THE COUNCIL OF THE CITY OF NEW YORK

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Speaker of the Council

Hon. Domenic M. Recchia, Jr., Chair
Committee on Finance

Hearing on the Fiscal Year 2014 Preliminary Budget

Financial Plan Overview, Economy, Revenue, Capital, and Debt Service

March 4, 2013

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Financial Plan Overview

Introduction

The March 4th hearing of the Finance Committee, starts the process of reviewing the Fiscal 2014 Preliminary budget (January 2013 Plan), which was released on January 29th, 2013. The hearing will begin with the testimony of Mark Page, Director of the Office of Management and Budget. This document will provide an overview of the January 2013 Plan, with emphasis on the tax revenue, debt service, and capital parts of the budget. This document also will examine the national and city economies. The document will provide the City Council Finance Division's (Council Finance) forecast of tax revenues for Fiscal 2013 through Fiscal 2017 and will offer a brief look at the capital plan. A separate document will examine the City's contract budget. Analysis of Agency budgets will be provided in reports for subsequent hearings.

Fragility

- **The January 2013 Plan contains some good news: the economy is improving; the projected out-year gaps are at their lowest level since 2007; and growth of some 'uncontrollable' expenses has slowed down.**
- **However, the City's assumptions about collective bargaining, the growth of agency spending, Federal aid, and revenue from taxi medallion sales pose some risks to the general outlook.**
- **The depletion of reserves accumulated over the boom years provides lower margin for error. Changes that widen the gap will be more difficult to handle, making this a fragile outlook.**

In some ways this is a good news budget. The out-year deficits are in manageable range, $2.4 billion in Fiscal 2015, $1.9 billion in Fiscal 2016 and $1.8 billion in Fiscal 2017 – respectively 4.5 percent, 3.4 percent and 3.3 percent of City funds revenues – the lowest level since prior to the beginning of the recession.

The city's economy continues to outperform the national economy, except, crucially, in unemployment. Both the city and national economies went through a weak patch in the second half of 2012. At the national level, conflict over the Federal budget and the restoration of the payroll tax will slow growth in 2013. It will be 2014 before the national economy shows healthy growth. At the city level, Wall Street had a pretty good year in 2012, and while that does not mean as much for the city's economy as it used to, it has helped the city. OMB expects tax revenue growth to average 4.3 percent through the plan period, which is well above inflation, though a bit under Council Finance's tax revenue forecast.

On the expense side there are also hopeful signs. One of the major 'uncontrollables' in the City's budget that skyrocketed in recent years – pension contributions – is slowing dramatically in the plan period. If the City's pension obligations stay on plan, they will grow at an average rate of 1.7

percent a year, which is below the rate of inflation. Another large uncontrollable, Medicaid, will also grow at a rate that is less than inflation.

This good news is partially offset by a set of risks or fragilities to the January 2013 Plan. These are ongoing pressures on the budget and budgetary assumptions that may be hard to maintain across the plan period.

There are still two other 'uncontrollables' that remain sources of pressure on the City's budget. One is the debt service growing an average rate of 8.3 percent a year during the plan, close to twice as fast as the city's economy.[1] Fringe benefits – primarily health insurance for City workers – are also growing rapidly, averaging about 8 percent a year over the plan period.

Agency spending grows slowly

City-funded 'controllable' agency spending is assumed to grow at an average rate of only 1.3 percent over the plan period. This is the city funded portion of the budget allocated to such tasks as garbage pickup, keeping the city safe, educating children, and maintaining parks. The 1.3 percent growth rate is artificially suppressed by failure to baseline spending on: social service, education, youth, seniors and other spending that is typically restored as part of the annual budget agreement between the City Council and the Mayor. However, even restoring this, overall controllable agency spending is assumed to grow slower than the rate of inflation. Whether or not this pace of spending can be maintained in a growing city is an open question. Since 2000 this spending has grown at an annual rate of 3.5 percent, suggesting that the current plan's slow growth rate could be difficult to sustain.

Labor costs help hold down agency spending growth

This slow growth of agency spending is in part a function of the slow growth of wages assumed in the financial plan. This brings us to another risk, collective bargaining. The reserve for collective bargaining provides for a 1.25 percent a year wage increases for the 2008-2010 round of collective bargaining. These raises would start in Fiscal Year 2015 and include no retroactive money for previous Fiscal Years. Over the last two business cycles wage increases for City workers have slightly outpaced inflation. Whether collective bargaining assumptions that are below inflation for significant period of time can be maintained remains to be seen.

Taxi medallion revenue uncertainty

A major source of revenue, the sale of taxi medallions, is currently subject to litigation. Funds have been delayed from Fiscal 2013 to Fiscal 2014 through Fiscal 2016, with the bulk of the money arriving in Fiscal 2014. The New York State's highest court, the Court of Appeals, will hear the arguments on this issue on April 24th, 2013. When and if the City receives these funds are an open question.

[11] In this calculation, debt service excludes the impact of prepayments.

State education aid also up in the air

The City may also find itself with a need either to reduce services or to find other revenue sources to offset a reduction in State education aid. The Bloomberg Administration and the United Federation of Teachers have been unable to reach an agreement over teachers' evaluations. A quarter of a billion dollars in Fiscal Year 2013 state aid is tied to the parties reaching such an agreement. In the New York State 2013-2014 Executive Budget, Governor Cuomo has baselined this $250 million reduction for each year in the State financial plan. An additional $224 million could be lost if the City and its educator's unions have not reached an agreement by September 1. At the time of writing a preliminary injunction from Justice Manuel Mendez of the State Supreme Court in Manhattan bars the State Education Commissioner from withholding any money from the City because of its failure to reach agreement over teacher evaluations.[2] The risk of loss of additional funds due to the failure to meet the September 1st deadline was also reduced when Governor Cuomo in his 30 day amendments to the Executive Budget, proposed mandatory arbitration for the teacher evaluation issue.

Federal sequestration all but certain

Another risk comes from the Federal Budget. At time of writing we are expecting a sequestration on March 1st that will impact on Federal spending primarily for Federal Fiscal Year (FFY) 2013.[3] The Budget Control Act of 2011 (BCA) created a set of Federal budgetary targets, dates for achieving those targets and a set of automatic budget cuts should Congress and the President fail to reach those targets. These automatic budget cuts are known as sequestration. A second smaller sequestration could occur on March 27th associated with the need to renew the continuing resolution (CR) under which the Federal Government is operating since it has not yet adopted a budget for FFY 2013.

If the March 1st sequestration lasts for a full FFY, non-defense discretionary appropriations will be reduced by $26 billion.[4] Much of the federal funding in the City's budget falls in to this category, including education, housing, social services, and public safety grants. Nationally, this would be a 5 percent reduction of spending. However 5 months of the FFY have already past and the cuts will fall only upon funds that have not already been disbursed. So these programs will see a 9 percent cut in spending for the rest of FFY 2013. [5]

[2] Al Baker, "Judge Says Cannot Withhold Aid to City Schools over Teacher Evaluations" New York Times, February 21, 2013.
[3] R. Kogan, "The Pending Automatic Budget Cuts" Center on Budget and Policy Priorities, February 26, 2013, pp. 1-2
[4] CBO numbers are cited in Kogan 2013, p. 2.
[5] White House. 2013. Impact of March 1st Cuts on Middle Class Families, Jobs and Economic Security: New York http://www.whitehouse.gov/sites/default/files/docs/sequester-factsheets/New-York.pdf

Table 1. Estimated Impact of Sequestration
City Fiscal Years 2013 and 2014, in millions

Service Area	Amount	Notes
Education	$69	Title I, IDEA, Teacher Quality Grants. Equivalent to approximately 800 teachers
Housing	$151	Section 8 vouchers ($76 million; 6,400 vouchers)
		NYCHA Operating Fund: $48 m
		NYCHA Capital Fund: $14 m
		CDBG: $8 million
Social Services & Health	$62	Head Start & childcare ($12 m; 1,300 slots)
		Ryan White HIV/AIDS: $7 m
		HOPWA: $3 million (125 fewer housing units)
		Senior meals: $4 m (261,000 meals)
		HHC: $19 million
Workforce Investment	$4	Dislocated worker job training and placement; career centers
Public Safety	$3	General law enforcement; bulletproof vests
Homeland Security	$17	Manhattan Security Initiative; counter-terrorism and disaster response training
All Other	$18	
TOTAL	**$324**	

Source: OMB

Full implementation of sequestration would reduce federal disaster funding to New York City for Hurricane Sandy by an estimated $506 million, including $66 million to the operating budget, $159 million to the capital budget, and $281 million in Community Development Block Grant (CDBG) Disaster Relief funds of $281 million.

It seems unlikely the sequestration will last the full FFY. For purposes of economic modeling the Finance Division has assumed the sequesters will end sometime in April and will reduce Federal spending $9 billion, of which perhaps $2.5-$3 billion will come from non-defense discretionary spending. However, any agreement between Congress and the President seems likely to reduce the non-defense discretionary spending, though the amounts are hard to anticipate.[6]

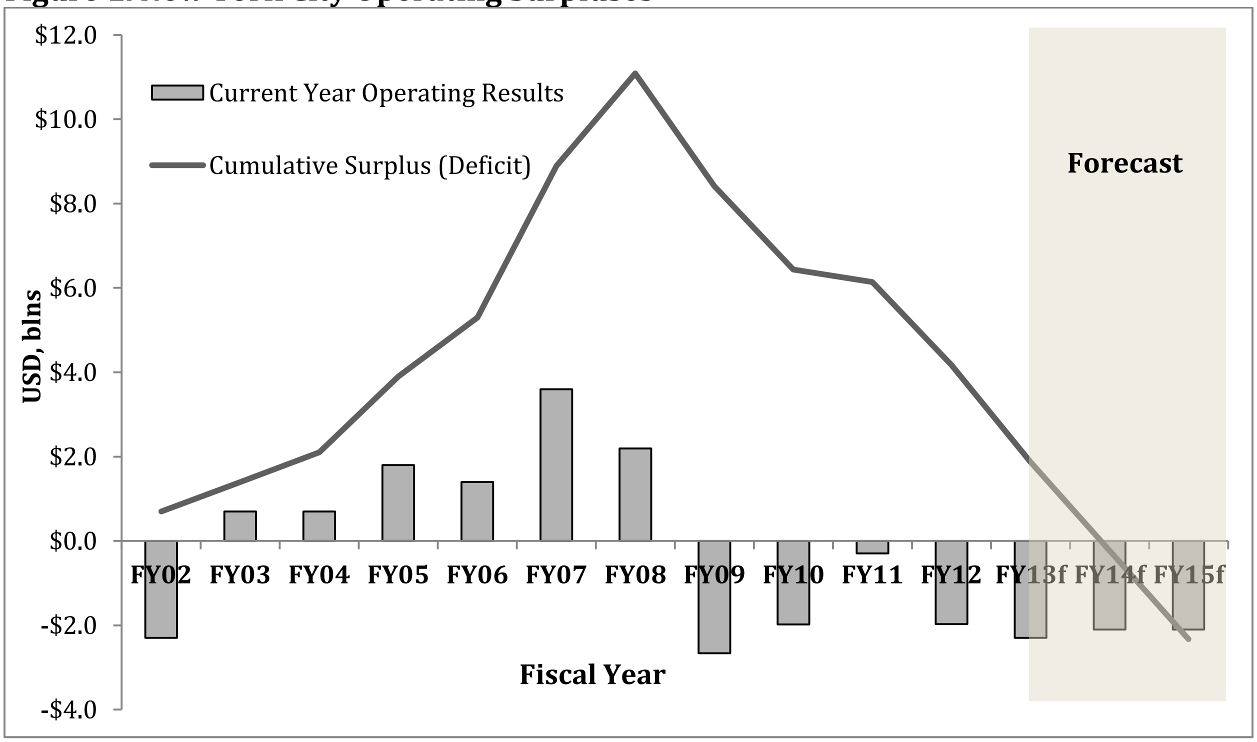
Prior accumulated surpluses have carried us through the recession

Risks to the City budget are normal and the improvements in the economy are encouraging. Almost every year some major expectation in the budget is disappointed. However, over the past decade the City has had an 'ace in the hole' for dealing with such disappointments. Between prepayments of expenses and the funds available in the retiree health benefit trust (RHBT) at one point the City had $11 billion available to help it manage disappointment. These funds have been put to good use, cushioning the impact of the financial crisis and slow national economic recovery

[6] Council Finance assumptions on the sequestration follow IHS Global Insight, "An Improving Economy Faces Policy Headwinds" US Macro webcast, February 14, 2014.

on the City budget. This cushion is running low. Major disappointments in budgetary assumptions will have to be met with immediate adjustments to spending or taxes, rather than the more gradual changes that the cushion has allowed. In this important way the City's budget outlook has become more fragile.

Figure 1. New York City Operating Surpluses



Source: New York City Council Finance, 2013

Closing the Fiscal 2014 Gap

- **The June 2012 Financial Plan projected a $2.5 billion gap for 2014.**
- **The gap increased primarily by anticipated delays in the sales of taxi medallions and by $452 million in new agency spending over Fiscal 2013 and Fiscal 2014.**
- **The gap was closed by a higher tax revenue forecast, a PEG program expected to yield $1.54 million over two years and by some of the usual end of the year take down of reserves**.

The City Council passed the 2013 Adopted Budget on June 28, 2012. As required the Fiscal 2013 budget was balanced. In the June 2012 Financial Plan the Fiscal Year 2014 budget had a $2.5 billion gap. A set of changes have occurred that had the potential to create a Fiscal Year 2013 gap and to widen the Fiscal 2014 gap.

The most important change opening a budget gap was in the continuing delay of the sale of additional taxi medallions. The City has been authorized to sell up to 2,000 additional taxi medallions and up to 18,000 new HAIL licenses for livery cabs. Ongoing litigation has delayed the sale. The Administration is still anticipating the receipt of $1.46 billion from the sale but as of January 2013 Plan it does not expect to receive any of this money until Fiscal 2014. This opened a $635 million budget gap in Fiscal 2013. However the expected delay provided extra funding for Fiscal 2014 onward.

The other major gap opener was the Fiscal 2012 shortfall in return to City pension funds. The funds have an assumed interest rate of 7 percent, but in Fiscal 2012 earned only 1.37 percent. The shortfall will require an additional contribution of $98 million in Fiscal 2014. This will grow to $393 million by Fiscal 2017, unless it is offset by stronger than expected returns this year and next year.

In the November 2012 and January 2013 plans the Administration proposed $452 million additional spending over a two year period. The Department of Homeless Services was the single biggest recipient, getting $88 million over the two year period.

Table 2. Revenue & New Needs
Dollars in millions

January and November Plans	**FY13**	**FY14**
Gap as of FY 13 Adoption	**$---**	**($2,508)**
Revenues		
Taxes	413	310
Non-Tax Revenue	30	(50)
Taxi Medallions	(635)	235
Subtotal, Revenue Changes	**(192)**	**495**
Expenses		
Baselined Agency Spending	194	258
Pension	-	98
Subtotal, Expense Changes	**194**	**356**
New Gap	**($386)**	**($2,369)**

Source: New York City Council Finance, 2013 based on OMB data

Resources to close the gap come from $703 million in additional tax, audit and miscellaneous revenue over the two year period.

The final major gap closer comes from the PEG program announced in November. Over the two year period the program provides $1.54 billion in resources.

