

March 2018

Analysis of the Mayor's 2019 Preliminary Budget: Overview, Economic, Revenue, and Expenditure Outlook

The February 2018 Preliminary Budget is the de Blasio Administration's first financial plan of its second term, and while the budgets proposed during the first term included commitments for high profile and costly initiatives such as affordable housing development and expanding early childhood education, this new budget is more focused on sustaining and expanding prior initiatives than starting new ones. Given the risks to the city's fiscal condition emanating from Albany and Washington, as well as the fiscal challenges facing agencies which are not part of the city's budget but inexorably linked to the city's overall health such as Health + Hospitals (H+H), New York City Housing Authority (NYCHA), and the Metropolitan Transportation Authority (MTA), such cautious budgeting seems warranted.

Based on the Independent Budget Office's (IBO) re-estimates of city spending and revenues, the budget for 2018 is projected to be \$88.3 billion rising to \$89.3 billion in 2019 (all years are fiscal years unless otherwise noted). Based on our analysis, the budgets for both years are not only balanced, but are projected to end with surpluses.

IBO's estimates yield smaller budget gaps in 2020 and 2021 than those estimated by the Mayor, while in 2022 we estimate a surplus.

The state is currently in the process of attempting to close a \$4.4 billion budget gap for the coming year and Governor Cuomo has already signaled his willingness to find savings at the city's expense. The Governor's current budget assumes millions of dollars less for the city than the Mayor estimates in his current financial plan. If these changes were to be adopted, the city would have to find ways to make up for these lost funds, either through reduced services or by finding other funding sources, most likely from the city itself.

Even more uncertainty exists at the federal level where the Trump administration and Congressional leaders have presented budget proposals that have the potential to negatively affect the city's finances. Thus far these proposals have had little impact as the President and Congress have been unable to adopt a federal budget, instead opting to provide short-term funding resolutions

Total Revenue and Expenditure Projections						
<i>Dollars in millions</i>						
	2018	2019	2020	2021	2022	Average Change
Total Revenue	\$88,252	\$89,341	\$92,220	\$95,281	\$98,100	2.7%
Total Taxes	57,971	60,199	62,625	65,307	67,926	4.0%
Total Expenditures	\$88,252	\$89,341	\$92,839	\$95,688	\$97,122	2.4%
IBO Surplus/(Gap) Projections	(\$0)	(\$0)	(\$620)	(\$407)	\$978	
Adjusted for Prepayments and Debt Defeasances:						
Total Expenditures	\$89,124	\$91,642	\$93,846	\$95,688	\$97,122	2.2%
City-Funded Expenditures	\$64,851	\$69,952	\$70,634	\$71,115	\$72,151	2.7%

NOTES: IBO projects a surplus of \$724 million for 2018 and \$283 million for 2019. The surplus is used to prepay some 2020 expenditures, leaving 2018 and 2019 with balanced budgets. Figures may not add due to rounding.

New York City Independent Budget Office



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Pricing Differences Between IBO and the de Blasio Administration

Items that Affect the Gap

Dollars in millions

	2018	2019	2020	2021	2022
Gaps as Estimated by the Mayor	\$-	\$-	(\$2,185)	(\$1,468)	(\$1,745)
Revenue					
Taxes					
Property	\$267	\$509	\$619	\$897	\$2,140
Personal Income	495	221	111	101	55
General Sales	(8)	(367)	(301)	(450)	(328)
General Corporation	152	25	110	252	392
Unincorporated Business	9	(48)	(56)	(28)	84
Real Property Transfer	(55)	(8)	47	61	59
Mortgage Recording	38	37	44	59	78
Utility	(1)	11	1	(8)	(14)
Hotel Occupancy	(34)	2	6	12	7
Commercial Rent	3	4	3	10	7
Cigarette	-	-	-	-	-
Other Taxes and Audits	-	-	-	-	-
Total Taxes	\$866	\$386	\$584	\$905	\$2,481
STAR Reimbursement	-	-	-	-	-
Misc. Revenue	-	25	25	26	-
TOTAL REVENUE	\$866	\$411	\$609	\$931	\$2,481
Expenditures					
Debt Service	51	38	-	-	-
Fringe Benefits:					
Health Insurance-Education	(2)	59	121	221	289
Health Insurance-City University	-	3	5	9	14
Health Insurance-All Other Agencies	(4)	101	202	354	452
Education	(55)	(72)	(82)	(113)	(125)
Fire	(50)	(50)	(50)	(50)	(50)
Police	(50)	(50)	(50)	(50)	(50)
Correction	(25)	(25)	(25)	(25)	(25)
Homeless Services	(77)	(96)	(118)	(127)	(127)
Public Assistance	16	8	8	8	8
Housing	-	(4)	(4)	(13)	(13)
Parks	(7)	(12)	(12)	(12)	(12)
Sanitation	61	49	35	7	-
Board of Elections	-	(35)	(35)	(35)	(35)
Campaign Finance Board	-	-	-	-	(40)
Small Business Services	-	(42)	(45)	(45)	(45)
TOTAL EXPENDITURES	(\$142)	(\$128)	(\$51)	\$130	\$241
TOTAL IBO PRICING DIFFERENCES	\$724	\$283	\$559	\$1,061	\$2,722
IBO Prepayment Adjustment 2018/2019	(724)	(283)	1,008	-	-
IBO SURPLUS/(GAP) PROJECTIONS	-	-	(\$620)	(\$407)	\$978

NOTES: Negative pricing differences (in parentheses) widen the gaps, while positive pricing differences narrow the gaps. Remaining banking corporation tax revenues reported with general corporation tax. Figures may not add due to rounding.

