Fiscal 2009
Executive Budget Hearings

Committee on Finance

MAY 2008

Revenue and Debt Service Report

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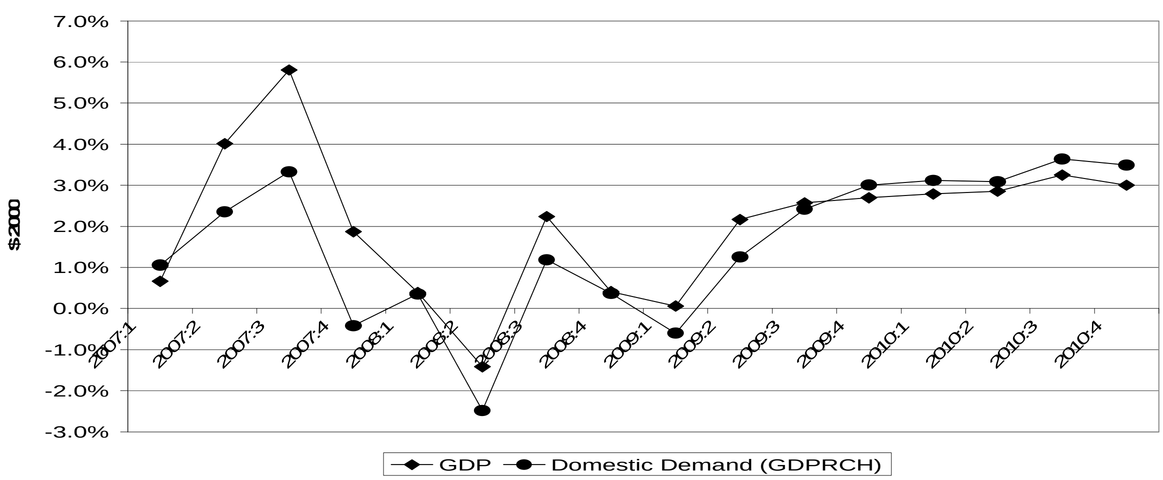
The Economy

THE NATIONAL ECONOMY: A LITTLE BETTER THAN EXPECTED

Recent economic news, while bad, was not as bad as expected. GDP grew in the first quarter by 0.6 percent aided by better than expected consumption of services and an increase in inventories. This increase in inventories (unsold goods) is not necessarily a good sign and could mean additional weakness in the second quarter. The number of jobs in the economy shrunk by 20,000 in April, but this is better than the 80,000 jobs a month the economy lost over the first quarter.

The good news has been the strength of the foreign sector. European and East Asian economies have not slowed down to the same extent as the American economy and the weak dollar has made our exports more attractive. This should help the national economy through 2009. Domestic demand, roughly American goods and services bought by Americans, has grown slower than the economy as a whole (see Figure 1). However, the economy will not return to its normal rate of growth (around 3 percent) until domestic demand grows at a more normal rate in 2010.

FIGURE 1: WEAK DOMESTIC DEMAND WILL KEEP THE ECONOMY BELOW TREND TILL 2010



Source: Global Insight May 08

Domestic demand is being weakened by several factors:

- Oil Prices: April's crude oil prices were on average 76 percent above the same time last year, an increase of a little under $50 a barrel.[1] By one estimate an increase of this size would knock 1 percent off economic growth in the first year, 2 percent in the second, and 2.5 percent in the third year.[2]
- Credit Tightening: The problems in the housing market spread to Wall Street and now they are spreading back to Main Street. In an April survey an overwhelming majority of banks reported tightening their lending standards on commercial/industrial and real estate loans to business. They also tightened their standards on consumer real estate loans (including home equity loans),

1 West Texas Intermediate Crude.
2 Global Insight Sept 2007.

and on credit cards. [3] This makes business investment, commercial and residential real estate constructions and purchases and consumer spending more difficult.

- Weak Housing Market: Last year's housing starts were 40 percent below that of two years ago, and by one estimate fewer houses will be started in 2008 then at any time since 1945.[4] Depending upon which index you use housing prices have fallen between 9.4 and 14 percent over the past two years. A recent survey of economists found their median projection was for a loss of an additional 5.6 percent to 12.3 percent over the next two years, once again depending on the measure used.[5]
- Losses in Other Asset Markets: There are many estimates for this; one of the firmer numbers is $180 billion in write offs announced by commercial and investment banks. About $100 million is in the US, but this does not include losses by other parts of the financial sector and by households.[6] The IMF has estimated that global losses related to mortgages, corporate and consumer debt could exceed $1 trillion.[7]

Offsetting this has been aggressive and innovative Federal Reserve policy and a less aggressive, but well timed fiscal policy response from Washington. These policies are already having some impact and are helping to keep the recession shallow. The Economic Stimulus Package Act of 2008 provides an income tax rebate of up to $600 for head of household and $1,200 for a married couple filing jointly, with an extra rebate of $300 per child.[8] Rebate checks have already started to go out, and over 80 percent checks should be received before the end of June. The Act also provides for extra depreciation for businesses, and allows Fannie Mae/Freddie Mac (FNMA/FMC) to buy larger mortgages. The program will provide a boost to the economy in the third quarter of 2008, helping to end the recession. The extra depreciation will mostly have the effect of moving forward business equipment spending that would have occurred in the first quarter of 2009 into the end of 2008. The result of this is the peculiar 'W" shape of the forecast in Figure 1. There are other views on economy. The median forecast in the Philadelphia Federal Reserve Survey of Professional Forecasters is 'U' shaped with the stimulus having a weaker impact, both in producing a recovery in the summer and a second slowdown in early 2009. What is common in the two views is that the economy will continue to drag till 2010.

OMB'S NATIONAL FORECAST

Council Finance is using the national forecast summarized in Figure 1 which is similar to the forecast used by OMB in the Fiscal 2009 Executive Budget. OMB's forecast is summarized in Table 1. Council Finance's GDP differs from OMB in having slightly more economic growth in 2008 and slightly less growth in 2009. This timing difference for economic growth carries through to most other variables including employment forecast and personal income.

3 Board of Governors of the Federal Reserve System, April 2008 Senior Loan Officer Opinion Survey.
4 Global Insight April 2008.
5 The lower numbers are for the OFHEO US Total House Price Index and the larger are for S&P/Case-Shiller Home Price Index - US National. The projections are from the Federal Reserve Bank of Philadelphia Survey of Professional Forecasters, Second Quarter 2008.
6 Bank of England, Financial Stability Report, April 2008 #23.
7 *International Monetary Fund, Global Financial Stability Report April 2008.*
8 The credit phases starts to phase out at AGI $75,000 ($150,000 for married filing jointly). Taxpayers with AGI over $87,000 ($174,000 for married filing jointly) will receive no rebate. There is a minimum rebate of $300, for those who had at least $3,000 in qualifying income in 2007. Taxpayers whose 2007 tax was less than the $600 maximum credit will not receive the full credit. They will receive the tax they paid or the minimum credit whichever is higher. This keeps some low income households from fully benefiting from the credit.

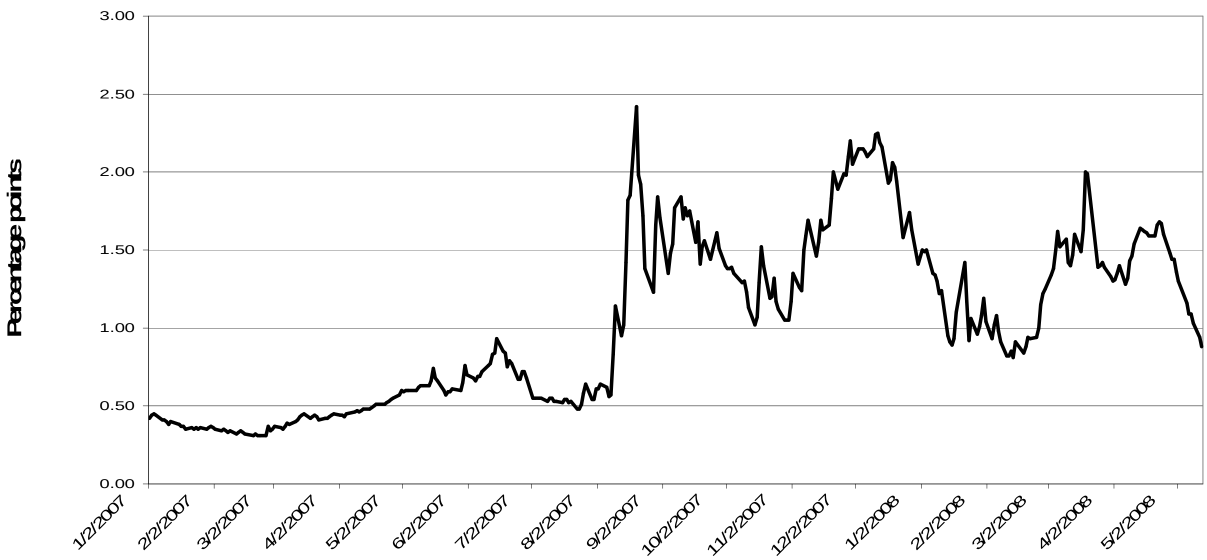
TABLE 1: OMB FORECAST OF SELECTED ECONOMIC INDICATORS

	2007	2008	2009	2010	2011	2012
National Economy						
Real GDP *Percentage Change*	2.2	1.1	1.7	3.2	3.3	3.0
Non-Agricultural Employment *Percentage Change*	1.1	0.0	0.4	1.3	1.7	1.5
Personal Income *Percentage Change*	6.1	4.1	3.1	5.2	5.8	6.0
New York City						
Real Gross City Product *Percentage Change*	3.2	-7.5	-1.3	2.7	2.9	2.4
Non-Agricultural Employment *Change from previous year (thousands of jobs)*	78.8	-10.7	-46.3	26.2	41.5	38.3
Wage Rate *(not corrected for inflation)* *Percentage Change*	8.1	-1.3	-1.9	3.4	4.0	4.3

