New York City Council
Finance Division

BUDGET REPORT

The Mayor's Fiscal Year 2010 Preliminary Budget

Financial Plan Overview
Economy, Revenue and Debt Service

March 9, 2009

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Speaker

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Committee on Finance

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PREFACE

On March 9, 2009, at 10 a.m., the Committee on Finance, chaired by the Hon. David I. Weprin, will hold a hearing on the Mayor's Preliminary Budget for Fiscal Year 2010. The Director of the Mayor's Office of Management and Budget will testify on the Expense, Revenue, and Capital budgets for 2010, as well as on the Contract budget, which will be heard jointly with the Committee on Contracts, chaired by the Hon. Letitia James. Also scheduled to testify before the Finance Committee are the Department of Finance, the Department of Design and Construction, the Office of the Comptroller, and the Independent Budget Office, as well as members of the public.

The City Charter (§236) requires the Mayor to submit by January 16th a Preliminary Budget for the upcoming fiscal year. The Charter (§247) also requires the Council to hold hearings on the Preliminary Budget and to submit recommendations to the Mayor by March 25th. The Charter allows for changes to the submission dates by local law. This year, by Local Law 3 of 2009, the date for the submission of the Preliminary Budget was changed to January 30th, and the date for the Council's response to April 8th.

This report, prepared by the staff of the Finance Division's Revenue Unit under the direction of Deputy Director and Chief Economist Ray Majewski, provides an overview of the January Financial Plan and 2010 Preliminary Budget, a review of the state of the national and local economies and their impact on projected tax and other revenues, and an overview of the financing program for the City's capital program.

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FINANCIAL PLAN OVERVIEW

In September, three months after the Fiscal 2009 budget was adopted in June, the financial services sector suffered an once-in-a-lifetime collapse: the real estate bubble burst, bringing along with it the entire structure of highly leveraged speculation that had contributed to the bubble. As credit markets and lending literally froze, businesses and households began to retrench, bringing economic activity to a halt. By the last quarter of 2008, the economy had plunged into a deep recession.

The City's tax revenues – which are disproportionately dependent on highly-paid securities and investment banking employees – have suffered a serious collapse. Since the June 2008 Financial Plan, the forecast for tax revenues has fallen 3 percent further in 2009.

In addition to the dramatic decline in tax revenues, the Governor's proposed Executive Budget for 2009-2010 proposed a series of measures that, if adopted, would also worsen the City's fiscal picture. Most notably, the Governor proposed eliminating revenue-sharing – known as Aid and Incentives to Municipalities, or AIM – which provides unrestricted state operating aid to the City's budget (other proposals in the Governor's budget are discussed below).

Together with other changes in spending projections, the gap at the time of the January Plan had grown to over $7 billion -- $1.35 billion in Fiscal 2009, and almost $5.8 billion in 2010. The 2009 budget relies on a $4.6 billion surplus from 2008, and projects rolling $1.55 billion of that surplus into 2010. In effect, this means the combined two-year gap impacts the 2010 bottom line.

Table 1: Budget Update: Changes Since Adoption

(Increase Gap) / Decrease Gap ($Millions)	2009	2010	2011	2012
Gap To Be Closed – June 2008 Plan	**$ -**	**($2,344)**	**($5,158)**	**($5,108)**
Revenue Changes				
Tax Forecast	($1,087)	($3,316)	($2,926)	($3,034)
Non-Tax Revenues	75	(33)	(15)	(2)
Subtotal, Revenue Changes	($1,012)	($3,349)	($2,941)	($3,036)
Expense Changes				
Pensions	($87)	$120	($345)	($612)
Energy	97	137	56	13
Debt Service	10	7	13	116
All Other Expense Changes	(34)	(118)	(103)	(110)
Subtotal, Expense Changes	($14)	$146	($379)	($593)
State Budget Impact				
Revenue Impact	(327)	(194)	(139)	(75)
Expense Impact	0	(32)	(51)	(67)
Gap to be Closed, Jan. 2009 Plan	**($1,353)**	**($5,773)**	**($8,668)**	**($8,879)**

SOURCE: City Council Finance Division, based on OMB Financial Plan documents.

To address the growing gap, the Mayor proposed a series of actions in the November and January Financial Plans, which are outlined below:

Table 2: November and January Plan Gap Closing Proposals

($Millions)	**2009**	**2010**	**2011**	**2012**
Gap to be Closed - Jan. 2009 Plan	**($1,353)**	**($5,773)**	**($8,668)**	**($8,879)**
Agency PEGs	$499	$2,001	$2,058	$2,080
Early Rescindment of Property Tax Cut	576	-	-	-
Cancel $400 Property Tax Rebates	-	256	256	256
Labor Actions				
Tier V	-	200	200	200
10% Co-Pay Health Ins. Premiums	-	357	386	418
FMAP	-	1,000	1,000	-
Sales Tax Increases				
State Base Broadening	16	198	207	217
Repeal Clothing Exemption	36	394	409	439
Increase Rate 1/4%	25	302	304	316
Use of Reserves				
Retiree Health Benefit Trust Fund	$-	$82	$395	$672
General Reserve	200	-	-	-
Prior-Year Payables	500	-	-	-
Restore AIM to FY 2008 Level	242	242	242	242
Total Gap Closing Program	**$2,094**	**$5,032**	**$5,457**	**$4,840**
Roll Additional 2009 Surplus	($741)	$741		
Surplus/(Gap) After Gap Closing Program and Prepayments	**$ -**	**$ -**	**($3,211)**	**($4,039)**

SOURCE: City Council Finance Division, based on OMB Financial Plan documents.

PEGs. Under the Program to Eliminate the Gap (PEG), the Mayor asked in November for cuts totaling 2.5 percent of discretionary agency spending for Fiscal 2009, and 5 percent in Fiscal 2010. In January he sought an additional 7 percent in PEGs for 2010. PEG actions may be either reductions in City funds spending, or increases in City revenues. The $2 billion in PEGs proposed for 2010 in the November and January Plans consists of approximately $1.6 billion in spending actions and $384 million in revenues.

Property Taxes. The Council approved rescindment of the 7 percent property tax cut enacted in the Fiscal 2008 budget, effective January 1, 2009, and the Mayor and the Council agreed that beginning in 2010, the $400 property tax rebate program would be canceled.

Labor. In January, the Mayor proposed two major workforce savings. First, at his urging, the Governor included proposals for new pension tiers for both civilian and uniformed employees. The January Plan assumes that the City will be able to recognize savings of $200 million annually if the new "Tier V" is enacted. Second, the Administration is in discussions with the City's labor unions on health insurance savings, which could take the form of a co-pay by workers (the basic plans offered by HIP and GHI are currently free for the employee).

Federal Stimulus. Although the federal stimulus bill had not been finalized by the time the Preliminary Fiscal 2010 budget was released, the Mayor assumed enactment of an increase in the share of Medicaid costs borne by the federal government (FMAP). He estimated this would save the City $1 billion annually for two years.

Sales Tax. As part of the State Executive Budget, the Governor proposed extending the sales tax to include a number of services not previously subject to the tax (see p. 22). In the January Plan the Mayor built upon the approximately $200 million annually the City would realize from the action, and proposed a repeal of the exemption on clothing and footwear valued at less than $110 as well as a quarter percent increase in the tax rate – bringing the City sales tax rate to 4 ¼ percent. Combined, these changes would yield roughly $900 million annually.

Reserves. The Mayor also recognized certain funding sources in the 2009 budget, including drawing down $200 million from the General Reserve, and a write-off of prior-year payables and receivables that would net $500 million.

Retiree Health Trust Fund. In November, in recognizing the necessity of funding losses in the City's pension fund investments, the Mayor assumed that deposits to the Retiree Health Benefit Trust Fund ("the Trust Fund") would be deferred beginning in 2010 in amounts equal to the pension funding liability -- $82 million in 2010, $395 million in 2011, and $672 million in 2012. There is no necessary linkage between pension funding and the balances built up in the Trust Fund, except to the extent that they both provide benefits to retirees. That is, deposits to the Trust Fund could be reduced by more than projected by the Mayor in order to help balance the 2010 budget. The Office of Management and Budget has expressed reluctance to deplete Trust Fund balances too quickly in anticipation of continuing outyear gaps.

State Revenue-Sharing. Finally, the January Plan assumes that State revenue-sharing (AIM), eliminated in the Governor's budget would be maintained at its 2008 level of $242 million. In February the State Legislature approved eliminating New York City's AIM payment for this year. The Administration has proposed that federal stimulus funds be used to at least partially restore AIM funding this year.

Federal Stimulus Funds and the State Budget

Two factors weigh heavily on how the Fiscal 2010 budget will ultimately look: the State budget, and funds from the federal stimulus package.

The Governor's Executive Budget for 2009-2010 contained actions that would have cut State funds to the City by $1.8 billion in Fiscal 2010. The cuts could be partially offset by revenue actions, including the sales tax base broadening mentioned above, and authorization for unlimited additional red light cameras, among others.

The biggest State cut would fall on the Department of Education. The Governor's plan would maintain Foundation Aid – the principal source of State funding for K-12 education under the Campaign for Fiscal Equity lawsuit – flat, stretching out the planned increase in State aid to education from 4 years to 8 years. In addition, the State would impose a Deficit Reduction Assessment on the DOE for 2010 of $362 million. A key issue for the City will be how the federal Fiscal Stabilization Grant funds are used to restore State cuts to education. Under one interpretation of the federal stimulus legislation, the State would restore the Deficit Reduction Assessment cut first, which would result in the City getting about one-third of the total. Alternatively, since the law refers to existing funding formulas, the State would restore Foundation Aid cuts, and the City would receive approximately 41 percent of the total. The difference is about $100 million.

