation records are being set, wages have been stagnant: the estimated overall average wage in 2013 is virtually unchanged in real terms from 2010.

Wall Street has been the major factor behind recent weakness in average wage growth in New York City, the mirror image of the role the sector played in prior expansions. Real average wages (including bonuses) in the securities sector have fallen 9.0 percent over the last four years, and are languishing almost 22 percent below their precrisis, 2007 peak. Other financial and management sector wages have been nearly flat, as have government wages. But even in the remaining, private nonfinancial portion of the economy real wage growth has been relatively tepid: only 5.5 percent over three years.

If this seems discordant with the city's robust recovery and expansion, one reason is that, while the city has far surpassed prerecession levels of employment, it has not returned to prerecession levels of utilization of those employed. Average weekly hours worked in the city tumbled in the recession and since then have remained persistently

Projected Average Wages and Changes in Employment by Industry, 2013-2017

	Employment Change, 2013-2017	Average Annual Change	Average Wage, 2013	Average Wage, 2017
Total	**272.5**	**1.7%**	**$82,752**	**$93,263**
Professional and Business Services	73.4	2.8%	104,637	119,469
Professional, Scientific, and Technical Services	34.3	2.3%	122,389	146,830
Administrative and Support Services	34.2	3.9%	52,302	54,226
Management of Companies and Enterprises	3.2	1.2%	184,641	207,940
Education and Health Care Services	68.0	2.0%	52,174	60,009
Health Care Services	34.2	1.9%	61,525	69,209
Social Assistance	18.5	2.5%	29,960	37,291
Education	15.4	2.0%	51,098	60,282
Leisure and Hospitality	35.3	2.3%	44,033	52,556
Retail Trade	25.2	1.8%	38,873	45,446
Construction	18.1	3.6%	78,696	87,529
Information	15.1	2.1%	119,581	126,831
Financial Activities	12.0	0.7%	207,030	226,497
Securities, Investments, and Related Activities	8.6	1.3%	342,529	363,490
Other Services	10.0	1.4%	49,866	57,193
Government	8.4	0.4%	61,918	70,386
Wholesale Trade	7.5	1.3%	90,710	108,094
Transportation and Utilities	0.2	0.0%	63,218	81,452
Manufacturing	(0.6)	-0.2%	58,805	62,087

NOTE: Employment in thousands. Wages in real 2013 dollars.
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low. As a result, aggregate hours have grown much more slowly than employment—and more in line with what we've been seeing in the average wage numbers.

IBO projects a modest uptick in average wage growth and with that, in per capita personal income growth. The overall average real wage (in 2013 dollars) is expected to rise to about $93,300 in 2017, enough to propel real per capita personal income growth of 3.5 percent per year over the 2014-2017 period.

As has been the pattern in recent years, IBO expects professional and business services and education and health care services between them to account for over half of the city's total projected employment growth. Next in terms of projected job growth are two industries that are buoyed by the city's vibrant tourism industry: leisure and hospitality (which includes food services, accommodation, and arts and entertainment) and retail trade. Construction, which continued to slump for two years after the rest of the city economy emerged from recession, is projected to be one of the fastest growing sectors over the next four years, second only to administrative and support services in terms of average annual growth. In contrast, financial activities are projected, along with government, transportation and utilities, and manufacturing, to be among the slowest growing sectors.

In 2013 a little over a quarter of the New York City's payroll workers were in industries with average industry real wages below $50,000, about half were in industries with average wages between $50,000 and $100,000, and a little less than a quarter were in industries with average wages over $100,000. Job growth has generally been strongest in the lower-wage industries, and continues to be so in our forecast. Prior to the last recession, the industries with the highest average wages also experienced by far the most rapid growth in average wages during expansions (as well as the steepest declines in wage growth during contractions). But during the current expansion beginning in 2009, average wage growth in the higher wage end of the distribution has markedly weakened, and has been almost matched by wage growth at the lower end. As the expansion continues, IBO projects that average wage growth will rise more rapidly in the lower-wage industries than in industries with higher wages.

Employment and Wage Growth in Lower-, Medium-, and Higher- Wage Industries

	Annual Employment Growth			Annual Real Average Wage Growth		
	Lower Wage	Medium Wage	Higher Wage	Lower Wage	Medium Wage	Higher Wage
1993-2000	3.2%	0.9%	2.4%	1.7%	1.7%	5.6%
2000-2003	-0.1%	-1.4%	-3.8%	1.0%	0.9%	-1.5%
2003-2008	2.4%	0.7%	2.1%	0.1%	0.0%	4.8%
2008-2010	-0.9%	-2.0%	-5.9%	-1.9%	-0.3%	-12.9%
2010-2013	3.5%	0.9%	1.4%	1.3%	1.4%	1.4%
2013-2017f	2.1%	1.5%	1.7%	4.2%	3.4%	2.5%

NOTE: Industries with average real wages under $50,000, between $50,000 and $100,000, and over $100,000 as of 2013.

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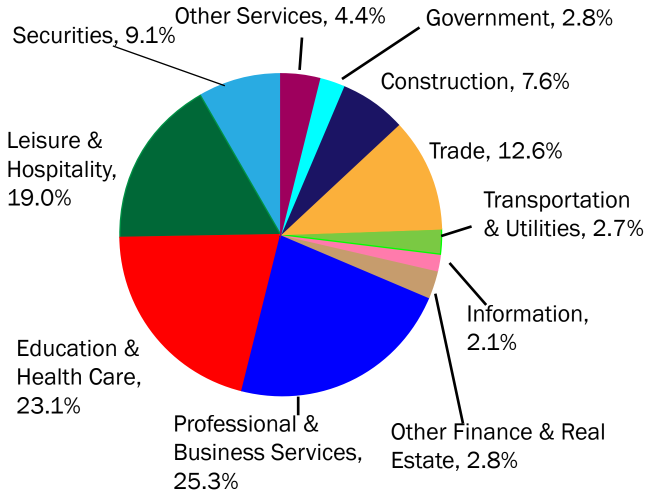
A major factor in this change is a sharp decline in the contribution of the securities industry to overall employment and—even more so—wage growth. This change is not expected to be transient, but has been ongoing since the recession began and will continue through 2017. Before the recession, from 2003 through 2008, securities accounted for 9.1 percent of the employment growth in the city—and a staggering 56.4 percent of the real aggregate wage growth. From 2013 through 2017, by contrast, the securities industry is expected to play a smaller but still significant role in driving the local economy, providing just 2.8 percent of the employment growth and 9.8 percent of the growth in aggregate wages.

With slower wage growth forecast for the securities industry, IBO expects the shares of wage growth accounted for by other sectors of the economy to get larger. For example, the professional and business services industry's share of wage growth is expected to increase from 19.9 percent in the 2003 through 2008 period to 27.2 percent in 2013 through 2017; for education and health care services the share is projected to grow from 6.0 percent to 15.6 percent.

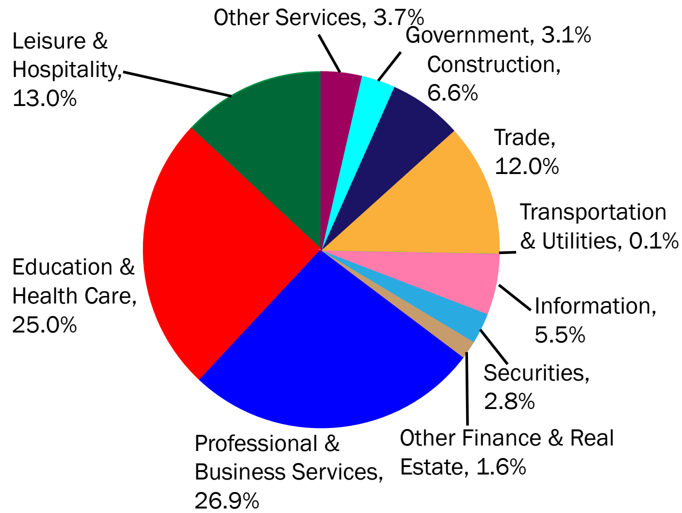
Wall Street Profits. Wall Street profits—as measured by the broker-dealer profits of member firms of the New York Stock Exchange—have seen wild swings since the onset of the financial crises. After losing $11.3 billion in 2007 and $42.6 billion in 2008, the firms had the largest one-year profit in history in 2009, when the industry as a whole made $61.4 billion. Profits stood at $23.9 billion in 2012, but IBO expects profits to fall to $15.4 billion for 2013 as revenue growth slows to 3.2 percent. Higher interest and compensation costs in coming years will largely offset gains in revenues, leaving profits on a relatively slow growth trajectory. IBO's forecast is for profits of $15.8 billion in 2014 and they are expected to reach $17.2 billion by 2017.