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that keep the federal government in operation, and postponing tough budget choices. Most recently, Congress voted to raise spending caps on the federal budget, although the allocation of those additional resources to specific programs has yet to be completed. Importantly, the additional spending will not be offset by additional revenue or cuts elsewhere. Meanwhile, the Trump Administration has released its budget proposal for the federal fiscal year that will start in October. Although the President's budget was greeted with skepticism, a budget combining some portions of the Trump budget proposal with those of the Congressional leaders is likely to eventually pass. IBO assumes that such a budget would have a net negative effect on the city's budget and economy.

The recently adopted federal tax changes could well have some effect on the city's finances although, the timing and extent depend on if and how the city and state adjust their own tax laws in response to the new federal tax code. For now, IBO, following the Office of Management and Budget (OMB), has assumed that the city will drop some links to the federal tax system so as to avoid impacts on the city's own revenues, but these steps would still leave many high-income city residents facing major changes in their federal taxes.

The following overview presents highlights from IBO's analysis of the de Blasio Administration's Preliminary Budget for 2019 and the financial plan for the current year through 2022.

Projected Surpluses and Gaps

IBO projects an additional \$142 million of city-funded expenditures in 2018 as a result of our re-estimates of spending projections in the February plan. This increase in expenditures is more than offset by IBO's tax revenue forecast for 2018 which is \$866 million above the estimate in the Mayor's financial plan. IBO's changes yield a total of \$724 million in net additional resources in 2018, increasing the projected budget surplus for 2018 from \$2.6 billion to \$3.3 billion. Barring a new need emerging in the remaining months of the fiscal year, the increased surplus estimated by IBO would be used to reduce future year budget gaps.

IBO estimates that planned city-funds revenues will once again exceed planned city-funded expenditures in 2019. City-funded spending is expect to eclipse OMB's forecast by \$128 million, primarily due to additional costs at the Department of Education and underestimates of the cost of homeless services and overtime expenses for uniformed workers. This additional spending is more than offset by IBO's projection that city source revenues will be \$411

million greater in 2019 than OMB has forecast. As a result, IBO estimates that instead of being in balance, 2019 will have a surplus of \$283 million. The additional \$724 million of 2018 resources coupled with the \$283 million of 2019 resources would create a surplus to be rolled into 2020. These funds together with IBO's estimate of \$559 million of additional 2020 revenue would reduce the 2020 gap as presented by the Mayor to just \$620 million—slightly less than 1 percent of city-funded revenue.

In 2021, IBO's projection for city-funded spending is \$130 million lower than OMB's. Combined with our tax revenue forecast that is \$931 million higher than OMB's, we forecast that \$1.1 billion in additional resources will be available in 2021. For 2022 IBO forecasts \$2.48 billion more in tax collections than currently estimated by the administration. These funds, along with our estimate that city-funded spending will be \$241 million less than projected by OMB for 2022, are more than enough to eliminate the \$1.75 billion budget gap presented in the February Financial Plan. In fact, IBO estimates that the city will have a surplus of \$978 million for 2022.

Economic Outlook

In light of the large fiscal stimulus from federal tax cuts and spending increases recently enacted by Congress, IBO has raised its forecast of near-term U.S. economic growth. Fueled by strong consumer demand and the addition of the stimulus, we project an acceleration of real growth to 2.9 percent in 2018, and somewhat slower growth of 2.6 percent in 2019. (In our discussion of the economic outlook, years refer to calendar years and monthly and quarterly data are seasonally adjusted.) The addition of the stimulus will heighten inflationary pressures, which were already growing in 2017 due to the tightness of the labor market. Inflation will accelerate and long-term interest rates will rise this year and next while the Federal Reserve steps up its efforts to prevent inflation from rising above its target range. IBO's forecast is premised on the success of the Fed's efforts to limit inflation without rattling financial markets. Missteps in monetary policy are a significant risk to the forecast.

Measured on a fourth quarter-to-fourth quarter basis (Q4 over Q4), New York City's economy added 67,000 jobs in 2017—an impressive ninth consecutive year of employment growth. But the pace of employment growth—1.5 percent—was slowest since the recession. IBO forecasts continuing but diminishing employment gains in the city, from 62,400 in 2018 and 50,000 in 2019 declining to 36,900 by 2022.