THE ECONOMY

The National Economy

"In terms of duration and severity, we find that recessions associated with housing busts and credit crunches are both deeper and longer lasting than other recessions…" **IMF** [1]

The last prop supporting the American economy is gone. Exports, boosted by the weak dollar, had moderated the recession in the first half of 2008. But now America's trading partners are in recession, among them Japan, the Eurozone, Britain and South Korea, and as a result, exports have fallen by nearly 20 percent in the fourth quarter of 2008. Consumption, investment and state and local government spending are all also falling – investment by more than 20 percent. Only Federal spending is in the positive column. In the fourth quarter of 2008 real GDP fell by 6.2 percent, the most rapid decrease since 1980. So far the economy has lost 3.6 million jobs through January 2009. Unfortunately, the worst is yet to come.

Behind this is the disaster in the financial and housing markets. Estimates of losses in the credit markets vary, but those in the range of $2.2 trillion (IMF) - $2.5 trillion (Bank of England) are common. And this does not include the reduced value of homes, commercial real estate or losses in the stock market. Including these losses the net worth of American households has decreased by over $6 trillion since the beginning of 2007. [2] Losses like these are scary and cause people to back off on what they spend. Adding to this is the difficulty in getting loans. Consumer credit, including revolving credit (credit cards), mortgage credit, and car loans, is shrinking. As one might expect, sales of houses, cars, furniture and other big ticket items that depend on credit are way down. Total business credit fell in 2008, caused by the collapse of the commercial paper market. The Troubled Assets Relief Program (TARP) and actions by the Federal Reserve are supporting the troubled commercial paper market and have somewhat improved the availability of business credit. But firms are having trouble financing their inventories, shipping and even bankruptcies. Development projects and expansions are stalled. Weak profits, difficulty getting credit, and the prospect of weak sales are all suppressing business investment. The glimmer of hope is that credit markets have stabilized somewhat, but at a very low level, and they are still very fragile.

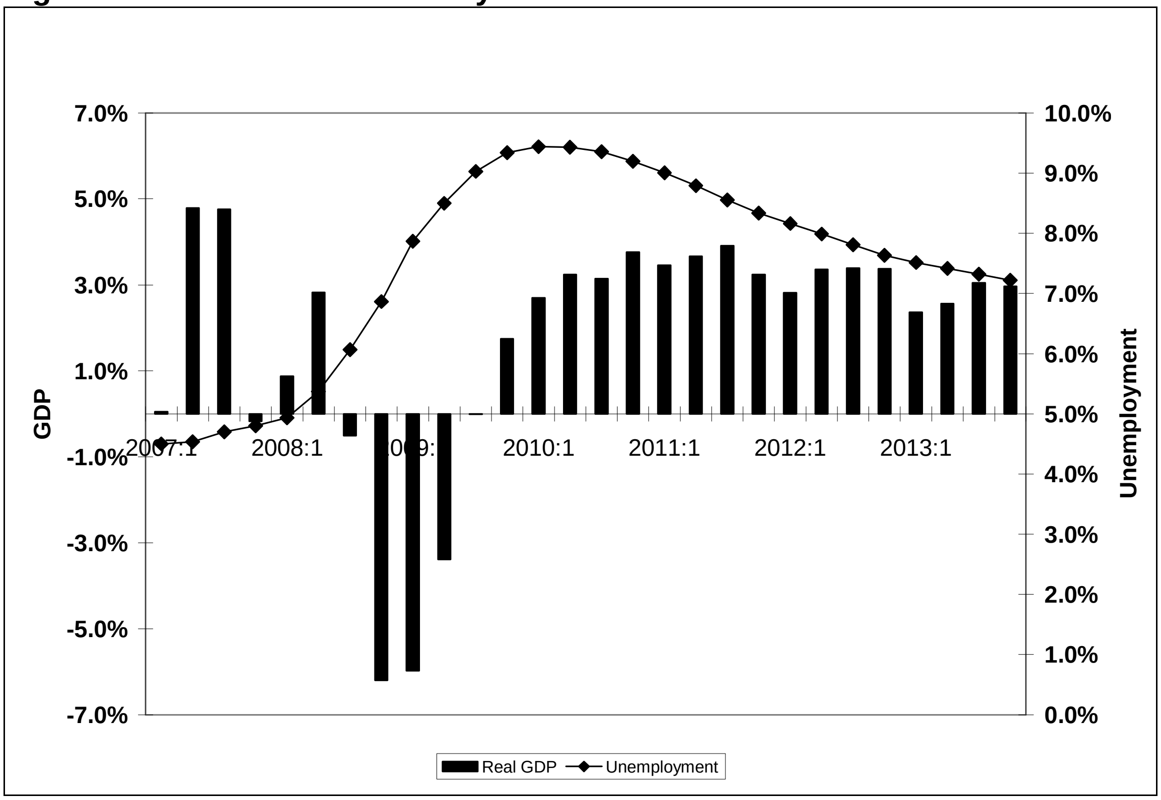
In the February Global Insight forecast, the economy continues to shrink into the third quarter of 2009. While recovery begins in the fourth quarter of 2009, the economy does not return to normal growth till the second quarter of 2010. Employment will continue to fall till the middle of 2010 and, at its worst, 6 million jobs will be lost and the unemployment rate will reach 9.4 percent. The economy will not get back to 2008's 5.8 percent unemployment till 2019. There is

[1] S. Claessens, M. Ayhan Kose & M. Terrones, "What Happens During Recessions, Crunches and Busts?", International Monetary Fund Working Paper, December 2008.

[2] City Council Finance Division calculations from Federal Reserve Flow of Funds Accounts, Third Quarter 2008. Net worth is the difference between the value of assets, such as real estate, stocks, bonds, savings accounts; and liabilities, such as mortgages, credit cards, and car loans. The calculation is for households and nonprofit organizations.

a risk of deflation—the consumer price index will fall through 2009. However, the measure watched by the Federal Reserve, the core Personal Consumption Expenditure deflator, which removes volatile energy and food prices, does a little better and will remain barely positive.

Figure 1: The National Economy



Source: Global Insight February 2009 Control Forecast.

Federal Stimulus – Vital but no Panacea

The passage of the American Recovery and Reinvestment Act of 2009 (ARRA) is welcome and absolutely vital. Continued efforts to revitalize the financial system through either the expanded TARP proposed by Secretary Geithner or some other plan are also necessary. Without a recovering credit market, the fiscal stimulus will fail and the period of recession and slow growth will be prolonged. Global Insight estimates that without the fiscal stimulus and TARP program, unemployment numbers would peak at 8 million instead of 6 million and unemployment rise to 10.4 percent. Without the stimulus, GDP would fall by a percentage point more in 2009 and recover by a percentage point less in 2010. The stimulus is helpful, but even with it, TARP and the continuing efforts of the Federal Reserve, this will be the worst recession since World War II.

ARRA provides significant aid that can be used to maintain services and close the budgetary gaps at both the City and State levels. But for the City there are at least three different kinds of funding:

1) Funding that will come directly or indirectly to New York City on known formulas;
2) Funding that will come to New York State that could be passed on to the City subject to decisions of the Governor and the Legislature, and;

3) Funding that will come through competitive grants.

As a result, the exact amount of aid the City will receive is uncertain.

What is clear, however, is that while the stimulus will reduce the pain, it will be insufficient by itself to close Fiscal 2010 or 2011 gaps. The Preliminary Budget assumed that the City would receive $1 billion a year in Fiscal 2010 and 2011 due to an increase in the Federal Matching Aid Percentage for Medicaid (FMAP).[3] A preliminary analysis suggests that the City could receive from other sources an additional $2.5 billion to $3.1 billion though Fiscal 2011. About $1 billion of this will be the City's share of stimulus' State Fiscal Stabilization grants and another $820 million will be education funding. Some of the stimulus components are discussed in the briefing documents for the relevant agency.

The ARRA contains significant capital funds for highway construction, mass transit, clean water, and drinking water. The ARRA has no earmarks, so capital fund will come though a combination of existing formulas, appropriation and competitive grants. Once again the amounts going to the City or the MTA are still not clear. The Stimulus includes a maximum of $311 million for water and sewer projects that we will have to apply for through the State. Although we would prefer that these funds be grants, the State could allocate up to half of this funding as no-interest loans. The City will also receive $233 million for transportation projects. City affiliated entities are poised to receive more than $1.3 billion in capital money, including $390 million for NYCHA, and more than $1 billion for the MTA.

Several stimulus provisions interact with New York City's income and business taxes in ways that will reduce City revenues. There will be decreases in personal income tax revenue due to the changes in the Federal EITC and the partial deduction for unemployment insurance benefits. Several changes to expensing and deductions for businesses could impact on City business taxes, including the bonus depreciation and business indebtedness discharge provisions which might pass through to City business taxes. A preliminary analysis from New York State Office of Tax Policy Analysis suggests that City personal income tax revenue could be decreased by $30 million in Fiscal 2010 as a result of provisions in the stimulus bill. Business tax provisions will have an additional impact. At time of writing, the Finance Division's Revenue Unit has not completed its analysis of these provisions. The tax policy section of this report contains a brief discussion of some personal income tax provisions of the stimulus that may be of interest to City residents.

OMB's Forecast of the National Economy

The near paralysis of the financial system that occurred in September through November 2008 was unanticipated by most forecasters and its implications are only slowly being understood. Most forecasters have lowered their forecast for 2009 and 2010 since summer and again since November. OMB is no different in this. If there has been good news, it is the passage of the Federal stimulus program. OMB's national economy forecast was completed in January 2009 before the details of the Federal stimulus package were known. However, the stimulus had been long anticipated and most economists estimated some sort of stimulus in their forecasts. As it

[3] On March 4th, Governor Patterson, Majority Leader Smith and Speaker Silver announced that New York City would receive and estimated $1.9 billion in State Fiscal 2008-09 through Fiscal 2010-11 from the increase in FMAP.

stands, OMB's forecast is slightly more optimistic than the February Global Insight forecast currently being used by Council Finance. Both forecasts are slightly more pessimistic than the average forecast in the February Philadelphia Federal Reserve Professional Forecaster's Survey or the central tendency of Federal Reserve forecasts.