FINANCIAL SERVICES: FAR FROM NORMAL

"…(A)t this stage conditions in financial markets are still far from normal." Ben Bernanke May 13, 2008

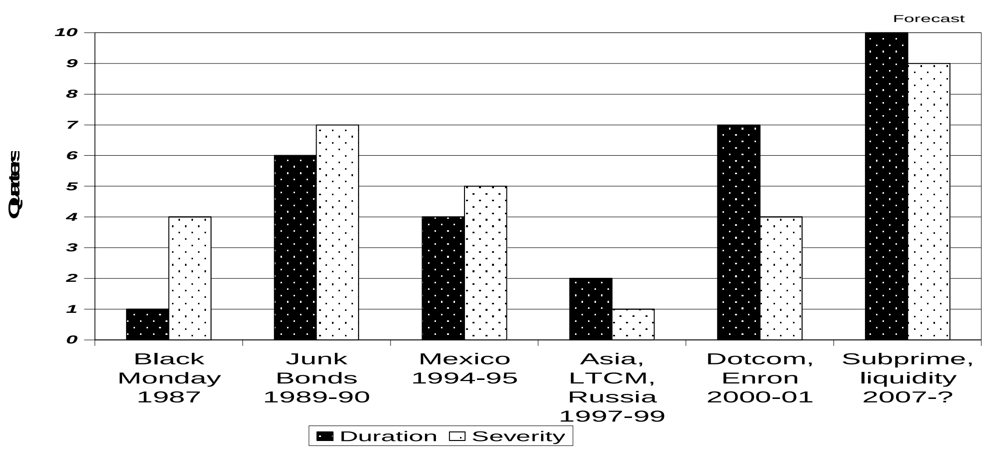
FIGURE 2: THE FINANCIAL CRISIS ISN'T OVER – THE TED SPREAD



Since the summer of 2007 the financial sector has been in a crisis which has waxed and waned as difficulties in individual markets were addressed, often by Federal Reserve action. One can get an idea of the timing of the difficulties and the current conditions of the markets by looking at the TED spread. The TED spread is the difference between the interest rate banks charge for loans to one another (3 month Eurodollar LIBOR) and the interest rate on a very safe asset, 3-month T-bills. When there is worry about the financial system banks seek higher interest from one another and investors seek safe assets like T-bills so this difference tends to go up. Till the summer of 07 this difference had been varying but was typically around 0.5 percent. (see Figure 2) Since soaring in August 07 there have been major spikes and periods of comparative calm. Since the third week of April markets have gotten over the concerns related to the collapse of Bear Stearns in March. Whether the fall in the spread in late April early May portends the beginning of the end of the crisis or simply another calm period, as in February, is an open question. But as Chairman Bernanke observed: "A number of securitization markets remain moribund, risk spreads--although off their recent peaks--generally remain quite elevated, and pressures in short-term funding markets persist."[9] It is not over yet.

The severity and duration of this crisis is still unknown. The industry losses reported so far, are striking. After a record 3rd Qtr 2007 loss of $3.8 billion, Wall Street reported a $16.4 billion loss in the 4th Qtr. These, combined with a strong first half of the year lead to an unprecedented $11 billion loss for 2007.[10] The largest annual loss in the 30 year for which Council Finance has records was $162 million in 1990. An analysis of investment banks done by Morgan Stanley and Oliver Wyman reported in the Economist looked at how many quarters of pre crisis earnings were wiped out by losses (Severity) and how many quarters it took for earnings to get back to pre-crisis levels (Duration). (See Figure 3) By this analysis the severity of the current crisis will be greater than any seen in the last 20 years wiping our 9 quarters of earnings. The duration will also be greater, lasting 10 quarters, so we would not expect investment banks to return to pre-crisis levels of earnings until 2010.

FIGURE 3: THE CRISIS WILL HAVE A GREATER IMPACT ON INVESTMENT BANK EARNINGS THAN ANY IN THE PAST 20 YEARS. – FOR DEFINITIONS OF SEVERITY AND DURATION SEE TEXT.



Source: Economist May 15, 2008, Morgan Stanley & Oliver Wyman

Credit market problems are impacting on the New York City economy through their impact on securities industry earnings and employment. By a recent tally major banks, brokerages and investment banks have announced over 30,000 layoffs world wide. While some of these are in mortgage banking, many of them are investment banking and securitization jobs of a kind that are likely to be located in the New York City. In the City, employment in both the credit and securities industries has been weakening since August, and by April 2008 employment in both industries was back to its April 2007 level. OMB believes that in 2008 the securities industry will loose 10,000 jobs and the financial sector as a whole including real estate, banking, insurance and funds as well as securities will loose close to 15,000. In 2009 securities will loose another 12,700 and finance 22,000.

9 Chairman Ben S. Bernanke, Liquidity Provision by the Federal Reserve, Federal Reserve Bank of Atlanta Financial Markets Conference, May 13, 2008
10 NYSE member firms – source NYSE and SIFMA.

Because the scale of industry losses is so unprecedented, the impact of this on the City's economy, business and income tax revenues are difficult to assess. Suffice it to say that this, combined with the ongoing nature of the credit crisis, makes the Executive Budget forecast riskier than usual. Some of these issues will be considered in the section on business and income taxes.

NEW YORK CITY ECONOMY[11]

New York City's economy has maintained momentum longer than the rest of the nation. City employment is still growing, while the U.S. has been shedding jobs since the beginning of the year. The City's economy is slowing down very gradually, with total private job growth only 1.1 percent last April from the same time a year ago. It was 1.6 percent only last January. The national credit crunch is not only impacting the City directly through reduced jobs and wages in the financial sector, but indirectly through increased credit costs for all City sectors, and less demand for certain business and professional services that are complementary to finance.

There are six sectors that represent the main drivers of the City's economy. As of April 2007, five of these sectors showed positive job growth (two just barely) compared to the same time the previous year, with education services suffering losses.[12]

- Finance (up 2,700 or 0.58%)
- Business Services (up 3,000 or 0.51%)
- Information (up 7,700 or 4.70%)
- Leisure and Hospitality (up 5,200 or 1.76%)
- Health Care (up 9,900 or 1.80%)
- Education (down 2,200 or -1.35%)

Most job losses are concentrated in the goods producing sector, which employs a small percentage of City workers

OMB expects a palpable slowdown in the City's economy for 2008 and 2009, with downside risks of it becoming more severe. According to its Gross City Product (GCP) calculations, City output is projected to drop a full 7.5 percent in 2008 and another 1.3 percent in 2009. It grew by 3.2 percent in 2007. OMB forecasts total nonagricultural employment growth to be basically flat in 2008 dropping 0.3 percent, and then falling 1.2 percent in 2009. This is similar to Council Finances' estimate of a fall of 0.1 percent and 1.0 percent respectively. [13] This means that in 2008 the City would to lose 10.7 thousand jobs and in 2009 shed 46.3 thousand jobs. Employment was previously growing at 2.1 percent in 2007. In terms of net job gains, total nonagricultural employment grew by 78.8 thousand in 2007.

OMB expects City personal income growth to be flat in 2008, and drop by a slight 0.3 percent in 2009. The average wage rate is projected to fall by 1.3 percent in 2008 and 1.9 percent in 2009. For 2008, Council Finance estimates a 1 percent increase in wages; less severe than OMB but still below the inflation rate. The City's economy is not expected to recover until 2010, with annual GCP of 2.7 percent, employment growth 0.7 percent, job gains of 26.7 thousand, and average wages growing 3.4

11 Unless otherwise cited employment data is from OMB.
12 Council Finance calculations are based on April over April growth. Data is from New York State Department of Labor establishment survey.
13 Council Finance forecasts private sector employment while OMB's total nonagricultural employment includes government employment.

percent. Employment growth will remain at a lackluster 1 percent in 2011 and 2012.

Industry Employment: OMB expects finance sector employment to contract by around 14,700 in 2008 and by another 22,100 in 2009. It also forecasts a 7.3 percent reduction in average wages in securities in 2008 and another 11 percent drop in 2009.

Professional and business services are highly dependent on Wall Street's demand for legal, accounting and other professional services. OMB projects that after steady employment growth averaging 17,000 jobs for the past three years, 2008 will witness job losses of 12.4 thousand in 2008 and 12.0 thousand in 2009.

Retail is bucking the trend by increasing employment at an increasing rate, with April jobs up 3.56 percent from the same time last year. This is largely attributed to the healthy growth in tourism. OMB expects the employment to eventually fall in 2009 by 6,000 jobs.

The Leisure and Hospitality sector is even more dependent on the strength of tourism in the City. In 2007 a record 46 million tourists visited the City, a 4.5 percent increase from 2006. This was helped by the weak dollar attracting foreign visitors. OMB expects the sector to gain 3,700 jobs in 2008, and lose only 200 jobs in 2009. This surge has aided the hotel industry, with 2007 occupancy rates averaging 90 percent, and room rates averaging over $300 per night.

Health Care and Education have been steady sectors in the City's economy, being fairly independent of business cycles. Their strength has been responsive to the City's growing population and the increasing attractiveness of living, working, studying and doing business in the City. Employment in Health and Education is slated to increase by 14.3 thousand in 2008 and by 13.4 thousand in 2009.