Shares of New York City Employment Growth, 2003-2008



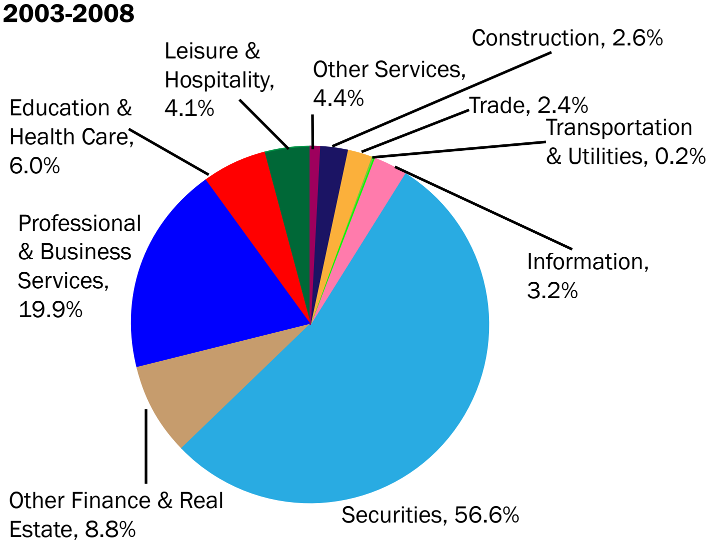
NOTES: Sums to <100. Manufacturing contributed -11.8% to 2003-2008 New York City employment growth.

Shares of New York City Employment Growth, 2013-2017



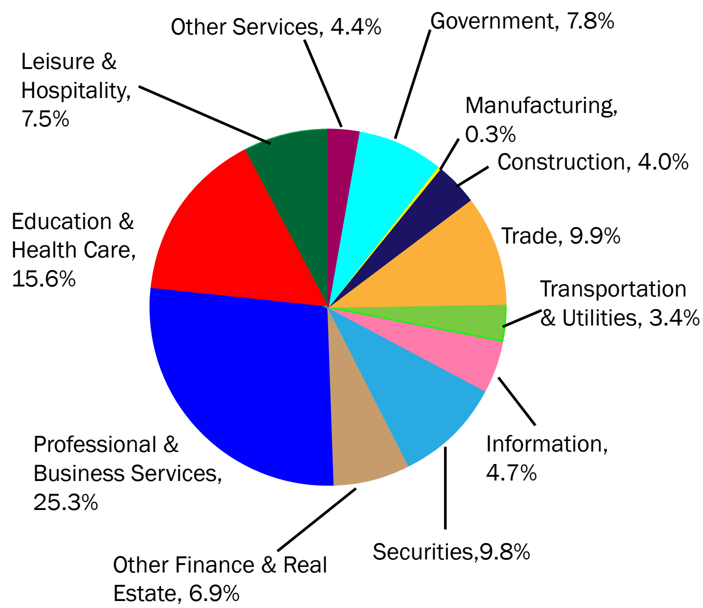
NOTES: Sums to <100. Manufacturing contributed -0.2% to 2014-2017 New York City employment growth.

Shares of New York City Aggregate Real Wage Growth, 2003-2008



NOTES: Sums to <100. Manufacturing contributed -2.6% and Government -2.0% to 2003-2008 New York City aggregate real wage growth.

Shares of New York City Aggregate Real Wage Growth, 2013-2017



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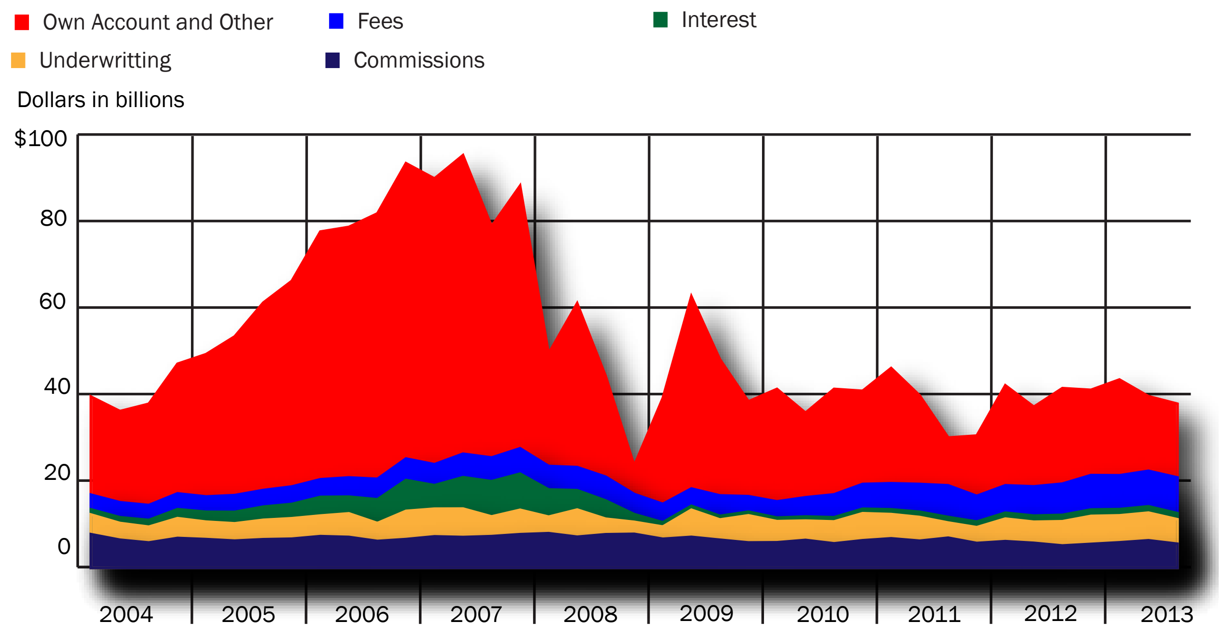
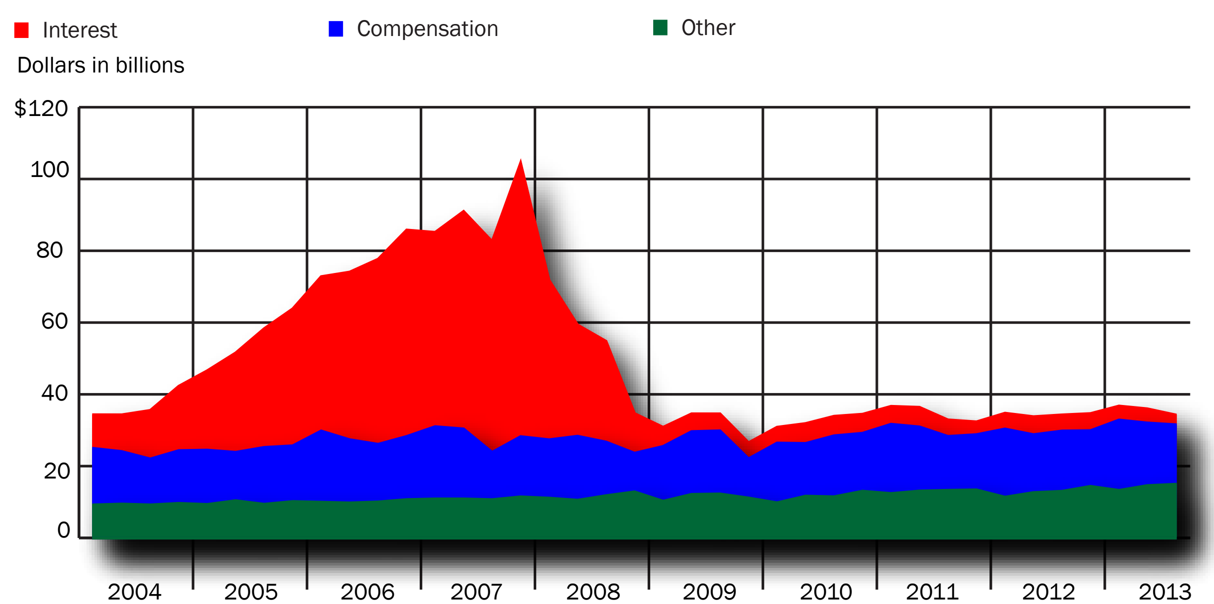
This outlook for profits does not seem to reflect the forecast of sluggish employment and wage growth in the city's financial sector. But in recent years broker-dealer profitability has not been a function of strong revenues—on the contrary, revenues are still running below half of their prerecession peak. Instead, the broker-dealer bottom line has been rescued (for now) by much reduced expenses, primarily resulting from extraordinarily low interest costs. The latter mostly reflect the near-zero interest rate policy pursued by the Federal Reserve.

New challenges will confront Wall Street, and new pressures will be exerted on industry employment and compensation, as interest rates head back towards normal, while tightened regulatory constraints are likely to preclude the kinds of extraordinary revenue gains seen in the pre-2008 boom. The most recent regulatory change was the adoption of the so-called Volcker rule, which is intended to prevent institutions protected by federal deposit insurance from engaging in proprietary trading. This has been an important source of profits for banks—albeit with considerable risks. To the extent banks are forced to shed their proprietary trading operations this could constrain their revenues and profits. Of course, if the trading units are spun off as new New York-based firms, the potential negative effects on local employment, output, and tax revenue may be reduced.