Table 3: OMB Forecast of Selected Economic Indicators

	2008	2009	2010	2011	2012	2013
National Economy						
Real GDP *Percentage Change*	1.2	(2.5)	2.2	3.2	2.8	2.6
Non-Agricultural Employment *Percentage Change*	(0.2)	(2.6)	0.0	1.6	1.7	1.4
Wage Rate *Percentage Change*	3.2	2.3	2.2	2.6	2.9	3.4
New York City Economy						
Real Gross City Product *Percentage Change*	(5.9)	(11.2)	0.0	4.0	3.9	2.9
Non-Agricultural Employment *Change from previous year (thousands of jobs)*	20	(175)	(100)	24	36	51
Wage Rate *(not corrected for inflation)* *Percentage Change*	(0.4)	(7.5)	0.2	3.8	4.6	5.0

Table 4: Other National Forecasts

	2009	2010	2011
GDP			
FOMC	(1.3)% to (0.5)%	2.5% to 3.3%	3.8% to 5%
Forecaster's Survey	(2.0)%	2.2%	
Unemployment			
FOMC	8.5% to 8.8%	8% to 8.3%	6.7% to 7.5%
Forecaster's Survey	8.4%	8.8%	

Source: FOMC – Minutes of Federal Reserve Open Market Committee: January 27-28, 2009. Forecaster's Survey – Federal Reserve Bank of Philadelphia Professional Forecaster's Survey, February 13, 2009.

New York City Economy [4]

Even several months after the nation slipped into recession, New York City's economy had maintained its positive momentum – but no longer. While U.S. private employment growth turned negative in January 2008, payroll employment in the City only began to drop in November 2008. While average U.S. home prices started their descent in the middle of 2006, prices in Brooklyn and Queens began falling as late as the 4th quarter 2007, and Manhattan coop and condo prices even more recently in the 3rd quarter of 2008.[5]

[4] Unless otherwise cited employment data is from OMB.
[5] Manhattan coop/condo prices, City Council Finance Division calculations from Miller Samuel data, www.millersamuel.com/data.

The City's economy is now fully in the throes of the national recession. The near total freezing of credit markets in September 2008 has weakened all cyclical sectors of the City's economy. The plummeting wages in the financial sector, New York's biggest spender, is dragging down all areas of consumption, including housing, retail and leisure. Major sectors dependent on Wall Street, such as professional and business services, have also been hit. According to the New York State Department of Labor, the City's total private employment in December showed a 49,100 decline since the same time the previous year. OMB forecasts a net loss of 175,000 City jobs in 2009 with an additional 100,000 lost in 2010.[6] The real average wage rate in the City is estimated to have fallen by 0.4 percent in 2008 and OMB forecasts it to fall an even more precipitous 7.5 percent in 2009, before leveling off to zero growth in 2010.

Six sectors represent the main drivers of the City's economy. As of December 2008, four of these sectors showed negative job growth compared to the same time the previous year:[7]

- Finance (down 18,800 or -4.0%)
- Business Services (down 8,900 or -1.5%)
- Information (down 700 or -0.4%)
- Leisure and Hospitality (up 1,300 or 0.4%)
- Health Care (up 8,300 or 1.5%)
- Education (down 2,000 or -1.2%)

Financial activities took the lead in reducing City employment in June 2008, with the securities industry subsector shedding jobs as early as April 2008. OMB forecasts a loss of 50,000 jobs in financial activities in 2009, followed by another 23,000 jobs in 2010. Many of these losses are in securities firms that are expected to lose around 29,000 positions in 2009 and 6,000 in 2010. Average finance salaries are expected to fall by 20 percent in 2009, followed by another 7 percent decrease in 2010.

Professional and business services include, among others, attorneys, accountants, advertisers, architects and temp office workers who are heavily dependent on Wall Street. Layoffs from accounting firms to temp agencies are well under way. This sector is expected to lose 40,000 jobs in 2009 and another 25,000 in 2010. The information sector will lose 11,000 jobs in 2009 and 10,000 positions in 2010. While the loss of advertising income is driving some of these losses, part of it also stems from the structural challenges facing newspapers and magazines due to the growing preference for the electronic media over print.

Construction activity has sharply slowed down as financing is no longer available. Demand for residential structures has also dried up due to falling home prices and lower income expectations. There's less demand for commercial fixed investment as businesses are retrenching and employing fewer office workers. OMB projects 23,000 jobs lost in 2009 and 2010.

[6] All actual employment numbers are from the New York State Department of Labor, Current Employment Survey (CES); all forecasted numbers are from OMB.
[7] City Council Finance Division calculations based on December over December growth data, New York State Department of Labor establishment survey.

Retail employment had been holding up through October but is now decreasing. New Yorkers are following the national trend in reducing consumption, highlighted by poorer than expected sales during the holiday season. 4,500 jobs were lost in December compared to the same time last year. City retail employment is projected to fall by a combined 32,000 during 2009 and 2010.

The City's leisure and hospitality sector witnessed employment growth throughout 2008, but is now losing steam. OMB expects the sector to lose a combined 24,000 jobs in 2009 and 2010 as New Yorkers spend less and tourism begins to wane. The Hotel subsector maintained slower but positive job grow through most of 2008, but began to show negative growth in December compared to the same time last year. OMB cites that the seasonally adjusted hotel occupancy rates fell sharply from 90 percent to 78 percent in just the three month span of August to November. Average room rates fell from $336 in September to $301 in November.

The health care and social assistance sector, which is less vulnerable to cyclical forces than others, increased its employment by 8.0 percent in 2008. OMB expects the sector to brave this recession as it did the previous two with employment increasing by a combined 14,000 jobs in 2009 and 2010. Indeed, health care would become the City's main growth engine during the forecast period. Education services are also relatively less responsive to business cycles and might gain a combined 1,000 to 3,000 jobs in the next two years. This estimate might be overly optimistic since December employment fell by 2,000 compared to the same time the previous year.

Real Estate Market

The sharp impact of the recession has negatively affected the City's office market. After growth that saw vacancy rates for Class A office buildings drop to around five percent and asking rents rise nearly 80 percent, we are beginning to see vacancy rates rise and asking rents fall. Thankfully, the relatively low levels of speculative building during this past boom means that the commercial real estate market should fare better than in past downturns. Nonetheless, OMB expects office market vacancies to reach a high of 14 percent with asking rents falling by 22 percent to about $64 per square foot by 2010.

The sales side of the commercial market, however, has seen a more dramatic shift due to the recession than the rental market. From a record sales activity of $38.6 billion in 2007, activity fell by 69 percent to $12.1 billion in 2008. Of that amount, $7.1 billion or nearly 60 percent consisted of distressed sales. OMB expects sales activity to stay low, save for the occasional distressed sale, until after 2010.

The residential market is struggling as well. In the third quarter, sales volume was down 30 percent year over year, and 58 percent off the third quarter 2005 – the peak sales quarter. OMB estimates that single-family home sales will drop 33 percent in 2008 and 5 percent in 2009, while average prices will fall by about 25 percent by 2010. The coop and condo market is expected to be harder hit by the recession due to higher inventory levels – a product of the recent boom in condo construction, which was mostly focused in Manhattan, but also spread to Brooklyn and Queens. As a result, activity in this market is expected to drop by over 15 percent per year from 2009 to 2011, while prices will drop by over 35 percent by 2010.

REVENUE BUDGET

The Fiscal 2009 budget modification MN-2 recognized $296.4 million in new revenues. This increase was a function of $576 million in increased revenues from the half-year effect of rescinding the 7 percent property tax cut coupled with a small net increase of $6.2 million in miscellaneous revenues. These increases were offset by a $285.8 million decrease in economically sensitive tax revenues. This newly recognized revenue was added to the budget stabilization account.

Revenues for Fiscal 2009 in the January Plan are $924 million above the June Adopted Budget. The bulk of this increase comes from $1.09 billion in additional State and Federal grants which were mostly recognized in the November Plan. This is in addition to $274 million more in miscellaneous revenue. These increases offset a $486 million reduction in anticipated tax revenues. Fiscal 2010 revenues have been reduced by $1.452 billion since budget adoption. Most of this reduction is due to weakening of the economically sensitive taxes, but reductions in State aid also played a part.

Table 5: Revenue Plan Changes from Adoption to the January Plan

($Millions)	**Adopted to November Plan**	**November Plan To January Plan**	**Total, Adopted to January Plan**
Fiscal 2009			
Total Taxes	$ 551	$ (987)	$ (436)
Federal Categorical Grants	450	221	671
State Categorical Grants	142	363	505
Non-Governmental Grants (Other Categorical)	47	42	89
Unrestricted / Anticipated State & Federal Aid	0	(86)	(86)
Total Miscellaneous	150	124	274
Net Disallowances & Transfers	(69)	(24)	(93)
Total, Fiscal 2009 Changes	**$ 1,271**	**$ (347)**	**$ 924**
Fiscal 2010			
Total Taxes	$ (460)	$ (1,102)	$ (1,562)
Federal Categorical Grants	16	27	43
State Categorical Grants	7	(317)	(310)
Non-Governmental Grants (Other Categorical)	14	22	36
Unrestricted / Anticipated State & Federal Aid	0	(86)	(86)
Total Miscellaneous	160	276	436
Net Disallowances & Transfers	6	(15)	(9)
Total, Fiscal 2010 Changes	**$ (257)**	**$ (1,195)**	**$ (1,452)**

Tax Revenues

Given the nature of the problem, the recession is reducing City tax revenues in the way one would expect. The first taxes to be affected were the two transactions taxes which fell significantly in Fiscal 2008 (see Table 6). The problem spread to the financial services industry

Financial Sector Recovery

The financial sector deserves special mention. Not only is it the source of many of the problems that led to the current recession, but it is also a source of considerable uncertainty for the financial plan.