Table 3. Closing the Gap
Dollars in millions

January and November Plan	FY13	FY14
Surplus/(Gap) to be Closed	**($386)**	**($2,369)**
Nov. PEG Program	540	1,000
Prior-Year Payables	500	-
General Reserve	200	-
Debt Service	56	200
HIP Rate Savings	11	191
Other Adjustment	35	21
Roll to Next Fiscal Year	(961)	961
Final Surplus/(Gap)	**$-**	**$-**

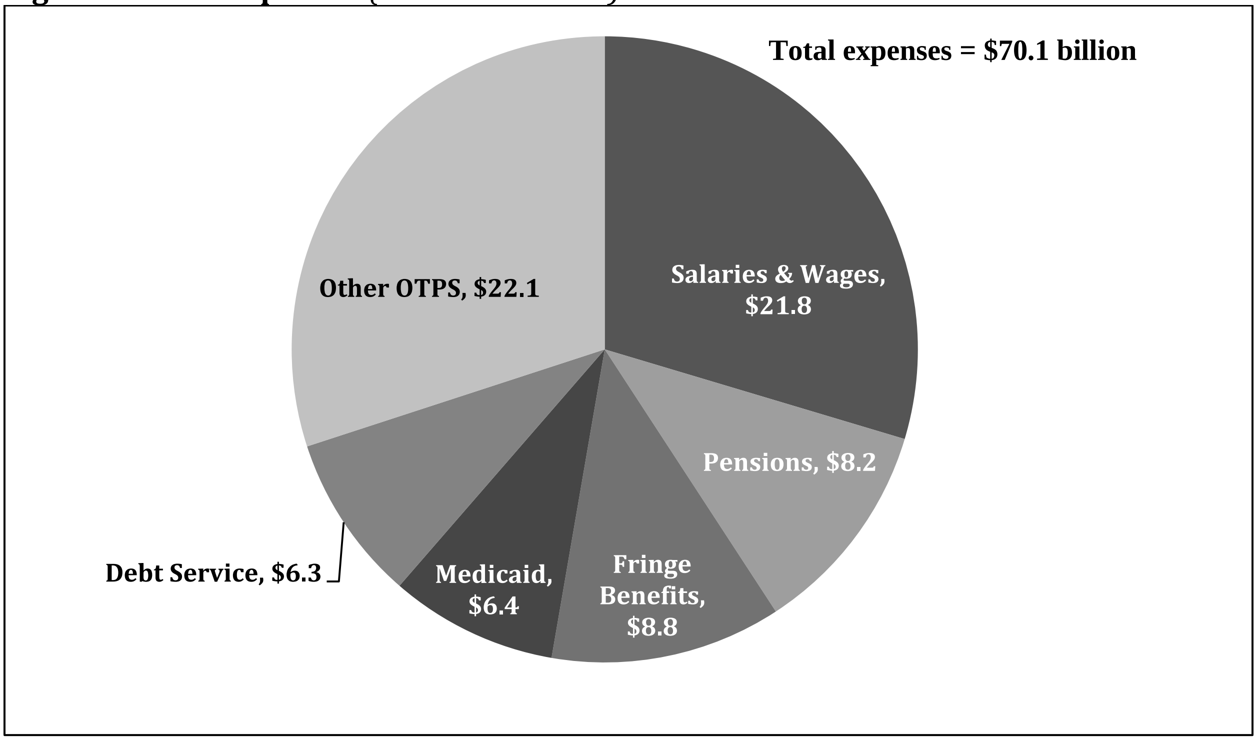
Source: New York City Council Finance, 2013 based on OMB data.

Budget Basics: Fiscal 2013 and Fiscal 2014

For Fiscal 2014 the January Plan proposes a $70.051 billion budget. On the expense side this understates things, because part of debt service is paid for using funds from Fiscal 2012 and Fiscal 2013, and because part of post-employment health care benefits are paid for by running down the RHBT. Adjusting for this, spending is around $72.719 billion, down 0.8 percent from a similarly adjusted Fiscal 2013 budget.

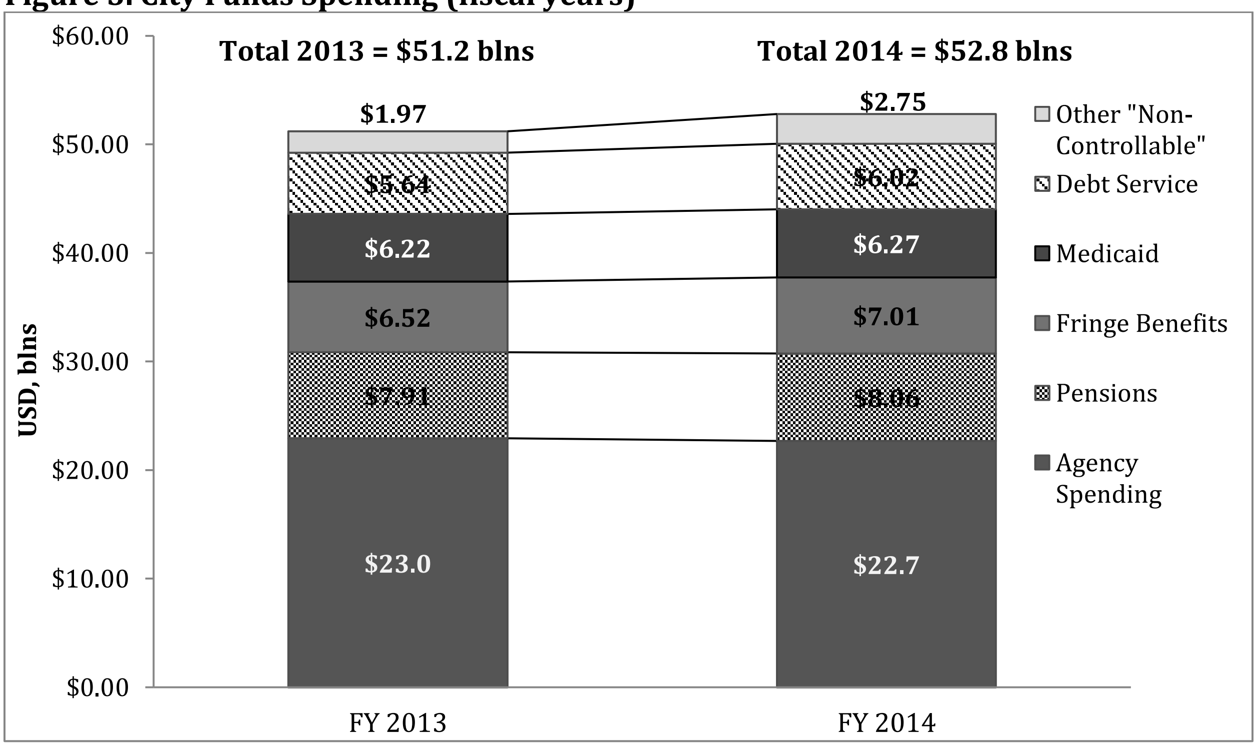
Analysis of City-funds spending offers a better way to view budget growth, as is shown in Figure 4. For Fiscal 2015 City funds spending, adjusted to include prepayments are $51.801 billion up 3.2 percent from Fiscal 2013. Debt service and fringe benefits are the major sources of growth in spending. City-funds agency spending is actually down 1 percent in Fiscal 2014.

Figure 2. Total Expenses *(dollars in billions)*



Notes: Debt service is after prepayments. Total adjusted for intra-city expenditures.
Source: New York City Council Finance, 2013

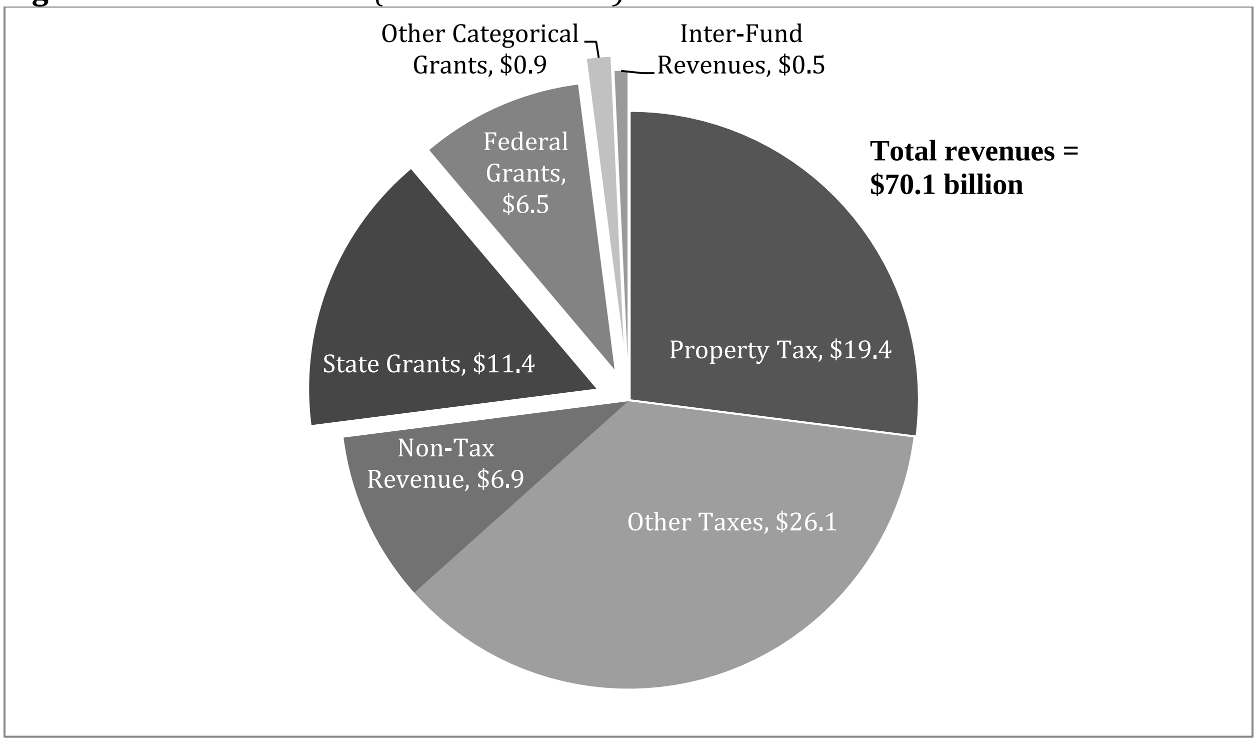
Figure 3. City Funds Spending (fiscal years)



Source: New York City Council Finance, 2013

In the January Plan, the Fiscal 2014 budget on the revenue side is also $70.051 billion, a decrease of about $322 million from Fiscal 2013. However, this comparison is not quite accurate. Categorical grants, especially Federal categorical grants, are typically brought into the budget over the course of the year, as claims against various reimbursable or cost sharing aid programs are made. This increases both the revenue and expense side of the budget and is why it is best to look at City-funds when comparing years in the financial plan. Federal categorical grants are up about $2 billion in the January Plan for Fiscal 2013 compared to the adopted budget. This is about fifty percent above the usual amount, and reflects the impact of Hurricane Sandy, including a $500 million FEMA emergency protective measures grant.

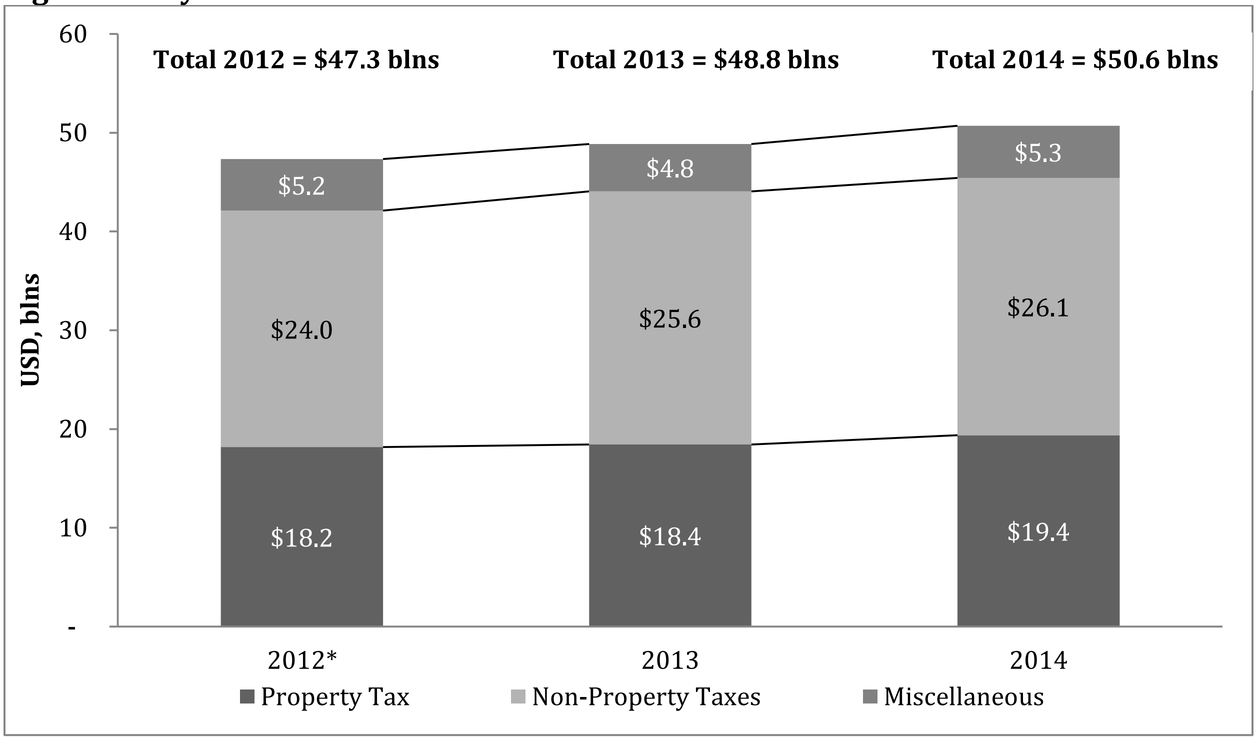
Figure 4. Total Revenues *(dollars in billions)*



Note: Adjusted for Intra-city revenue and disallowances against categorical grants.
Source: New York City Council Finance, 2013

Turning to City funds, tax revenues are growing at an average annual rate of about 4 percent. This represents an economy that is growing, but at a slower pace than one would like. Miscellaneous revenues grow at a rate of 0.6 percent during the period. For the most part this reflects the high baseline in Fiscal 2012, which included $469 million from the Citytime settlement. The growth in miscellaneous revenues between Fiscal 2013 and Fiscal 2014 is largely a product of the anticipated taxi medallion sales, which in the January Plan start producing revenue in Fiscal 2014.

Figure 5. City Funds Revenue



Note: Data for Fiscal 2012 is from the Comprehensive Annual Financial Report of the Comptroller.
Source: New York City Council Finance, 2013

The Out-years: Fiscal 2015 to Fiscal 2017

- **In the out-years the growth of operating expenses exceeds the growth of revenue, which combine with the end of prepaid expenses and the exhaustion of the RHBT produces outyear gaps.**
- **Council Finance tax revenue forecast and usual end of the year take down of reserves go a long way to closing these out-year gaps.**

Fiscal 2015 through Fiscal 2017 have relatively slow growth in revenue in the January Plan, averaging about 3 percent. The plan assumes 2.6 percent growth for State categorical grants and a decline of 1 percent in Federal grants. City funds grow at 3.6 percent slowed by a decline in miscellaneous revenues as the taxi medallion money peters out. Tax revenues grow 4.6 percent during the period.

Some of this slow growth in revenue is an artifact of OMB estimating techniques, which for example show no growth in tax audits or minor taxes in the out-years. However, there are some real concerns, especially about Federal categorical grants.

The Budget Control Act of 2011 also has implications for the out-years. Under the Act, total discretionary spending will grow at a rate of a bit over 2 percent a year. Over the last 20 years, federal aid to the City has grown at an average rate of about 4 percent annually. The Budget Control Act caps will cut this growth in half, inevitably increasing over time the City's reliance on its own resources, and generating pressure to replace services previously funded by Federal aid with City funds. The goals of the Budget Control Act of 2011 would reduce discretionary spending to a post WWII low by Federal Fiscal Year 2017. If agreement over deficit reduction measures required by the Budget Control Acts cannot be reached by the Congress and the White House, automatic cuts through a prolonged sequestration, would achieve this post-WWII low of discretionary spending in 2014.

On the expense side, operating expenses are growing 3.2 percent, which is faster than the growth of revenue.[7] After Fiscal 2014 the City exhausts its prepayments of expenses and the RHBT is going to be depleted. This is a formula for deficits in the out-years.

Table 4. Fiscal Year 2014 January Plan Financial Summary
Dollars in millions

	FY13	FY14	FY15	FY16	FY17
REVENUE					
City Funds*	$48,865	$50,685	$52,656	$54,671	$56,424
Total	$70,373	$70.051	$72,126	$74,579	$76,453
Expense					
Personal Services	$37,593	$37,721	$39,505	$40,716	$41,981
Other than Personal Services	$29793	$28,429	$29,122	$29,553	$29,929
Debt Service	$6,010	$6,325	$7,183	$7,502	$7,710
General Reserve	$100	$300	$300	$300	$300
Less: Intra-City Expenses	($1,777)	($1,608)	($1,611)	($1,616)	($1,613)
Total Operating Expenses	$71,719	$71,167	$74,499	$76,455	$78,307
FY 2012 Budget Stabilization & Discretionary Transfers	($2,431)	($31			
FY 2013 Budget Stabilization & Discretionary Transfers	$1,085	($1,085)			
Total	**$70,373**	**$70,051**	**$74,499**	**$76,455**	**$78,307**
Gap	$0	$0	($2,373)	($1,876)	($1,845)

Note: *with interfunds agreements
Source: OMB Fiscal 2014 January Plan

The NYC Council Finance Division's tax revenue forecast will have an impact on out-year deficits, providing a surplus in Fiscal 2014 and reducing deficits in the out-years. End of the year adjustments, such as the reductions to the reserve for prior year payables and the general reserve, typically produce resources of $750 million or more in years in which the assumptions of the Financial Plan are more or less met. Combined with the Finance Division's forecast this will still leave the City around $1 billion short of balancing Fiscal 2015.