New York Stock Exchange Member Firm Quarterly Revenues



New York Stock Exchange Member Firm Quarterly Expenses



SOURCE: New York Stock Exchange

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Real Estate Markets. Median sale prices of one- to three-family homes sold outside Manhattan are up 5.4 percent this year, but prices still remain about 15 percent below their 2007 peak. That peak may still not be regained by the end of the forecast period. Conversely, the coop-condo and residential rental markets have been very strong, the former fueled by high-end demand from foreign buyers, the latter by chronic shortages of available units.

There has been a large year-over-year increase in commercial real estate sales (and especially high value sales) in 2013, and aggregate commercial market values have also climbed (up 6.3 percent), although not as strongly as in recent years. However, average Manhattan office rents have not budged much, edging up a modest $1.60 per square foot. Projected growth in office rents is also relatively subdued, only 2.9 percent per year over the next four years—barely keeping pace with inflation.

The Unemployment Rate and Labor Force Participation. The city's strong jobs growth has not produced as large a decline in the unemployment rate as one might expect.

IBO Versus Mayor's Office of Management and Budget Economic Forecasts

	2012	2013	2014	2015	2016	2017
National Economy						
Real GDP Growth						
IBO	2.8	1.7	2.8	3.4	2.9	2.9
OMB	2.8	1.6	2.6	3.2	3.1	3.1
Inflation Rate						
IBO	2.1	1.4	1.8	2.2	2.5	2.5
OMB	2.1	1.5	1.5	1.6	1.9	1.9
Personal Income Growth						
IBO	4.2	2.9	6.0	7.0	6.2	5.0
OMB	4.2	2.7	4.7	4.8	5.1	5.3
Unemployment Rate						
IBO	8.1	7.4	6.7	6.3	5.8	5.5
OMB	8.1	7.5	7.1	6.5	6.1	5.7
10-Year Treasury Bond Rate						
IBO	1.8	2.4	3.3	4.2	5.0	4.9
OMB	1.8	2.4	3.1	3.5	3.9	4.6
Federal Funds Rate						
IBO	0.1	0.1	0.1	0.7	3.0	4.0
OMB	0.1	0.1	0.2	0.4	2.2	3.8
New York City Economy						
Nonfarm New Jobs, *thousands*						
IBO	79.5	75.1	67.3	71.0	70.9	63.3
OMB	80.0	73.0	48.0	47.0	51.0	50.0
Nonfarm Employment Growth						
IBO	2.1	1.9	1.7	1.8	1.7	1.5
OMB	2.1	1.9	1.2	1.2	1.2	1.2
Inflation Rate (CPI-U-NY)						
IBO	2.0	1.8	2.2	2.8	3.0	3.0
OMB	2.0	1.7	1.8	1.8	2.1	2.0
Personal Income, *$ billions*						
IBO	479.2	497.8	527.3	562.4	598.6	627.7
OMB	466.2	474.3	494.4	513.4	535.5	561.0
Personal Income Growth						
IBO	3.7	3.9	5.9	6.6	6.4	4.9
OMB	2.3	1.7	4.2	3.9	4.3	4.8
Manhattan Office Rents, *$/sq.ft*						
IBO	66.7	68.3	69.6	72.1	74.6	76.7
OMB	67.9	68.1	67.1	69.4	71.4	74.3

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 2012, New York City personal income and growth rates are estimated, pending BEA release.

Independent Budget Office

Indeed, New York City's persistently high unemployment rate—still at 8.7 percent as of October 2013—remains a puzzle for those analyzing the city economy. In contrast to the new employment highs achieved in the city, payroll employment in the United States as a whole remains far below the prerecession peak. And yet the national unemployment rate has dropped more than a percentage point below the city's rate. One potential explanation for the lower U.S. unemployment rate is the steeper decline in labor force participation at the national level.

IBO expects New York City's unemployment rate to drop rapidly so that by 2016 it will have "caught up" to the declining national rate (6.3 percent). By 2017, the city rate is projected to be down to 5.2 percent—below the nation's rate.

Risks to the Forecast. As noted above, in the coming years New York City's financial institutions will come under increasing pressure from rising interest costs and regulatory constraints on revenue growth. The question is how far this could curtail—or even reverse—the growth in our forecast. This depends first on how tightly those pressures grip the financial sector, and second on the resiliency of the city's economy if employment and wages in the financial sector contract. The key to resiliency is retaining the strengths that have made New York City a magnet for both millions of highly productive workers and tens of millions of tourists. Those strengths could also be tested by external risks related to the city's position as a world banking, trade, and tourism center.

Taxes and Other Revenues

IBO's forecast of revenue from taxes and other sources including state and federal aid totals $73.5 billion in fiscal year 2014 and $74.6 billion in 2015, a relatively small increase of only 1.5 percent. But growth in total revenue next year will be pulled down by the presence of $1.1 billion in federal assistance for recovery from Hurricane Sandy in the 2014 budget that is not included in subsequent years. Without the Sandy aid, total revenue growth for 2015 would be 3.1 percent.

While total revenue growth is expected to be tepid from this year to next, the tax revenue portion of that total is forecast to increase by $2.6 billion (5.6 percent) to $48.3 billion. In contrast, the city's own nontax revenues are projected to fall by $319 million (-5.0 percent) to $6.1 billion and noncity revenues in 2015 are expected to be 5.4 percent lower than in 2014, thanks to the drop in federal grants.

Following 2015, total revenues are expected to grow in a more typical pattern, increasing to $77.3 billion in 2016 and $80.5 billion by 2017. Annual revenue growth will average 3.9 percent in these years, driven by city taxes, which are forecast to increase at an average annual rate of 5.2 percent. Growth in noncity revenue sources is projected to average 2.0 percent annually in 2016 and 2017.

The first part of this section presents IBO's tax revenue forecast, followed by a detailed discussion of each of the city's major tax sources. It concludes with a brief overview of the outlook for nontax revenues.

Tax Revenue Overview. IBO's forecast for tax revenue in the current fiscal year is $45.7 billion, an increase of 1.8 percent from 2013. For 2015, IBO projects faster revenue growth of 5.6 percent to $48.3 billion. Tax revenue growth in 2014 was slowed by a shift in the timing of capital gains realizations by taxpayers seeking to lock in the lower capital gains rates that expired at the end of December 2012, thereby boosting personal income tax (PIT) revenues for 2013. Much of the activity that was shifted to 2013 would have normally occurred in 2014, and as a result PIT revenues are expected to decline by $654 million (-7.1 percent) this year. More than offsetting this decline are year-over-year gains from two of the city's business income taxes, the property transaction taxes, and the sales tax. Growth from 2013 to 2014 is expected to be particularly strong in the real property transfer tax (17.6 percent) and the mortgage recording tax (9.7 percent); although the real property transfer tax grew at a similar pace last year, the mortgage recording tax increased at the even faster rate of 38.3 percent.

Much of the additional tax revenue forecast by IBO for 2015 is expected to come from the personal income tax—an increase of $898 million (10.6 percent)—thanks to steady employment growth and strong personal income growth during calendar years 2014 and 2015, and from the real property tax, where strong assessment growth, particularly for multifamily housing and commercial property, account for much of the $806 million increase (4.1 percent) in revenue. IBO also expects a robust, 7.7 percent increase in the business income taxes next year.

For 2016 and 2017, IBO expects steady tax revenue growth to resume, averaging 5.2 percent annually. Tax revenues are forecast to reach $53.4 billion by 2017. Growth from the personal and business income taxes, as well as the property tax and the transfer taxes is expected to remain strong over the two years.

IBO Revenue Projections
Dollars in millions

	2014	2015	2016	2017	Average Change
Tax Revenue					
Property	$19,757	$20,563	$21,566	$22,613	4.6%
Personal Income	8,514	9,413	9,997	10,502	7.2%
General Sales	6,468	6,775	7,096	7,394	4.6%
General Corporation	2,846	2,931	3,094	3,258	4.6%
Unincorporated Business	1,946	2,117	2,310	2,478	8.4%
Banking Corporation	1,202	1,409	1,466	1,542	8.7%
Real Property Transfer	1,277	1,283	1,399	1,532	6.3%
Mortgage Recording	814	847	934	990	6.7%
Utility	416	443	467	483	5.1%
Hotel Occupancy	493	490	517	544	3.4%
Commercial Rent	695	729	750	770	3.5%
Cigarette	59	58	56	55	-2.5%
Other Taxes, Audits, and PEGs	1,202	1,211	1,211	1,211	0.2%
Total Taxes	**$45,688**	**$48,267**	**$50,862**	**$53,371**	**5.3%**
Other Revenue					
STaR Reimbursement	$844	$880	$885	$889	1.7%
Miscellaneous Revenues	5,566	5,211	5,058	5,168	-2.4%
Unrestricted Intergovernmental Aid	-	-	-	-	n/a
Disallowances	(15)	(15)	(15)	(15)	n/a
Total Other Revenue	**$6,395**	**$6,076**	**$5,928**	**$6,042**	**-1.9%**
Total City Funded Revenue	**$52,084**	**$54,344**	**$56,790**	**$59,413**	**4.5%**
State Categorical Grants	$11,754	$12,013	$12,355	$12,888	3.1%
Federal Categorical Grants	8,176	6,822	6,786	6,775	-6.1%
Other Categorical Aid	915	881	869	865	-1.9%
Interfund Revenues	534	514	514	514	-1.3%
TOTAL REVENUES	**$73,463**	**$74,574**	**$77,313**	**$80,455**	**3.1%**

NOTES: Estimates exclude intra-city revenues. Figures may not add due to rounding.