The financial sector played a major role in the City's recovery from the 2001-2003 recession. The question now is how this recovery will compare to our most recent experience.

An investment of $100 in the typical financial stock in 2003, as represented by the financial firms in the S&P 500, would have been worth around $190 by the summer of 2007; an increase of about 90 percent over four years.* This growth reflected both the boom in financial services and the optimistic vision of the future prospects of the industry. Currently, those shares are worth about $35. At least in the short run, that vision of the industry's prospects turned out to be wrong. Indeed, by this and most other measures the conditions and prospects for the industry are a lot worse than they were in our last downturn.

The financial services industry contributed tremendously to New York City's prosperity in the last several years. During the recovery through 2007, total wages paid in New York City went up by just under $86 billion; a robust growth averaging better than 7 percent a year. But 43 percent of that growth, or $36 billion, came from just one part of the financial sector – securities – where wage growth averaged better than 14 percent a year.

There are many reasons to think that financial services and the securities industry will recover. A rise in the stock market usually precedes an economic recovery, and a rising market is usually good for the industry. Short term interest rates are low, at least for firms that are not perceived as excessively risky, and that usually helps financial industry profits. Furthermore, as the recovery proceeds, there will be less uncertainty regarding housing and other credit market losses and many credit assets will sell for higher prices, also helping financial firms' bottom lines.

But the recent past was atypical, and should not guide planning for the future. The City's financial planning could not prudently assume the same rise in finance sector earnings, the same increases in profits, bonuses, and their impact on the City's economy and tax revenues that we saw between 2003 and 2007; nor that commercial rents and property taxes will once again reflect the willingness of hedge fund managers to pay $120 a square foot for midtown office space, or that our transactions taxes will reflect multimillion dollar condos and the home equity loans that the boom allowed.

Based on all of the evidence we have to date, the financial services industry has been hurt in a far more fundamental way than in the last recession or in anytime since the Great Depression. It is changing and will continue to change. What it will look like, how it will be regulated, what its employment will be and what income it will generate are subject to the greatest uncertainty. Forecasts of the City's economy – especially forecasts of the outyears, Fiscal 2011 through 2013 – should reflect that uncertainty.

*Prices are for the AMEX Financial SPDR, an exchange-tradable fund that tracks the performance of the financial components of the S&P 500.

and the volatile bank tax started falling in the spring of 2008. The general corporation tax (GCT) and the unincorporated business tax (UBT) apply to all industries in the City and were affected more slowly and less severely than the bank tax. The strength in the personal income tax and the sales tax has been a pleasant surprise; it is only in the last three months of 2008 that the recession caught up with them. In Fiscal 2009 revenues from all taxes, except the real property, commercial rent (CRT), hotel and utility taxes are expected to fall. Some of this is policy: there were midyear increases in both the property tax and hotel tax rates. Some of it is about the nature of the taxes. Because of the way they are structured, the real property tax and the CRT are slow to fall in recessions and slow to rise in booms. Recovery starts with the business taxes returning from their plunges as business starts to come back from the depths of the recession. Eventually improved business raises income and sales taxes. The laggards are the commercial rent tax which feels the recession after it is over in Fiscal 2011 and the real property tax whose growth is slow in Fiscal 2012 and Fiscal 2013.

Table 6: Tax Revenue Growth Rates in the Financial Plan

	2008	2009	2010	2011	2012	2013
Real Property	0.8%	9.9%	13.2%	5.7%	3.4%	2.2%
Personal Income	13.8%	-18.1%	-20.4%	18.3%	8.9%	6.8%
General Corporation	-6.2%	-17.0%	-9.9%	12.1%	13.9%	7.9%
Banking Corporation	-48.4%	-28.9%	27.5%	16.1%	6.8%	4.8%
Unincorporated Business	11.0%	-6.1%	-15.5%	2.9%	10.8%	6.7%
Sales	5.4%	-6.4%	-9.1%	4.9%	6.8%	7.4%
Commercial Rent	6.3%	2.1%	-2.3%	-2.2%	0.4%	4.5%
Real Property Transfer	-18.3%	-41.2%	-21.1%	7.7%	6.0%	14.5%
Mortgage Recording	-27.5%	-40.3%	-25.5%	7.3%	5.9%	14.8%
Utility	8.9%	1.2%	-1.5%	7.4%	3.3%	1.2%
Hotel	16.3%	2.7%	7.5%	4.3%	-2.1%	0.0%
All Other	7.5%	0.7%	-1.2%	4.1%	2.5%	4.2%
Audits	-6.3%	-33.1%	-12.4%	0.0%	-0.2%	-0.2%
Total Taxes	**0.6%**	**-7.0%**	**-2.3%**	**7.9%**	**5.7%**	**4.7%**

Personal Income Tax

OMB's January Plan forecasts personal income tax (PIT) revenues to decline by 18.1 percent in Fiscal 2009, a $1,583 million drop compared to the previous year (or -15.3 percent on a common rate and base). This amounts to $227 million less revenue than was forecast in the November Plan. In Fiscal 2008, total PIT revenue growth was positive at 13.8 percent over Fiscal 2007. The first seven months of total collections net refunds in Fiscal 2009 show a 6.2 percent drop from the same period a year earlier.

Total withholdings are expected to fall 5.2 percent in Fiscal 2009 after 7.5 percent growth in Fiscal 2008. This reflects a loss in wage income stemming from the accelerating losses in payroll employment which turned negative in November 2008. OMB estimates that in calendar year 2009, there will be 175,000 job losses, 43,000 (or nearly one-fourth) of which will be from the extremely high paying finance sector. Bonuses payments are estimated to suffer around a 47 percent decline[8], reflecting huge Wall Street losses and write-offs in calendar year 2008.

Installment payments in Fiscal 2009 are expected to fall 19.3 percent. This drop in nonwage income reflects a more than 50 percent fall in capital gains realizations in tax year 2008 after

[8] New York State Comptroller, "Review of the Financial Plan of the City of New York", December 2008.

trillions of dollars worth of equity value was wiped out. Nonwage income from dividends, interest payments, rents and unincorporated business profits also declined.

Fiscal 2010 PIT revenue is forecast to continue its slide and drop by 20.4 percent over Fiscal 2009, a $1,462 million fall (or -16.2 percent on a common rate and base). This represents $418 million less revenue than the forecast in the November Plan. Withholdings are estimated to decline another 11.5 percent as layoffs in the City continue and bonuses, based on still worse asset performance in calendar year 2009, fall further. Fiscal 2010 installment payments are projected to fall another 20.3 percent from the previous year. This largely stems from OMB's 15 percent expected fall in capital gains in tax year 2009. The other nonwage components (dividends, interest, rent and business profits) are also expected to drag down installments.

In the out years of 2011 through 2013, OMB estimates PIT revenues to recover at an average rate of 6.8 percent annually.

Business Income Taxes

OMB forecasts that business income tax revenues (general corporation, banking corporation, and unincorporated business taxes) will fall by 14.7 percent in Fiscal 2009, showing $85 million less revenue than estimated in the November Plan. This follows a 10.0 percent decline in total revenues in Fiscal 2008. Collections for the first seven months of Fiscal 2009 show a 13.1 percent fall from the same period the previous year.

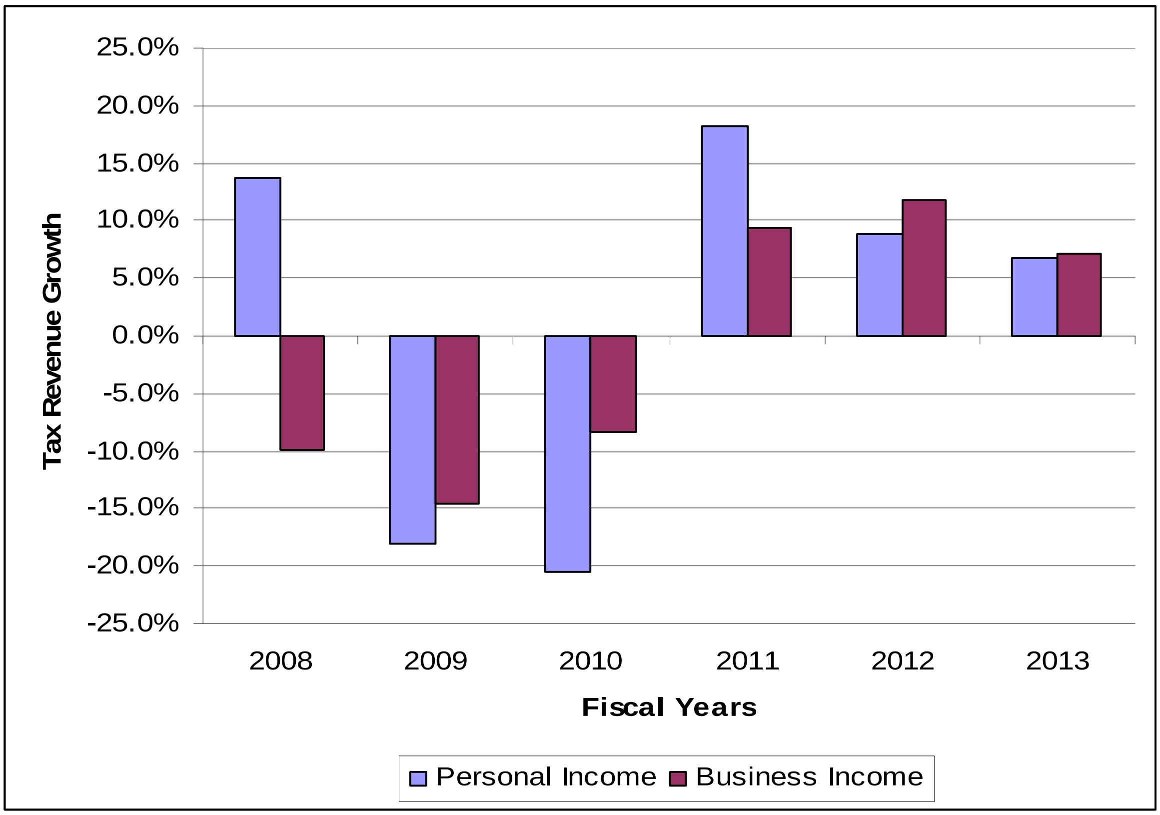
The financial firms' huge losses began in the second half of calendar year 2007, when the sub-prime mortgages backing the securities they held defaulted in record numbers. As a result, the members of the New York Stock Exchange (NYSE) began reporting net losses, starting with $3.8 billion in the 3rd quarter 2007. As losses from financial firms increased, non-financial firms, unable to receive affordable credit from the damaged financial sector, also began to suffer losses. September 2008 began a quick succession of events that severely accelerated the downturn. Lehman Brothers filed for bankruptcy; Fannie Mae, Freddie Mac, and AIG were taken over by the government due to insolvency; Merrill Lynch sold itself to Bank of America also due to insolvency issues; and Goldman Sachs and Morgan Stanley became bank holding companies with tighter limits on leveraging. OMB estimated $1.6 trillion in asset write-downs, making banks redirect funds from loans to repairing their capital. Equities, which had been doing poorly up to then, plummeted as credit markets totally froze. As layoffs increased, a retrenchment in consumption has reduced business revenues, squeezing profits further.