Real Estate: Turning to real estate, last year's growth in office-based employment and limited availability of office space (especially Midtown) had pushed overall Manhattan office rents to $65 per square foot (psf) by December 2007, a 29 percent increase year-over-year. The corresponding vacancy rates dropped to 5.7 percent, compared to 6.7 percent the year before.[14] Currently, the declining office-based employment expected in 2008 and 2009 coupled with the unavailability of credit will decrease the demand for commercial space. On the supply side, although there's scarcely any additional construction in midtown, major projects downtown (such as the Freedom Tower and Goldman Sachs) may become available as early as 2009. OMB calculates that these market dynamics will raise the overall vacancy rates from 6 to 10 percent by mid 2009. Average midtown rents would drop from around $85 psf to $75 psf, and downtown rents from $55 to $49 psf. Nonetheless, as of April 2008 average overall asking rents were still rising, reaching $66.42 psf, 1.6 percent above $65.38 psf in March, although vacancy rates had increased a half a percent during the same duration. Retail space has shown no signs of cooling, with rents having grown 3 percent from a year ago at $111 psf.[15]

The market for single-family homes had maintained its momentum through the first half of 2007, bucking the downward trend nationwide. The market has subsequently weakened as mortgage conditions tighten, defaults increase as Adjustable Rate Mortgages get reset, and consumers are

14 Cushman & Wakefield
15 The Real Deal

understandably wary of investing in a home at this time. The S&P Case-Shiller Home Price Index for 2008 4th quarter shows a 7 percent drop from the same time a year ago. OMB predicts that home sales will average around 21,000 in both 2008 and 2009, about half the volume during the market's peak in the 3rd quarter 2005. Prices are forecasted to drop by 16.9 percent from peak to through.

The Manhattan condo and coop market was especially strong in 2007. In the 1st quarter 2008, prices are still rising by double digits, but the sales volume is dropping sharply. The median sales price of a coop in the 1st quarter 2008 was $750,000, an 11.1% increase from the $675,000 price the same quarter in 2007. The median price for a condo was $1,160,000, a 17.1% jump from the same quarter last year. The volume of sales, however, experienced a 34.3 percent drop in the 1st quarter 2008 compared to the same quarter a year ago, though this sharp decline should be viewed in the context of an exceptionally high volume of sales in 2007.[16] Still, this reduced level of sales is a response to the crisis in the financial sector, reflecting increased difficulty in obtaining credit, the expectation of sharply reduced bonuses this year, and the prospect of additional Wall Street layoffs. OMB expects that sales prices will eventually join sales volume in negative growth. They project that prices will fall cumulatively around 20 percent before the end of 2009.

Summary: New York City is finally showing signs of an economic slowdown, a few months after the U.S. as a whole. This is largely due to the subprime mortgage and other high risk credit contagion spread by Wall Street. Income growth of New Yorkers is expected to be generally flat in 2008 and 2009, recovering in 2010. OMB expects real wages to decline between 1 and 2 percent annually, and employment to cumulatively fall by 57,000 during these two years.

Changes to the Financial Plan

The Fiscal 2009 Executive Revenue Budget recognizes an additional $1.980 billion in Fiscal 2008 revenue compared to estimates made in the January Plan. This surplus revenue will be used to pay down outstanding debt due in Fiscal 2010. Additional resources resulting from expense budget savings will be used to prepay health benefit liabilities due in Fiscal 2009. As of the January Plan, the Fiscal 2009 budget was in balance when the agency reduction program was taken into account. However, the Fiscal 2010 budget gap had increased to $4.2 billion after gap closing actions are included.

In the Executive Budget, revenues for Fiscal Years 2008 and 2009 combined were increased by $2.7 billion, and then lowered by a combined $1.6 billion in Fiscal Years 2010 and 2011. These shifts occurred primarily in tax revenue and represent the delayed impact of the credit crisis on local tax revenue. As this delayed impact continued to create surplus resources, the Administration has shifted these monies to Fiscal 2010 and beyond to offset declining revenues in those years as well as growing expenses, especially the impact of recent collective bargaining agreements. Even with the elimination of $2 billion in debt service costs for Fiscal 2010, the 2010 budget gap stands at $4.6 billion before gap closing actions are taken into account.

16 MillerSamuel, Prudential Douglas Elliman Real Estate Manhattan, Market Overview 1Q 08

TABLE 2. CHANGES TO THE FINANCIAL PLAN SINCE THE FISCAL 2008 JANUARY PLAN

	2008	2009	2010	2011	2012
January Plan Budget Gap	**($543)**	**($1,185)**	**($5,270)**	**($6,639)**	**($6,332)**
Revenue Adjustments					
Tax Forecast	$1,914	$630	($977)	($661)	($432)
NonTax Revenue	$66	$62	($20)	$32	$42
Total Revenue Adjustments	**$1,980**	**$692**	**($997)**	**($629)**	**($390)**
Expense Adjustments					
Pay Down Outstanding Debt	($1,986)		$1,986		
Federal Fringe Benefits Reimbursement Rate Increase	$126	$116	$89	$89	$89
Pension Re-estimates	$5	$59	($164)	($266)	($360)
Debt Service	$39	$93	$65	$156	$211
Other Expense Changes	$161	($512)	($298)	($290)	($339)
Total Expense Adjustments	**($1,655)**	**($244)**	**$1,678**	**($311)**	**($399)**
Net Adjustments	**$325**	**$448**	**$681**	**($940)**	**($789)**
Remaining Gap	**($218)**	**($737)**	**($4,589)**	**($7,579)**	**($7,121)**
Gap Closing Actions					
Agency Program	$618	$1,306	$1,206	$1,146	$1,110
Rescind 7% Property Tax Cut			$1,223	$1,298	$1,359
Restructure Employee Health Insurance			$200	$200	$200
Total Gap Closing Actions	**$618**	**$1,306**	**$2,629**	**$2,644**	**$2,669**
Budget Gap Before Prepayments	**$400**	**$569**	**($1,960)**	**($4,935)**	**($4,452)**
Additional Prepayments in Exec.					
2008 to 2009	($400)	$400			
2009 to 2010		($969)	$969		
2010 to 2011			($350)	$350	
Additional Net Prepayments	**($400)**	**($569)**	**$619**	**$350**	**$0**
Budget Gap After Prepayments	**$0**	**$0**	**($1,341)**	**($4,585)**	**($4,452)**

Of the additional resources generated in Fiscal 2008, $1.3 billion is attributable to sources that are for the most part nonrecurring. These special actions include an additional $500 million in tax enforcement revenue, a reduction in prior year payables totaling $500 million, a reduction in the general reserve by $200 million, and the elimination of the $100 million earmarked for pay-as-you-go capital spending.[17]

On the expense side of the budget, estimates for collective bargaining costs, debt service, pension costs, energy costs and agency new needs as a group have continued to grow in the Executive Budget.

17 The Financial Plan also anticipates prepaying Fiscal 2009 TFA debt service in the amount of $546 million

Excluding the impact of the reduction in outstanding debt, expense budget increases for the Fiscal 2009-2012 period average $323 million. This figure does not include the future costs associated with the recent contract agreement with the PBA which is expected to grow to over $200 million annually, and even more if other unions reopen their contracts.

The above actions are insufficient to close the budget gaps starting in Fiscal 2010. At budget adoption, the Fiscal 2010 budget gap was $3.4 billion and increased to $4.4 billion by Fiscal 2012. The updated budget gaps as presented in the January Plan added approximately $1 billion to each out-year budget gap. The Executive Budget provides options to address the out-year budget gaps. The adjusted agency PEG reductions provide between $1.1 billion and $1.2 billion in savings. Reversing the 7 percent property tax rate reduction implemented in Fiscal 2008 provides $1.2 billion in additional resources. Changes to the financial plan since adoption and the proposals to eliminate the budget gaps are presented in Table 2.

Although the ability to utilize near term surpluses to address out year gaps is a sound budget process, it masks an underlying stress building in the Financial Plan. This stress is caused by the fact that the budget is growing more dependent on the surplus roll to achieve current year balance. If for a given year more money is rolled out than rolled in, current operations for that year were in the black and generated a current year surplus. If less is rolled out than rolled in, then the current year operations were in the red and the fiscal year was dependent on the prior year surplus. As Table 3 shows, Fiscal 2007 had a net positive roll of $849 million. In Fiscal 2008 the net roll turns negative by $81 million. In Fiscal 2009, $4.5 billion is rolled in from Fiscal 2008 while only $1.3 billion is rolled out into Fiscal 2010. This means that $3.2 billion of the resources rolled into Fiscal 2009 are consumed in that year and not available to be rolled into Fiscal 2010. Stated another way, but for the surplus anticipated to be rolled from the current year, Fiscal 2009 would require reductions of $3.2 billion in order to be in balance.