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The shift of income tax revenue from 2014 to 2013 is a critical explanation, but the expectation that tax revenue growth will be slower this year and then accelerate in 2015 is also generally consistent with IBO's economic forecast. Strong employment gains during calendar year 2013 are expected to be followed by a smaller increase in 2014, but then somewhat larger increases is 2015 and 2016. This same pattern is broadly followed by the tax revenue forecast.

One thing not found in IBO's forecast is a projection for double-digit tax revenue growth, something that did occur each year from 2004 through 2007. In the near-term, continued difficulties in the securities industry, including lower aggregate earnings, declines in employment, and an expectation of lower profits will mean less tax revenue generated from Wall Street. IBO expects growth in the securities sector—along with growth in city tax revenues—to remain relatively modest compared with growth during the pre-2008 expansion or even the more recent years of slow recovery. Indeed, the projected annual average growth in total tax revenue over the three years after 2014 is 5.3 percent, significantly lower than the 7.3 percent average over the most recent three-year period after 2010.

Compared with the city's revenue forecast when the 2014 budget was adopted last spring, IBO's new forecast is $1.2 billion (2.7 percent) higher for this year and our outlook for 2015 is $1.3 billion (2.8 percent) above the adopted budget estimate. While the strength in 2014 collections is not entirely surprising—IBO's estimates last spring indicated that the city was underestimating 2014 revenues by over $600 million—the local labor market and the market for real estate have proved to be even stronger than expected last spring, prompting large upward revisions in our forecast of the personal income tax, the general corporation tax, and the real property transfer tax. But in this latest round of forecasts, IBO has made only modest revisions to our projections from last spring for 2015 through 2017—our forecast of total revenues declined slightly for each year.

IBO's latest tax revenue forecast for 2014 is $683 million, or 1.5 percent, higher than the OMB forecast that accompanied the November 2013 financial plan update. Beginning with 2015, the gap between the two forecasts grows each year from $1.3 million next year to $2.5 billion in 2017, but the differences never exceed 1.3 percent of total tax revenues.

Real Property Tax. IBO projects that property tax revenues will grow from $19.8 billion in 2014 to $20.6 billion in 2015, a 4.1 percent increase. We expect property tax revenue to grow at an average annual rate of 4.6 percent over the financial plan period.

IBO's revenue forecast for 2014 includes $50 million in nonrecurring revenue from retroactive changes to the coop and condo abatement program. In January 2013, the state legislature enacted changes to the abatement program, retroactive to the July 1, 2012 start of the 2013 fiscal year. The Department of Finance reflected these changes on 2014 property tax bills beginning in June 2013.

Additionally, the state is requiring recipients of the School Tax Relief program (STAR) to register with the state; previously administration of the program was handled locally. City homeowners who receive STAR benefits enjoy a partial property tax exemption of about $300 a year and the state reimburses the city for the foregone taxes. The registration requirement will not affect city tax collections because the taxes will either be paid by taxpayers or reimbursed by the state; however, low registration rates (about 60 percent of recipients registered by December 9, 2013) suggest that city residents could lose out on roughly $68 million in state property tax relief.

Background. The amount of tax owed on real estate in New York City depends on the type of property, its value for tax purposes (as calculated by the city's Department of Finance from estimated market value), and the applicable tax rate.[2] Under property tax law, there are four tax classes: Class 1, consisting of one-, two-, and three-family homes; Class 2, composed of apartment buildings, including cooperatives and condominiums; Class 3, made up of the real property of utility companies; and Class 4, comprising all other commercial and industrial property.

The method of assessing properties and recognizing market value appreciation differs by tax class, so each class can have its own assessment ratio (the share of market value actually subject to tax) and tax rate. Because of differences in class assessment ratios, the share of assessed value borne by each class is not proportional to its share of market value. Class 1 accounts for a much smaller share of total assessed value than its share of market value—9.5 percent of assessed value on the 2014 roll compared with 46.1 percent of the department's estimate of total market value in the city. The other classes, especially Classes 3 and 4, bear a disproportionately large share of the property tax burden because their shares of assessed value are much bigger than their shares of market value.

Coop and Condo Abatement. The coop and condo abatement provides a reduction in property taxes for owners of cooperative and condominium units. After having expired on June 30, 2012, the abatement was renewed with significant changes in January 2013, retroactive to July 1, 2012. The abatement program's eligibility criteria were revised to restrict the abatement to apartments used as primary residences. The renewed abatement also has a higher percentage of taxes abated for most owners who remained eligible. IBO has documented shortcomings of the original abatement: it was supposed to be a temporary first step toward equalizing tax burdens on apartment owners and homeowners; it does not address disparities among apartment owners; and it is inefficient because the abatement provides more relief than needed to some owners and less to others. Our analysis of the most recent changes found that these shortcomings remain.

Due to the retroactive nature of the changes, the Department of Finance is recouping coop and condo benefits granted in 2013 to owners whose apartments are not their primary residences and therefore no longer eligible for the tax break. Although the abatement expired at the start of 2013, the finance department, assuming a retroactive extension would be enacted, decided to leave the abatement unchanged on 2013 property tax bills. Because the abatement was instead revised to reduce benefits for nonresident owners for 2013, the department is seeking to recoup those benefits by adding to property tax bills in 2014. Rather than adding the charge as a lump sum at the beginning of the year, the finance department has spread out the additional tax for 2013 across all the bills for 2014.

According to finance department tax billing data, roughly $67 million in abatement benefits for 2013 will be billed in 2014. The city has already collected $12 million in 2013 (from bills mailed in June and paid before July 1, 2013) and another $27 million so far this year. IBO expects that $50 million will be collected this year (this estimate allows for some nonpayment). While the city has not yet reflected this additional 2014 revenue in the financial plan, IBO's estimate of 2014 property tax revenue has increased to reflect the revenue we expect the city to recoup over the year.

Finance department data show that the modified abatement will cost the city about $400 million in foregone property tax revenue in 2014, which is the amount reflected in the IBO forecast for this year. IBO expects the cost to decrease to $370 million in 2015 as the changes are fully phased in. Our estimates are significantly lower than what the Mayor's financial plan assumes the program will cost the city by about $50 million in 2014 and $80 million in 2015. Although the abatement was only extended through 2015, our forecast assumes it is continued in 2016 and 2017 without further changes.

Assessment Roll for 2015. IBO projects that when the tentative assessment roll for 2015 is released in January 2014, it will report 5.2 percent growth in market values in the city. Assessed value for tax purposes is forecast to grow by 4.6 percent in 2015.

Class 1: The aggregate market value of Class 1 properties is expected to grow 4.2 percent in 2015. This growth is stronger than in the past six years (four of which saw declining market value), although Class 1 market value in 2015 is projected to remain below the peak recorded in 2008. The growth reflects an increase in the median sale price for Class 1 homes in calendar year 2013. The median sale price of one-, two- and three-family homes outside Manhattan in the first three quarters of 2013 was $465,000 compared with a median of $440,000 in the first three quarters of 2012.

IBO projects assessed value for tax purposes in 2015 will increase by 3.0 percent over 2014. In Class 1, the assessed value of a property moves toward a target of 6.0 percent of market value, with assessment increases capped at 6.0 percent a year or 20 percent over five years. If a parcel is assessed at less than 6 percent of market value, its assessed value will grow each year until it hits the target ratio of 6.0 percent of market value or it reaches the cap on annual assessment increases—even if the market value stays flat or declines compared with the prior year. When the housing market was strong, the median ratio for one-family homes outside Manhattan declined, from 5.4 percent in 2004 to a low of 3.7 percent in 2008, well below the 6 percent target. More recently, the median assessment ratio has increased, rising from 4.0 percent in 2009 to 5.4 percent in 2014.

Class 2 and Class 4: IBO projects that on the final roll for 2015, aggregate market value for all properties in Class 2 will total $215.1 billion, a 6.2 percent increase over 2014. The Class 2 increase is higher than in recent years, stemming from strong projected growth in market values across all property types in the class. Class 4 aggregate market value is expected to reach $248.8 billion, a 6.3 percent increase over 2014. This growth is slightly slower than in recent years; annual market value increases in Class 4 averaged 7.3 percent from 2011 through 2014.

Aggregate assessed value for tax purposes for Class 2 is expected to be $60.9 billion, 3.4 percent higher than 2014, and $89.2 billion for Class 4, a year-over-year increase of 5.7 percent. This projected growth in 2015 is lower than annual growth for Classes 2 and 4 from 2006 through 2014, which averaged 5.4 percent and 6.6 percent, respectively.