Looking at revenues from the individual business taxes, the general corporation tax in the first seven months of collections in Fiscal 2009 shows an 18.6 percent decline over the same period last year. These losses largely reflect those of the NYSE members, incorporated professional and business services and other non-financial firms. The banking corporation tax shows a 40.7 percent fall for the same period. Those huge losses reflect the $272 billion that OMB estimates that banks operating in the City have written down by the 3rd quarter 2008. The unincorporated business tax collections increased 5.1 percent during the same first seven months. This tentative growth is expected to turn negative as hedge funds and private equity funds, as well as unincorporated businesses and professional services file for huge refunds towards the end of the fiscal year.

With the unanticipated severity of the downturn, a large component of the drop in business tax revenues comes from especially high refunds in Fiscal 2009. Of the 13.4 percent drop in general corporation tax revenues during the first six months of Fiscal 2009 year-over-year, there was a 10.8 percent decrease in gross collections and a 15.8 percent increase in refunds.

In Fiscal 2010 business income tax revenues are forecast to drop a further 8.4 percent, which represents $208 million less revenue than estimated in the November Plan. OMB estimates that there will be a resumption of positive growth in business income tax revenues in the outyears, averaging 9.5 percent a year from Fiscal 2011 to 2013

Figure 2: Personal and Business Income Tax Revenue Growth Rates



Source: OMB January 2009 Financial Plan Revenue Forecast Documentation, January 2009.

Real Property Tax

The Fiscal 2010 Preliminary Budget takes into account the taking of effect in the second half of Fiscal 2009 of the Council resolution passed on December 18, 2008, that rescinded the 7 percent property tax reduction which had been enacted in June 2008. As a result of a clause in the State legislation authorizing the $400 homeowner rebate, the December 18th resolution also eliminated the rebate for Fiscal 2010. In the November Plan, the Mayor proposed eliminating the 2009 rebate as a gap closing measure. However, as a result of negotiations with the Administration the Council retained the $400 rebate for Fiscal 2009, and the rebate checks were mailed out at the end of December. The January Plan assumes both the continuation of the property tax increase and the elimination of the annual $400 rebate in Fiscal 2010 through 2013.

Real Property Tax Levy. As a result of the mid-year tax increase, OMB's estimate of the Fiscal 2009 levy increased by $576 million, a total increase of 10.8 percent from Fiscal 2008. (There were no changes in OMB's estimate of the levy between the June and the November Plans.) Before factoring in the tax increase, OMB had forecast that the levy would grow by nearly seven percent a year in Fiscal 2009 and 2010, and then increase at an annual rate of 4.9 percent from Fiscal 2011 through 2013. However, with the continuing decline in the economy and the freezing up of the real estate markets, OMB forecasts that levy growth will average 3.5 percent a year from Fiscal 2011 through 2013. The tax increase offsets most of the decrease in the levy due to changes in the economy. However, by 2013, half of the $1.4 billion additional levy anticipated from the tax increase is offset by more than $700 million lost due to declines in property values.

In Fiscal 2010, OMB raised the estimate of the levy by $1,259 million from the June 2008 plan--$36 million as a result of a slightly higher than anticipated tentative assessment roll issued by the Department of Finance (DOF) on January 15th and $1,223 million from the continuation of the tax increase. The levy continues to grow by nearly 11 percent in Fiscal 2010, partly as a result of the full-year effect of the tax increase. But even with a levy increase of $1,244 million, growth drops to 5 percent in Fiscal 2011. In Fiscal 2012 the levy increases by $1,062 million, but year-over-year growth drops to 3.5 percent. By Fiscal 2013, growth in the levy has declined to 2.0 percent with a levy increase of only $632 million.

Real Property Tax Revenue. In the Preliminary Budget, OMB increases the estimate of revenue from the real property tax in Fiscal 2009 by $576 million from the November Plan and $574.6 million from the Adopted Budget. OMB made only a minor change to the reserve for the plan period between the Adopted Budget and November Plan, which was to account for State legislation authorizing green solar and green roof abatement credits--$1.4 million in Fiscal 2009, rising to $3.6 million in Fiscal 2013. However, in the Preliminary Budget, OMB eliminates the cost of the $400 rebate from the reserve, adding $256 million a year to the revenue estimate for Fiscal 2010 through 2013.

Due to the combined effect of the tax increase, the removal of the rebate cost and certain other minor adjustments to the reserve, revenue is anticipated to increase by $1,511 million from the November Plan in Fiscal 2010 ($1,509 million from June); $1,505 million in Fiscal 2011 ($1,502 million from June), and $1,348 million in Fiscal 2012 ($1,344 million from June). Tax revenue increases by nearly 10 percent in Fiscal 2009, following an increase of only 0.8 percent in Fiscal

2008, the first year of the 7 percent decrease in the property tax rate. OMB forecasts revenue growth of 13.2 percent in Fiscal 2010, dropping to 5.7 percent in 2011, with an average annual increase in revenue of 3.8 percent from Fiscal 2011 through 2013.

Market Value. On the Fiscal 2010 tentative assessment roll released by DOF, the market value of the City's one million parcels of taxable real estate decreased by 1.2 percent over the prior year, the first decrease in several years. This follows an anemic increase of only 1.9 percent last year—evidence that the City's property values are starting to reflect the softening in the real estate markets. The total value of taxable real estate is still high, at $801.2 billion.

For the second year in a row, the market value of class one properties declined—by 5 percent following a 1 percent decline in value last year. After eight years of double digit growth, evidence continues that home prices are softening, since changes in market value closely mirror the trend in sales prices. The market value of class two residential properties decreased by 1.1 percent from last year, the first decline in years. However, most of this decrease was felt in the rental market, where the value of rental properties has declined by more than five percent. Based on the tentative assessment roll, which does not reflect the most recent economic conditions, the condo market, bolstered by new construction, is still holding up, with a 15.5 percent increase in market values. The market value for class four commercial properties increased by more than 7 percent from last year. However, DOF uses the income capitalization approach to value commercial property which tends to lag economic conditions. The most recent income information on the Real Property Income and Expenses statements submitted for the Fiscal 2010 roll is based on 2007 data. OMB anticipates that class four market values will begin to show evidence of current declining market conditions on next year's roll.

Overall property values dropped in the Bronx, Queens and Staten Island because of the high concentration of class one homes in these boroughs. Sharp declines in the value of rental properties also contributed to the decrease in values in the Bronx. Growth in value continues in Manhattan, the borough with the highest concentration of commercial property and newly constructed high-end condominiums, although at a slower rate from last year. The change in Brooklyn market values remained flat, bolstered by strong growth in the value of condos.

Table 7: 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%
2008-2009	1.9%	- 1.0%	5.9%	14.1%	3.6%
2009-2010F	- 1.2%	- 5.0%	- 1.1%	1.4%	7.1%
2002-2009	**106.7%**	**134.0%**	**116.5%**	**54.0%**	**61.8%**
2002-2010F	**104.2%**	**122.4%**	**114.1%**	**56.1%**	**73.4%**

Sources: New York City Department of Finance, Annual Report on the NYC Real Property Tax, Fiscal Year 2008, Tentative Assessment Roll, Fiscal Year 2010.

While strong growth in market value for class one residential properties relative to the other classes increased its share of total market value in Fiscal 2009 to nearly 52 percent from 46 percent in Fiscal 2002, the share drops to 50 percent on the 2010 tentative roll. Conversely, the share of class four commercial properties decreased from 28 percent in 2002 to 22 percent in Fiscal 2009, but increases to 24 percent on the 2010 roll.

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 $10.6 billion from Fiscal 2009 for a total of $143.6 billion. This 8.0 percent increase in value is somewhat higher than the 6.8 percent growth experienced last year, though growth on the final roll will more than likely be lower than the tentative roll growth. However, 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 effectively lowers the actual assessment to market value ratio. In Fiscal 2010, this ratio will drop to about less than 4 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. Even with continuing decreases in market value, class one's BAV on the tentative roll increases by 4.4 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 each year, is always lower than the tentative roll, due to Tax Commission actions, DOF changes by notice, and completion of exemption processing. In the Preliminary Budget, OMB estimates that the final roll BAV will be $1.3 billion or 1.0 percent lower than the tentative roll, resulting in final roll increase of 7 percent over Fiscal 2008—growth of 6.0 percent for class two, 8.8 percent for class four, and 3.9 percent for class one. 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 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 and a "drying up" of the accumulated value in the pipeline. OMB anticipates that the BAV will increase at an annual average rate of only 3.5 percent from Fiscal 2011 through 2013.