TABLE 3: SCHEDULE OF DISCRETIONARY TRANSFERS

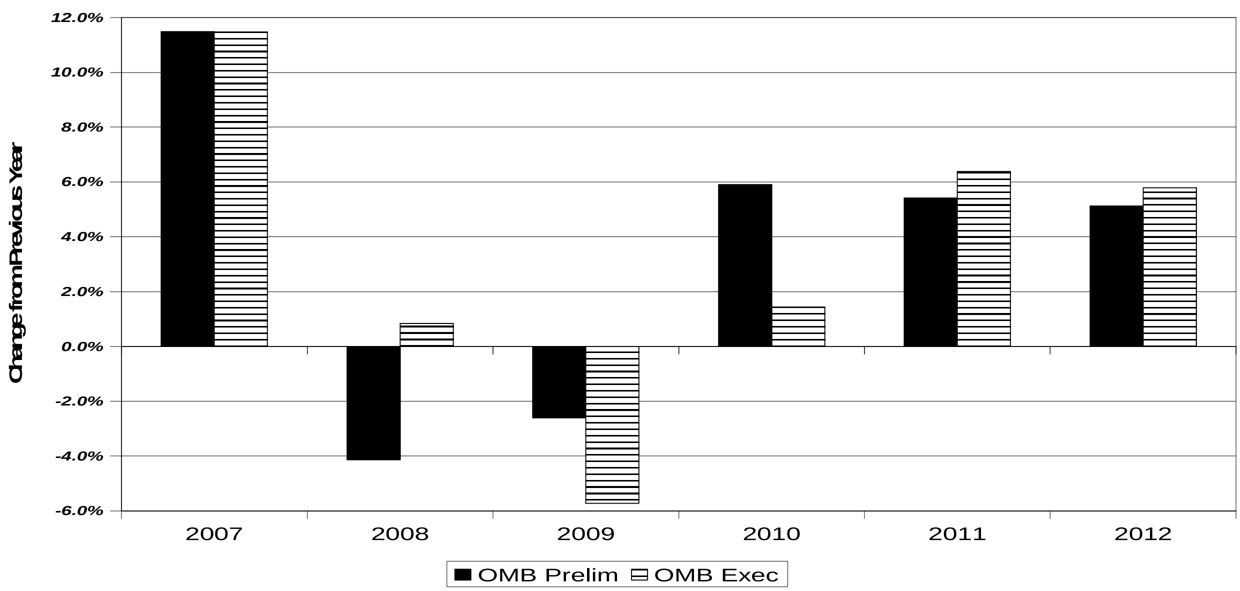
By Benefit Year (in millions)	2007	2008	2009	2010	2011
2006 to 2007					
Subsidies	$ 472				
BSA	$ 3,205				
Lease Purchase	$ 74				
Total	**$ 3,751**				
2007 to 2008					
Subsidies		$ 639			
BSA		$ 3,315			
Lease Purchase		$ 100			
TFA Grant		$ 546			
Total		**$ 4,600**			
2008 to 2009					
Subsidies			$ 500		
Health Trust Fund			$ 400		
BSA			$ 3,073		
TFA Grant			$ 546		
Total			**$ 4,519**		
2009 to 2010					
BSA				$ 1,319	
Total				**$ 1,319**	
2010 to 2011					
BSA					$ 350
Total					**$ 350**
Net Roll / Operating Deficit	**$ 849**	**$ (81)**	**$ (3,200)**	**$ (969)**	**??**

Tax Revenue

After several years of double digit growth, the City's tax revenues are slowing down. Through April, collections from the major taxes were approximately 2.2 percent ahead of the same time last year. OMB expects the City to end Fiscal 08 with tax revenues 0.85 percent above Fiscal 07. Some of this slowdown is due to changes in tax policy, including the 7 percent cut in the property tax.[18] Without these tax cuts Fiscal 08 revenues would be up 4.2 percent, still a weak performance for the City.

The economic slowdown has been impacting on different taxes in different ways that reflect the sectors most affected by the slowdown. Nationally and locally, problems started in the real estate and the mortgage markets. The City's two transactions taxes are already strongly impacted, and are down 17 percent from last year. The financial crisis has already dramatically affected the bank tax which is down 27 percent. The general corporation tax, with its diverse tax base, is only slightly below last year's levels. The other income sensitive taxes, personal income, unincorporated business and sales are doing well, and in the case of personal income and unincorporated business taxes strikingly well. It is their strength along with the better than expected performance of the general corporation tax that is responsible for most of OMB's $1.9 billion increase in the Fiscal 08 forecast since the Preliminary Budget.

FIGURE 4: IN THEIR EXECUTIVE BUDGET FORECAST OMB HAS CHANGED THE TIMING OF THE SLOWDOWN IN TAX REVENUE GROWTH



Since the Preliminary Budget, OMB has changed its mind about the timing of the slowdown's impact on tax revenues, delaying both the downturn and the recovery. This is partially economic. Financial sector bonuses were much stronger in the first quarter of calendar 08 than OMB expected, giving the

18 Last year the Council, working with the Mayor and (for some taxes) the State Legislature, reduced the City's property tax by 7 percent, created a new child care credit, exempted all clothing and footwear from the sales tax, reduced double taxation on City residents that pay the unincorporated business tax, and enacted a set of business tax reforms aimed at small businesses. All together these will reduce City tax revenues by nearly $1.3 billion in Fiscal 2008.

City economy a boost that's lasting into the second quarter. Some of it is in the timing of taxes, as we will explore in the section on income taxes. Losses are impacting on tax revenues more slowly than OMB first assumed. The decrease in revenues in Fiscal 09 is striking and perhaps over pessimistic, but not unprecedented. The Fiscal 10 recovery is weak, revenues growing less than inflation. It is only in Fiscal 11 that revenues return to modest but positive growth.

TABLE 4: FISCAL 2009 PRELIMINARY BUDGET TAX FORECAST GROWTH RATES

Tax	2007	2008	2009	2010	2011	2012
Real Property	3.9%	0.4%	6.4%	7.4%	6.7%	5.1%
Personal Income	5.1%	11.8%	-11.9%	-7.1%	9.5%	6.7%
General Corporation	31.3%	-7.4%	-9.4%	2.1%	10.2%	7.2%
Banking Corporation	85.7%	-29.2%	-25.0%	6.7%	10.0%	6.3%
Unincorporated Business	27.6%	15.5%	-13.5%	7.6%	4.9%	9.5%
Sales	4.6%	4.3%	-3.1%	0.0%	3.7%	6.7%
Commercial Rent	7.4%	7.4%	2.9%	3.0%	3.1%	3.7%
Real Property Transfer	33.1%	-17.9%	-24.8%	-2.8%	-1.2%	5.6%
Mortgage Recording	16.0%	-26.6%	-25.4%	-2.4%	-1.3%	6.1%
Utility	-8.0%	6.1%	-1.3%	8.2%	5.4%	5.1%
Hotel	9.9%	13.9%	6.2%	8.4%	6.8%	5.7%
All Other	17.1%	7.6%	-2.1%	1.6%	4.1%	2.6%
Audits	40.0%	-2.4%	-45.5%	0.2%	0.0%	0.0%
Total Taxes	**11.5%**	**0.8%**	**-5.7%**	**1.4%**	**6.4%**	**5.8%**

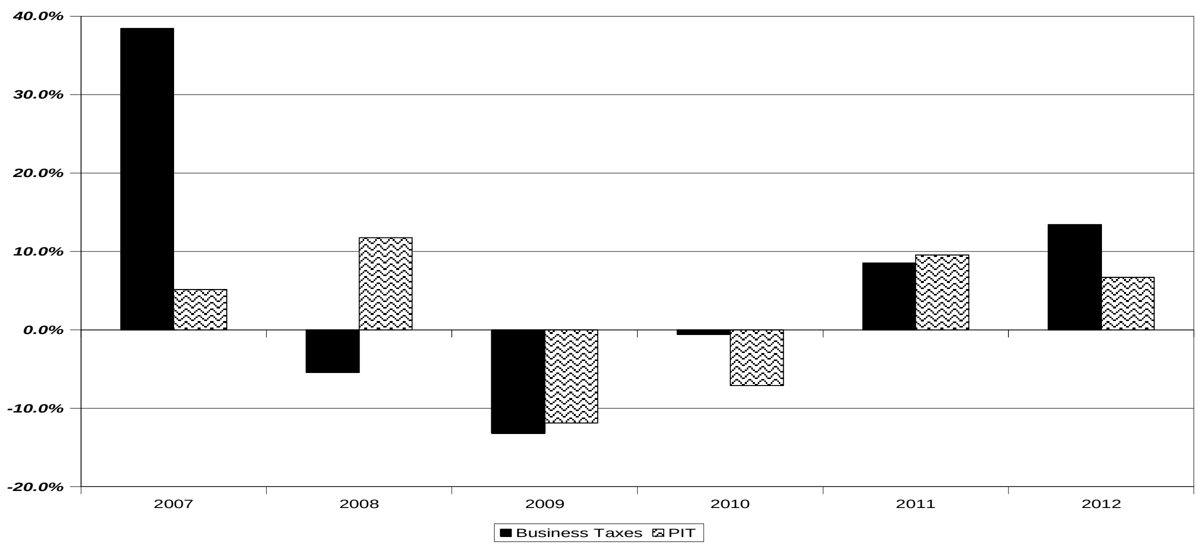
BUSINESS AND INCOME TAXES: ACCOUNTING AND TAX LOSSES

Collectively, the City's business taxes—the unincorporated business tax (UBT), general corporation tax (GCT) and banking corporation tax (BCT)—are holding up surprisingly well, down 3.3 percent through April compared to the same time last year. The decline is primarily in the BCT which is down 27 percent from last year. The UBT is actually up by close to 15 percent. In this way it is similar to the personal income tax which is up by 15 percent compared to last year. A large part of this is due to unusual strength of the estimated portion of the PIT which is up 48 percent. April's estimate payments were spectacular, exceeding full year collections for any year prior to 2006.

With the dramatic losses in the securities industry, OMB in the Preliminary Budget was expecting a much stronger decline the income taxes than has occurred so far, and has revised its forecast upward. There are two things behind this. First, tax year 2007 was a good year for a lot of taxpayers. There are payment rules affecting the business taxes and the PIT that tend to increase the size of first payments after a good year. OMB has emphasised these 'safe harbour provisions' as a source of March and

April's strong collections.[19] Second, one should note that the rules of GAAP accounting used in investment banks financial statements and rules of tax accounting are not always the same. Reported losses are not necessarily tax losses, or they may only become tax losses at a later date. As problems in the housing market and the credit market work them self out we may see transactions that realize for these already reported losses for tax purposes. But as the Institute of International Finance has pointed out "The writedowns required under current interpretations (of accounting rules) may be substantially in excess of any actual or reasonably probable loss on many instruments".[20]

FIGURE 5: LOSSES WILL IMPACT ON BUSINESS AND PERSONAL INCOME TAXES OVER THE NEXT TWO YEARS.