This stable growth in assessed value for tax purposes is due in part to the method for translating market value changes into assessed value for tax purposes. Increases and—in many cases—decreases in parcels' market values are phased in over five years. The assessed value changes from the preceding four years that have yet to be recognized on the tax roll are called the pipeline. Strong growth in assessed value in recent years, especially in Class 4, has replenished the pipeline, which had begun to shrink due to slow growth in the preceding years. IBO projects that the pipeline will reach $16.5 billion in 2015, up sharply from $6.6 billion in 2011.

Outlook for Market and Assessed Values in 2016 and 2017. For 2016, IBO forecasts an increase in aggregate market value of 4.7 percent. Growth in market value is projected at 3.2 percent in Class 1, 5.8 percent in Class 2, and 6.2 percent Class 4. Class 1 growth slows a bit in 2017, forecast at 2.5 percent, while Class 2 and Class 4 are projected to grow by 5.9 percent and 6.2 percent, respectively.

IBO projects that aggregate assessed value for tax purposes will grow 5.1 percent in 2016 and 5.0 percent in 2017, slightly faster than in 2015. Class 1 assessed value for tax purposes is expected to grow by 2.8 percent in both years. With the pipeline replenished, growth of assessed value for tax purposes in both Classes 2 and 4 is strong through 2017, especially in Class 4. Assessed value for tax purposes in Class 2 will grow 3.2 percent in 2016 and 3.7 percent in 2017. The Class 2 pipeline, estimated at $5.3 billion following the 2014 final roll, is expected to grow to $6.3 billion by 2017. With an even larger pipeline, Class 4 growth in assessed value for tax purposes will be even stronger, averaging 6.5 percent a year through 2017. IBO estimates that the Class 4 pipeline was $9.4 billion after the 2014 roll was finalized, and will grow to $11.7 billion by 2017.

Revenue Outlook. The Department of Finance is responsible for finalizing the assessment roll, while the actual property tax levy is determined by the City Council when it sets the tax rates for each class. IBO's baseline property tax revenue forecast and the Bloomberg Administration's forecast both assume that the average tax rate during the forecast period will remain at 12.28 percent, the rate set by the City Council in December 2008 when the Council enacted the Mayor's proposal to rescind a short-lived 7.0 percent rate reduction.

The amount of property tax revenue in a fiscal year is determined not only by the levy, but also by the delinquency rate, abatements granted, refunds for disputed assessments, and collections from prior years. Taking these other factors into account, IBO projects that property tax revenue for 2014 will total $19.8 billion, 5.4 percent higher than in 2013. For 2015, IBO forecasts property tax revenue of $20.6 billion. From 2015 through 2017, revenue growth is projected to average 4.9 percent a year, reaching $22.6 billion by the last year of the forecast period. This projected revenue growth is slower than the 6.3 percent average annual growth seen from 2007 (before the most recent property tax rate decrease and increase) through 2013.

IBO's property tax revenue forecast is $147 million above OMB's for 2014, stemming primarily from differences in estimating the savings from changes to the coop and condo abatement program and estimates of prior year collections. In 2015 through 2017, IBO forecasts somewhat stronger market value growth than OMB, and our revenue forecast is respectively $236 million, $308 million, and $587 million above OMB's.

Real Estate Transfer Taxes. Revenues from the real property transfer tax (RPTT) and the mortgage recording tax (MRT)—collectively referred to as the transfer taxes—have rebounded strongly since 2010, when in the wake of the financial crisis they bottomed out at $981 million (a 70.2 percent drop from their 2007 peak). For 2014, IBO forecasts a total of $2.1 billion in revenues from the two taxes, growing to $2.5 billion in 2017—still about 25 percent below the 2007 peak of $3.3 billion.

Because the RPTT and MRT are based on a certain percentage of real property sales and mortgages, respectively, the recovery of real estate markets since the recession has boosted transfer tax revenue. Taxable sales of residential properties soared to $12.5 billion during the first quarter of this fiscal year, the highest level since the July-September 2007 quarter. The increase in sales activity occurred in all five boroughs, although Manhattan continued to account for the majority of sales value with 59.7 percent in the quarter.

After a spike in commercial real estate sales at the end of calendar year 2012, when buyers and sellers rushed to complete transactions in anticipation of higher capital gains tax rates taking effect in January 2013, taxable commercial sales fell by over 60 percent to $5.9 billion in the April to June quarter of 2013. Sales then rebounded in the July to September quarter (the first quarter of the 2014 fiscal year), to $10.4 billion. There have been 41 taxable commercial sales valued at more than $100 million in the first five months of this fiscal year compared with 24 during the same period of 2013. Five of these sales were valued at over $500 million compared with just two during the same period last year. The largest transaction so far this year has been the $1.3 billion sale of 650 Madison Avenue, recorded in October—the highest-value taxable transaction in the city since December 2010.

In response to the strength of collections so far this fiscal year, IBO has raised its 2014 forecast of RPTT revenue by $169 million over our May 2013 projection, to slightly under $1.3 billion—on a year-over-year basis, revenue is now expected to grow by 17.6 percent in 2014. Our forecast for 2015 through 2017 is essentially unchanged since May, with growth moderating to an annual average of 6.3 percent. By 2017, RPTT revenues are forecast to be $1.5 billion, roughly 90 percent of their 2007 peak.

The MRT does not track the value of real estate sales as closely as does the RPTT because not all sales involve a mortgage and new taxable mortgages need not involve a sale. All-cash sales are common in the city's luxury housing market, both among U.S. residents and the foreign buyers who account for a significant share of high-end residential purchases. The latter are in many cases not able to obtain financing locally, and if they borrow overseas there is no mortgage recorded in the city and therefore no MRT liability. In addition to mortgage activity related to property purchases, the MRT can be triggered in some mortgage refinancings–it is levied on the portion that involves new money ("cash out") and also in cases where there is a new lender and the original lender does not assign the note. MRT collections in recent years have been boosted by the large volume of refinancing activity that historically low mortgage interest rates have induced.

As we did with our forecast for RPTT collections, IBO has increased its forecast for 2014 MRT revenue since last spring. MRT revenue this year is now expected to be $814 million, $72 million (9.7 percent) over 2013 revenue. Even though mortgage rates remain very low by historic standards, credit standards are more stringent than during the real estate boom of the previous decade, and it is likely that most mortgage holders who would benefit from refinancing and are able to access credit have already refinanced. The Mortgage Bankers Association has also reported a decline in refinancing activity in recent months. For these reasons, IBO forecasts slower MRT growth in 2015 of 4.1 percent, with revenues of $847 million. After 2015, annual average growth of 8.1 percent is projected, with MRT collections reaching $990 million in 2017—still 37 percent below the peak a decade earlier.

Differences between IBO's and OMB's forecasts of the transfer taxes are relatively small. IBO's projections for the RPTT are slightly above those of OMB in each year—by 1.3 percent for the entire forecast period. IBO's mortgage recording tax projections are slightly below OMB's in 2014 and 2017, and higher in 2015 and 2016. For the entire 2014-2017 period, our MRT forecast is 0.9 percent above OMB's.

Personal Income Tax. In contrast to most of New York City's other major sources of tax revenue, net collections (gross collections minus refunds) from the personal income tax (PIT) are expected to decline this year. IBO forecasts $8.5 billion of PIT revenue this year, $654 million less than what was generated in 2013. The drop in revenue is the consequence of federal fiscal policy rather than declines in the income and/or employment of city residents. In anticipation of expected increases in federal income tax rates, particularly rates on capital gains income, many taxpayers shifted capital gains and salary bonuses from calendar year 2013 to 2012, boosting fiscal year 2013 PIT receipts at the expense of receipts in 2014. As a result, PIT revenue growth is expected to be uneven, with a 15.3 percent increase in 2013 followed by a projected 7.1 percent decline this year and then a projected 10.6 percent increase in 2015.

The shift of capital gains realizations into 2013 swelled estimated payments, which are made by taxpayers who are self-employed or anticipate realizing capital gains from the sale of financial and property assets, along with those filing for extensions to delay the deadline for final returns past April 15th. IBO's projection of a 26.9 percent decline in estimated payments in 2014 is the major reason for our forecast of a decrease in total PIT revenue. Another contributing factor is an expected 8.9 percent increase in refunds this year.

In contrast, withholding payments—the single largest component of PIT receipts—are expected to show modest growth in 2014. Fueled by job growth over the past year, year-to-date (through November) withholdings are up 4.5 percent over the same period in 2013. With a decline in Wall Street profitability expected for calendar year 2013, however, we expect bonus compensation from securities firms to be less than bonuses paid out of profits in calendar year 2012. As a result, withholdings during the all-important December through March bonus season will be substantially less than withholdings in the same period in 2013. Consequently, withholding growth for the year as a whole will be constrained to a relatively modest 3.2 percent.

IBO's 2015 PIT forecast is $9.4 billion—10.6 percent higher than we project for 2014. Withholding growth is expected to remain moderate, reflecting slightly slower employment gains in calendar year 2014 relative to the two previous years. However, PIT growth will be fueled by a projected 32.1 increase in estimated payments as capital gains realizations rebound.