Other Real Estate Taxes

Real Property Transfer and Mortgage Recording Taxes

The real estate market in New York City has soured faster than just about anyone predicted. The virtual freezing of the credit markets has limited the ability of individuals, save those with the best credit ratings and sizeable down payments, to borrow. As a result, year-to-date collections through December from the real property transfer (RPTT) and mortgage recording taxes (MRT) in the residential market are running 19.5 percent and 43.7 percent behind the same time last year, respectively. And as dire as things in the residential market are, they are even worse in the commercial markets. Year-to-date collections from that market are 49.9 percent (RPTT) and 53.3 percent (MRT) lower than same time last year.

As a result, OMB has been revising projections for Fiscal 2009 collections of these taxes downward with each new plan and now expects Fiscal 2009 revenues from the mortgage recording tax to be $679 million, while revenues from the real property transfer tax will be at $828 million, drops of 56.7 percent and 51.9 percent, respectively, off their peak two years ago.

Table 8: Changes in RPTT and MRT Forecasts

($Millions)	**Real Property Transfer Tax**	**Mortgage Recording Tax**
June 2008 Plan	$1,063	$871
Nov. 2008 Plan	$1,030	$795
Jan. 2009 Plan	$828	$679
Total Change, June 2008 to Jan. 2009	**($235)**	**($192)**

OMB believes that the market will continue to weaken into the next fiscal year and will not begin to recover until 2011. As a result revenues from these taxes will bottom out in Fiscal 2010, and then begin to grow in Fiscal 2011. Even with the growth forecast in the out years, these taxes are forecast to remain at least 50 percent below peak throughout the forecast period through 2013.

Commercial Rent Tax

The weakening of the commercial office market in Manhattan has slowed the growth of the commercial rent tax, though not stopped it. The revenue forecast for Fiscal 2009 shows growth at a modest 2.1 percent over last year, same as was predicted in the November Plan. This continued growth is greatly attributable to the extraordinary rise in the commercial rents in the middle of the decade – between 2004 and 2007, average asking rents rose by over 50 percent to reach $72 per square foot. However, as vacancy rates are forecast to continue to rise (and asking rents drop) due to corporate downsizing, commercial rent tax revenues will fall by 2.3 percent in Fiscal 2010. OMB expects revenue from this tax to begin rebound in 2011 and average an annual growth of 0.9 percent from then on.

Sales, Utility and Other Taxes

Sales

The striking thing about sales tax revenue is how well it had held up. As of last October collections were significantly ahead of the same time last year. That has now changed: in the past three months, November through January, collections averaged 5.5 percent below last year. The recession has reached the New York City consumer. Accelerating unemployment, and a decline in hotel occupancy took effect and diminished both local and visitor expenditures. The International Council of Shopping Centers rates the 2008 holiday period as the worst since at least 1969. While the seasonally adjusted hotel occupancy rate reached a record 90 percent in August 2008, by November, year-over-year total airport arrivals and hotel room nights sold were both down, according to NYC and Company.

OMB has revised their sales tax revenue forecast down from the November Plan. In the Preliminary Budget, OMB estimates that in Fiscal 2009 and 2010 sales tax revenue will total $4,555 million and $4,139 million, respectively: $194 million less and $346 million less, respectively, than the November Plan. These changes are quite pessimistic; annualized growth for the balance of the fiscal year would have to be -16.8 percent to meet this new plan. After growth of 5.4 percent in Fiscal 2008, OMB forecasts a decline of 6.4 percent in revenue in Fiscal 2009 followed by a 9.1 percent decline in Fiscal 2010.

The credit crisis and the weak real estate market continue to reduce real estate related taxable consumption. Fiscal 2009 sales tax revenue is forecast to fall by 6.1 percent on a common rate and base. Job losses and reduced visitor volume will continue through 2010. In Fiscal 2011 sales tax revenue will begin to recover; growing 4.9 percent over the prior year. The labor and real estate markets will eventually stabilize and resume growth, and from Fiscal 2011 through 2013, sales tax revenue will grow 6.4 percent a year on average.

Utility

The utility tax revenue forecast for Fiscal 2009 is $397 million, a growth of 1.2 percent, and $9 million more than anticipated in the November Plan. Through December, collections are up 13.9 percent, relative to the first half of Fiscal 2008. In spite of fewer cooling degree days this past summer and a steep drop in fuel prices, a greater number of heating degree days in the first two quarters of Fiscal 2009 and growth in telecommunications related utilities resulted in increased collections overall. However, energy consumption has already started to fall. It declined 3.5 percent in the second quarter of Fiscal 2009. This decrease in energy consumption combined with a projected drop in employment give a Fiscal 2010 forecast of $391 million, a 1.5 percent decline from Fiscal 2009 and $26 million less than in the November Plan. From Fiscal 2010 through 2013, annual average utility tax revenue growth will be 3.9 percent.

Cigarette

In the Preliminary Budget, the Fiscal 2009 cigarette tax revenue forecast remains at $102 million, the same as in the November Plan, decreasing 17.4 percent from Fiscal 2008. Starting in the first quarter of Fiscal 2009, the State cigarette tax increased from $1.50 per pack to $2.75 per pack, which increased the combined City/State cigarette tax to $4.25 a pack from $3.00 a pack. This $1.25 increase reduced cigarette sales in the City. People are buying less or buying elsewhere. In Fiscal 2010, the forecast is down 2.9 percent from Fiscal 2009, and from Fiscal 2011 through 2013, the average annual decline will be 2.4 percent.

On January 14, 2009, the House of Representatives passed the "Children's Health Insurance Program Reauthorization Act of 2009," which includes largely proportional rate increases in excise tax rates on tobacco products and cigarette papers. Specifically, effective March 31, 2009, federal excise tax on a pack of 20 cigarettes will rise from $0.39 per pack to $1 per pack. Given State minimum price laws for cigarettes, this $0.61 increase per pack will increase the retail price per pack by about $0.68 in the City, raising the price of a typical $8 pack of cigarettes by about 8 percent. Although this increase will also add to City sales tax revenue by $0.03 per pack, this revenue increase will be offset by further declines in demand.

Hotel

The recession has finally reached the City's vibrant tourism industry. Visitor volumes are dropping, and so are occupancy rates and room rates. In calendar year 2008 visitor volume was exceptional until the last quarter, when occupancy rate decreased, year-over-year, from 88.3 percent to 81.5 percent, and the average room rate declined from $377 to $346. Room rates are not forecast to recover till the first quarter of Fiscal 2010, and occupancy rates not till the third quarter.

As in the November Plan, the Preliminary Budget forecast for Fiscal 2009 hotel tax revenue totals $389 million, an increase of 2.7 percent from Fiscal 2008. Most of the growth is due to Local Law 65 of 2008: an amendment to the City's Administrative Code that increases the hotel tax rate by 0.875 percentage points from 5 percent to 5.875 percent, effective from March 1, 2009, to December 1, 2011. Otherwise, on a common rate and base, revenue would drop by 1.3 percent. OMB estimates the tax increase to generate $15 million in additional revenue in Fiscal 2009, $62 million in 2010, $66 million in 2011, and $35 million in 2012.

The Fiscal 2010 revenue forecast is $418 million, for a growth of 7.5 percent from Fiscal 2009, and $21 million above the November Plan estimate. However on a common rate and base, without the temporary increase in the hotel tax, revenue would total $356 million, a 4.8 percent decline from fiscal 2009, and $41 million below the November Plan. OMB forecasts that hotel tax revenue will experience anemic growth in the remainder of the plan period, averaging 0.7 percent a year from Fiscal 2011 through 2013.

Other Taxes

The Fiscal 2009 forecast for the other consumption and use taxes is $446 million, a 6.7 percent growth from Fiscal 2008. The forecast is $15 million above the November Plan estimate largely due to an increase in Section 1127 waivers. Fiscal 2010 revenues are forecast to decline to $400 million, a 10.3 percent decrease from the prior year, but $4 million above the November Plan.

Tax Enforcement Revenue

Fiscal 2009 audit revenues are forecast at $680 million in the Preliminary Budget, the same as in the November Plan. To reduce the projected budget gap, the Department of Finance will pursue delinquent tax payers through audit activities, and computer matches in particular. Although the forecast for Fiscal 2010 is $7 million more than the November Plan, audit revenues are forecast to decline to $596 million. From 2011 through 2013, the forecast holds fairly steady at $596 million, $595 million, and $594 million, respectively.

Tax Policy

Mayor's Preliminary Budget Proposals

Sales Tax

The Mayor has proposed two policies for generating additional tax revenue. One would repeal the sales tax exemption on apparel and footwear priced below $110, and replace it with two, one-week sales tax exemption periods for apparel and footwear priced below $500. If effective as of June 1, 2009, this change in policy is forecast to generate $36 million, $394 million, $409 million, and $439 million in additional sales tax revenue in Fiscal 2009 through 2012, respectively. The other proposal would increase the City sales tax rate from 4 percent to 4.25 percent. This would generate additional revenue of $25 million, $302 million, $304 million, and $316 million in Fiscal 2009 through 2012, respectively. Both proposals would require State legislative approval.

Raising the sales tax is regressive because people with lower income generally spend a greater share of their income than do people with higher income. That is, in proportion to income, this tax weighs more heavily on the poor. However, the sales tax base is broad, which means that some of the increase would be borne by commuters and tourists, as well as residents.

Miscellaneous Revenue Initiatives

Plastic Bag Fee. In the Preliminary Budget, the Administration proposes that stores be required to charge customers a 5 cent fee for each carryout plastic bag. The plan anticipates raising $100 million in revenue in Fiscal 2010 from this measure. In addition to raising revenue for the City, the proposal is intended to reduce waste and litter and encourage the use of reusable bags. More than 5.2 billion plastic bags are disposed of annually through the City's municipal waste stream.