Going forward, the business taxes do not return to their Fiscal 2007 levels within the forecast period, with the worst years being Fiscal 2009 and 2010. While some of this results from the uniqueness of New York City's economy with its heavy reliance on the hard hit financial sector, it is also similar to a more general phenomenon. Global Insight forecasts that nationally, state and local corporate income taxes will fall 14 percent between City fiscal 2007 and Fiscal 2010 and not return to Fiscal 07 levels within the forecast period. This is a product of expected weak growth in corporate profits.

The PIT declines sharply in Fiscal 2009. This is a product of a fall in withholdings due primarily to a fall in financial sector employment and a weak 2008-2009 bonus season. There is also a sharp fall of over 12 percent in estimated payments. This is due largely to a decline in capital gains realizations, and from weaker equity, credit and real estate markets. This decline is similar to that expected at the national level by the Congressional Budget Office. The CBO expects personal income tax liabilities from realized capital gains to fall by a total of 11 percent in 2008 and 2009.[21] The City's OMB differs

19 .For the business taxes the first payment has to equal at least one quarter of the prior years liabilities. For the PIT there is the well know safe harbour rule, as long as your tax payment during the year equal 110 percent of prior year liabilities you are exempt from any penalties or interest for being under-withheld.

20 Quoted in Financial Times , "Top banks call for relaxed writedown rules" May 21 2008.

21 Congressional Budget Office "Budget and Economic Outlook Fiscal Years 2008 to 2018" January 2008.

from CBO, expecting a 20 percent decline from estimated payments in Fiscal 2010. CBO expects Federal liabilities from capital gain realizations to return to 2008 levels in 2010. The City's income tax recovers slowly and does not reach Fiscal 2007 levels within the forecast period.

SALES, UTILITY AND OTHER TAXES

OMB forecasts sales tax revenues in Fiscal 2008 at $4,817 million, growing 4.3 percent from the previous year, and $113 million more than in the Preliminary Plan. Fiscal 2009 is projected to raise $4,666 million, decreasing 3.1 percent, $24 million above Preliminary. Comparing the actual collections through April, revenue growth from the first ten months of Fiscal 2008 comes to 6.0 percent over the same period in 2007. The growth in Fiscal 2008 collections is tempered by the extension of the tax exemption on shoes and clothing to items priced over $110. Without this change sales tax revenues would have grown by 6.6 percent in Fiscal 2008, a pretty good year. OMB attributes sales tax growth in 2008 to the 75 thousand additional wage earners in calendar 2007, unusually large discounts from skittish retailers, and the strong growth in tourism. Healthy wage growth and large bonuses in Fiscal 2007 has also fueled taxable consumption. In Fiscal 2009, however, reduced sales tax revenue is anticipated, with the national slowdown and credit crisis making consumers more cautious and apprehensive for the future. Higher costs for nontaxable food will also reduce the share spent on taxable items. OMB estimates sales tax collections in 2010 through 2012 as growing on average by 3.4 percent a year, as wages recover.

The utility tax is expected to take in $382 million in Fiscal 2008, increasing 6.1 percent over Fiscal 2007, and $22 million more than was projected in the Preliminary Plan. The first ten months of Fiscal 2008 show a 2.6 percent increase over the same period in 2007. Increased electricity costs of 7.5 percent, and the switch from nontaxable oil to more economical but taxable natural gas has contributed to higher collections. There was also increased telecommunication use. Fiscal 2009 projects $377 million, decreasing 1.3 percent from 2008, and $2 million above Preliminary. This reduction is traced to reduced employment and demand for energy, in the workplace and at home. In the outyears, projected revenue growth averages 6.2 percent annually between Fiscal 2010 and 2012.

Cigarette tax revenues in Fiscal 2008 are estimated to take in $121 million, a 0.9 percent drop from 2007 levels, exactly the same as in the Preliminary Plan. This is part of a general downward trend in taxable cigarette consumption, motivated by the stark increase in the City's cigarette tax from 8 cents to $1.50 per pack in 2002. The New York State 2008-2009 budget, with its own $1.25 per pack cigarette tax hike will further discourage taxable consumption, with the combined City and State tax now at $4.25 per pack. Fiscal 2009 forecasts a further 15.7 percent drop in revenues to $102 million, with Fiscal 2010 through 2012 continuing the trend, falling 2.7 percent annually.

The hotel tax projects continued strong growth in Fiscal 2008 at $371 million, 13.9 percent over the previous year ($5 million over the Preliminary Plan). The first ten months of Fiscal 2008 collections already show a 14.6 percent increase from the previous year. Due to the heated demand from visitors rooms hotel occupancy rates have averaged 86.5 percent during the first three quarter of Fiscal 2008, while average room rentals skyrocketed to an average $313 per night. This growth has been stoked by 46 million tourists in calendar year 2007, a 4.5 percent increase over the previous year. Foreign tourism, comprising 18.4 percent of visitors, has been especially strong, growing by 22.0 percent from the previous year. This vibrant tourist industry has been fueled by the increased amenities and safety in the City, and the continuing decline of the dollar. Hotel tax revenues for Fiscal 2009 are projected at $394 million, a slower 6.2 percent growth from 2008, and $7 million over the Preliminary. OMB expects revenues to grow at an average 7.0 percent from Fiscal 2010 to 2012.

REAL PROPERTY TAX

The Fiscal 2009 final assessment roll released by the Department of Finance on May 27th showed a growth in the billable assessed value (BAV) of 7 percent from Fiscal 2008, for a total of $134.6 billion, slightly less than OMB 's forecast in the Executive Budget . Because the final assessment roll was not published at the time the Executive Budget was issued, OMB did not change its estimate of the levy for Fiscal 2009 from the Preliminary Budget estimate of $15,388.2 million. However, the final levy will be about $15,362.2 million; $26 million below OMB's forecast.

MARKET VALUE: The market value of the City's nearly 1,000,000 parcels of taxable real estate increased only 2.8 percent over the prior year on the tentative assessment roll released in January, evidence that the City's property values are beginning to experience some of the softening in the real estate markets. The total value of taxable real estate is still high, at $818.4 billion. With the exception of class one properties which experienced its first decline in value in years, the other three classes of properties experienced market value growth, although the rise in value for classes two and four was substantially below last year's double-digit growth. Property values dropped in Brooklyn, Queens and Staten Island, because of the high concentration of class one homes in these boroughs. Growth was still strong in Manhattan, the borough with the highest concentration of commercial property, and the Bronx, where market value growth was bolstered by large increases in the value of multi-family properties.

The most notable change to the assessment roll this year was the change in the way DOF determined the market value for class two multi-family properties with more than 10 units. For the first time, DOF used the Gross Income Multiplier (GIM) approach to value these properties rather than the net income capitalization method. (For several years DOF has used the GIM method to value class two properties with less than 11 units.) Net income capitalization uses the income stream and expenses of a building and applies an appropriate capitalization rate to determine the full value of the property. DOF found that the expense ratios for multi-family buildings often varied so greatly that they were an unreliable indicator of value and tended to lower the values of those properties that overstated their expenses. The GIM method avoids using building expenses, and applies a gross income multiplier based on property type to the income stream of a building in order to determine market value. DOF hopes this method will be more accurate and make the estimate of market values for multi-family properties more predictable in the future. Initially, DOF developed two different GIM schedules; one for rental buildings and another for co-op and condo buildings. However, this approach was found to be open to legal challenge. DOF revised its GIM and combined the two schedules into one GIM schedule which it applied to both rental buildings and co-op and condo properties. DOF mailed out a revised change of notice on February 15th to more than 150,000 properties. The effect of the revision is virtually "revenue neutral"; it doesn't change the total assessed value for class two, but rather increases the values for rental buildings and decreases them for co-op and condos.

Market value growth has been remarkable since September 11, 2001, until this year. Total market value has more than doubled since Fiscal 2002, while class one (one-, two-, and three-family homes) market value has increased by 134 percent. As can be seen in the table below, class one properties experience the first decline in market value in several years, decreasing by nearly 1 percent from Fiscal 2008—evidence that home prices are beginning to soften, since growth in market value closely mirrors the trend in sales prices. In fact, this is the first decrease in class one market value since Fiscal 1994, occurring after a long run of double digit growth since Fiscal 2001.

TABLE 5: MARKET VALUE GROWTH BY TAX CLASS SINCE FISCAL 2002

Fiscal Year	All	Class 1	Class 2	Class 3	Class 4
2002-2003	9.5%	13.5%	9.4%	4.7%	3.9%
2003-2004	8.6%	13.6%	3.6%	2.7%	4.5%
2004-2005	15.8%	21.7%	18.9%	6.6%	3.0%
2005-2006	13.6%	14.6%	13.4%	13.5%	11.6%
2006-2007	9.8%	12.9%	7.3%	6.8%	5.2%
2007-2008	18.1%	16.3%	24.7%	-2.9%	19.0%
2008-2009F	2.8%	- 0.9%	8.1%	7.4%	6.2%
2002-2009F	**108.6%**	**134.0%**	**121.0%**	**44.9%**	**66.0%**

Sources: New York City Department of Finance, Annual Report on the NYC Real Property Tax, Fiscal Year 2007; Tentative Assessment Roll, Fiscal Year 2009.

Strong growth in market value for residential properties (class one) relative to the other classes has increased the share of total market value to nearly 52 percent from 46 percent in Fiscal 2002. Conversely, the share of commercial property (class four) has decreased from 28 percent in 2002 to 22.5 percent in Fiscal 2009.