With IBO expecting personal income growth to peak in calendar years 2015 and 2016, we project that PIT revenues will increase at an annual average rate of 5.6 percent in 2016 and 2017—faster than the annual average rate of 1.3 percent in 2014 and 2015. PIT revenue is forecast to reach $10.5 billion by 2017, 20.0 percent higher than the previous revenue peak in 2008, before the Great Recession.

IBO projects faster city income and employment growth in its economic outlook than does OMB throughout the forecast period, and as a result IBO's personal income tax forecast exceeds OMB's each year through 2017, with the difference between the two forecasts growing over time. For the current year, our forecast is $190 million (2.3 percent) above OMB's and for 2015 the difference rises to $368 million (4.1 percent). Combined 2016 and 2017 revenue is 7.2 percent higher in the IBO forecast than in OMB's.

Business Income Taxes. After stronger than anticipated revenue growth in 2013 (9.2 percent) from the city's three business income taxes, combined collections to date in

2014 (through October) are essentially flat (-0.4 percent) compared with the same period a year before. For the remainder of 2014, IBO forecasts only slightly faster growth, resulting in a very modest increase of 2.3 percent in business income tax revenue for the year as a whole. The expected change in revenue varies among the three taxes. In 2014, collections of the general corporation tax (GCT) and the unincorporated business tax (UBT) are projected to exceed 2013 revenues by 5.7 percent and 7.6 percent, respectively. Banking corporation tax (BCT) revenues, however, are forecast to decline 11.5 percent this year. For 2015, IBO expects more robust growth of 7.7 percent in the combined business income taxes, with all three taxes contributing to the increase.

IBO's general corporation tax forecast is $2.8 billion for 2014—5.7 percent ($154 million) greater than revenue in 2013. Through October, GCT collections for 2014 are up $72 million (15.3 percent) over the same period last year. Data on current-year payments from large taxpayers (those with payments of $1 million or more) indicate that much of the growth so far has come from firms in finance and insurance (up 64.9 percent) and manufacturers (up 135.8 percent). In contrast, collections from large information firms were down 60.8 percent. GCT collections this year are being boosted by the $23.9 billion in profits Wall Street firms enjoyed in calendar year 2012—the third highest level on record. Relatively strong Wall Street profits in calendar year 2013—$13.5 billion through the third quarter of the year—will also bolster GCT revenue in 2014 and 2015. But securities firms' interest and compensation expenses are projected to increase starting late in calendar year 2014, reducing Wall Street profits and slowing the increase in GCT revenue to 3.0 percent in fiscal year 2015. For 2016 and 2017, IBO projects that GCT collections will grow at an average annual rate of 5.4 percent.

UBT revenue growth is expected to exceed that of the other two business taxes over the entire forecast period, due in large part to robust growth in the professional and business services industry, which added 44,000 jobs from 2010 through 2012 and is expected to add another 18,500 jobs in calendar year 2013. For 2014, IBO forecasts $1.9 billion in UBT revenue—$138 million (7.6 percent) greater than 2013 collections—which would bring UBT collections to $94 million above their 2008 prerecession peak. September and October collections are up $41 million (11.9 percent), compared with the same period last year, but growth is expected to slow in the remainder of the fiscal year. With both the local and national economies gaining momentum in calendar year 2014, IBO anticipates even faster UBT revenue growth next year and beyond: 8.8 percent in 2015 and an average annual rate of 8.2 percent in 2016 and 2017, when UBT revenue reaches $2.5 billion.

The bank tax is the city's most volatile major source of revenue, with strong revenue growth in one year often followed by a steep decline the following year. The bank tax's volatility is primarily due to very large fluctuations in refunds resulting from overpayments of estimated liabilities made throughout the fiscal year—overpayments often affected by the timing of deductions for net operating losses. Through October, BCT collections for the current fiscal year are $118 million (28.4 percent) less than during the same period last year, a revenue decline completely offsetting the combined growth of GCT and UBT revenue so far this year. For 2014 as a whole, IBO forecasts that BCT revenue will fall by 11.5 percent to $1.2 billion, and then rebound, increasing 17.2 percent to reach $1.4 billion in 2015. Following the sharp rise in 2015 collections, IBO expects BCT growth in 2016 and 2017 to average a more moderate 4.6 percent a year.

There are several reasons to expect BCT revenue growth to slow in the coming years. Rising interest rates will increase to cost of obtaining funds and thereby take a toll on bank profits. Many of the recent settlements between large banks and the U.S. government over practices leading up to the 2008 financial crisis include payments by the banks. To the extent these payments are tax deductible, they lower banks' taxable income, thereby shrinking BCT collections. Instituting Dodd-Frank regulations, including the just-adopted Volcker Rule, is also expected to take a toll on BCT collections by limiting some activities by banks, including highly lucrative (and potentially risky) proprietary trading. The still high standards for issuing small business loans will also limit potential bank profits.

IBO's forecast for the combined business income tax revenue is $218 million (3.8 percent) higher than OMB's in the current year—$231 million higher for GCT, $101 million lower for BCT and $88 million higher for UBT. For 2015, IBO's forecast is a total of $467 million above OMB's—$174 million higher for GCT, $214 million higher for UBT, and $79 million higher BCT. The difference between the two forecasts grows each year and reaches $824 million in 2017, reflecting IBO's forecast of faster employment and productivity growth.

General Sales Tax. IBO forecasts relatively steady growth in general sales tax revenue for 2014 and subsequent years. For the current year, revenue is expected to total $6.5 billion, a 5.5 percent increase over the prior year—matching the growth rate in 2013. For 2015, IBO projects $6.8 billion in revenue, a gain of 4.7 percent over 2014. In the following two years the sales tax is expected to grow at an annual average rate of 4.5 percent, to $7.4 billion in 2017.

Through October, collections of the city's general sales tax this year are 7.0 percent greater than during the same period in 2013. Nominal personal income growth of city residents has been a moderate 3.7 percent this calendar year, so it is likely that much of the recent sales tax growth is attributable to nonresidents, especially tourists and business travelers. The latest estimates indicate that New York City had a record number of visitors in calendar year 2013, and there are many other indications—such as increases in the number of hotel stays, rising hotel room rates, and large increases in restaurant employment—that visitor spending has had an especially large role in increasing sales tax revenue. (Hotel bills are subject to sales tax, in addition to a separate tax on hotel occupancy.)

Beyond the current year, IBO expects that somewhat slower increases in visitor spending will be largely offset by faster growth in residents' personal income. Personal income is projected to grow 3.7 percent in calendar year 2013 with growth accelerating to 6.1 percent in 2014 and remaining above 6 percent in 2015 and 2016. Steady employment growth in the city will also stimulate consumer demand and retail sales, thereby fueling sales tax growth.

IBO projects substantially higher employment and personal income than does OMB over the forecast period. As a result, IBO's sales tax forecast exceeds OMB's by $98 million (1.6 percent) in 2014 and in subsequent years by increasing amounts, reaching $302 million (4.3 percent) in 2017.

Hotel Occupancy Tax. In spite of another year in which a record number of visitors came to New York, IBO forecasts a 2.4 percent decline in hotel tax revenue this fiscal year, to $493 million, followed by another, smaller decline to $490 million in 2015. The reason IBO expects hotel tax revenue to decline is that the hotel tax rate reverted to 5.0 percent on December 1, 2013, after having been 5.875 percent since March 1, 2009. As of this writing it is not clear whether the City Council will act to renew the higher rate and whether renewal could be made retroactive to December 1st as city officials hope. For now IBO assumes the rate will remain at 5.0 percent through at least 2017. The rate change reduces annual revenue by about $40 million in the remaining months of 2014 and by roughly $80 million annually starting in 2015.

Hotel tax revenue is a function of the tax rate, the number of hotel stays, and room rates. The outlook for growth in the hotel tax base is strong in both the short run and long run. Data from NYC & Company show that for January through September 2013, average daily hotel rates were up 4.2 percent over the same period in 2012, while occupancy rates through September reached 88.1 percent, compared with 86.6 percent during the same period in 2012. The recent increase in occupancy rates is particularly noteworthy given that, according to NYC & Company, the number of New York City hotel rooms has grown steadily—by 2.6 percent in calendar year 2012 and by a projected 6.5 percent in 2013.

In the longer run, IBO expects increases in hotel tax revenue to average 5.4 percent a year from 2015 through 2017, with revenue reaching $544 million by 2017. These increases are driven by a combination of further increases in room rates and stable rates of occupancy despite increasing inventory, which is projected by NYC & Company to reach 110,000 rooms in 2016—up from 93,000 thousand in 2012. One potential upside to IBO's forecast is revenue that could come from the city's efforts to collect the tax from online short-term rentals, such as those arranged through Airbnb. At present our forecast does not assume any new revenue from this initiative.

Though IBO forecasts faster growth in the tax base, for all years of the forecast OMB's projections of the hotel tax are between 5 percent and 9 percent higher than IBO's due to their expectation that the higher tax rate of 5.875 percent would be in effect throughout the entire forecast period.