Speed Cameras. The Preliminary Budget proposes a demonstration project to examine the use of specialized cameras to detect and record speeding violations, which are often a significant factor in causing injury or death to motorists and pedestrians. The program would be modeled on the City's red light camera program.

Governor's Proposals with Impact on New York City Tax Revenues

There are proposed tax reforms and actions in the Governor's Fiscal 2009-10 Executive Budget that could affect the City. Most of these actions would broaden the State's sales tax base, and therefore broaden the City's base as well. The table below lists these actions and their likely effect on City tax revenues in Fiscal 2010.

Table 9: Sales Tax Proposals in State Executive Budget with City Tax Revenue Impact in Fiscal 2010
(Millions)

Extend Sales Tax to Cable and Satellite Television and Radio	$68
Narrow the Sales Tax Definition of Capital Improvement	$60
Create a Program for Compliance with the Tax Law	$43
Extend Sales Tax to Entertainment-Related Spending	$27
Extend Sales Tax to Transportation-Related Spending	$23
Standardize Tax on Flavored Malt Beverages	$8
Impose a Sales Tax on Digital Products	$8
Expand Definition of Affiliate Nexus for Internet Sales	$5
Repeal Private Label Credit Card (Bad Debt) Law	$4
Prohibit Certain Sales Tax Avoidance Schemes	$2
Treat Coupons Consistently	$2

Revenue Estimates: City Council Finance Division

In addition the State Executive Budget proposed authorization for additional red light cameras in the City. The City's Preliminary Budget anticipates $140 million in additional revenues from red light cameras in Fiscal 2010.

City Council Proposals

Personal Income Tax Reform

There are two basic problems with the New York City's Personal Income Tax (PIT). First, it taxes low income households that do not pay Federal or State income taxes. There are 224,200 low and moderate-income households with taxable incomes under $40,000 whose income is too low to owe Federal or State PIT, but still have to pay the City PIT. Behind this is the fact that New York City's tax credits for low income households are not as generous, relative to our tax rates, as the State and Federal's credits. Second, New York City's top tax bracket begins at $90,000 for a married couple filing jointly. This means that a family with a teacher and a police officer or an accountant is in the same 3.648 percent bracket as top executives of Fortune 500 firms. In many other places this isn't the case. Ohio's top tax bracket starts at $200,000, Vermont's at $357,000, New Jersey's at $500,000, California and Maryland's at $1 million.

To address this, Speaker Christine Quinn in her February 12th State of the City speech made two proposals:

First, to expand the City's low income credits the Speaker would adapt a proposal from Council Member David Yassky and the Drum Major Institute for Public Policy to create a new credit covering the entire City PIT liability for filers owing no Federal and/or State PIT, whose New York City adjusted gross incomes are below $45,000.[9] Of the 224,000 households that would benefit, 97 percent have children or other dependents. Households receiving the credit would save, on average $321 in City taxes. The credit would work in conjunction with the City's earned

[9] The credit will phase out so that households with adjusted gross incomes between $45,000 and $55,000 will receive a partial credit. The exact limits are still under discussion. This is liability net of other credits. Most of these households will receive both the City household credit and the City EITC.

income tax credit, which is received by three-fourths of these households. The credit would be non refundable. The credit would reduce City tax revenues by approximately $72 million starting in Fiscal 2010.

Second, the City would create three new tax brackets, at taxable incomes of $250,000, at $500,000 and at $1 million.[10] This would affect about 133,000 taxpayers or about 3.8 percent of filers.

- Taxable incomes over $250,000 but under $500,000 would pay a tax rate of 4.25 percent – this is the same rate that a taxpayer with this income would have paid in 2003.
- Taxable incomes over $500,000 but under $1 million would pay a tax rate of 4.45 percent – this is the same rate that a taxpayer with this income would have paid in 2003.
- For all taxable incomes over $1 million a tax rate of 4.65 percent would be added.

These new tax brackets would raise approximately $1 billon in Fiscal 2010 and $835 million in Fiscal 2011. These revenues would be used not only to fund the low income credit, but also as gap closing measures in place of the Mayor's sales tax proposals to eliminate the exemption on clothing and footwear, and increase the City portion of the sales tax to 4.25 percent.

The Council recognizes that tax policy should not be done without thinking about changes to Federal and State taxes. It is important that the City, State, and Federal Governments do not 'pile on', increasing the same taxes for the same group of tax payers. At time of writing the New York State Executive Budget proposes increases of sales tax not income taxes. The Obama Administration proposes income tax increases on households earning over $250,000 but not until 2011.

Emerging Biotechnology Credit

With nine world class research institutions, 26 medical centers, 175 hospitals, and an unparalleled talent pool, New York City has a natural advantage in the bioscience industry. Yet it lags behind other cities, such as Boston and San Diego, in commercialization of new technologies

Speaker Christine Quinn in her February 12th State of the City speech proposed a New York City Emerging Biotechnology credit, in part modeled after the facilities, operation and trainings component of New York State's Qualified Emerging Technologies Credit (QETC). Whereas the QETC focuses on several industries, the proposed New York City credit would focus solely on bioscience companies located in the City. Firms would be provided with a refundable credit of up to $250,000 per year, for three types of expenses: qualifying expenses related to acquiring research and development property, certain expenses related to training employees, and other research and development expenses. The credit would be limited to small firms engaged in research and development. They would be eligible for the credit for up to four years. The credit would help a young firm equip a lab, train technicians, and pay for temporary access to high tech equipment that they do not own. The credit would complement recent City investments in the East River Science Park and BioBAT at the Brooklyn Army Terminal. These facilities, along

[10] Brackets apply to married filing jointly.

with existing spaces, will provide two million square feet of laboratory space for biotechnology firms.

The credit would cost $2 million in Fiscal 2010 and would rise to $4 million by 2012.

Business Tax Reform

Besides closing our budget gaps in a responsible way, it is important also to look at ways to help the City come out of this recession with a vigorous and more diverse economy. In a speech on October 15, 2008, to the Citizens Budget Commission, Speaker Quinn made two proposals:

Single Sales Factor Apportionment. New York City should adopt New York State's method for taxing companies that do business both within and outside of the City. For businesses like this it is necessary to decide what portion of their income was earned within New York City and thus taxable by the City. Single sales factor determines the percentage of a company's net income earned in New York City by the percentage of their sales that occur in New York City. Currently, our tax law increases the corporate tax for multistate, New York-based businesses that add jobs or invest at home even if their income remains the same. This method of taxation discourages these large companies from anchoring here and adding to the economic diversity our City needs.

Adopting single sales factor is costly, and we simply cannot afford it right now. This proposal would have to be phased in over a 3-5 year period and its cost offset by other business tax reforms, such as adopting New York State rules on combined reporting. But enacting a measure like this now would allow businesses to make plans for recovery based on a more favorable business tax environment.

Exempt Sole Proprietors and Freelancers with Incomes Under $150,000 from the Unincorporated Business Tax. The unincorporated business tax is designed to deal with the fact that many businesses are not corporations. But double taxation on a group of independent workers and small business owners does not make sense. It discourages them from locating in the City, and it was not what the tax was intended to do. This would cost approximately $20 million in Fiscal 2010.

Tax Policy in the American Recovery and Reinvestment Act of 2009 – Selected Tax Provisions of Interest to City Residents

Make Work Pay Credit. This credit is a personal income tax credit of 6.2 percent of earned income. The credit is capped at $400 for an individual and $800 for a married couple filing jointly. Individuals with modified adjusted gross income (MAGI) under $75,000 or married couples filing jointly with MAGI up to $150,000 can receive the full credit. The credit is phased out for higher income households. Note that individuals without earned income, such as retirees, are not eligible for the credit. New withholding tables have just been released and people eligible for the credit will see lower withholdings and higher take home pay starting no later than April 1.

Economic Recovery Payment. Provide a one time $250 payment to individuals on certain fixed incomes, including social security, railroad retirees, disabled veterans and those on Federal pensions.

Alternative Minimum Tax (AMT) Patch. The AMT exemption level does not automatically adjust for inflation, as do most other parts of the Federal income tax. Each year Congress makes such adjustment. This year they are doing it early in the stimulus bill. The 2009 AMT exemptions are $79,950 for joint filers and $46,700 for singles, which are slightly up from last year.

New Car Sales Tax Deduction. Local sales and excises taxes on the purchase of a new car are now deductable from Federal income tax. This applies to taxes on the first $49,500 of the purchase price, and the deduction is phased out for individuals with incomes over $125,000.

Unemployment Compensation Partial Exclusion. Unemployment benefits are currently taxable in the same way as any other income. In 2009 the first $2,400 of benefits will be excluded from gross income and thus not subject to the tax. The Finance Division's Revenue Unit is still reviewing the law but believes that this will also be the case for New York City and State income taxes, since we generally follow the Federal definition of income.

Earned Income Tax Credit. The Act creates a new range of the credit for households with three or more children. These households will receive a credit up to 12 percent larger than they received in 2008. Households with less than three children are unaffected. This higher credit for larger households will affect the City's EITC, which is 5 percent of the Federal credit.

Miscellaneous Revenue

The budget for miscellaneous revenue is separated into various classes, with more detailed descriptions available in briefing books for the appropriate agency. 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.

Licenses, Permits and Franchises. The Preliminary Budget anticipates fees from Licenses, Permits and Franchises in the current fiscal year to be $14 million higher than the November Plan, for a new total of $483 million. The largest contributors to this increase include increases in various building permit revenues (+$7.3 million), increased sidewalk café fee revenue (+$2.5 million) and sidewalk interruption permits (+$2.3 million). The remainder of the increase is broad based throughout many agencies. Revenue from this category decreases by $7 million to $476 million in Fiscal 2010.