[7] This analysis follows OMB, which does not adjust for the draw-down of the RHBT in calculating operating expenses.

Table 5. Council Forecast: Impact on Gap
Dollars in millions

	FY13	FY14	FY15	FY16	FY17
January Plan GAP	**$0**	**$0**	**($2,373)**	**($1,876)**	**($1,845)**
Council Finance Tax Forecast*	($23)	$163	$343	$588	$568
Net Change to Surplus Roll	($23)	$140	$483	$588	$568
Restated (Gap)/Surplus	**$0**	**$140**	**($1,888)**	**($1.288)**	**($1,277)**

Note: *Difference from OMB February Plan Forecast. Assumes surpluses rolled into the next fiscal year.
Source: OMB Fiscal 2014 January Plan

Council Economic Forecast

National Economy: Adapting to the New Normal

- **The new normal for the U.S. economy is slower growth in the medium term.**
- **Unemployment remains high due to sparse job growth.**
- **However, as households no longer focus on just paying down debt, consumer expenditure will pick up, and there will be modest improvements in new home sales and housing starts.**
- **Risks of European recession and volatility in China will have adverse impacts on U.S. net exports which may be partially offset by improving U.S. competitiveness.**
- **A major headwind to recovery is the uncertain direction of U.S. fiscal policy and the fear that monetary policy will exhaust its effectiveness in the next few months.**

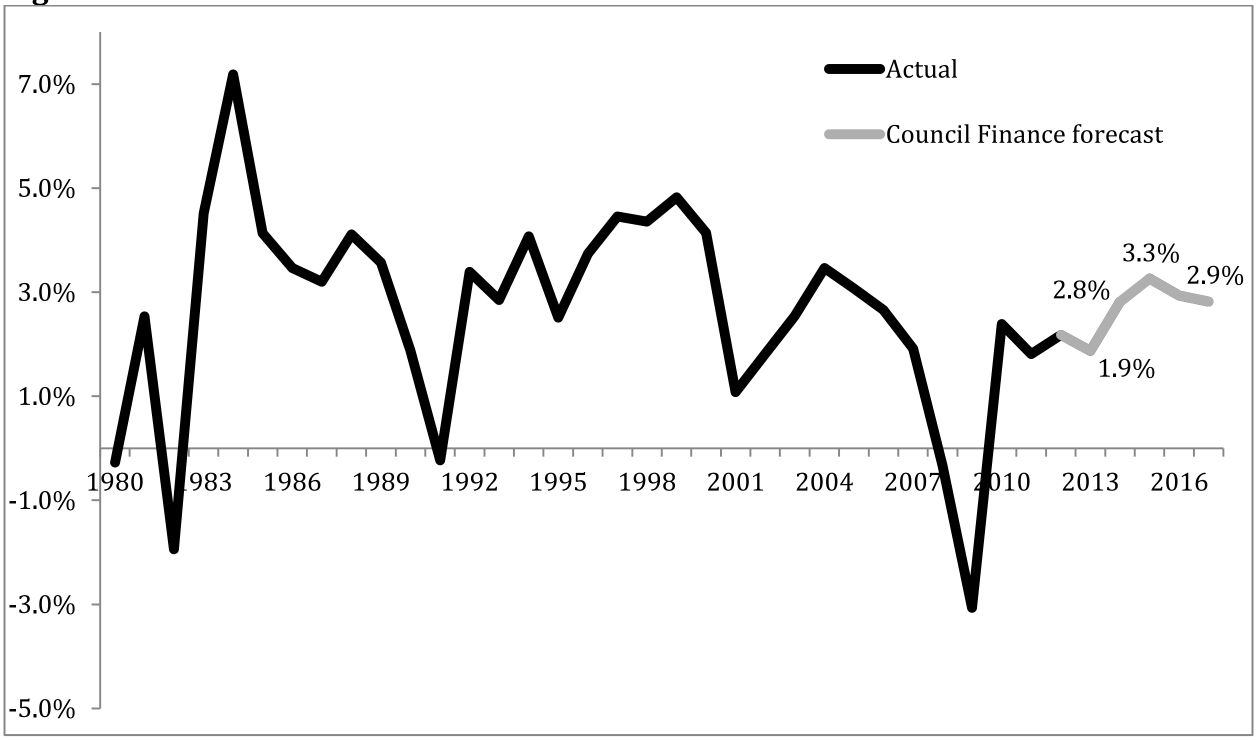
The U.S. economy is expected to reach an average inflation-adjusted 1.9 percent growth rate for the year 2013 after growing only 0.1% in annualized fourth quarter of 2012 growth. Consistent with Global Insight, NYC Council Finance estimates economic growth reaching 2.8 percent, 3.3 percent, and 2.9 percent in 2014, 2015, and 2016 respectively (see Figure 6). These expectations reconfirm the conservative outlook presented last year in the Council Finance's Fiscal 2013 Executive Budget Briefing Report.

Since May 2012, several conditions in the U.S. economy have improved (e.g. lower unemployment, continued households' deleveraging, and escape of the severe "fiscal cliff" impact in early 2013,just to name a few), but others have either persisted or re-emerged, worsening the economic outlook for the medium term.

Council Finance predicts a "new normal" macroeconomic environment for the U.S. economy where lagging growth, not the robust growth of the 2000s, is the norm. We expect this environment to last over the next several years, having strong implications for regional economies, New York City included. Some of the major headwinds affecting the U.S. economy contributing to this outlook are:

- atypical slow recovery compared to earlier post-recessionary episodes;
- Persistent weakness in job creation and prolonged unemployment of workers marginally attached to the labor force.
- Fiscal consolidation from the "fiscal cliff" deal reached earlier in 2013 and the impacts of fiscal sequestration-primarily affecting the second half of the year.
- Uncertain U.S. exports growth as the country's major trading partners enter recession or experience volatility in growth.

Figure 6. U.S. Real GDP Growth



Source: IMF World Economic Outlook (2013) and IHS Global Insight (2013) and NYC Council Finance calculations.

The latest economic downturn has been more severe than any comparable economic recession since post World War II according to the National Bureau of Economic Research (NBER) recession cycles timing.[8]

Labor market

The most visible factor contributing to the weakness of the economy has been uneven job growth. According to the Bureau of Labor Statistics, employment growth in 2012 averaged to 181,000 workers per month. In January 2013, the BLS reported a total increase of 157,000 total nonfarm employees for the month. While economic observers remain optimistic about employment growth, Council Finance notes that much of this growth has been in low wage, low skilled sectors, further suppressing incomes and adding to income disparities, with disproportionate growth in the trade and hospitality, healthcare and construction sectors. The other sectors have reported either losses or dismal growth. These figures are consistent with the current phase of the recovery.[9]

Despite positive job growth since the fourth quarter of 2010, there is yet to be a significant dent made on the unemployment rate. The U.S. unemployment rate declined from the annual peak of 9.6 percent in 2010 to a slightly lower 2012 average of 8.1 percent (seasonally adjusted).[10] As of February 2013, the unemployment rate is at 7.9 percent. Data available from the Bureau of Labor

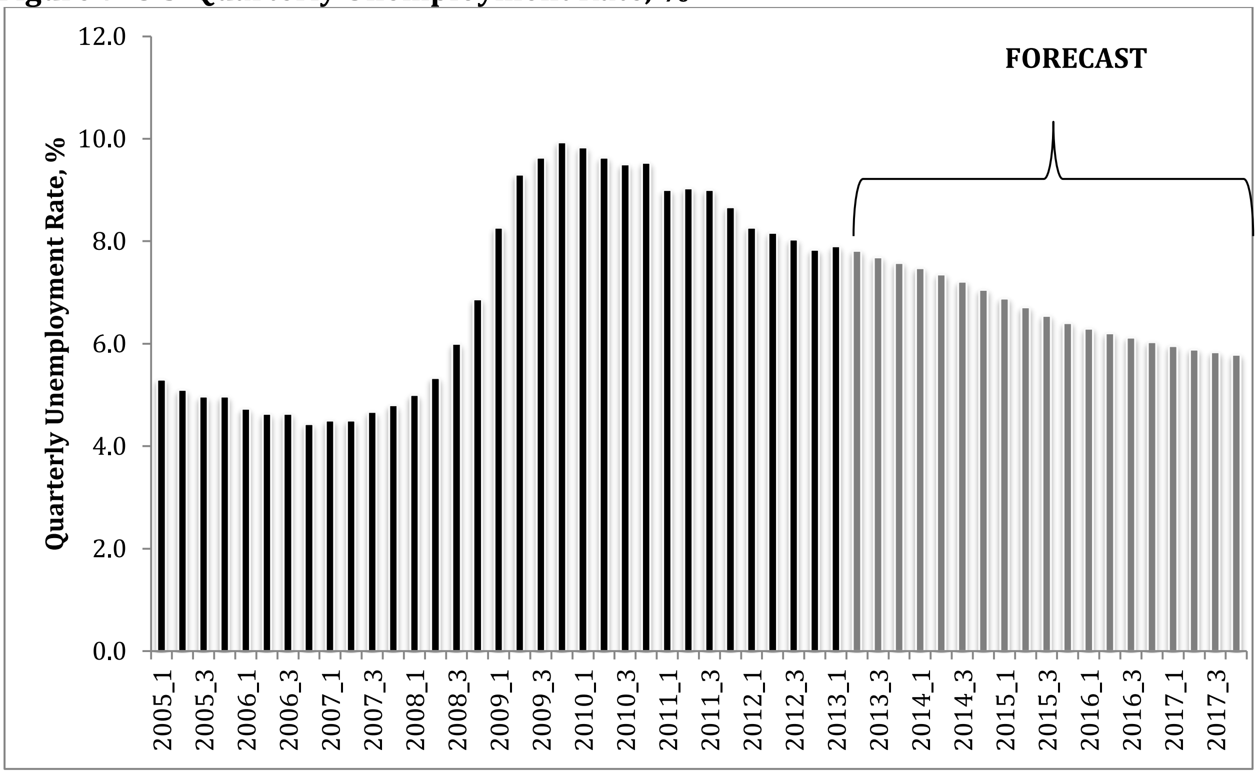
[8] Information on U.S. business cycles dating done by NBER is available online: http://www.nber.org/cycles.html

[9] Applied to the New York City scale, one finds further confirmation of the fact with additional qualifying information in the recently released by the New York City Council Finance report The Middle Class Squeeze, available online: http://council.nyc.gov/html/action/acpdfs/middle_Class_squeeze.pdf

[10] Unemployment started to decline in the later part of 2011 and in December 2011 the monthly unemployment rate dropped to 8.5 percent.

Statistics suggests that the largest share of the unemployed is the teenage youth population. While the U.S. unemployment is expected to decline, it will be slowed by the economy's sluggish recovery (see Figure 7).

Figure 7. U.S. Quarterly Unemployment Rate, %



Source: Bureau of Labor Statistics for actuals through January 2013; Global Insight and NYC Council Finance for forecast.

It may also be argued that a more inclusive unemployment measure is the one that accounts for "discouraged workers". This has trended downward from its peak of 16.1 percent in January 2011 to 14.5 percent of total labor force in April 2012 and then 14.4 percent as of January 2013—all high levels compared to the past decades.[11] At the same time, the labor force participation rate has consistently grown since 1960s through early 2000s, and it has now reached its lowest level since 1981. Participation is expected to decline in the medium term according to Global Insight's forecast.

Pertaining to the labor market, Council Finance draws three conclusions:

1. The U.S. economy has yet to recover from the crisis of 2008, and stronger jobs growth is needed.

2. Due to prevailing concerns of the prolonged effects of unemployment on workforce skills, many marginally attached workers are continuing to experience difficulties finding jobs. The effect also has an impact on the U.S. economy's relative competitiveness discussed below.

[11] This compares the Bureau of Labor Statistics' U-3 rate, which is the one most often reported in the press, with its more inclusive U-6 rate. For BLS's various measures of labor utilization see BLS Table A-15 http://www.bls.gov/news.release/empsit.t15.htm

3. Lack of robust jobs growth in the skill-based and middle-income category has had a decelerating impact on consumer spending, placing a downward pressure on economic growth in the near term.

Consumer and housing markets

Despite problems with persistent unemployment, real consumer spending—one of the key economic growth engines—grew at an annualized rate of 2.2 percent in the fourth quarter of 2012, down from its high in early 2011. Consumer spending is expected to run at quarterly lows from 1.8 percent to 2.2 percent during Calendar 2013 according to Global Insight. While consistent with below-trend recovery, these growth rates are below the annual 3.0 percent norm of the pre-crisis decade in the U.S.

This can be partially attributed to lower than normal real income and wealth growth since real disposable grew only 1.5 percent during Calendar 2012, amidst mixed performance of other indicators.[12] Real disposable income growth is expected to further slow to a staggering 0.7 percent in Calendar 2013 before picking up to an average of 3.3 percent over 2014-2017. While this would be a reversal of the overall declining trend, it is still below the 2006 high rate of 4.0 percent.

Recently, economists have drawn urgent attention to the problems of stagnant income growth. Related is the precipitous decline in the savings rate as percent of disposable income from post-crisis high of 5.1 percent in Calendar 2011 to a forecast Calendar 2013 of 2.7 percent of disposable income (3.9 percent in Calendar 2012). This may suggest that most of recent expenditure has been financed out of savings rather than earned income, adding to uncertainty in forward outlook.

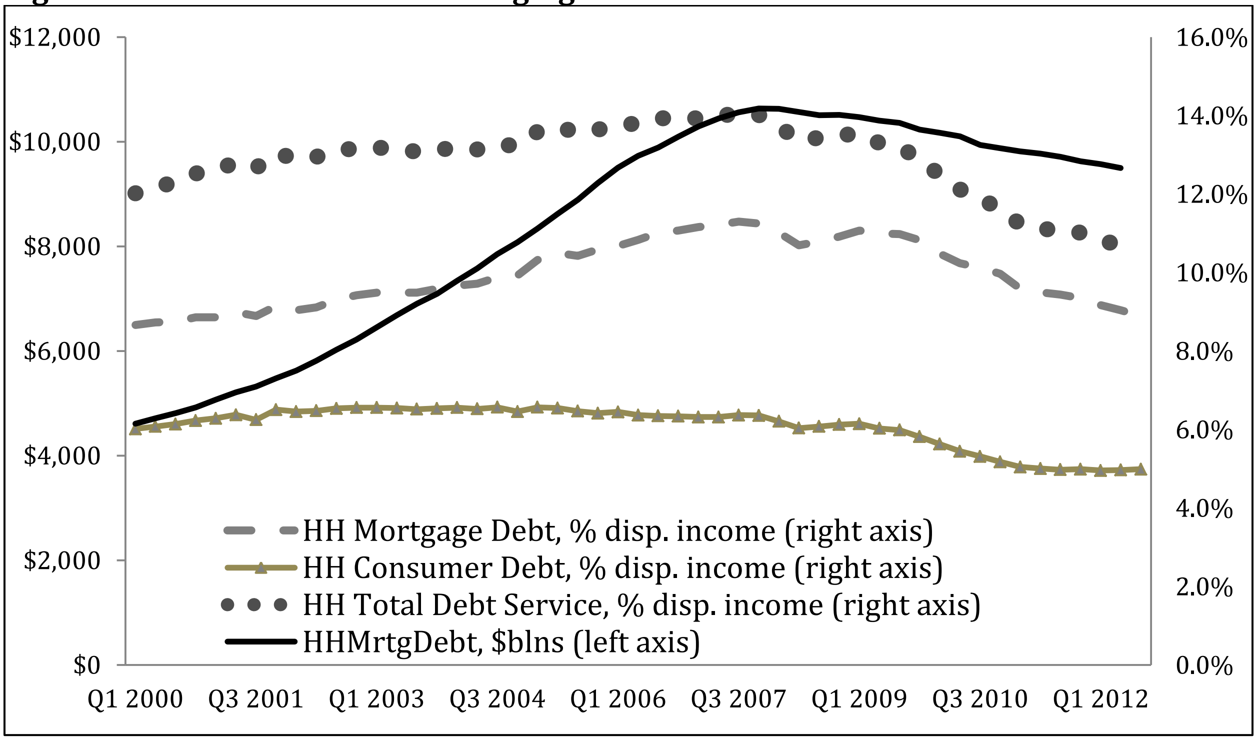
Conversely, there has been an overall positive change to households' balance sheets. One contributing factor has been the improvement in net worth due to asset prices recovery. This balance sheet correction is evident in the decline of the absolute U.S. household debt levels since late 2006. This trend corresponds with the declines in the mortgage and consumer debt as shares of disposable income (see Figure 8). Offsetting these improvements are continued foreclosures and personal bankruptcies files, albeit at a slower rate, and the continued decline of housing prices.