Other Revenues. The city's nontax revenues combine a variety of fees, fines, charges, interest income, and other miscellaneous revenue, which total $6.4 billion this year. The Mayor's November financial plan anticipates that nontax revenues will fall to $6.1 billion next year, a decline of $319 million, with much of the difference due to anticipation of the sale of city assets in 2014 to bring in $275 million. The estimate for both 2014 and 2015 were revised upwards in November by $64 million and $81 million, respectively, as revenue from the sale of new taxi medallions—an initiative that had been delayed by court challenges but is now proceeding—has exceeded expectations. Plans to continue selling medallions in subsequent years help to sustain total city nontax revenues at $5.9 billion in 2016 and $6.0 billion in 2017.

State, federal, and other categorical aid and interfund revenue are the remaining sources among nontax revenues. They are expected to total $21.4 billion this year, although that figure includes $1.1 billion in anticipated

Pricing Differences Between IBO and the Bloomberg Administration
Items that Affect the Gap
Dollars in millions

	2014	2015	2016	2017
Gaps as Estimated by the Mayor	**-**	**-**	**$(1,472)**	**$(951)**
Revenues				
Taxes				
Property	$147	$236	$308	$587
Personal Income	190	368	600	779
General Sales	98	185	267	302
General Corporation	231	174	228	235
Unincorporated Business	88	214	363	422
Banking Corporation	(101)	79	126	167
Real Property Transfer	24	17	12	17
Mortgage Recording	(6)	19	28	(10)
Utility	26	38	48	60
Hotel Occupancy	(28)	(46)	(43)	(32)
Commercial Rent	16	14	5	(8)
Cigarette	(1)	(4)	(4)	(4)
	$683	**$1,292**	**$1,937**	**$2,514**
STaR Reimbursement	8	8	8	8
Total Revenues	**$692**	**$1,300**	**$1,944**	**$2,522**
Expenditures				
Fringe Benefits:				
Health Insurance - Education	$(6)	$55	$(12)	$21
Health Insurance - City University	(29)	(6)	(19)	(29)
Health Insurance - All Other Agencies	(22)	5	(82)	(49)
Education	(65)	(21)	(41)	(51)
Public Assistance	45	46	46	46
Police	(25)	(25)	(25)	(25)
Homeless Services	(19)	(25)	(25)	(25)
Corrections	-	(15)	(15)	(15)
Small Business Services	10	(4)	(6)	(6)
Total Expenditures	**$(111)**	**$10**	**$(179)**	**$(133)**
Total IBO Pricing Differences	**$581**	**$1,310**	**$1,765**	**$2,389**
IBO Prepayment Adjustment 2014/2015	(581)	581	-	-
IBO Surplus/(Gap) Projections	**$-**	**$1,891**	**$294**	**$1,438**

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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Hurricane Sandy assistance from the federal government. The bulk of that money has been allocated through the federal government's Community Development Block Grant process to help in the recovery and is scheduled to be spent this year, which accounts for the drop-off in this revenue category to $20.2 billion in 2015. The city is counting on an additional $1.4 billion in federal rebuilding assistance but has not yet included the money in the financial plan pending release of the funds from Washington. After 2015, state, federal, and other categorical and interfund revenues resume growing at a slower pace; annual growth is expected to average 2.0 percent in 2016 and 2017. By the last year of the financial plan, these grants are expected to total $21.0 billion.

Spending

While IBO expects city tax revenues will exceed the Bloomberg Administration's projections by nearly $700 million this year and $1.3 billion next year, our estimates for spending under the Mayor's budget plan reveal only modest differences. For the first time since 2008, the Mayor's budget plan includes no spending cuts under a program to eliminate the gap, or PEG. Although the budget plan restores much of the funds that had been part of the annual "budget dance" between the Council and the Mayor and provides for new needs such as $47 million for fire department staffing, IBO anticipates overall city spending will remain relatively flat for most agencies. However, this is largely an artifact of the collective bargaining situation. Once a labor settlement is reached, funds will be allocated to agencies to cover the new labor costs and agency spending growth will look more robust.

Under the terms of Mayor Bloomberg's financial plan for fiscal years 2014 through 2017, IBO estimates that total city spending—including state and federal aid and adjusting for the use of last year's surplus to prepay some of this year's expenses—will grow from just over $75 billion this year to about $79 billion in 2017, an average annual increase of 1.8 percent. Looking just at city-funded expenses, we estimate spending will rise from $53.6 billion in 2014 to just under $58.0 billion in 2017—an average annual growth rate of 2.7 percent, or about half the average annual rate of growth we project for tax revenue.

Engines of Spending Growth. As in much of the past decade, just a few portions of the budget account for much of the growth in city spending. The key factors are spending on education, health insurance and other fringe benefits for city employees and retirees, and debt service on the funds the city borrows for construction projects and major purchases such as vehicles and equipment. Spending in each of these areas is projected to increase by more than $1 billion over the 2014-2017 period.

Under the Bloomberg Administration's financial plan, IBO projects that the biggest increase in spending—both in dollar terms and in terms of average growth rates—will be for debt service. After adjusting for the use of this year's projected surplus to prepay some of next year's debt service, spending on interest and principal for these borrowed funds will rise from $6.0 billion this year to $6.9 billion in 2015, a year-to-year increase of nearly 15 percent. Under the plan, debt service would continue to rise, reaching $7.6 billion in 2017, an average annual increase of 8.3 percent from 2014 through 2017.

Over the past few years, the Bloomberg Administration has consistently projected that interest rates would be substantially higher than they actually were. In the November plan the Mayor's budget office recognized $84 million in savings this year on its variable rate debt due to lower-than-projected interest rates. In addition, changes in the amounts planned for borrowing and refunding of existing debt enabled the Mayor's budget office to claim savings of $38.7 million this year and $91.9 million next year. The Mayor's budget office also recognized savings on debt issued through the city's Transitional Finance Authority: $19 million this year and $43 million in 2015. Still, even if additional savings are recognized later in the fiscal year because interest rates remain lower than the city's revised estimates, debt service will continue to be a driver of city spending. And with expectations that Federal Reserve policy will allow interest rates to begin to rise towards the end of calendar year 2014, it will become more difficult for the city to continue to reap such large savings on debt service.

The Department of Education also continues to be a major source of city spending in terms of total dollars—about 28 percent of next year's entire projected budget—as well as increased spending over the 2014 through 2017 period. IBO projects education department spending will rise by $400 million in 2015 and reach $20.2 billion. By 2017, IBO anticipates education department spending will total $21.3 billion, an increase of $1.5 billion over 2014-2017 at an average annual rate of 2.5 percent.

Although the plan expects that state aid for schools will increase by about $960 million over 2014 through 2017 and reach $9.6 billion, city-generated funds will continue to be a major share of the increased spending. About half of next year's budgeted increase comes from city funds, which will grow from $9.3 billion this year to $9.5 billion in 2015. The budget plan expects that federal aid for the city's schools will increase minimally in the coming years and grow by less than $12 million to total $1.8 billion in 2017.

Health insurance and other fringe benefits for city employees and retirees are the other major factor driving increased city spending. Expenditures on health insurance and other fringe benefits are expected to grow by $139 million in 2015 (after adjusting for the use of $1 billion from the Retiree Health Benefits Trust Fund in 2014) and total $5.2 billion. By 2017, health and related costs are expected to rise by an additional $924 million and reach $6.1 billion, an average rate of growth of 6.7 percent over 2014 through 2017.

While expenditures on Medicaid and pensions for city employees remain significant components of city spending,

IBO Expenditure Projections
Dollars in millions

	2014	2015	2016	2017	Average Change
Health & Social Services					
Social Services					
Medicaid	$6,549	$6,629	$6,598	$6,598	0.3%
All Other Social Services	2,927	2,893	2,862	2,863	-0.7%
HHC	261	81	81	81	-32.3%
Health	1,395	1,362	1,359	1,359	-0.9%
Children Services	2,809	2,816	2,816	2,816	0.1%
Homeless	1,030	993	993	993	-1.2%
Other Related Services	645	556	524	524	-6.7%
Subtotal	**$15,616**	**$15,331**	**$15,232**	**$15,233**	**-0.8%**
Education					
DOE (excluding labor reserve)	$19,791	$20,191	$20,779	$21,324	2.5%
CUNY	870	833	835	826	-1.7%
Subtotal	**$20,661**	**$21,024**	**$21,614**	**$22,150**	**2.3%**
Uniformed Services					
Police	$4,716	$4,656	$4,644	$4,637	-0.6%
Fire	1,953	1,809	1,789	1,770	-3.2%
Correction	1,069	1,077	1,078	1,077	0.3%
Sanitation	1,416	1,464	1,463	1,464	1.1%
Subtotal	**$9,153**	**$9,007**	**$8,973**	**$8,948**	**-0.8%**
All Other Agencies	**$9,111**	**$8,042**	**$8,099**	**$8,252**	**-3.5%***
Other Expenditures					
Fringe Benefits	$4,062	$5,200	$5,716	$6,148	6.7%**
Debt Service	5,592	4,468	7,311	7,643	8.3%*
Pensions	8,190	8,116	8,227	8,395	0.8%
Judgments and Claims	663	674	710	746	4.0%
General Reserve	150	300	300	300	n/a
Labor Reserve:					
Education	-	-	-	-	n/a
All Other Agencies	265	465	714	983	n/a
Expenditure Adjustments	-	56	123	219	n/a
TOTAL EXPENDITURES	**$73,463**	**$72,683**	**$77,019**	**$79,017**	**2.5%**

NOTES: *Represents the annual average change after adjusting for prepayments.
**The annual average change includes the transfer of $1.0 billion from the Retiree Health Benefits Trust. Fringe benefits exclude DOE and CUNY expenditures, which are reported within DOE and CUNY budget amounts.
Expenditure adjustments include energy, lease and non-labor inflation adjustments. Estimates exclude intra-city expenses. Figures may not add due to rounding.