Charges for Services. The Preliminary Budget anticipates Fiscal 2009 revenue from charges for services to total $631 million, an increase of $12 million over the November Plan targets. An increase in fee revenue from the 421-a program is anticipated to yield an additional $11.5 million, and additional revenue from Single-Space Meters is projected to bring in an additional $4.2 million. The larger downward revisions include a reduction in City Registrar fee activity (-

$8.8 million) and reduced sidewalk assessment revenue (-$2.5 million). The remainder of the net increase in this category is comprised of many changes in many agencies. Looking forward to Fiscal 2010, revenue from this category is estimated to increase by $17 million to $648 million.

Rental Income. For Fiscal 2009, the Preliminary Budget increases rental income to $228 million, $8.7 million over the November Plan. Additional property rental income accounts for $6.2 million of the increase, and accelerated payment of Yankees audit rental payments for Yankee Stadium accounts for $2.5 million. Revenue from this category decreases by $16 million in Fiscal 2010 from Fiscal 2009.

Fines and Forfeitures. For Fiscal 2010, the Preliminary Budget increases fines and forfeitures revenue by $6.5 million, for a total of $782 million. Increases stem mainly from Department of Buildings fines (+$4 million), summons collection efforts (+$2.5 million). Other smaller increases are balanced by lowered revenues from taxi fines. Revenue from this category increases by $223 million in Fiscal 2010 from Fiscal 2009, to $1,005 million. This large increase is primarily due to expansion of the red light camera program (+$140 million) and increased parking violation revenue stemming from the hiring of 200 more traffic enforcement officers to increase enforcement of the “Block the Box” program (+$66 million).

Interest Income. For Fiscal 2009, the Preliminary Budget estimate for interest income is unchanged from the November Plan of $90 million. The Fiscal 2010 forecast is reduced to $20 million predicated on lower cash balances and less favorable interest rates, which are near record lows. 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 2009, it is likely that the current target will be surpassed.

Miscellaneous Revenue Sources. This category of revenue serves as a catchall for all revenue sources not classified in one of the above categories. For Fiscal 2009, the Preliminary Budget adds $52 million to the November Plan for a total of $786 million. The most significant adjustment is $49.7 million restitution agreement – the City’s share of a settled case against Lloyd’s of London. Remaining miscellaneous revenue sources decrease by $124 million in Fiscal 2010 compared to Fiscal 2009, to a level of $663 million. This decrease reflects one time gains in Fiscal 2009 from delayed FICA refunds to the City originally due in 2008 (-$134 million) and the aforementioned restitution agreement. These, and other smaller decreases, are offset by projected revenues from the plastic bag fee (+$100 million). The Administration revised upwards the estimate of revenue from plastic bag fees by $84 million in the Preliminary Budget from the $16 million estimated in the November Plan. Other increases include small program adjustments throughout various agencies.

Water and Sewer Fees. In the Preliminary Budget, Fiscal 2009 revenue increases by $5 million from the $1,312 million being carried in the November Plan for Fiscal 2009. This increase is mostly due to savings from collective bargaining agreements with various employee groups (+$6.9 million) which are partially offset by decreased revenues in other areas. In Fiscal 2010, the Preliminary Budget projects revenue collections of $1,253 million, down $59 million from Fiscal 2009.

FINANCING PROGRAM AND DEBT SERVICE

Debt Service

The City's Fiscal 2009 debt service budget, as presented in the Preliminary Budget, totals $1.65 billion, a decrease of $278.2 million compared to the November Plan. (Total debt service for purposes of this discussion consists of general obligation and Transitional Finance Authority long-term debt service, interest on short-term debt, lease purchase debt. Also included is the Budget Stabilization Account, used to hold budgeted surplus funds.)

Table 10: Debt Service Budget Breakdown

($Millions)	**2009**	**2010**	**2011**	**2012**	**2013**
G.O. Debt	$326.0	$719.7	$4,107.4	$4,889.4	$5,175.5
TFA Debt	224.8	216.13	1,114.0	1,157.8	1,161.5
Short-Term Debt	-	74.6	74.6	74.6	74.6
Lease Purchase Debt	95.3	238.3	251.5	247.0	245.7
Total Debt Service	**$646.0**	**$1,248.7**	**$5,547.5**	**$6,368.8**	**$6,657.3**
Budget Stabilization Account	1,007.7	350.0	--	--	--
Total Debt Service & BSA	**$1,653.7**	**$1,598.7**	**$5,547.5**	**$6,368.8**	**$6,657.3**

The most significant change was the decrease in the Budget Stabilization Account by $250 million to $1 billion**.** Since this money was planned to prepay Fiscal 2010 debt service, the Fiscal 2010 prepayment has been reduced by the same amount. Consequently, Fiscal 2010 debt service is projected to increase by $241 million to $1.7 billion as a result of the lower prepayment and other minor adjustments. However, by Fiscal 2011, budgeted debt service jumps nearly 250 percent to $5.5 billion, then increases by nearly 15 percent in 2012 to $6.4 billion, before returning to growth of around 5 percent in 2013.

In Fiscal 2009 and 2010, prepayments reduce debt service costs by more than $2.4 billion and $3 billion, respectively, and nearly $1 billion a year in TFA costs. In addition, in 2007 and 2008, the City defeased bonds that were due in 2008, 2009 and 2010.

The Preliminary Budget continues the Administration's plan to prepay $350 million of debt service in Fiscal 2011 from accumulated surplus funds. However, by 2012 debt service costs will not be reduced by accumulated surplus prepayments as the effects of the economic downturn will no longer produce surplus City revenue rolls for the remainder of the plan period.

Because of the City's practice of rolling budgetary surpluses from one year into the next by pre-paying debt service (and often other lump-sum payments as well), the budgeted debt service figures can present a confusing picture of actual debt service growth. Reversing the effect of these actions presents a truer picture of the burden of debt service on the City's budget and its growth. Excluding TFA debt, debt service is projected to grow at an average annual rate of 9.5 percent between 2009 and 2013.

The Mayor's Preliminary Budget also measures the City's debt burden by comparing debt service costs as a share of tax revenues and total revenues. For Fiscal 2009, debt service payments are 13.4 percent of total taxes and 8.1 percent of total revenue. By 2013 these figures rise to 15.5 percent of total taxes and 9.9 percent of total revenue.

The growing burden of debt service prompted the Mayor to announce his intention to reduce the City's capital plan by 30 percent in the 2010 Executive Budget. The reduction would reduce the long-term average annual growth in debt service costs to 3.4 percent, equal to the level of forecast growth in City revenues. The capital cut would eliminate nearly $7 billion worth of planned commitments from the current Ten-Year Plan, and comes on top of the Administration's prior action that stretched out the 2009-2012 capital plan from four years to five years, effectively reducing the capital budget by 20 percent.

Capital Financing Program

Since September 2008, with the failure of Lehman Brothers, the issuers of City debt have been less able to sell large bond issues. In response, the City has increased the number of bond issues, but in smaller size. Borrowing costs have also increased, but the increases have not exceeded the amounts provided for in the City's debt service budget. In order to reduce financing costs, the city has requested State legislation to raise the New York City Transitional Finance Authority (TFA) borrowing cap. Barring an increase in bonding capacity of the TFA, the City anticipates financing $26.7 billion of its capital program through the use of general obligation (GO) debt in the period from Fiscal 2009 though 2013 period. This represents about 70 percent of the total financing program for the plan period. So far this year, the City has completed six sales for a total of about $3.4 billion. Five of the sales were new money sales, raising a total of about $3.1 billion. The single refunding sale raised $250 million, and should realize $20 million in debt service savings over the plan period. The City plans to issue $2.4 billion more in GO bonds for capital purposes, this year. If the State legislature approves increasing the TFA cap, the City plans to issue through TFA up to half of what would have been raised through GO bonds, producing significant savings in financing costs. The TFA has been an important source of diversification in the financial markets as well as a source of financing savings because TFA bonds generally have a lower interest rate than GO bonds.

Table 11: Financing Program: Sources of Funds *(In $Millions)*

Source of Funds	2009	2010	2011	2012	2013	Total
City General Obligation Bonds	5,538	6,230	5,830	4,860	4,220	26,678
Transitional Finance Authority	-	-	-	-	-	-
TSASC Bonds	-	-	-	-	-	-
Water Authority Financing	2,718	2,402	2,135	2,030	1,805	11,089
Total Funds	**8,256**	**8,632**	**7,965**	**6,890**	**6,025**	**37,767**

Variable Rate Debt. The City has issued variable rate debt in order to realize cost savings in the capital program. More than $10.5 billion of floating rate bonds are currently outstanding, issued by the City and its related entities. The exposure of floating rate debt in the current credit market climate is of some concern, because certain events can cause unexpected increases in costs, such as rising interest rates, changes in the tax code, and deterioration of the City's credit. These events do not increase the costs of fixed rate debt. However, fixed rate debt borrowing costs are often higher than variable short-term debt, and fixed rates cannot benefit from declines in interest rates. The City has acted conservatively in issuing floating rate instruments. The proportion of variable to fixed rate debt (consisting of GO bonds; TFA, TSASC bonds and conduit debt) is currently 17.4 percent. However, taking into account the short-term assets of $3.6 billion in the General Fund, which are offsets to floating rate liability, the City's ratio drops to 10.9 percent. This makes risk management more manageable.

TFA Financing for the Department of Education. In April 2006, the State authorized TFA to issue up to $9.4 million in Building Aid Revenue Bonds (BARBs) to fund the Department of Education's capital costs. Since the inception of the program, TFA has issued $3.27 billion in BARBs. The State legislation provided for the bonds to be secured by State building aid that had previously been paid directly to the City. The current financial plan includes issuance of $2.5 billion, $250 million, $800 million, $700 million, and $750 million in Fiscal 2009 through 2013, respectively.