BILLABLE ASSESSED VALUE: The total taxable or billable assessed value (BAV) on the tentative roll, before accounting for the STAR and veterans exemptions, increased by $9.8 billion from Fiscal 2008 for a total of $135.6 billion. The 7.0 percent increase in value is only slightly less than the 8 percent growth experienced last year. The continued growth in BAV for class two and four properties reflects strong market value growth over the past several years. During periods of economic growth, increases in market value result in a substantial “pipeline” of accumulated assessed value that is phased-in for classes two and four (assessed value increases are phased in over five years for these two classes of property). Large yearly increases in market value for class one properties are rarely captured in BAV growth because State law caps class one growth in assessed value at 6 percent a year and 20 percent over five years. However, after a long period of high market value growth, the cap on assessment increases lowers the “real” assessment to market value ratio. In Fiscal 2009, this ratio will drop to about 3 percent. The “target” assessment ratio for class one is 6 percent. While the cap on assessment increases acts as a break on steep increases in assessed value in any one year, the assessments can still increase up to the cap even when market value is declining, until the target assessment ratio is reached. This is the case with class one properties in the upcoming fiscal year, where market values are declining, while the BAV is anticipated to increase by nearly 5 percent. Contrast this with Fiscal 2008, when class one experienced a growth in market value of more than 16 percent, yet assessed value only increased by 4 percent.

However, the final assessment roll, released on May 25th, was lower than the tentative roll, due to Tax Commission actions, DOF changes by notice, and completion of exemption processing. In the

Executive Budget, OMB estimated that the final roll BAV would be $0.8 billion or 0.6 percent lower than the tentative roll, resulting in final roll increase of 7.2 percent over Fiscal 2008—growth of 8.1 percent for class two, 7.8 percent for class four, and 4.3 percent for class one. The final roll was nearly $1 billion lower than the tentative roll, resulting in a 7.0 increase from 2008. Class one experienced BAV growth of 4.5 percent; the BAV for classes two and four increased by 6.4 percent and 7.6 percent, respectively, from Fiscal 2008.

Because of the high growth in market value from prior years resulting in a large accumulation of assessed value in the pipeline for classes two and four, OMB has carried through the high growth in the BAV throughout the plan period, though at a declining rate to account for OMB's forecast of a slowdown in the real estate markets. OMB anticipates that the BAV will increase at an annual average rate of 6 percent from Fiscal 2010 through 2012.

Real Property Tax Levy and Revenue: In the Executive Budget, OMB did not change its estimate of the levy for the plan period from the Preliminary Budget. The levy is anticipated to increase at an average annual rate of 6 percent from Fiscal 2010 through 2012. However, as mentioned above, the final roll levy will be approximately $26 million below OMB's estimate, for a total of $15,362 million; still a healthy increase of 7 percent from Fiscal 2008.

OMB made only one change in the reserve estimate for Fiscal 2008, and increased anticipated collections from prior year payments by $10 million, most likely due to the "lien sale" effect. In December, the Council passed legislation renewing the City's ability to conduct tax and water lien sales. The legislation had expired on August 31, 2006. On May 19th, the City conducted a lien sale and anticipates to net $58 million in property tax related lien sale proceeds, no change from the Preliminary Budget estimate. Total property tax revenue for Fiscal 2008 is estimated at $13,009 million, a slight growth of less than one percent from 2007, due to a 7 percent reduction in the average tax rate implemented in Fiscal 2008.

Revenue then jumps to a growth of 6.4 percent in Fiscal 2009. OMB made one major change to the reserve estimates for Fiscal 2009 and 2010, reducing revenue by $81 million in each year from the Preliminary Budget estimates, for total revenue of $13,838.2 million in Fiscal 2009 and $14,867.8 million in Fiscal 2010. OMB increased its refund estimates by $85 million in each of those years in anticipation of refund claims by utility companies due to a recent court decision that permits the acceleration of the depreciation of certain utility property due to functional obsolescence brought about by technological innovation.

From 2010 through 2012, revenue is estimated to increase by an annual average rate of 6.4 percent, because OMB assumes continuation of the 7 percent property tax reduction through Fiscal 2012 in its calculation of the levy and property tax revenue. However, the Executive Budget's proposal to eliminate the 7 percent reduction in Fiscal 2010 through 2012 is included in the total sum of anticipated tax revenue for the plan period. Rescinding the 7 percent reduction will save the city $1.223 billion in Fiscal 2010, $1.298 billion in Fiscal 2011 and $1.359 billion in Fiscal 2012. Also included in the plan is the renewal of the current co-op/condo abatement program which sunsets this June, and continuation of the $400 property tax rebate through Fiscal 2012. The rebate was extended last year for three more years through Fiscal 2010. Two bills have passed the State legislature renewing the co-op/condo abatement through Fiscal 2012.

OTHER REAL ESTATE TAXES

REAL PROPERTY TRANSFER AND MORTGAGE RECORDING TAXES: In Fiscal 2008, revenue from both the real property transfer tax and mortgage recording tax will reach $1,414 million and $1,167 million, respectively, near historically high levels. OMB decreased its estimate for the transfer tax by $61 million from the Preliminary Budget, but increased its forecast by $13 million for the mortgage tax. Revenue from both the transfer tax and mortgage tax is anticipated to decrease from Fiscal 2007 by 17.9 percent and 25.7 percent, respectively. The slowdown in sales and softening of prices as a result of continuing turmoil in the credit market are beginning to be felt in both the residential and commercial real estate markets. However, the residential market continues to experience strong sales of high-end condos in the Manhattan market, somewhat offsetting the slowdown of sales of 1-3 family homes in the outer boroughs. The falling off of sales of highly valued buildings in the commercial market due to the tightness of credit will continue to dampen commercial markets. April 2008 collections were below the Executive Budget plan for both taxes, by $8 million for the transfer tax and $12 million for the mortgage tax. But the anticipated sale for $3.95 billion of the Macklowe commercial properties in Manhattan, including the G.M. building, will bolster transfer tax collections by about $80 million in either Fiscal 2008 or 2009, depending upon when the closing occurs. Whether or not these buildings will be purchased with a mortgage is unclear, since most of the funding is being provided by the governments of Kuwait and Qatar.

In Fiscal 2009, OMB anticipates that revenue from both the transaction taxes will decline by about 25 percent then decrease again, but at a much lower rate in both Fiscal 2010 and 2011, before returning to growth of approximately 6 percent for each tax in Fiscal 2012, as both the residential and commercial markets recover from the credit crisis.

COMMERCIAL RENT TAX: OMB has not changed its forecast of revenue from the commercial rent tax throughout the plan period since budget adoption in June. OMB anticipates collecting $550 million from the tax in Fiscal 2008, for a growth of 7.4 percent from Fiscal 2007. The strong growth in 2008 results from a tight market in commercial space with a prime office vacancy rate of 5.9 percent in March, and a high asking rent of nearly $80 per square foot. However, OMB forecasts weak growth in office employment during the plan period due to the national recession and employment losses on Wall Street. As a result, OMB estimates that the vacancy rate in the primary market will increase to 10.6 percent by the end of 2009. As a result, growth in collections is anticipated to slow to an annual average of 3.2 percent from Fiscal 2009 through 2012.

TAX ENFORCEMENT REVENUE

In Fiscal 2007 audit revenues grew by 40 percent, thanks to a series of settlements of ongoing business tax audits. OMB expects audit revenues to come down only slightly from this record level in Fiscal 2008. This represents an increase of $500 million since the budget adoption. OMB is forecasting audits to return to their historic average in Fiscal 2009, a drop of 45 percent, and to remain around that level for the rest of the forecast period.

Tax and Debt Service Policy

EXECUTIVE BUDGET

The Executive Budget contains three proposals that were a part of the Administrations Plan 2030.

Wave NYC Sales Tax for Hybrid Vehicles: The Administration proposes to wave the New York City sales tax for eligible hybrid vehicles. According to the Administration if 10 percent of the City's gas vehicles were hybrids, CO_2 emissions in the City would be lowered by 2 percent. OMB estimates the fiscal impact at $1.6 million in Fiscal 2009 growing to $2.8 million by Fiscal 2012. This would only affect only the 4 percent New York City portion of the tax, the 4 percent New York State and 3/8th percent MTA portions of the tax would remain.

Solar Tax Abatement: The Administration proposes to create a four-year real property tax abatement as an incentive to install solar electric systems on Class 2 and Class 4 buildings in New York City. The abatement will be based on eligible installation costs of the systems. OMB estimates the fiscal impact at $0.4 million in Fiscal 2009 growing to $2.6 million by Fiscal 2012

Green Roof Abatement: This proposal would provide a one-year property tax abatement to building owners who install green roofs--partially or completely cover roof with plants. Value of the abatement would be based on eligible installation costs. It is a pilot program for five years and OMB expects it to reduce City revenues by $1 million for each fiscal year.

EXTENDERS

Renewal of the Co-op/Condo Property Tax Abatement: S7714 / A10688 extends the current Coop/Condo abatement for 4 years. At time of writing the bill had past both houses of the legislature but had not been submitted to or signed by the Governor. Without this legislation the abatement would sunset in June. The current abatement has been in effect since 1997 and was renewed twice before, in 2001 for fiscal years 2002 through 2004, and for four years beginning with Fiscal 2005. The amount of the abatement is 25 percent of the property tax liability for units in buildings where the average assessed value per unit (BAV) is $15,000 or less, and 17.5 percent for units where the average assessed value is more than $15,000. Evidence suggests that tax inequity still exists between class one and class two homeowners. Removal of the abatement would create a steep rise in taxes during a time when increasing property values have kept property taxes high. On the tentative assessment roll for Fiscal 2009, class two co-op owners will see about an 8 percent increase in assessments over Fiscal 2008, and condominium owners more than a 12 percent increase.