Further offsetting this general deleveraging trend is the trend of nonmortgage-consumer debt, which is expected to rise, reaching pre-2008 high levels for the first time (approximately 24.1 percent of disposable income in 2013, according to Global Insight).

More optimistically, housing recovery has logged positive trends in new home sales, housing starts, and housing prices. New home sales in the third quarter of Calendar 2012 were up 23.7 percent over the third quarter in 2013 according to the analysis put together by JPMorgan Chase Bank (JPMC).[13] The same report also notes intensifying decline in homeownership, confirming an analysis done by Council Finance staff with data from the Federal Reserve Board. The JPMC report shows a decline in ownership from 66.1 percent in the third quarter of Calendar 2011 to 65.3 percent in the same quarter a year later. This decline had a disproportionate negative impact on younger households.

[12] Real disposable income is after tax income corrected for inflation.
[13] JPMorgan (2013) Special Report: The US economic outlook for 2013. January 7, 2013.

Figure 8. U.S. Households Deleveraging Trend



Source: The Federal Reserve Board for household ratios and St. Louis Fed for home mortgage debt outstanding. 2013.

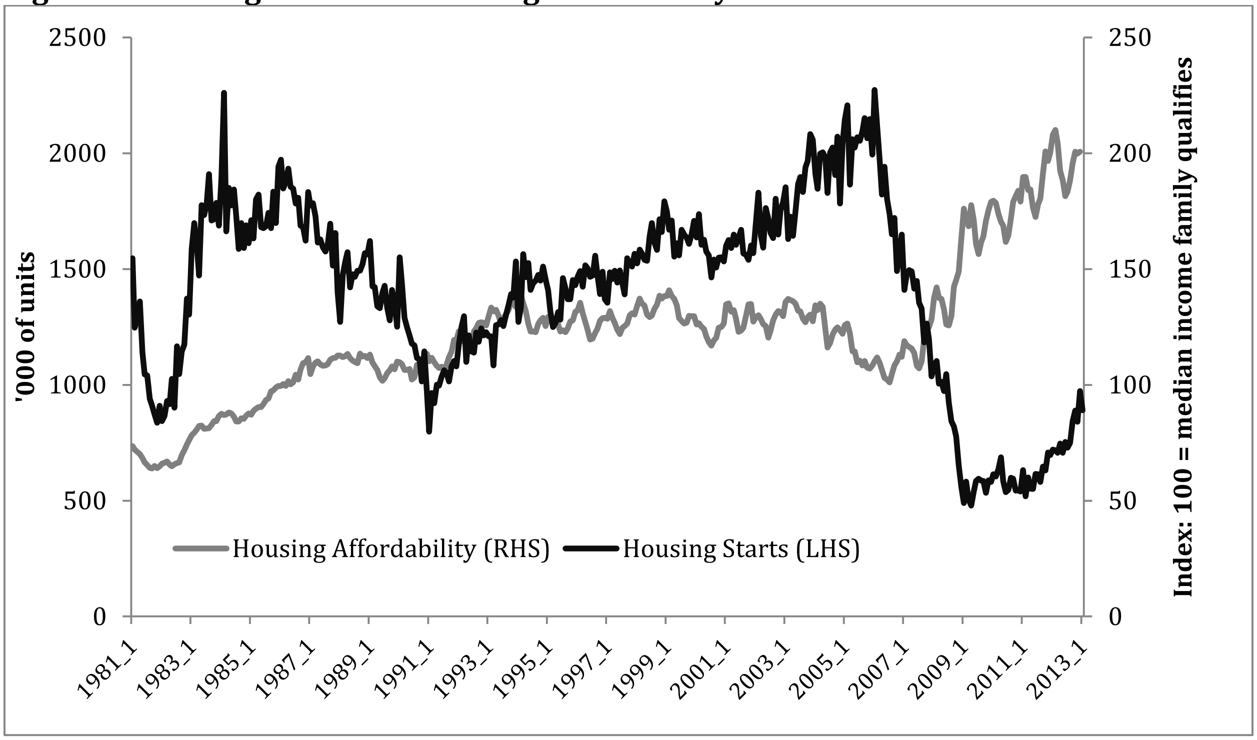
Modest improvements in the job market may help push household formation and as a result demand for new houses (even if for the demand is for rental units as opposed to home ownership). In fact, reduction in housing vacancies during Calendar 2012 substituted growth in available housing stock from new construction. It is expected that as vacancy rates decline and housing prices pick up stronger incentives for developers would emerge stimulating new housing starts. Preliminary housing starts data (Figure 9) suggests the beginning of this trend.

According to Global Insight, single family housing indicators (e.g. existing home sales, housing permits, and new home sales) are improving gradually. Overall housing starts grew 28 percent in Calendar 2012 though from a lower base. Global Insight and JPMC expect 24 percent annual growth rate in new housing in Calendar 2013 to 31.4 percent respectively.

Additionally, Global Insight's forecast finds evidence of accelerating growth in multi-family housing starts as builders respond to pent-up demand. This is refined in greater detail in reports by T. Rowe Price suggesting that between 2006 and 2008 housing market deducted a full percentage point from economic growth and now is expected to contribute three-tenths of a percent to the economy.[14]

[14] T. Rowe Price (2012) What's ahead for the markets? 2013 Investment and Economic Outlook; Available online: https://www2.troweprice.com/iws/wps/portal/public_Media/pressbriefing

Figure 9. Housing starts and housing affordability index



Source: NYC Council Finance based on the data from the Federal Reserve Board and St. Louis Fed (2013).

Housing affordability has been consistently rising, suggesting more affordable housing units on a national scale (see Figure 9). This however is in contrast to a slower recovery in housing prices which recently rebounded, and is expected by Global Insight to reach the low levels of Calendar 2007.

Corporate profits, business spending and the financial sector

Business performance is critical to growth, and trends in sales, investments and business spending on nonresidential equipment and software reflect the general direction of aggregate demand in the economy.

According to the National Association for Business Economics' most recent Industry Survey, sales growth was reported stable in the last quarter of Calendar 2012, though lower share of the survey respondents reported rising sales, in the background of restrained growth. Firms' capital equipment spending, an important driver of GDP growth, grew faster between 2009 and 2011, but it sharply decelerated in real terms in Calendar 2012. According to JPMC, the decline in business investment in equipment and software was up to 2.6 percent in the third quarter of last year. This may be attributed to the firms' cautious outlook ahead of fiscal cliff resolution, as spending bounced back at 12.4 percent in the fourth quarter. This had a temporary effect and on the annual basis, Global Insight's data suggest growth of 5.5 percent in Calendar 2013 below 6.9 percent in Calendar 2012.

Overall, business climate is uncertain in the medium term. The three factors explaining this are:

1. Absent of healthy demand for goods or services, capital investment may be slow to reach pre-crisis highs.

2. Risks in the global economy affecting U.S. manufactures and financial businesses t may be adapting to an environment of limited opportunities to expand.
3. Medium term uncertainty of fiscal cliff/sequestration/debt-ceiling resolution will have drastic effects on the economy. The most visible of these effects are the decline in disposable incomes which affect sales.

Some analysts (e.g. T. Rowe Price report) express hope that business performance will improve due to growth in and accumulation of substantial profits among U.S. financial and non-financial corporations. Potentially, these cash balances can be used to accelerate investment and hiring should firms feel comfortable enough to do so.[15]

Concerning low interest rates, effective deflation and reserved optimism over immediate growth, U.S.-based banks have continued to conservatively ease their credit standards and expand business, auto, and prime residential mortgage lending facilities according to the Federal Reserve's January 2013 Senior Loan Officer Survey.[16]

According to the latest release by the Federal Deposit Insurance Corporation, U.S. bank earnings in the third quarter of Calendar 2012 were the highest in six years, as loan balances increased. Banks' aggregate net income for Q3 2012 was $37.6 billion (compared to $35.2 billion in Q3 2011).[17] Most of the improvement year-over-year accounted to increased noninterest income. The report also finds evidence of deposits growth by $182 billion. At the same time the number of financial institutions declined to 7,181 as 49 were absorbed by mergers and 12 failed.

In addition, consumer loans have shown a restrained (1 percent) growth despite demand (especially for auto loans—a consistent trend over time). The perceived optimism of these results is offset by this tendency being a reflection of still recovering housing market (and limited collateral), tight credit terms in consumer lending, and cautious business spending. It is also a reflection of the workings of the financial economy as households and businesses acquire immediate operational funds.

Further facilitating potential investment demand and consumer spending on the financial side, core interest rates are expected to stay low while headline CPI inflation is expected to oscillate around 1.4 percent through Calendar 2013—a decline from 2.1 percent in Calendar 2012. In a groundbreaking decision during its December 2012 meeting, the Federal Open Market Committee (a monetary policy setting group within the Federal Reserve System) has committed to sustain its highly accommodative monetary policy stance (purchasing $45 billion of Treasury securities per month and $40 billion of agency mortgage-backed securities per month in addition to other measures) until the unemployment rate falls below a 6.5 percent mark.[18] At the same time there is growing concern about lack of a complementary fiscal policy component to such a highly accommodative monetary policy in steering the macroeconomic environment. On a narrower subject, the exact impact of the Fed's successive quantitative easing programs is still unclear.

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[15] NYC Council Finance reported on this earlier in the May 2012 Executive Budget Report.

[16] The Federal Reserve Board. 2013. The January 2013 Senior Loan Officer Opinion Survey on Bank Lending Practices. Available online: http://www.federalreserve.gov/boarddocs/snloansurvey/201302/default.htm

[17] FDIC 2012 Quarterly Banking Profile Third Quarter 2012, Available online: http://www2.fdic.gov/qbp/2012sep/qbp.pdf

[18] The Federal Reserve Board of Governors. (2012). FOMC Press Release, December 12, 2012. Available online: http://www.federalreserve.gov/newsevents/press/monetary/20121212a.htm

Net exports

The decline in U.S. economic growth over the fourth quarter of Calendar 2012 has been preliminary attributed to a decline in the U.S. exports among other factors.[19] According to Global Insight U.S., exports represent roughly 13.5 percent of U.S. GDP, and exports between the third and the fourth quarter of 2012 dropped 26.9 percent (see Figure 10). While exports are expected to recover (to approximately 20 percent quarterly growth in 2013), this factor is not likely to be the key driver in the near term.

Council Finance expects the U.S. to continue to run a current account deficit in Calendar 2013 and beyond with modest export growth beginning at 2.4 percent in Calendar 2013 and averaging 6.1 percent over 2014-2017. Though recent efforts by the U.S. Federal Reserve (i.e. the quantitative easing, QE1, 2, 3) have contributed to a significant depreciation in the US currency, the dollar is expected to strengthen against the euro primarily due to the Eurozone recession. Appreciation will lead to more affordable imports purchases by American businesses and consumers and higher costs for those buying U.S. exports.

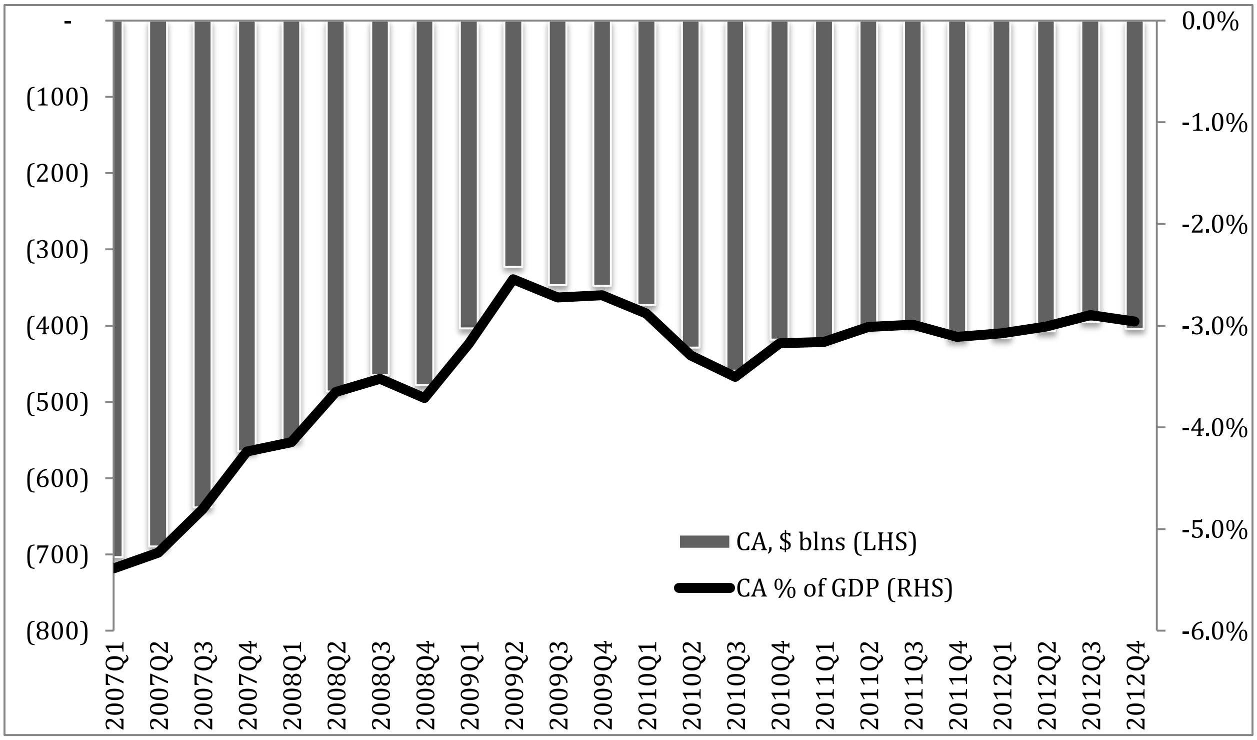
In fact, consistent with economic theory, Global Insight reports U.S. export levels to be in-sync with its major trading partners' growths. This is another reason why the expected severe contraction of the EU economy has had a negative impact on the U.S. economy (as the weakness spreads into the locomotive of the EU economy, France and Germany, as noted by T. Rowe Price). Approximately, 13.2 percent of U.S. exports were directed to the EU in Calendar 2012 with 19 percent going to Canada. At the same time, for its 18.7 percent share of total imports, U.S. relies on trade with China, according to the latest data from the U.S. Census Bureau. Hence, volatility in the economies with which the U.S. has established trade links may act as a negative external shock to the U.S.

There are two upsides worth mentioning to the growth potential of U.S. exports:

1. Global Insight has forecasted a reduction in the current-account deficit to 2.7 percent in 2013 from 3.1 percent in 2012 due to reduced reliance on imported energy products. This is a signal of the growing self-reliance in energy in the U.S. albeit checked by development of energy efficient power-generating technologies.
2. Improving productivity (an index measuring output per hour), as U.S. manufactures adopt more labor-saving and efficient technologies, has contributed to improved competitiveness of the domestic firms, measured in unit labor costs relative to key trading partners U.S.

[19] Other contributing components to slower Q42012 growth were declining inventories, drop in defense spending, and declining government purchases. As a possible explanation but lacking consensus, some economists have pointed to pre-payments in the third quarter in anticipation of the fiscal changes to take effect in early 2013. Exact relevance of this view will be tested as new revised data becomes available later in this year.

Figure 10. U.S. Current account (USD blns and % of GDP)



Source: NYC Council Finance based on the data from IHS Global Insight (2013).

However, these opportunities present also uncertainties concerning the direction of U.S. exports due to dynamic nature of the global economy.

Fiscal policy

The U.S. avoided "falling off the fiscal cliff" in January 2013 by adopting a compromise resolution delaying the provisions of the Budget Control Act of 2011 (e.g. unemployment benefits and the enhancement of the Earned Income Tax Credit which were set to expire).[20] At the time of writing, the U.S. economy is at risk of running into another self-made crisis. This crisis is the result of sequestration—automatic spending cuts—commencing in early March 2013 if no deal is reached in Congress. This is an outcome of failed agreements on the debt ceiling by the so-called Supercommittee put together back in 2011 to determine $1.2 trillion of deficit reductions over ten years. The deadline happens to be right around with Treasury runs out of possibilities to further raise the debt ceiling.