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they each are growing at rates of less than 1 percent a year. The city's contribution for pensions is projected to rise from $8.2 billion this year to $8.4 billion in 2017, a relatively modest increase of $200 million. The expected increase in Medicaid spending is even smaller, just $49 million, as it inches up from $6.5 billion this year to just under $6.6 billion in 2017.

Cost Differences. There are a number of program areas where IBO has modestly different estimates of costs than those presented by the Bloomberg Administration. One area of difference is the projected cost of shelter for the homeless. Although the daily census and length of stay in family shelters is higher this fiscal year than last, the Bloomberg Administration has budgeted slightly less funds. We estimate that the cost of providing shelter to families will be $49 million ($17 million in city funds, the remainder state and federal) higher this year than the $490 million currently allocated. We also expect that the already delayed plan to have families with young children share living space will not proceed in 2015 and when combined with the higher shelter census will add $75 million ($23 in million city-generated dollars) to next year's cost for sheltering homeless families. In addition, the state's highest court recently overturned a Bloomberg Administration plan for diverting single adults from the shelter system, which we expect to add another $2 million annually to the cost of providing shelter for the homeless.

In addition, IBO estimates that the city will need to add $65 million of its own funds to meet projected budget needs for the education department this fiscal year. Two factors drive this estimated need. One factor is the expectation that the education department will not be able to achieve the level of Medicaid reimbursements for special education related services forecast in the budget plan. Despite investment in a new claiming system, the education department continues to fall well below its projections. The shortfall in Medicaid claims is projected to cost the city $59 million in 2014. The other factor is the underestimate of enrollment in charter schools, which repeats a pattern of recent years and will add $6.6 million in additional city expenditures this year and $21 million in 2015.

IBO also forecasts that overtime for police and correction officers will cost more that has been budgeted: $25 million annually for police officers in 2014-2017 and $15 million a year for correction officers in 2015-2017. Conversely, IBO projects that the Bloomberg Administration over-budgeted for the city's share of public assistance costs in 2014-2017 by about $45 million a year.

New Needs. The November budget plan adds $129 million in 2014 and $167 million in 2015 for what are termed new needs. The largest of these needs is additional funding to cover personnel costs for newly hired firefighters. The budget plan adds $47 million this year and $75 million next year for firefighter staffing.

The plan also adds $24 million just for 2015 to pay for senior and youth services in the city's public housing developments that were previously funded by the housing authority. Funds also have been added by the Bloomberg Administration to continue and expand the pilot program for the collection of residential organic waste. Now operating in Westerleigh in Staten Island, the program will expand to selected neighborhoods in the other boroughs at a total cost of $8.3 million this year and an additional $7.6 million in 2015.

Federal Cutbacks, Local Costs. Budget measures in Washington are adding to the pressure on the city's already fiscally strained public housing and public hospitals. Federal subsidies for public housing have been shrinking for a number of years. Sequestration that went into effect in March cut $205 million in aid to the city's housing authority, including $114 million from the originally expected $907 million in federal operating subsidies. Under the Affordable Care Act, the federal government will cut in half its subsidy to hospitals that treat large numbers of uninsured patients. The cut starts relatively small this year and then begins ramping up in 2017, when the city's Health and Hospitals Corporation could lose $56 million, and more than $100 million annually in the ensuing years. While the affordable Care Act should increase the number of New Yorkers with health insurance, the public hospitals will likely continue to treat large numbers of undocumented immigrants who will still not be insured.

Music Over for Budget Dance? With little fanfare, the Mayor's financial plan restores funding in fiscal years 2015 through 2017 for dozens of programs that have typically been the focus of annual budget negotiations between the Council and the Mayor. In past years, the Mayor would leave funding for these programs out of the budget and then agree during negotiations to restore all or some of the funds for just the upcoming fiscal year. This process, which predates the Bloomberg Administration, became known as the "budget dance."

In recent years, restorations for these programs have totaled about $400 million annually. Mayor Bloomberg's financial plan matches the amounts restored for each program in 2014 and adds them to the budgets for each fiscal year from 2015 through 2017. For example, the $51 million restored for the Out-of-School Time program in 2014 has now been added, or baselined, in 2015 through 2017 as well. About $30 million has been restored to the parks department through 2017 for a variety of purposes previously subject to the annual dance of cuts and restorations such as funds for pools and seasonal maintenance workers. Likewise, the same $6.0 million unrestricted subsidy to the public hospitals, $5.1 million for supportive housing services for people with AIDS, and $1.5 million to support food pantries across the city that was restored in 2014 during last spring's budget process has now been baselined in the financial plan through 2017.

There is at least one notable exception to this extension of 2014 restorations to the rest of the financial-plan period: fire companies. In 2014, $44 million was added to the budget to prevent the Mayor's plan to eliminate staffing of 20 fire companies. The November financial plan does not include these funds for 2015 through 2017.

Sandy. The budget for 2014 includes about $1.1 billion in federal funds to help the city in the aftermath of Hurricane Sandy. Most of these funds, $957 million, came through an initial allocation of Community Development Block Grant-Disaster Relief dollars. (A second allocation of more than $1.4 billion has not yet been received and so is not accounted for in the city's budget plan.) More than a third of the funds the city has through the initial allocation, just over $360 million, have been budgeted with the Department of Environmental Protection to assist multifamily housing. An additional $327 million is budgeted in the Department of Small Business Services mainly to aid businesses affected by the storm. The funds will be distributed by the Economic Development Corporation, though there is no timetable yet.

This year's budget also includes $145 million in aid from the Federal Emergency Management Agency. About $83 million of these funds are being used for emergency protective measures, $29 million for buildings and equipment related to post-storm recovery, and $14 million for debris removal.

From Surplus to Shortfall? Rather than the fiscal burden predicted by some budget watchdogs in recent months, Mayor-elect de Blasio and the new City Council will inherit a budget for 2015 with a surplus of nearly $2 billion based on IBO's tax revenue and spending estimates under the terms of the Bloomberg Administration's latest financial plan. But this inheritance must be looked at with a good bit of caution.

Foremost among the reasons for caution are the expectations built into the budget plan with regard to a settlement of expired contracts with the city's municipal unions. A costless settlement covering the years of expired contracts prior to 2014 may be more doable on paper than in practice. Depending on the terms of the settlements, the projected surplus could quickly evaporate. In May, IBO estimated that under one plausible scenario the cost of settlements with the unions could be $6.3 billion through 2014. In this scenario, the teacher and principal unions would get the same 4 percent raises other unions received in 2008-2010 and all the municipal unions would get 2 percent wage increases from the point their contracts expired in the years 2010-2013.

Moreover, diminished federal aid, especially for the city's public housing and hospitals, may present increasing fiscal challenges. And the projected surplus for 2015 may fuel expectations for expanding services or cutting taxes. Given the city's balanced budget requirements, new initiatives that entail recurring costs will need to be funded by recurring revenue or savings elsewhere in the budget.

A number of economic risks could also upend IBO's tax revenue forecast, shrinking or even reversing the projected surplus. Long-expected regulations for Wall Street are beginning to fall into place, including recent approval of the Volcker rule. These regulations will likely decrease the profitability of the city's big banks. The extent to which New York City's economy can continue to grow without the kind of boost from Wall Street the city has benefited from in the past remains to be seen. Overseas events also could affect local growth. Chief among these are the economic and fiscal difficulties facing Europe and China, which have already begun to have an impact on international trade and finance.

Balancing the desire to come to terms with the unions, make up for diminished federal aid, and meet public expectations for local services may be difficult and could quickly erode the projected surplus. The city's fiscal outlook is a long way from that of Detroit, as some doomsayers portrayed it earlier this year. But the Bloomberg Administration's last financial plan does not reflect all the fiscal pressures ahead.

Endnotes

[1]See IBO Fiscal Brief, "Unraveling the Discrepancy Between City Job Growth & A High Unemployment Rate," February 2013.
[2]For additional information about the complications of the city's real property tax, see "Twenty-Five Years After S7000A: How Property Tax Burdens Have Shifted in New York City," Independent Budget Office for New York City, December 2006. When IBO refers to market values and assessments, the reference includes only taxable property. The assessed value for tax purposes (also referred to as billable taxable value) reflects the required phase-in of assessment changes for apartment, commercial, and industrial buildings. In this report the billable taxable values are shown before applying the STAR exemptions.

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