In Fiscal 2007, owners of more than 417,000 coop and condo units received an average abatement of about $740 per unit.

The cost of the abatement is more than $300 million a year in foregone property taxes. The fiscal impact of the abatement is $330 million in Fiscal 2009, rising to $372 million in 2012.

<u>Personal Income Tax, General Corporation Tax, Cigarette Tax, Sales taxes on Credit Reporting, and Personal Services Extender:</u> S8152 would extend a set of City taxes necessary for the financial plan. The City's personal income tax would revert to a minimum tax on January 1, 2009. The bill extends the tax at current levels through 2011. Similarly, the City's general corporation tax would revert to 6.7 percent down from the current 8.85 percent tax on January 1, 2009 and would be extended the current rate till December 31, 2011. The cigarette tax reverts to 2 cents per 10 cigarettes on January 1, 2009 from the current 75 cents for ten cigarettes. This extends the tax at current levels till the end on 2011. The City's main sales tax whose revenues went first to the Municipal Assistance Corporation was replaced as a part of the New York State Enacted Budget by a New York City sales tax at the same 4 percent level. But there are several smaller sales taxes that are scheduled to sunset this year. This includes the 4 percent sales tax on credit reporting services and the 4 percent sales tax on personal services including Barbering, manicuring and health salon services. These taxes are being extended at current levels through 2011.

<u>Bond Financing Powers Extender:</u> S8157 Padavan through 2010 a variety of powers that make it easier for the City to market and manage their bonds. This includes the ability to enter into swaps, issue variable rate debt, to sell bonds at private sale, and to refinance bonds. It also extends some bond provisions of the Financial Emergency Act concerning the method of calculating savings on refund transactions and the ability of the City to include State pledges in certain agreements with City bondholders.

OTHER ADMINISTRATION PROPOSALS

<u>Legal Defeasance of Bonds:</u> Defeasance is a way of prepaying bond and is one of the way the City rolls money forward from one fiscal year to the next. A8988a Farrell/S6934a Padavan will allow the City to legally defease its bonds. Currently it only has the power to economically defease. In a legal defeasance an irrevocable escrow account is created and US treasuries deposited sufficient to service the bond. The bond is legally no longer an obligation of the City but is now paid out of the escrow account. The City currently can not create escrow accounts of this kind. The Mayor and Comptroller will work out a defeasance financial plan showing bonds to be defeased and available appropriations to fund the defeasance. The ability to do legal defeasance would give the City more choice in the bonds it could prepay, allowing it to high cost bonds resulting in additional savings in debt service. The Administration believes this will annually save the City $5 million in debt service costs starting in Fiscal 2009.

CITY COUNCIL TAX POLICY PRIORITIES

<u>Renters Tax Credit:</u> Council Speaker Quinn in the State of the City speech renewed her support for State legislation authorizing the City to create by local law a renters credit of up to $300 against the City's personal income tax, and calls on the State to enact A. 06849 (Wright)/S.03961 (Savino). This credit would help alleviate the burden on renters who absorb property tax increases through higher rents. This proposal is part of the Council's broader effort to make housing more affordable for all New Yorkers. The credit would be passed by the New York City Council at a time and at a level that is fiscally prudent

It is generally accepted as fiscally reasonable to spend no more than 30 percent of income on rent. According to the most recent Census data, over 40 percent of renters in the City spend more than this threshold, and the figure jumps to 67 percent for those renter households eligible for the credit. As documented by the most recent Housing and Vacancy Survey (2005), the median monthly rent in the City increased by nearly 32 percent from 1999 to 2005. Unfortunately, the increase in personal income of most renters has not kept pace with the growth in rent with incomes only increasing 23 percent during this same period.

Property taxes have played a roll in this. In the past six years (New York City Fiscal Years 2003-2008), the tax bills in multi-family buildings[22], have increased by nearly 63 percent, despite the 7 percent rate reduction enacted last year.

Under the this proposal, this credit would ease rent costs for families making less than $75,000 per year and individuals earning less than $43,000 per year. If enacted by the City at the maximum level, qualifying renters would receive a flat $300 refundable credit on their personal income tax that can be used either to pay their taxes or as a direct rebate to offset living expenses or for other needs.

Homeowners have faced similar pressure from property taxes and other housing costs, though they are generally better off than the renters targeted by this credit. Last year, the Council, along with the Mayor, was able to secure an extension from the State Legislature of the $400 property tax rebate for homeowners.

Approximately 1.1 million households may qualify for the renter's credit and if enacted at the full level they would save $261 million a year. The Council's plan would treat tenants more equitably with homeowners and provide tax relief to help New Yorkers with the ever-increasing pressure of rising rents.

<u>Reduce Double Taxation of Small Business Owners:</u> The Council Speaker in the State of the City address reiterated her support for creating a tax credit for S-Corporation shareholders, and calls on the State Legislature to enact S.6247-A (Padavan)/A.9482 (Farrell) of 2008. Today, more than three quarters of all businesses in New York City have fewer than 20 employees. Many of the City's small businesses and independent workers are structured as S-Corporations. Currently, there are 123,000 S-Corporations in New York City. These businesses, spanning all sectors of New York City's economy, range from law to finance, and from retail to health care.

To help these small businesses grow and thrive, the Federal government offers an important tax break: an exemption from the Federal corporate income tax. All profits are passed on to the owners, who pay personal income taxes on their earnings. New York State also largely exempts these businesses from the corporate franchise tax. Yet, S-Corporation shareholders currently receive no local tax relief. Last year, the Council supported a City credit based on a sliding scale that ranged from a 100 percent credit of General Corporation Tax liability for City resident taxpayers with State taxable income of $42,000 or less, and gradually phasing out to zero percent for taxable income of $250,000 or more. The credit reduces the personal income tax of New Yorkers who are shareholders in S-Corporations by $35 million in its first full year. Last June, the Council enacted by local law a similar PIT credit for New

22 Class two multi-family buildings, this includes co-op and condo owners, as well as renters.

Yorkers subject to the unincorporated business tax, lessening the double taxation of another group of small business owners. Equity considerations require a comparable treatment for S-Corporation shareholders.

This bill also would accelerate by one year the 50% phase-out of the alternative income-plus-compensation tax base of the City's general corporation tax (GCT) recently approved by the State Legislature

In order to prevent companies from lowering their taxable income by disguising dividends as salaries, the City's GCT uses an income-plus-compensation as an alternative tax base. Paying salaries to owners instead of dividends could lower the company's taxable income because salaries are deductible and dividends are not. The alternative tax calculation adds salaries paid to any shareholders who own more than 5% of the corporation's outstanding stock to net income.

Due to changes in Federal laws and enforcement practices, the need for this alternative tax base calculation has diminished. This proposal would accelerate the 50% phase-out of this tax rate from four years under current law to three years, with the full 50% reduction occurring in 2010 instead of 2011. The most common type of taxpayer affected is a small to medium size firm. About 25,000 firms would benefit from this proposal. This will save owners of small businesses in New York City around $35 million.

Miscellaneous Revenue

The budget for miscellaneous revenue is separated into various classes, with more detailed descriptions available under the appropriate agency by revenue source code. The accounting rules mandate that this type of revenue be counted on a 'cash basis.' The City operates under the guidelines that it can charge a fee to provide services according to the cost required to perform the service. The approval process for establishing fees is spelled out in the City Charter: When a fee increase is requested, the agency responsible must provide the appropriate approving bodies a cost analysis that spells out the actual cost incurred in providing the service. There are some fee levels that are not cost driven, but are based on competitive bidding at auction.

Overall, the Executive Budget increases anticipated miscellaneous revenue by $193 million in Fiscal 2008 and by $225 million in Fiscal 2009 compared to estimates made in the January Plan. Below are the more significant contributors to this net change.

Licenses, Permits and Franchises: The Executive Budget anticipates an increase of $12 million in fees from Licenses, Permits and Franchises in the current fiscal year to a level of $469 million. The largest contributors to this increase include increases in construction related permit revenue (+$6 million), increased revenue from sidewalk cafes (+$3 million) and street permit and fair revenue (+$1.5 million). The remainder of the increase is broad based throughout many agencies. Revenue from this category decreases by $10 million to $459 million in Fiscal 2009.

Charges for Services: The Executive Budget Plan anticipates Fiscal 2008 revenue from charges for services to total $614 million, an increase of $27 million over the January Plan targets. An increase in fee revenue from the 421-a program is anticipated to yield an additional $10 million. Revenue from tuition and fees is increased by $5.3 million. Additional revenue from multi-spaced meters is anticipated to add $3.5 million. The updated projection for Civil Service Exam fee revenue provides an additional $1.7 million. The remainder of the net increase in this category is comprised of many changes in many agencies. Revenue from this category decreases by $23 million in Fiscal 2009 from Fiscal 2008.

Rental Income: For Fiscal 2008, the Executive Budget increases rental income to $247 million, $35 million over the January Plan estimates. Revenue generated from extended use of school facilities is increased by $8 million. Rental income generated from Yankee Stadium is increased by $9.7 million. Anticipated Shea Stadium is also increased by just under $4 million. Additional commercial rental income provides $10 million. Revenue from this category decreases by $29 million in Fiscal 2009 from Fiscal 2008, primarily the result decreased stadium rents.