While most analysts, pointing to the fact that sequestration is not in the interest of either political party, agree that some temporary measures will be found to avoid full-blown cuts, some spending will likely be curtailed. A full sequester would result in over $85 billion in spending cuts in the current fiscal year and $110 billion more per year thereafter. Global Insight estimates a gradual decline with possibility of federal spending being reduced by $9 billion during federal fiscal year 2013, impacting Medicare, Medicaid, Social Security, defense, and nondefense discretionary spending (fall of 2.5 percent and 2.6 percent in 2013 and 2014 respectively).

[20] For additional details see NYC Council Finance Committee Report on Fiscal Cliff, December 10, 2012; and Global Insight 2013 US Economic Outlook, January 2013.

In the long run this may help avoid the excessive national debt pile up and prevent an unsustainable debt crisis. Moreover, the Congressional Budget Office recently estimated that federal revenues are rising faster than spending. As a result, the deficit is project to fall below 2.4 percent of GDP by 2015, but it will then rise again in later years, reaching up to 4 percent of GDP by 2023. Federal debt would be above 73 percent of GDP and continue to increase relative to the economy.[21]

On a macro scale, it follows that despite an accommodative Federal Reserve policy of low interest rates, there is a strong possibility that severe fiscal consolidation may strain the economy further. In fact, according to the JPMC report mentioned earlier, current estimates of the fiscal contraction may amount to a full 1 percent of GDP, further restricting economic growth. In view of many economists, the Federal government possesses the operational and financial capacity to put the economy on track before scaling back on its current spending or raising taxes.

[21] Congressional Budget Office (CBO) (2013). The budget and economic outlook: fiscal years 2013 to 2023. February 5, 2013. Available online: http://www.cbo.gov/publication/43907

City Economy

- **City adds 74,300 payroll jobs in 2012, with 77,300 in the private sector.**
- **Employment is at an all-time high but unemployment is a disappointing 8.8 percent.**
- **The securities industry had earning in 2012, but has restored only 29 percent of jobs lost since 2007.**
- **Tourism continues to boost employment.**
- **Leasing commercial space is stable and residential market begins to strengthen.**
- **Council Finance forecasts moderate growth through 2013, picking up in subsequent years.**

City adds 74,300 payroll jobs in 2012, with 77,300 in the private sector

The City's economy continues to grow but faces formidable headwinds. The valuable financial sector returned to posting profits in 2012, but faces precarious global markets and a new regulatory environment. Employment expands but the job mix continues to shift towards lower paid jobs. Commercial leasing lost some of its momentum in 2012, but residential real estate is beginning to strengthen. Hurricane Sandy is estimated by OMB to have cost the City $5.7 billion in lost economic activity alone, not including property damage.[22] However, the lion's share of the economic loss is expected to be recovered in the 1st quarter 2013. By the 4th quarter 2013, one year after Sandy, the City economy is expected to be only $1.4 billion or 0.2 percent smaller than if Sandy had not occurred. [23]

Employment in the City continued to expand at an impressive rate in 2012. Total payroll increased by 74,300 in 2012 compared to 2011, roughly equal to the 74,700 jobs added in 2011. The private sector contributed 77,300 positions last year, compared to 85,300 in 2011, but there was less of a loss of government jobs in 2012 compared to 2011. The City has now recovered around 227,900 private sector jobs since the upturn in September 2009, 163 percent of the jobs lost in the recession. [24]

Changing mix of jobs and 'why the high unemployment rate?'

The jobs created in 2012 have continued the post-recession trend of generally favoring sectors that pay less. Since December 2011, finance and insurance, which pays an average wage of $141,600, added only 1,700 employees, and its securities industry, paying $362,900, lost 1,000 positions. On the other hand, retail employment with average pay under $36,000 grew by 9,800 workers. Accommodations and food services with an average wage of $29,200 added 9,000 employees.[25] The New York City Council Finance Division recently released a report "Middle Class Squeeze" which employed Current Population Survey data showing persons in middle income

[22] Office of Management and Budget, "January 2013 Financial Plan: Fiscal Year 2013-2017, p. 11.
[23] Forecast is from IHS Global Insight.
[24] U.S. Department of Labor, Bureau of Labor Statistics, , Current Employment Statistics (CES) seasonally adjusted through December 2012.
[25] U.S. Department of Labor, Bureau of Labor Statistics, Quarterly Census of Employment and Wages, through 2nd quarter 2012.

households shrinking as a percentage of the City's population. The report traced the 'hollowing in the middle' to a smaller share of jobs in sectors that support middle income households.[26]

Table 6. Employment Gains Since the Pre-Recession Peak August 2008 thru December 2012 and the Percentage of Jobs Recovered from Recession
Thousands - Seasonally-Adjusted

	Gains (thous.)	Percent Recovered
Total Private	**88.2**	163%
Finance and Insurance	(22.0)	37%
Banking	(3.1)	58%
Securities (Wall Street)	(17.6)	29%
Real Estate and Leasing	(3.7)	15%
Professional and Business Services	40.3	188%
Employment Services	15.6	263%
Information	1.9	133%
Construction	(24.1)	-63%
Leisure and Hospitality	43.0	751%
Arts, Entertainment, and Recreation	(2.1)	52%
Accommodation and Food Services	45.1	2,006%
Accommodations (Hotels)	4.4	499%
Food Services and Drinking Places	40.6	3,585%
Healthcare and Social Assistance	40.2	no job loss*
Education Services	14.3	no job loss*
Government	(14.3)	no job loss*

Source: NYS Department of Labor, Current Employment Statistics, Seasonally-adjusted by NYC Council Finance
*These sectors experienced no job loss during the recession. Large percent recovered figures (e.g. food services) mean that relatively few jobs were lost during the recession compared to the jobs gained during the recovery

Despite strong payroll growth, the City's unemployment rate continues to be extremely high at 8.8 percent as of December, reflecting a real discrepancy between two different surveys of the Bureau of Labor Statistics. While the establishment survey[27] posted a 74,300 increase in City payroll for 2012, the household survey[28] reported a 1,100 decrease in City resident employment, which underlies the high unemployment rate. This disconnect has puzzled experts, producing explanations ranging from commuters monopolizing the job growth to people moving from self-employment to payroll (a move counted by the establishment survey but not the household survey). There is a growing consensus that the household survey undercounts City resident employment. It's based on a monthly sample of only 60,000 nationwide and is calibrated to the decennial U.S. Census due to the small size of the sample. The problem with the 2010 Census as a benchmark, however, is that there's ample evidence that it undercounted the City's wage-earning population. This resulted in the household survey underreported the City's employed population.

[26] The New York City Council – Finance Division, 'The Middle Class Squeeze,' February 2013.
[27] Current Employment Statistics (CES), op. cit.
[28] U.S. Department of Labor, Bureau of Labor Statistics, Current Population Survey (CPS).

On the other hand, the establishment survey is based on a much larger sample of 486,000 each month. In addition, it's re-benchmarked each year based on the entire payroll furnished by the government's unemployment insurance records. It's very likely that the real unemployment rate is considerably lower than the one reported.[29]

Changes in the securities industry

Turning to individual sectors, the prized securities industry has been struggling since the recovery. Annual gross revenues have been decreasing in 2010 and 2011, making profits dependent on the near-zero federal funds rate and the shedding of staff. The securities industry has been facing the challenges of the European debt crisis, weakening global markets, domestic concerns about the fiscal cliff, and the daunting regulatory environment of the Dodd-Frank Act. The 848 page Dodd-Frank Act entails 398 required rules, of which around 40 percent have been completed.[30] Financial institutions have been restructuring to meet its requirements. To discourage excessive risk taking, bonuses are being transformed from immediate cash to deferred compensation and stock options.

Earnings have been on a roller coaster. When the European debt crisis reached a critical point, the securities industry suffered $7.7 billion in losses in the last half of 2011. The losses sustained during the last half of 2011 entailed a deep 13.5 percent cut in the bonus pool that year. As European leaders assumed more aggressive measures to prop up their banks and sovereign bonds, the securities industry again posted strong earnings of $23.9 billion in 2012. The bonus pool rebounded 8 percent.

Employment in securities has also been volatile. While the overall private sector recovered 163 percent of payroll lost in the recession, Wall Street has only restored 29 percent. As banks anticipate higher capital requirements, greater constraints in hedging bets and reduced profits, there's been a continuous flow of announced layoffs. JPMorgan Chase most recently announced a 4,000 reduction in staff this year. Between November 2007 and January 2010, the industry shed 28,100 of its workforce (seasonally adjusted). It subsequently recovered 9,300 positions up through December 2011 only to lose another 1,000 jobs in the next 12 months. The higher bonuses were shared by a smaller workforce.

For those lucky enough to retain their positions, a job in securities commands an enviable average wage of $362,900. It's no wonder that the State Comptroller's office estimates that one job in securities supports two jobs in other sectors.[31] Council Finance anticipates further losses in securities employment this year, as financial firms continue to adjust to the new regulatory environment.

Professional and business services took over finance's mantle in leading the City out of the recent recession. Over the last 12 months it's added 36,500 positions, about 46.4 percent of total payroll growth. This super-sector includes law firms, accountants, advertisers, computer professionals, architects, management companies, and employment services. Its major sectors, particularly legal

[29] Federal Reserve Bank of New York, "Current Issues in Economics and Finance: Explaining the Recent Divergence in Payroll and Household Employment Growth," Chinhui Juhn and Simon Potter, Vol. 5, Number 16, December 1999. Eastern Consolidated, "NYC Employment Alert: Why is New York City's Unemployment Rate Increasing When Job Growth is So Strong?" Barbara Byrne Denham, August, 2012.

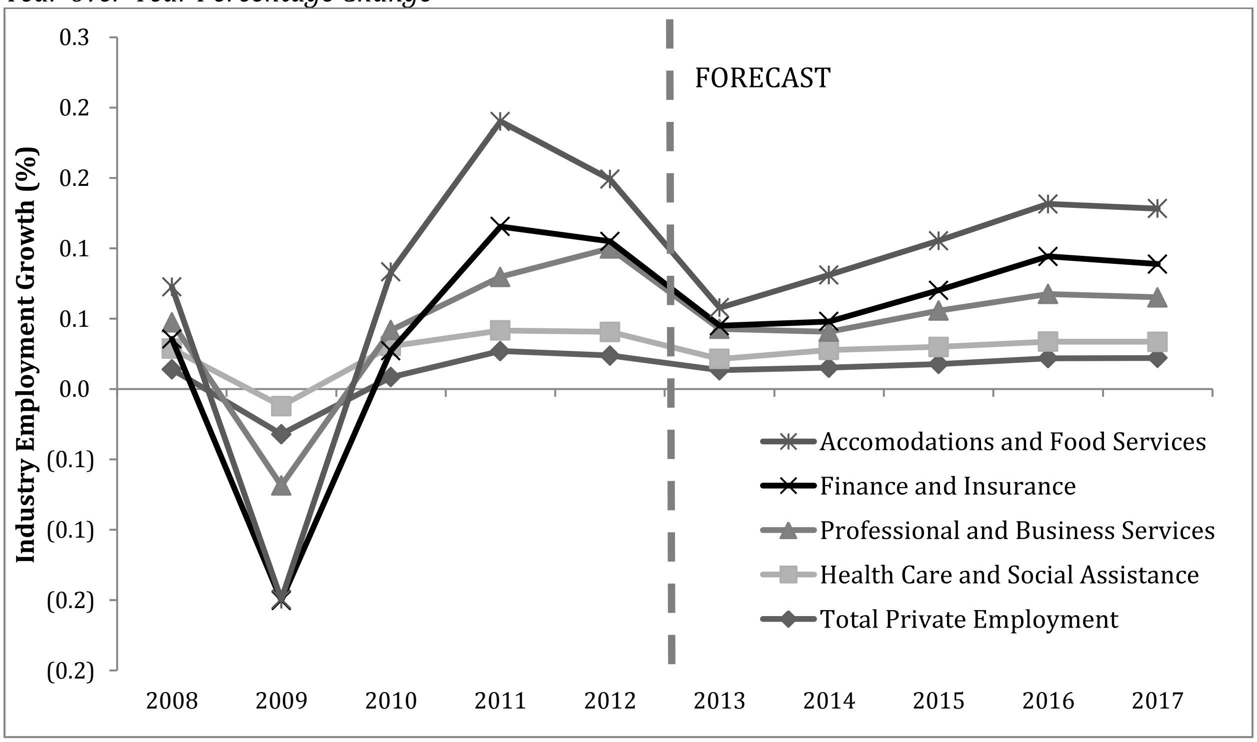
[30] Office of the State Comptroller, "The Securities Industry in New York City," October 2012, p. 2.

[31] Ibid., p. 8.

and accounting, receive much of their business from the finance sector. Consequently, it was encouraging to see business services flourishing despite tepid growth in the finance sector. Wages in this super-sector, like its occupations, cover a wide gamut, with an average wage of $100,350 in 2011.

Information picked up only 900 positions since December 2011. Its structurally-downsized publishing sector lost 2,100 jobs, but its vibrant motion picture and sound recording sector expanded by 4,000 positions.

Figure 11. Industry Employment Growth, Actuals and Forecast for 2013-2017
Year-over-Year Percentage Change



Source: NYS Department of Labor, Current Employment Statistics, December 2012.

Tourism continues to boost employment

Year-over-year growth was also seen in leisure-hospitality and retail, both vitalized by record tourism. Tourism in 2012 surpassed its previous record in 2011 with 52 million visitors to the City. The many entertainment and cultural attractions of the City, along with the weak dollar, drew in both domestic and foreign travelers.

The leisure and hospitality super-sector flourished in the last 12 months, increasing its payroll by 9,600. Food service and drinking places accounted for 92.7 percent of this employment growth. As mentioned earlier, these positions tend to be low paying jobs.

The hotel industry has benefited from average occupancy rates above 85 percent since 2010. In 2012 they averaged 87.6 percent, up from 85.2 percent the previous year. The average daily rate has also risen to $281 per room in 2012, the best year since 2008. There were 29.0 million hotel room nights sold in 2012, a 6.3 percent increase over the prior year.[32] Hotel employment, however, has been basically flat in the last 12 months.

Retail establishments have also performed well last year thanks to tourists and less frugal New Yorkers. This sector has added 9,800 workers since December 2011. Retail is also low paying. The industry is likely to be pummeled this year by more frugal consumers reeling from the payroll tax increase.

Employment in non-cyclical healthcare and social services slowed in the last 12 months, adding 6,000 positions, a 1 percent increase. Private education services picked up steam, adding 7,300 jobs, a 4.2 percent increase. Manufacturing continued its structural decline, losing another 1,400 workers year-over-year. It now employs a little more than half the workforce a decade ago.