Fines and Forfeitures: For Fiscal 2008, the Executive Budget increases fines and forfeitures revenue by $61 million from the January Plan to $823 million. The largest increase is in parking violation revenue, increasing by $36 million. Projections for Fiscal 2008 Environmental Control Board fine revenue is increased by $9 million. Remaining increases are broad based including Department of Buildings and Red Light Camera program fines. Revenue from this category decreases by $75 million in Fiscal 2009 from Fiscal 2008. Half of the year to year decline is attributable to a return of Parking Violation revenue back to levels anticipated in the January Plan.

Interest Income: For Fiscal 2008, the Executive Budget estimate for interest income is reduced from the January Plan by $30 million to $357 million. The Fiscal 2009 forecast is reduced to $85 million, predicated on lower cash balances and less favorable interest rates. Recent experience has shown that during the course of the fiscal year, the forecast for interest income is increased. Though it is unlikely that this revenue source will reach levels achieved in Fiscal 2008, it is likely that the current target for Fiscal 2009 will be surpassed.

Miscellaneous Revenue Sources: For Fiscal 2008, the Executive Budget adds $48 million to the January Plan for a total of $1.179 billion. This category of revenue serves as a catchall for all revenue sources not classified in one of the above categories. The more significant adjustments include a $47 million in increase in revenue as a result of affirmative litigation, and reimbursement for debt service expenses totaling $8 million. These increases are offset by a net decrease resulting from many small changes in many agencies. Remaining miscellaneous revenue sources decrease by $516 million in Fiscal 2009 compared to Fiscal 2008, to a level of $663 million. The bulk of this decrease is from a year-over-year decline in tobacco settlement revenue from $552 million in Fiscal 2008 to $143 million in Fiscal 2009. The Fiscal 2009 level represents the new baseline going forward, and the Fiscal 2008 level represents the final impact year of the restructuring of tobacco monies that occurred in Fiscal 2006.

Water and Sewer Fees: In the Executive Budget, Fiscal 2008 revenue increases by $19 million from the $1.213 billion being carried in the January Plan for Fiscal 2008. Decreases in rollover revenues (-$24 million) coupled with a reduction in the Water Board Rental payment (-$1 million) are offset by increased revenue from the Fringe Benefit reimbursements (+$32 million). In Fiscal 2009, the Executive Budget projects revenue collections of $1.297 billion, up $65 million from Fiscal 2008.

Unrestricted and Anticipated Intergovernmental Revenue

The Executive Budget includes the New York City budget impact of the State Executive Budget. The Adopted State Budget retreats from the State's pledge to fully restore Aid to Municipalities (AIM) disbursements to the City at its historical level of $327 million that was assumed in the Financial Plan. In Fiscal 2007, this important source of general aid was reduced to $20 million, with the understanding that a full restoration would occur in Fiscal 2008. The finalized State Budget restored only $242 million of the $327 million for Fiscal 2008. The Executive Budget assumes that the full amount will be restored in Fiscal 2009.

Financing Program and Debt Service Budget

The City's Fiscal 2008 debt service budget, as presented in the Executive Budget, increases by $1.925 billion to $5.537 billion, compared to the January Financial Plan. This is the result of the proposed pay down of $1.986 billion in outstanding G.O. debt due in Fiscal 2010. Offsetting this large increase for Fiscal 2008 are savings in debt service costs associated with the City's holdings of variable rate debt producing savings of $43.3 million, and reduced interest exchange agreement payments that produce savings of $10.5 million. The Administration has increased the projected prepayment of Fiscal 2010 debt service using Fiscal 2009 resources by $969 million to $1.319 billion. This increase is offset by savings in lease purchase debt service (-$99 million).

Debt Affordability: The Mayor's Executive Budget examines the City's debt burden by comparing debt service costs for the five issuers responsible for financing the great majority of the City's capital program (excluding the Water Authority and the Metropolitan Transportation Authority) to total taxes and total revenues. For Fiscal 2008, debt service payments are 16.3 percent of total taxes and 10.2 percent of total revenue. In Fiscal 2012, these percentages decrease to 15.0 percent and 9.6 percent, respectively. According to the Executive Budget presentation, debt service increases at an average rate of 34.2 percent per year from 2010 to 2012 compared to total revenues that will experience a 4.7 percent average growth rate.

General Obligation Bonds: The City anticipates financing $26.9 billion of its capital program through the use of general obligation debt during the Fiscal 2008 through 2012 period. This represents a reduction of $2.7 billion in issuance during the Financial Plan period as a result of the 20% reduction in the capital program. This reduction was achieved by stretching out the commitment plan by one year. So far this year, the City has completed eight sales, totaling $7.381 billion. Four sales raised $2.525 billion to support the ongoing capital program. The proceeds from the four bond refundings to date will provide $88 million in combined debt service savings in Fiscal 2009 through Fiscal 2010. As a result of the projected gradual increase in the general debt limit, the City is not expected to exceed the constitutional debt limit through the Plan period.

TABLE 6: FINANCING PROGRAM: SOURCES OF FUNDS (IN MILLIONS)

	2008	2009	2010	2011	2012	Total
Sources of Funds:						
City General Obligation Bonds	$3,675	$4,800	$6,800	$6,200	$5,400	$26,875
Transitional Finance Authority	--	--	--	--	--	--
TSASC Bonds	--	--	--	--	--	--
Water Authority Financing	2,484	2,514	2,320	2,305	2,206	11,830
Total	**$6,159**	**$7,314**	**$9,120**	**$8,505**	**$7,606**	**$38,705**

Transitional Finance Authority: The New York City Transitional Finance Authority (TFA) was created in 1997, and is authorized to issue debt backed by the City's personal income tax (PIT) revenue for the purpose of financing a portion of the City's capital program. The TFA was initially authorized to issue up to $7.5 billion of bonds and notes. In June 2000, the authorization was increased to $11.5 billion and an addition $2 billion in bonding authority was granted in 2007. The State Legislature has also increased TFA's variable rate capacity to 20 percent of its bonding capacity. The Administration is currently seeking an additional TFA bonding authority up to the existing limit on G.O. bonding authority. This would allow cheaper TFA debt to replace future G.O. issuance, generating $14 million in savings in Fiscal 2009, growing to $35 million in Fiscal 2011.

TFA Financing for September 11th Related Costs: On September 13, 2001, the State Legislature enacted an amendment to the TFA statute allowing the TFA to issue an additional $2.5 billion in debt backed by the PIT for the purpose of financing costs related to the World Trade Center (WTC) attack. These bonds and notes are subordinate to bonds issued under TFA's original $11.5 billion authorization. In October 2001, the TFA issued $1 billion in Recovery Notes under this new authorization. This first Recovery Bond issue was used to replace lost revenues resulting from the WTC attack. Another $1 billion was used to retire existing Recovery Notes.

Tobacco Bond Financing: TSASC, Inc. is a special purpose corporation that the City created in November of 1999 for the purpose of issuing bonds to fund a portion of the City's capital program. TSASC bonds are secured by the City's share of the Tobacco Settlement Revenues (TSRs) received pursuant to the Master Settlement Agreement between 46 states and the four largest domestic tobacco manufacturers (Philip Morris, Reynolds Tobacco, Brown & Williamson, and Lorillard). The City sold the right to receive these funds to TSASC in 1999. After TSASC retains sufficient tobacco settlement revenue (TSR) for debt service, the remaining revenue flows through to the City's general fund.

Since November of 1999, TSASC, Inc. has sold two bond issues in the amount of $1.298 billion. In December 2001, TSASC and the City completed a $150 million loan agreement with the U.S. Department of Transportation (USDOT). The loan agreement provides for funding by the USDOT for one-third of the capital costs associated with the Staten Island ferries and ferry terminals. The remaining $59 million in TIFIA loans has been drawn down last year.

In May 2003, RJ Reynolds was downgraded below investment grade. This triggered a trapping event where more of the residual settlement revenues that would have flowed to the City are instead retained in TSASC debt service accounts. The City restructured its outstanding TSASC bonds to release the trapped funds. The restructured bonds issued under an amended indenture limits the tobacco revenues pledged to TSASC to 38 percent with the remainder of the funds flowing to the City's general fund. Also, as a result of the restructuring, budgeted tobacco revenues of $232 million in Fiscal 2006 and $121 million in Fiscal 2007 were rescheduled and will be received in Fiscal 2008 for a total of $454 million.

New York City Municipal Water Finance Authority (NYW): The Water Authority was created in 1985 to finance capital improvements to New York City's water and sewer system. The Authority has sold $33.8 billion in bonds, including $11.8 billion in refunding bonds to date. The Authority has also defeased $752 million in outstanding debt with revenues prior to maturity. Of the total amount, $18.3 billion in bonds are still outstanding. To date in Fiscal 2008, NYW has completed six bond transactions and expects to issue an additional $1.2 billion in bonds before the end of the current fiscal year. If the current low interest rate climate prevails, refunding opportunities may arise. For the remainder of the Financial Plan period, NYW plans to sell approximately $2.3 billion in bonds annually to fund improvements to the City's water system.

Budget Stabilization Account (BSA): In the October Plan, $296 million was removed from the Budget Stabilization Account based on weaker revenues and a net increase in expenditures in the first quarter of Fiscal 2008. The January Plan increased the BSA by $818 million to $3.073 billion, resulting from identifying mostly one time revenues in Fiscal 2008 and using those revenues as a prepayment to Fiscal 2009 to shore up the declining revenues anticipated in Fiscal 2009. As a result of revenues exceeding expectations since the release of the January Plan, almost $2 billion in additional resources have been identified in Fiscal 2008. As of the January Plan, the Fiscal 2009 budget has been in balance, so the Administration has earmarked this year's additional surplus to pay down outstanding debt that is due in Fiscal 2010. The Executive Budget also allocates $350 million of Fiscal 2010 resources for the prepayment of Fiscal 2011 expenses.