Construction starts increased by 5 percent in 2012 compared to 2011 to $16.1 billion. The increase was driven by residential construction starts which soared 54 percent to $5.1 billion. Non-residential starts (private and public), however, declined by 7 percent to $8.9 billion. Public works, including roads, bridges, water systems and other infrastructure, also dropped by 12 percent to $2.1 billion. The top two projects in 2012 were the $400 million renovation of Macy's Herald Square, and the $325 million entrances for the 96th Street station of the 2nd Avenue subway. Construction employment, however, continues to contract, losing 2,000 in payroll since December 2011. Looking ahead to 2013, non-residential construction "is off to a promising start" according to Richard Anderson, president of the New York Building Congress. He points to Related's 1.7 million square foot office tower in Hudson Yards, and the possible beginning of 2.5 million square foot 3 World Trade Center, pending one or two anchor tenants.[33]

Leasing commercial space is stable and residential market begins to strengthen

The real estate market is stable and generally improving. Commercial leasing in Manhattan slowed to 23.2 million square feet in 2012, down 23.3 percent from 2011. Nevertheless, 2011 was the most dynamic year since 2000. Market conditions were stable through 2012, with little change in vacancy rates and asking rents. In the 4th quarter 2012 the overall vacancy rate rose 0.3 of a point year-over-year to 9.4 percent, and the overall asking rent rose 4.0 percent year-over-year to $59.54 per square foot. Leasing activity picked up in the second half of the year with 4th quarter activity at 6.4 million square feet, a 6.7 percent increase over the same quarter in 2011. Looking ahead, the likely completion of One and Four World Trade Center in 2013, plus the properties at Brookfield Place will add 5.6 million square feet to the downtown market. Cushman & Wakefield expects the additional space to increase vacancy rates from 8.8 percent to over 13 percent. [34]

The City's residential market is a mixed bag. As of November 2012, single-family home prices in the New York City metropolitan area had fallen by an average 1.2 percent year-over-year, while national prices had already jumped by 5.5 percent. Prices in the metropolitan area are determined to a greater degree by suburban homes than those in the five boroughs. On the other hand, condo prices in the metro area, which are heavily weighted to Manhattan, soared 7.3 percent.[35] The Manhattan rental market continued to tighten in 2012, although the fourth quarter witnessed

[32] New York City & Company, "NYC Hotel Occupancy, ADR & Rooms Sold," February 1, 2013.
[33] New York Building Congress, "Update: Surge in New Residential Projects Spurs 5 Percent increase in 2012 NYC Construction Starts," February 12, 2013.
[34] Cushman & Wakefield, "Market beat Office Snapshot, Manhattan," Q4 2012.
[35] Standard & Poors / Case-Shiller.

slight rent reductions, as some renters became home purchasers. Rents for Manhattan studios rose 4 percent in 2012 averaging $2,027 per month. Rents for one bedroom apartments rose 5 percent averaging $2,773 per month.[36]

Table 7. Forecast of Employment Gains
Year-Over-Year Growth in Thousands

	CY12	CY13	CY14	CY15	CY16	CY17
Total Private	**77.3**	**44.5**	**51.2**	**60.6**	**76.0**	**78.7**
Finance and Insurance	1.6	0.7	2.3	4.6	8.6	7.8
Banking	0.9	0.2	1.2	1.5	1.3	1.0
Securities (Wall Street)	0.5	0.4	1.2	2.9	7.1	6.6
Retail	13.0	(1.0)	6.3	8.0	8.4	7.6
Professional and Business Services	35.4	13.5	8.3	16.8	22.8	21.9
Real Estate and Leasing	(0.5)	0.5	1.6	1.2	0.8	0.5
Information	2.8	0.0	0.4	1.4	3.0	3.4
Leisure and Hospitality	14.0	2.9	12.0	12.3	13.5	14.8
Arts, Entertainment, and Recreation	1.9	(0.8)	2.4	1.7	1.9	2.1
Accommodation and Food Services	12.1	3.7	9.6	10.5	11.6	12.7
Accommodations (Hotels)	1.5	(0.3)	(0.1)	1.0	1.2	1.1
Healthcare and Social Assistance	10.0	4.8	7.7	7.5	7.3	7.2
Education Services	(0.3)	2.7	1.8	2.6	3.2	3.5

Source: NYS Department of Labor; Forecast by NYC Council Finance

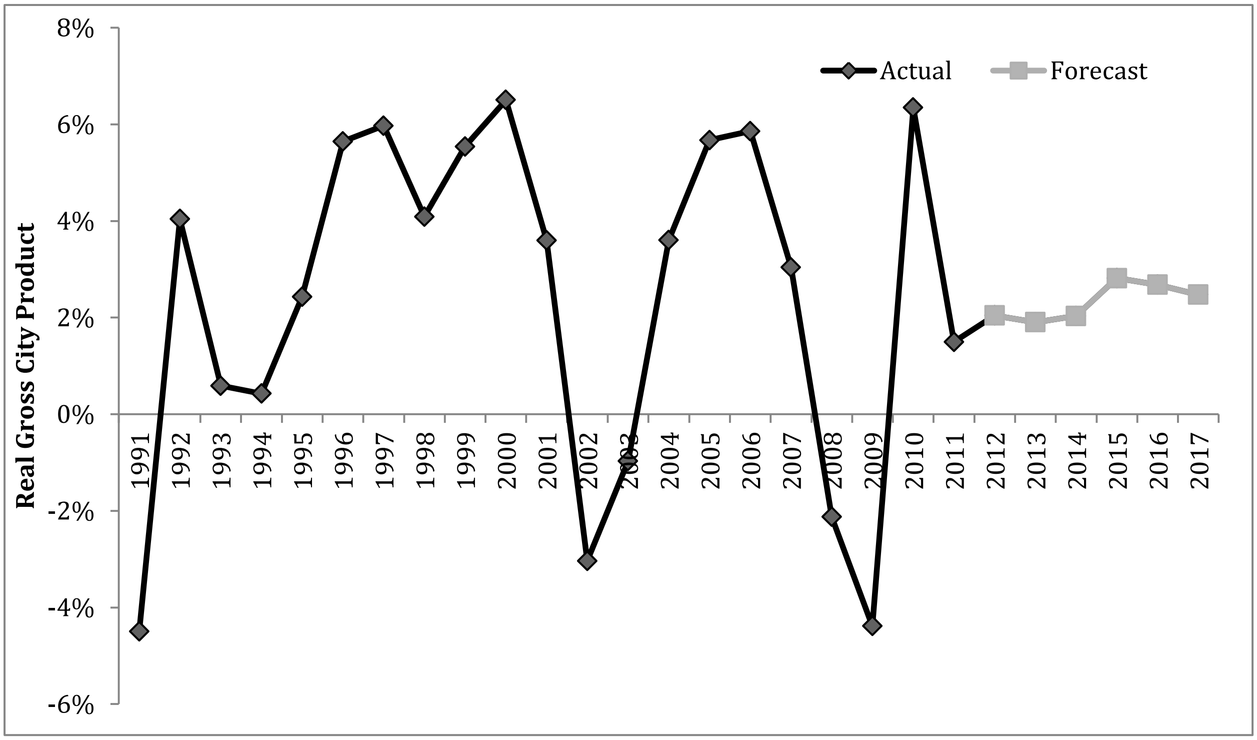
Council Finance forecasts moderate growth through 2013, picking up in subsequent years

Looking ahead, Council Finance expects private payroll growth to be less spectacular than a year ago, adding around 44,500 jobs in the private sector in 2013. This is stronger than OMB's estimate of total payroll growth of 41,000. The slower job growth stems from the reduced consumption from the higher payroll tax and a restructuring financial sector. Council Finance expects employment to gain momentum in 2014, adding 51,200 jobs, and averaging over 70,000 in the out-years.

If recent trends continue, the new jobs on average will tend to be lower-skilled and with lower wages, partially due to the downsizing of Wall Street and the information sector, as well as a booming tourist industry. Total wages in the private sector are expected to rise by 3.2 percent in 2013, driven by a larger workforce and moderate increases in Wall Street bonuses. This is slightly stronger than OMB's forecast of a 2.9 percent increase in 2013. Council Finance projects wage growth to accelerate to 3.9 percent in 2014, and average over 5 percent in the out-years. Looking at real gross city product, IHS Global Insight forecasts annual growth in 2013 and 2014 to languish at a little over 2 percent before accelerating to 2.8 percent in 2015.

[36] CitiHabitats, "Manhattan Residential Rental Market Report," Q4 2012.

Figure 12. Real Gross City Product Will Remain Around 2 Percent in 2012 and 2013



***Source**: IHS Global Insight, real gross city product.*

Table 8. Forecast of Selected Economic Indicators

	CY12	CY13	CY14	CY15	CY16	CY17
National Economy						
Real Gross Domestic Product *Percentage Change*	2.2	1.9	2.8	3.3	2.9	2.8
Private Employment						
Level Change (million)	2.4	2.1	2.3	2.6	2.5	1.8
Percentage Change	2.2	1.8	2.0	2.2	2.1	1.5
Total Wages *Percentage Change*	1.8	1.8	2.0	2.1	2.2	2.3
New York City Economy						
Private Employment						
Level Change (thousand)	77.3	44.5	51.2	60.6	76.0	78.7
Percentage Change	2.4	1.3	1.5	1.8	2.2	2.2
Total Private Wages *Percentage Change*	2.1	3.2	3.9	4.4	5.3	5.1
Total Revenue of NYSE Members *Percentage Change*	10.8	3.3	3.7	3.4	3.2	2.9

Source: IHS Global Insight, February 2013 (Nat'l); New York City Council - Finance Division (City)

City Tax Forecast

- **City tax revenues will grow at an average rate a little above 4 percent a year.**
- **Slowing overall tax revenue growth is the real property tax. It reacts slowly to the economy**

Introduction

Overall, Council Finance has a tax revenue forecast that moves in the same general directions as OMB. Council Finance expects tax revenues to grow at 4.6 percent in Fiscal 2013 while OMB projects roughly the same growth at 4.65 percent. This is slightly stronger than the 4.26 percent growth in Fiscal 2012. Council Finance forecasts revenue growth to slow to 3.5 percent in Fiscal 2014 while OMB expects a slightly steeper deceleration to 3.1 percent growth. Both forecast expect collections to pick up in the out-years, with Council Finance forecasting annual growth averaging 4.6 percent, about half a percentage point stronger than OMB.

Underlying Fiscal 2013's stronger growth in collections are an expanded payroll and Wall Street's return to profits. Revenue growth is expected to slow in Fiscal 2014 as employment expansion softens in calendar 2013, consumers respond to the pinch from the higher payroll tax, and the effects of Washington's fiscal austerity filter into the City . While Fiscal 2013 benefited from more realized capital gains to avoid higher taxes, Fiscal 2014 will experience the 'hangover' of depleted realizations. Revenue growth picks up in the out-years as employment expands at a faster rate, consumers adjust to the old payroll rate, Wall Street makes its adjustments, and higher real property values sustain healthy growth in the property tax.

Table 9. Council Forecast: Growth Rates

	FY12*	FY13	FY14	FY15	FY16	FY17
Real Property	6.4%	2.8%	5.9%	4.0%	5.7%	4.3%
Personal Income	4.0%	8.0%	(1.5%)	7.7%	5.0%	3.6%
General Corporation	7.4%	(2.3%)	8.6%	5.4%	0.5%	1.5%
Banking Corporation	(5.1%)	3.3%	(5.4%)	5.4%	3.1%	1.1%
Unincorporated Business	(2.3%)	6.8%	7.2%	9.5%	8.1%	5.3%
Sales	4.0%	4.0%	3.6%	3.6%	3.4%	4.0%
Commercial Rent	4.3%	3.9%	4.5%	4.5%	4.5%	4.4%
Real Property Transfer	14.7%	17.5%	6.6%	8.7%	8.8%	8.8%
Mortgage Recording	23.6%	27.2%	9.6%	8.1%	8.0%	6.7%
Utility	(5.9%)	3.4%	5.0%	3.4%	5.0%	6.0%
Hotel	12.7%	3.4%	2.9%	3.3%	5.8%	5.4%
All Other	4.1%	1.4%	2.6%	(0.1%)	(0.1%)	0.0%
Audits	(24.8%)	12.8%	(15.3%)	0.0%	0.0%	0.0%
Total Taxes	**4.4%**	**4.6%**	**3.5%**	**5.0%**	**4.8%**	**4.0%**

Source: Council Fiscal 2014 Preliminary Budget
*Actuals

Table 10. Council Forecast: Difference from OMB Forecast
Dollars in Millions

	FY12*	FY13	FY14	FY15	FY16	FY17
Real Property	$0	$0	$176	$142	$366	$532
Personal Income	$0	$101	($32)	$86	$166	$146
General Corporation	$0	($101)	$29	$54	($57)	($200)
Banking Corporation	$0	($41)	($36)	($56)	($150)	($175)
Unincorporated Business	$0	($15)	$10	$135	$251	$263
Sales	$0	($15)	($71)	($104)	($96)	($87)
Commercial Rent	$0	$2	$5	$8	$12	$16
Real Property Tran	$0	$35	$46	$54	$63	$37
Mortgage Recording	$0	$27	$36	$34	$33	($3)
Utility	$0	$1	$2	$3	$13	$38
Hotel	$0	($10)	$2	($3)	$3	$20
All Other	$0	($8)	($6)	($11)	($16)	($19)
Audits	$0	$0	$0	$0	$0	$0
Total Taxes	**$0**	**($23)**	**$163**	**$343**	**$589**	**$568**

Source: Council Fiscal 2014 Preliminary Budget and OMB Fiscal 2014 February Plan
*Actuals

Personal Income Tax Collections jump in 2013 drop in 2014

Personal income tax revenue is expected to increase by 8.0 percent in Fiscal 2013. Withholdings are projected to grow by 4.6 percent from an expanded payroll and larger cash bonuses, rebounding after having been slashed last year. Estimated payments are expected to jump 19.2 percent, largely from capital gains being realized in late tax year 2012 to avoid the anticipated tax hikes in 2013. Final settlements in April are also expected to be strong, garnering the frontloaded taxes both from capital gains and cash bonuses paid in December 2012 rather than 2013 to dodge the higher rates.

Fiscal 2014 will experience the opposite dynamics, with collections expected to fall by 1.5 percent. Withholdings will soften to 3.6 percent growth as employment continues to grow in tax year 2013 but more slowly. Estimated payments will plummet 6.1 percent and April settlement will also fall from the frontloading of the capital gains realizations.

Collections in the out-years will pick up as employment continues to expand and realizations return to normal, growing at an estimated average of 5.5 percent.

Business Taxes: Little Growth

The growth of New York City's three business taxes- the General Corporation Tax (GCT), the Unincorporated Business Tax (UBT) and the Banking Corporation Tax (BCT) – is determined by the profits of corporate and non-corporate business in the City. Yearly fluctuations in the GCT and the BCT are driven primarily by the fortunes of securities and other financial service firms. As discussed in the City economy section, NYSE member profits have been volatile in recent year. But this profitability is based on low interest rates, efforts to contain costs and little revenue growth. This weak revenue growth seems likely to continue.

In addition, going forward, pretax corporate profits are expected to grow at 2 percent over the entire forecast period- far below the historic of 8 percent per year. The dismal performance of these key variables have reduced Council Finance's forecast for the GCT and the BCT through the forecast period. For the UBT, however, the relative strength of the non-financial sector plays a bigger role and explains its stronger growth.

Hotel and Utility Taxes

The Hotel and Utility Tax forecasts have been adjusted down slightly from the Fiscal 2013 Adopted Budget despite the fact that the base generating these revenues remains vibrant. Instead, the downward adjustment reflects less optimistic growth than originally anticipated. For the Hotel Tax, this resulted from a modest adjustment to the City's projected business services activity, and for the Utility Tax, this was the product of slower projected energy price growth.

Sales Tax

Sales tax accounted for 13.9 percent of total collections in Fiscal 2012 with overall sales tax collections reaching $5.8 billion. This made sales tax collections the third largest source (12.3 percent) of city's own funded revenue after real property tax (38 percent) and personal income tax (17 percent).

Sales tax continues to exhibit limited volatility throughout the past couple of years. Fiscal 2013 year-to-date through January 2013 collections exceeded same period Fiscal 2012 by 4.5 percent. Total Fiscal 2013 collections are expected to increase by 4.0 percent reaching $6.1 billion. As before, this is partially due to some improvements in the economy but a lackluster 2012 holiday season sales. Contributing to this were relatively cheaper U.S. exports and diverse retail shopping opportunities in the city, attracting tourists and other buyers from outside.

While consumer confidence, a general indicator of expected consumer spending and by extension a measure of sales tax collections, has been unsteady in recent months we expect collections to continue to increase at an average 4.1 percent in Fiscal 2013 year over year.

Real Property Tax Transfer

The real property transfer tax (RPTT) is the tax imposed on real property transfers in the five boroughs. The tax is either payable by the seller or the buyer (if the seller is exempt from the tax, as for example is the case with many sales of shares of stock in cooperative housing corporations). Residential and commercial transactions are the two major components of the RPTT. In Fiscal 2012 RPTT accounted for 2.2 percent of total collections in the year reaching $0.9 billion.

A function of real estate cycles, overall income growth and its dual structure (residential and commercial components) RPTT is quite volatile. Collections grew from just under $0.5 billion in Fiscal 2000 to over $1.7 billion in Fiscal 2007 and later fell to a low of $0.6 billion in Fiscal 2010.

Fiscal 2013 will most likely record a rise in collections compared to Fiscal 2012: fiscal year-to-date through January 2013 collections have already exceeded the same period in Fiscal 2012 by 18.5 percent. Total Fiscal 2013 collections are expected to increase by 17.1 percent reaching $1.1 billion. This is partially due to gradual improvements in the economy and improving City's real estate market. Also significant are isolated high value property sales (either residential or commercial) that will help raise overall collections, add some degree of volatility in RPTT trend.

Consistent with Council Finance view of new normal macroeconomic conditions for the City, RPTT while increasing will be growing at a slower pace than in the decade prior to the 2007 crisis.

Mortgage Recording Tax

The mortgage recording tax (MRT) is the tax on all real property mortgages in the City. The tax is payable on mortgage registration and is administered by the NYC Department of Finance. Similar to RPTT, MRT's two main components are residential and commercial transactions that are taxed differently. In 2012 overall MRT collections accounted for 1.3 percent of total collections in fiscal year reaching $0.5 billion.

MRT follows a similar volatile trend as the above described RPTT and is also dependent on mortgage refinancing activity. MRT collections grew from just above $0.4 billion in Fiscal 2000 to over $1.5 billion in Fiscal 2007 and later fell to a low of $0.3 billion in Fiscal 2010.

Fiscal 2013 collections are expected to grow 21.4 percent reaching a total of $0.5 billion for the year. So far, fiscal year-to-date through April 2012 collections have already exceeded the same period in Fiscal 2011 by 27.2 percent. Due to its close association with RPTT, mortgage recording tax will follow RPTT's growth trend, consistent with reasons described above.

In addition, as RPTT, MRT while increasing will be growing at a slower pace than in the decade prior to the 2007 crisis consistent with Council Finance view of new normal.

Real Property Tax

For Fiscal 2013, both OMB and Council Finance expect the Real Property Tax (RPT) to generate $18,440 million in revenues. This represents a modest $10 million increase over the November plan due to changes in the reserve[37]. As the fiscal year gets closer to the end, small adjustments like this are generally made to the reserve.

Looking to Fiscal 2014, OMB has increased revenue projections by $386 million to $19,356 million. Council Finance agrees with an upward adjustment to the Fiscal 2014 revenue project, but it believes the City can expect an even larger uptick in revenues to $19,532 million. These increases are largely the result of a larger than expected increase on the preliminary assessment roll which was released by the Department of Finance (DOF) on January 15, 2013.

Billable Assessed Value on the preliminary roll is up a substantial $11.2 billion over the prior year – an increase of 6.9 percent. While all four classes of property saw at least some growth, three-fifths of the growth can be attributed to the Class 4 commercial properties which saw a large 8.6 percent increase in their BAV. Class 4, along with Class 2 which saw a 6.6 percent increase in its BAV, make up over 75 percent of the taxable value in the city, and so changes in the BAV of these two classes will largely impact the amount of revenue raised by the RPT.

[37] The levy is the raw amount of revenues that would be raised by the property tax and is generally determined at the outset of a fiscal year as the overall tax rate and billable assessed values are for the most part set at that point. The reserve reflects the various tax abatement programs, collections adjustments, and lien sale which when taken into account with the levy, result in the actual revenue impact in the budget.

Table 11. Market Values and Billable Assessed Values

	Market Values			Billable Assessed Values		
	FY 2013	FY 2014	% Change	FY 2013	FY 2014	% Change
Class 1	$400.3	$403.7	0.8%	$15.8	$16.4	3.6%
Class 2	$195.3	$204.6	4.8%	$55.9	$59.6	6.6%
Class 3	$26.1	$26.4	1.2%	$11.3	$11.4	0.8%
Class 4	$216.4	$239.0	10.5%	$79.3	$86.1	8.6%
TOTAL	$838.1	$873.7	4.3%	$162.3	$173.5	6.9%

Source: NYC Department of Finance.

This growth in BAV is being driven by large market value increases over the past several years, which continue this year. Class 4 saw an increase of 10.5 percent in overall market value on the preliminary roll, on top of 4.8 percent and 9.0 percent increases seen in Fiscals 2013 and 2012 respectively. Since changes in market values for Class 4 are phased in over five years, this period of high market value growth is pushing and will continue to push BAV growth up in the outyears. These climbing market values are a combination of low interest rates (which have kept cap rates low) and net incomes rising, both of which strengthen commercial real estate's value as an investment compared to other such vehicles.

While the preliminary roll provides decent guidance of where the final roll will end up, inevitably there will be some reductions by the time the final property tax roll is released in late May. However, this year has seen some added difficulty over interpreting the preliminary roll as there have been some serious concerns raised about its accuracy. The Independent Budget Office (IBO) noted that several properties that should be listed as tax exempt, such as the Chrysler Building and the new Barclays Center, were listed as taxable on the preliminary roll[38]. IBO surmised that this might have something to do with the recent push by DOF to ensure only eligible properties were receiving exemptions. This effort is one of DOF's PEGs (see DOF hearing report).

OMB's forecast appears to be reflecting a larger than expected downward revision to the final roll than usual, perhaps due to the issues raised by IBO as well as valuation reductions for properties damaged by Hurricane Sandy that have not been reflected on the roll. Council Finance does not see as large of a reduction which accounts for its slightly larger Fiscal 2014 revenue estimate. It should be noted that uncertainty from this issue does present about a $100 million to $200 million risk to the Council Finance Fiscal 2014 forecast of property tax revenues.

OMB believes growth in RPT revenues will slow to an average of 4.2 percent in the outyears as market value growth begins to moderate. Council Finance does see some moderation in market value growth; however, it also sees a slightly higher growth rate of 4.6 percent in the same period.

[38] *City's Assessment of Property Values May Need Some Reassessing*, IBO Weblog http://ibo.nyc.ny.us/cgi-park/?p=643

Financing and Debt Service

- **The Preliminary Budget estimates $32 billion in long term borrowing for the Fiscal 2013 to 2017 period.**
- **The Budget assumes $2.4 billion in short term borrowing for Fiscal 2014. The $75.62 million allocated in the Fiscal 2013 Preliminary Budget to service similar borrowing in Fiscal 2013 was not used.**
- **Throughout Fiscal 2012 substantial savings resulted from lower than assumed interest rates. The present value savings from refundings by the City's three major issuers is $536 million.**

Financing Highlights

New York City assumes debt to fund its capital program, and the Preliminary Budget estimates $32 billion in long-term borrowing between Fiscal 2013 and 2017 to fund the City's capital needs. However, not all of these borrowings are direct obligations of the City; much of the debt will be issued on behalf of the City. The City's overall borrowing strategy is based on many factors, such as market conditions, project contracts and cash flow concerns.

Table 12. Summary of Fiscal 2014 Capital Financing Plan

Dollars in millions

	FY 2012 (Actual)	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Financing Plan						
GO Bonds	$4,950	$1,650	$2,400	$2,720	$2,370	$2,100
TFA Bonds(1)	3,500	2,978	3,200	2,720	2,370	2,100
Water Authority Bonds	3,510	2,124	1,468	1,242	1,267	1,176
Total	**$11,960**	**$6,752**	**$7,068**	**$6,682**	**$6,007**	**$5,376**
Debt Outstanding						
GO Bonds	$42,286	$41,926	$42,368	$42,740	$42,766	$42,525
TFA Bonds(1)	20,955	23,157	25,692	27,537	28,895	29,909
Other Debt(2)		2,939	2,846	2,751	2,650	2,557
Subtotal	**71,860**	**68,022**	**70,906**	**73,028**	**74,311**	**74,991**
Water Authority Bonds	28,378	29,274	30,440	31,357	32,222	32,971
Total	**$91,619**	**$94,357**	**$98,500**	**$101,634**	**$103,883**	**$105,405**
Debt Financing Burden (excludes Water Debt)						
Debt Outstanding(3)/Statutory Debt Limit	68.54%	73.26%	73.46%	70.69%	72.26%	73.31%
Debt Outstanding/NYC Personal Income	14.70%	14.20%	14.40%	14.30%	14.10%	13.70%

Source: New York City Council Finance; Fiscal 2014 Preliminary Plan; OMB 2012 Statement of Debt Affordability; Comptroller Fiscal 2013 Annual Report on Capital Debt and Obligations

1) TFA Bonds do not include BARBs issued for education capital purposes which are secured by Building Aid revenues from the State

2) Includes Conduit Debt; see end of section for discussion.

3) Only TFA in excess of $13 billion and GO count against the debt limit. This ratio includes all debt other than NYW.

In Fiscal 2012 all borrowing by the City was split between three types of debt: 41 percent coming from the City's credit or General Obligation (GO), 30 percent from the Transitional Finance Authority (TFA), and 29 percent from the New York City Municipal Water Finance Authority (NYW). This division sharply contrasts the percent of issuances by type planned for Fiscal 2013, with TFA picking up 44 percent of all issuances.

This contrast is due to the substantial amount of refunding transactions occurring throughout Fiscal 2012. A refunding transaction uses favorable borrowing rates to replace existing debt with cheaper obligations. The size of these transactions and their present value savings can be seen in Table 1 below. Market conditions suggest that additional refunding opportunities will occur; however, the administration does not forecast future refundings, and, as a result, only "new" money is assumed in the Budget. The savings are realized over the lifetime of the bonds. The present value of these future savings is shown in the table below.

Table 13. Fiscal 2012 Refundings

Dollars in millions

Bond Type	**Refundings**	**Present Value Savings**[39]
City GO Bonds	$2,230	$277
TFA Bonds(1)	700	59
NYW	1,350	200
Total	**$4,280**	**$536**

Source: Comptroller Fiscal 2012 CAFR.
1) TFA Bonds do not include BARBs

Since refunding requires a bond issuance, and the taste for a given type of debt is limited, expected GO refundings in Fiscal 2013 and 2014 are one reason why the plan assumes more debt will be issued on the TFA credit than the GO. Another reason is that the credit of TFA is rated better by the three largest rating agencies. This rating discrepancy occurs because rating agencies rate the reliability of a debtor to repay a loan (similar to how credit bureaus rate consumer credit), and lenders are often more willing to provide cheaper funds to better rated borrowers. The chart below shows the ratings of NYC's current debt issuing entities. These rating remain unchanged from the previous year. As discussed later, ratings differ because the City secures various types of debt in different ways.

Table 14. Ratings of Major Debt Issuing Entity

Bond Type	**Fitch**	**Moody's**	**S&P**
City GO Bonds	AA	Aa2	AA
TFA Bonds (Senior/Subordinate)	AAA/AAA	Aaa/Aa1	AAA/AAA
TFA Bonds (BARBS)	AA-	Aa3	AA-
NYW (Senior/Subordinate)	AA+/AA+	Aa1/Aa2	AAA/AA+

Source: Fiscal 2013 Executive Budget

[39] Present value savings are a way of summing up the savings over the life of the bond that is being refinance. It is not the same as the Fiscal 2012 budgetary savings from these refinancing.

The main standard used to measure the ability of the City to repay its debt is the value of all taxable real estate. In fact, the NYS Constitution limits debt obligations of the City (mostly GO and TFA debt beyond $13.5 billion[40]) to 10 percent of the market value of taxable real property, averaged over the most recent five years. In Fiscal 2013 NYC expects to be $21 billion below the expected limit of $76.853 billion.[41] In contrast, the City was $24 billion under the limit in Fiscal 2012[42].

Short term debt financing

Other than to finance its capital program, the City can use short-term debt to meet cash shortfalls during the fiscal year. During Fiscal 2013, the City did not borrow the $2.4 billion in short-term financing assumed in the Adopted Budget. This $2.4 billion borrowing is also assumed to be needed in 2014, but the City's cash position suggests that this borrowing will not take place either.

Conceptually similar to short-term debt, the City can also save surplus revenues in anticipation of future needs. The City uses a budget stabilization account (BSA) in order to prepay future debt service costs. Such an account is allowed by accounting standards that otherwise limit the use of current revenues to prepay future operating expenses. The Preliminary Budget allocates $1.085 billion in Fiscal 2013 to the BSA; however it is possible that additional funds will be transferred into future years. In the January 2012 Financial Plan, $1.297 billion was allocated to the Fiscal 2012 BSA, but ultimately $2.431 billion was transferred via the BSA and other means.

Debt Service Highlights

Debt service is the cost of repaying all debt outstanding according to any terms agreed upon with lenders. These repayments will constitute nine percent of all revenues in Fiscal 2013, rising somewhat in the outyears – although lower than projected yields and refundings will likely reduce this ratio.

Table 15. Debt Service Payments in January Financial Plan

Dollars in millions

	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Debt Service					
GO Bonds	$3,936	$4,163	$4,610	$4,713	$4,749
TFA Bonds(1)	1,760	1,838	2,257	2,467	2,649
Conduit Debt	507	872	379	345	345
Total	**$6,203**	**$6,873**	**$7,246**	**$7,525**	**$7,743**
Debt Service Burden					
Debt Service/Total Revenue	8.81%	9.81%	9.73%	9.84%	9.89%

Source: Council Finance, Fiscal 2014 Preliminary Plan
1) TFA Bonds do not include BARBs

[40] NYW debt is not an obligation of the City and does not count against the debt limit. The remainder of this section is limited to debt obligations of the City.

[41] Another measure is the ratio of debt outstanding to City personal income. In Fiscal 2013, debt outstanding will account for 14.7 percent of personal income- 2.4 percent higher than the 31-year average of 12.3 percent as reported by the NYS Financial Control Board's March 15th Staff Report.

[42] According to Comptroller's Fiscal 2012 Annual Report on Capital Debt and Obligations

Municipal bonds pay investors with interest that is either fixed by the indenture or varies based on predetermined rules- often a function of a "prevailing" interest rate. Variable rate bonds (VRDB) can be attractive to the City because they reduce investor risk and therefore investors are willing to accept lower interest rates. Nevertheless, variable rate debt exposes the City to changes in the prevailing interest rate, the tax code, credit rating of the City, and liquidity or credit enhancement provider. For example, savings occur for the City when a lower prevailing interest rate translates to lower interest rate payments on variable rate debt.

As a protection against volatile VRDBs, which constitute roughly 16 percent of all debt outstanding, the City sometimes engages in interest rate exchange contracts (swaps), and the Preliminary budget allocates $37 million for swap payments in Fiscal 2013. As of December 31, 2012, the City had $1.8 billion outstanding from 14 different swaps with a negative net value to the City of $189 million.[43] This negative net value is the amount the City would owe if all agreements were terminated. However, three terminated swap agreements accounted for over $40 million in unplanned savings during Fiscal 2012.[44]

New York City General Obligation (GO)

Currently 63 percent of the City's long-term debt (excluding NYW) is in GO bonds. These bonds are secured by the City's full faith and credit, and the New York State Constitution mandates the increase of taxes or reduction of expenditures in order to service these obligations. In addition, City property tax is retained by the State Comptroller to pay for GO debt service before it is put into the general fund.

Transitional Finance Authority (TFA)

TFA was created in 1997 to finance a portion of the City's capital program. TFA was initially authorized to issue up to $7.5 billion; however in June 2000, the authorization was increased to $11.5 billion. An additional $2 billion in bonding authority was granted in 2007. Since 2009, all bonds issued in excess of $13.5 billion count against the City's debt limit[45]. TFA bonds are paid by the City Personal Income Tax (PIT) before deposited in the general fund. Conversely, building aid revenue bonds (BARBs) are secured by state building aide to finance educational facilities.

The City issues two types of American Recovery and Reinvestment Act bonds: Build America Bonds (BAB) and Qualified School Construction Bonds (QSCB). There are no BAB issuances planned. Proceeds from QSCBs must be used for constructing, rehabilitating or repairing public school facilities or acquiring land for public schools. These taxable bonds receive a 100 percent interest subsidy from the Federal government. TFA has already issued $1.14706 billion of the $1.3 billion cap.

As mentioned earlier, TFA PIT is rated AAA by all three rating agencies, and TFA BARBs are rated AA-. In addition to credit rating, cash flow is an important consideration in determining whether to secure QSCBs with tax or building aid revenues.

[43] January 2013 New York City Quarterly Report on Interest Rate Exchange Agreements.
[44] According to the Fiscal 2013 Adopted Budget
[45] This excludes Recovery Bonds.

Conduit Debt

Other notable entities with outstanding debt in excess of $1 billion are the Hudson Yards Infrastructure Corporation (HYIC), the Sales Tax Asset Receivable Corporation[46] (STARC) and the Tobacco Settlement Asset Securitization Corporation (TSASC). The debts of these public benefit corporations are technically speaking not obligations of the City and therefore do not count against the City's debt limit, but this is more a legal than budgetary distinction.

[46] STARC has no significant actions planned for Fiscal 2012- 2016.

Capital Budget

- **Total Fiscal Year 2013–2016 Capital Commitment Plan increased by $5 billion (14.4 percent)**

Fiscal 2013-2016 Four-Year Capital Commitment Plan

The Preliminary Capital Commitment Plan for Fiscal 2013-2016 authorizes agencies to commit $39.3 billion, of which $32.9 billion will be City-funded. The Adopted Capital Commitment Plan for Fiscal 2013-2016 authorized agencies to commit $34.4 billion, of which $27.8 billion was City-funded.

The targeted level for City-funded commitments is $11.5 billion in Fiscal Year 2013. The aggregate agency-by-agency authorized commitments of $19 billion exceed the Fiscal Year Financial Plan by $7.5 billion. Excess authorizations in this proportion have proven necessary to achieve commitment spending targets because they accommodate such factors as scope changes and delays.

The difference in City-funded commitments between the Adopted and Preliminary Four-Year Plans consists mainly of the addition of $3 billion in funding for Super Storm Sandy as well as the acceleration of capital funding in the amount of $1.2 billion for critical infrastructure projects. Capital funding for Super Storm Sandy is spread out over 27 City agencies, and funds were accelerated for critical infrastructure in 11 City agencies. Specific projects and timelines will be discussed in detail in the appropriate Committee's Preliminary Budget Briefing documents.

Table 16. Four Year Plan: Adopted and Preliminary

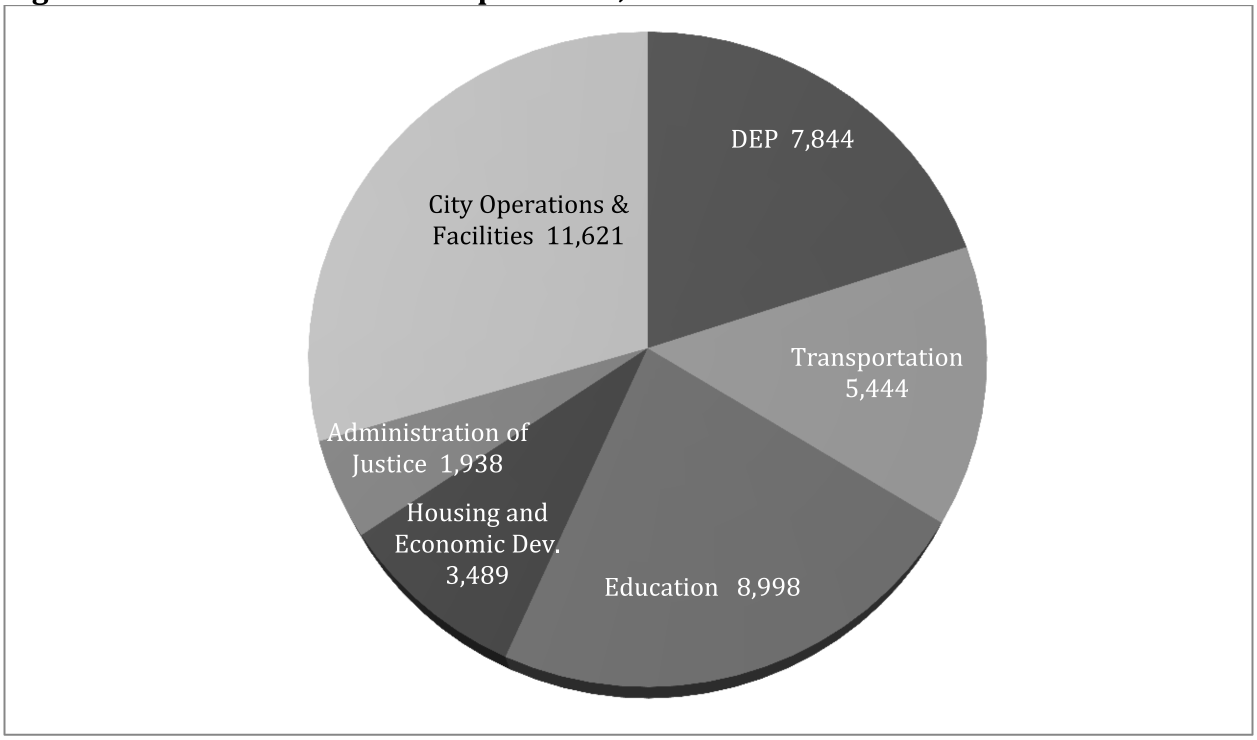
Dollars in millions, all funds

					Total
Adopted	**FY13**	**FY14**	**FY15**	**FY16**	**FY13-16**
Total Capital Plan	$17,915	$7,496	$4,565	$4,400	$34,376
DEP	2,993	1,707	1,273	1,062	$7,035
Total Minus DEP	$14,922	$5,789	$3,292	$3,338	$27,341
Preliminary					
Total Capital Plan	$19,027	$9,739	$5,849	$4,722	$39,337
DEP	2,269	2,029	2,193	1,353	$7,844
Total Minus DEP	$16,758	$7,710	$3,656	$3,369	$31,493
Change					
Level	$1,112	$2,243	$1,284	$322	$4,961
Percentage	6.20%	29.90%	28.10%	7.30%	14.40%

Source: Fiscal 2014 Preliminary Capital Plan

FY 2013-2016 Four Year Capital Plan, by Programmatic Area

Figure 13. FY13-16 Four Year Capital Plan, All Funds



Source: Fiscal 2014 Preliminary Capital Plan

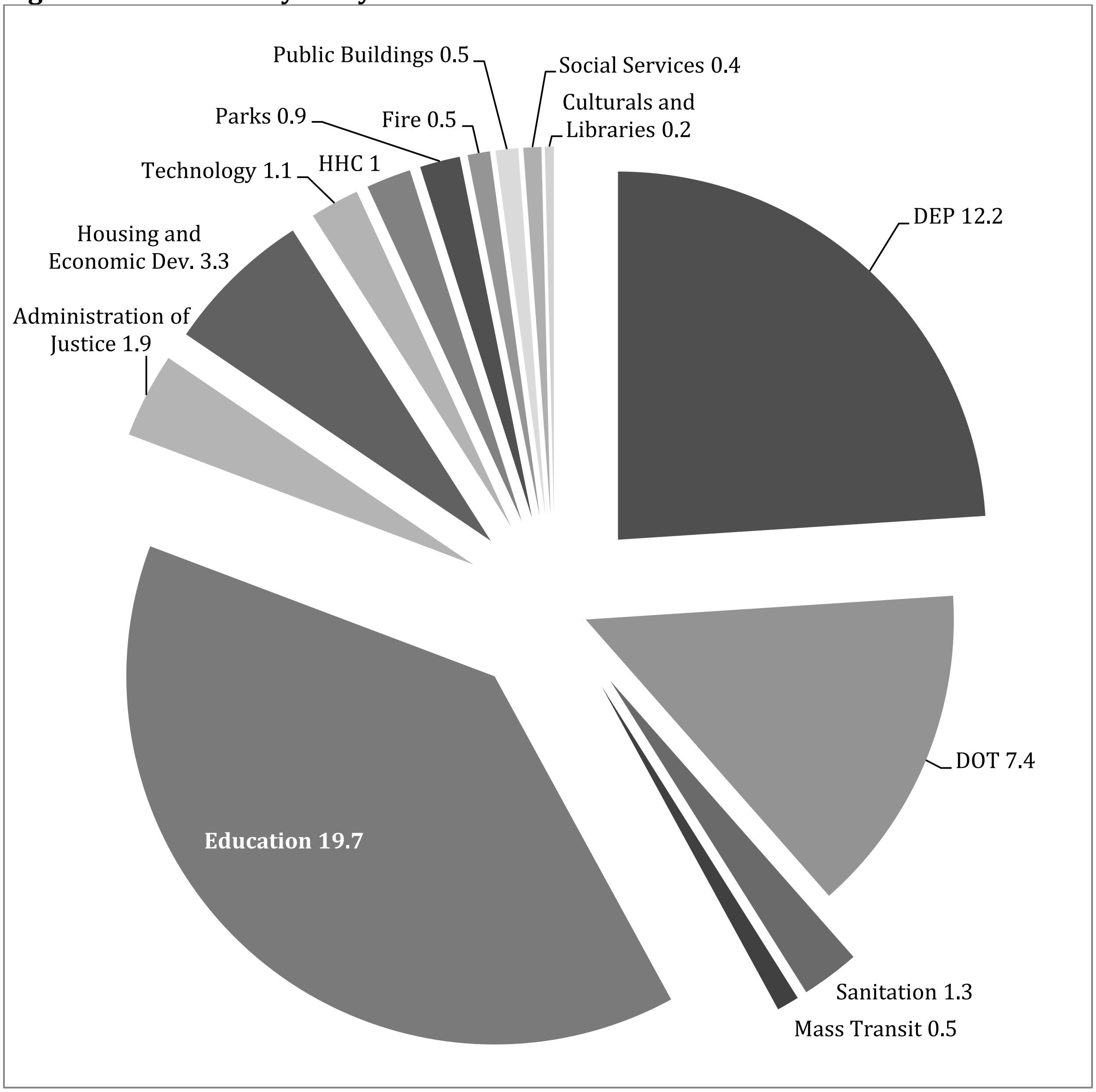
Preliminary Ten-Year Capital Strategy Fiscal 2014-2023

As mandated by the City Charter the City prepares a comprehensive Preliminary Ten Year and Ten Year Capital Plan every other Fiscal Year. The Preliminary Ten Year and Ten Year plans are intended to give a long range view of the City's capital program.

The Fiscal 2014-2023 Preliminary Ten-Year Capital Strategy totals $50.9 billion. This includes $38.3 billion in City funds and $12.6 billion in non-City funds. The City has increased the Capital Program for Fiscal 2013 from $17.9 billion in the Adopted Plan to $19 billion in the Preliminary Plan, an increase of $1.1 billion or 7.2 percent. The Preliminary Ten-Year Capital Strategy does not include Fiscal 2013 and will likely increase significantly when unspent capital funds are rolled into Fiscal 2014

The Preliminary Ten-Year Capital Strategy includes $19.7 billion (39 percent of total) for school construction, repair and technology. Another $12.2 billion (24 percent of total) provides funding for capital projects for the DEP which are primarily funded with Water Authority Bonds issued by the Municipal Water Finance Authority. The Strategy also includes $7.4 billion (14 percent of total) of plan for transportation projects. This includes bridge, road and street repair and maintenance.

Figure 14. Preliminary Ten year Plan 2014-2023 all funds



Source: Fiscal 2014 Preliminary Capital Plan

Appendix

Table 17. Fiscal Year 2013 Executive Budget: Executive Budget					
Dollars in millions	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**
REVENUE					
Taxes					
General Property Tax	$18,440	$19,356	$20,176	$21,105	$21,870
Other Taxes	$24,793	$25,368	$26,639	$27,773	$29,015
Tax Audit Revenue	$838	$709	$709	$709	$709
Tax Program					
Sub-total, Taxes	$44,071	$45,433	$47,524	$49,587	$51,594
Miscellaneous Revenues	$6,747	$6,586	$6,875	$6,758	$6,715
Unrestricted Governmental Aid	$25	$0	$0	$0	$0
Anticipated State Action	$0	$0	$0	$0	$0
Less: Intra-City Revenues	($1,790)	($1,777)	($1,608)	($1,611)	($1,616)
Disallowances	($15)	($15)	($15)	($15)	($15)
Sub-total City Funds	$48,865	$50,685	$52,656	$54,671	$56,424
Other Categorical Grants	$1,036	$981	$940	$907	$895
Inter-Fund Revenues	$555	$571	$518	$517	$517
TOTAL City, Capital IFA & Oth. Cat. Funds	$50,417	$52,143	$54,080	$56,083	$57,832
Federal Categorical Grants	$7,666	$8,655	$6,543	$6,361	$6,349
State Categorical Grants	$11,312	$11,301	$11,365	$11,685	$12,147
TOTAL Revenues	**$70,373**	**$70,051**	**$72,126**	**$74,579**	**$76,453**
EXPENSE					
Personal Services	$37,281	$37,593	$37,721	$39,505	$40,716
Other than Personal Services	$28,484	$29,793	$28,429	$29,122	$29,553
Debt Service	$5,623	$6,010	$6,325	$7,183	$7,502
Adjustments					
Prior Year Surplus Roll	($2,431)	($31)			
Current Year Surplus Roll	$1,085	($1,085)			
General Reserve	$40	$100	$300	$300	$300
Sub-total	$69,414	$72,150	$71,659	$76,110	$78,071
Less: Intra-City Expenses	($1,790)	($1,777)	($1,608)	($1,611)	($1,616)
TOTAL Expenditures	**$70,373**	**$70,051**	**$74,499**	**$76,455**	**$78,307**
GAP	**$0**	**$0**	**$2,373**	**$1,876**	**$1,854**

Source: OMB Fiscal 2014 February Plan

Table 18. Fiscal 2014 Preliminary Budget Revenue Plan
Dollars in millions

	FY13	FY14	FY15	FY16	FY17
Taxes					
Real Estate	$18,440	$19,356	$20,176	$21,105	$21,870
Sales	6,061	6,336	6,594	6,808	7,065
Mortgage Recording	656	712	775	840	935
Personal Income	8,488	8,494	9,030	9,408	9,775
General Corporation	2,493	2,567	2,683	2,809	2,994
Banking Corporation	1,361	1,284	1,372	1,506	1,545
Unincorported Business	1,763	1,864	1,918	1,969	2,075
Utility	382	400	413	424	425
Hotel	502	504	526	550	563
Commercial Rent	653	679	706	734	763
Real Property Transfer	1,036	1,096	1,187	1,287	1,433
Cigarette	63	63	62	60	59
All Other	506	501	501	501	502
Audit	838	709	709	709	709
Tax Program	0	0	0	0	0
STAR	829	868	872	877	881
Total Taxes	**$44,071**	**$45,433**	**$47,524**	**$49,587**	**$51,594**
Federal Categorical Grants	**$8,655**	**$6,543**	**$6,361**	**$6,349**	**$6,346**
State Categorical Grants	**$11,301**	**$11,365**	**$11,685**	**$12,147**	**$12,275**
Non-Governmental Grants (Other Cat.)	**$1,552**	**$1,458**	**$1,424**	**$1,412**	**$1,408**
Unrest. / Anticipated State & Federal Aid	**$0**	**$0**	**$0**	**$0**	**$0**
Miscellaneous Revenue					
Charges for Services	876	920	916	916	916
Water and Sewer Charges	1,505	1,514	1,512	1,530	1,541
Licenses, Permits, Franchises	554	579	582	585	598
Rental Income	303	282	296	296	296
Fines and Forfeitures	800	816	816	815	814
Other Miscellaneous	754	1,145	1,013	892	537
Interest Income	17	11	12	65	143
Intra City	1,777	1,608	1,611	1,616	1,613
Total Miscellaneous	**$6,586**	**$6,875**	**$6,758**	**$6,715**	**$6,458**
Net Disallowances & Transfers	(1,792)	(1,623)	(1,626)	(1,631)	(1,628)
Total Revenue	**$70,373**	**$70,051**	**$72,126**	**$74,579**	**$76,453**

Source: OMB Fiscal 2014 Preliminary Budget

Table 18. Fiscal 2014 Preliminary Budget Revenue Plan (continued)
Dollars in millions

	FY13	FY14	FY15	FY16	FY17
City Funds: does not include Unrestricted Aid	$48,865	$50,685	$52,656	$54,671	$56,424
Federal & State Revenue	$19,956	$17,908	$18,046	$18,496	$18,621
Federal & State as a Percent of Total	28.4%	25.6%	25.0%	24.8%	24.4%
City Funds as a Percent of Total Revenue	69.4%	72.4%	73.0%	73.3%	73.8%

Source: OMB Fiscal 2014 Preliminary Budget

Table 19. Fiscal Year 2014 Preliminary Budget: Revenue Changes from Fiscal 2013 November Plan
Dollars in millions

	FY13	FY14	FY15	FY16
Taxes				
Real Estate	$10	$386	$544	$830
Sales	$0	$10	($5)	($31)
Mortgage Recording	$62	$26	$8	($8)
Personal Income	($5)	($27)	($99)	($89)
General Corporation	$16	($118)	($105)	($108)
Banking Corporation	$53	$43	$104	$94
Unincorporated Business	($7)	($36)	($53)	($65)
Utility	($20)	($21)	($21)	($22)
Hotel	$25	$15	$13	$14
Commercial Rent	$0	($15)	($25)	($36)
Real Property Transfer	$90	$41	$13	($13)
Cigarette	($3)	($3)	($2)	($2)
All Other	$6	$0	$0	$0
Audit	$0	$0	$0	$0
Tax Program	$0	$0	$0	$0
STAR	$5	$9	$13	$18
Total Taxes	**$232**	**$310**	**$385**	**$582**
Federal Categorical Grants	$1,393	($45)	$2	$2
State Categorical Grants	($265)	($338)	($357)	($374)
Non-Governmental Grants (Other Cat.)	$36	($2)	$0	$1
Unrest. / Anticipated State & Federal Aid**	$0	$0	$0	$0
Miscellaneous Revenue				
Charges for Services	($12)	($1)	($1)	($1)
Water and Sewer Charges	($3)	($3)	($3)	($3)
Licenses, Permits, Franchises	($15)	($7)	($1)	($9)
Rental Income	$12	($9)	$3	$3
Fines and Forfeitures	($12)	$1	$1	$1
Other Miscellaneous	$37	($213)	$33	$141
Interest Income	$0	$0	$0	$0
Intra City	$73	$2	$2	$2
Total Miscellaneous	**$80**	**($230)**	**$34**	**$134**
Net Disallowances & Transfers	($73)	($2)	($2)	($2)
Total Revenue	**$1,403**	**($307)**	**$62**	**$343**
City Funds: does not include Unrestricted Aid	**$239**	**$78**	**$417**	**$714**
Federal & State Revenue	**$1,128**	**($383)**	**($355)**	**($372)**

Source: OMB Fiscal 2013 November Plan and Fiscal 2014 Preliminary Budget