In the forecast, moderate increases in the working-age population and a weakening pace of job creation combine to keep the city unemployment rate within a narrow range—4.2 percent to 4.5 percent—over the next five years.

U.S. Economy

The current economic expansion is now in its ninth year and there are no signs that it is nearing an end. A strong labor market and wealth effects spurred by rising housing and financial asset prices are fueling consumer demand, which has been the primary driver of recent economic growth. Adding to overall demand is the expansionary fiscal policy of tax cuts and spending increases, which IBO projects will accelerate real (inflation-adjusted) gross domestic product (GDP) economic growth to 2.9 percent in 2018. With an already tight labor market, this rate of growth is not sustainable, and the addition of the fiscal stimulus will result in higher inflation and interest rates. Economic growth will begin to slow in the middle of 2019, with rising interest rates and Federal Reserve action to thwart excessive inflation slowing economic growth to 1.6 percent in 2020.

Beyond fiscal and monetary policy, other factors that have been driving economic growth are expected to continue, helping to sustain the expansion that has been underway since 2010. The most important are those fueling consumer spending: the strong labor market and a wealth effect from rising housing and financial asset prices. Households are in a strong financial position to continue spending. Thanks to interest rates that until recently were near historic lows, their debt service burden—the share of disposable (after-tax) income required to stay current on debt obligations—has also remained at historic lows. Wealth effects are expected to remain strong in the coming year, particularly from housing. Other conditions favorable to continued economic growth include moderate energy costs and a robust global economy that will keep demand for U.S. exports strong.

The changes to federal business and individual taxes, enacted in December, will further stimulate the economy, at least in the short run. After-tax income for businesses—which receive the bulk of the tax savings—will increase, as it will for many (but not all) households. Increases in households' disposable income are likely to extend the consumer spending spree that has fueled the current expansion and further boost business profits. To the extent that increased business profits are capitalized in stock prices, the wealth effect on consumer spending would also

be positive. Moreover, the addition of \$320 billion in new federal spending over the next two years will add more fuel to economic growth. (The downside of the substantial increases in the federal deficit caused by these fiscal policies are discussed below.)

IBO forecasts real GDP growth of 2.9 percent in 2018, up from 2.3 percent in 2017. The most recent unemployment rate—4.1 percent in January—is already below what economists consider to be full employment, the threshold under which labor markets are tight enough to spur inflation. IBO forecasts an inflation rate of 2.5 percent in 2018, up from 2.1 percent in 2017. The strong labor market will induce real wage increases, which will draw more participants into the labor force and support GDP growth. The unemployment rate will continue to drop, to a projected 3.8 percent in 2018 and 3.6 percent in 2019—the latter rate lower than any monthly rate since 1969.

With little slack in labor markets and other resource constraints, this relatively rapid real GDP growth rate is not sustainable. IBO forecasts slower growth beginning in the middle of 2019, with real GDP growth averaging 2.6 percent in 2019 and 1.6 percent in 2020. With inflationary pressures in the economy already building toward the end of 2017, even before the extent of the fiscal stimulus was known, the Federal Reserve had signaled its intention to increase the federal funds rate (the rate at which banks lend funds overnight to other banks) three times in 2018, as it did in 2017. More than three rate increases in 2018 are now likely. The increases are expected to be small, and IBO forecasts an average of Federal Funds rate of 1.9 percent rate for the year as a whole. In an effort to keep inflation close to the 2.0 percent rate it considers optimal, we expect the Fed to continue raising the Federal Funds rate, to 3.4 in 2019 and 3.7 percent in 2020, preventing inflation from rising above the 2.5 percent rate we forecast for this year.

The increases in the Federal Funds rate will be accompanied by increases in longer term interest rates. IBO forecasts a rise in the 10-year Treasury rate from an average of 2.3 percent in 2017 to 3.1 percent in 2018 and 4.0 percent in 2019 and 2020. Investor concern over the mushrooming of the federal government's budget deficit—from \$666 billion this past fiscal year to \$850 billion and \$1.15 trillion in federal fiscal years 2018 and 2019, respectively—will also have the effect of pushing up interest rates.

Pursuing a policy of fiscal stimulus at this point in the business cycle eschews conventional economic policy

making approaches. Although the tax cuts will initially spur growth, given that the economy is already at or near full employment, the added demand from households, businesses, and the government is likely to have more of an impact on prices than on economic output, add considerably to the federal government's deficits and debt load, and drive up long-term interest rates. While lower taxes will encourage businesses to invest, increases in long-term interest rates would have the opposite effect, negating much of the potential impact of the stimulus.

By putting upward pressure on inflation and interest rates, the fiscal stimulus will complicate monetary policy. The challenge of the Federal Reserve in the coming years will be to raise interest rates and unwind quantitative easing (the central bank's unconventional policy of purchasing securities during the Great Recession) just enough to slow economic growth and tame inflation, but not so much as to substantially reduce business investment and consumer spending. Years of historically-low interest rates have fueled large increases in the price of equities. With stocks at record highs and—by many measures—overvalued, a misstep by the Federal Reserve risks disruptions that could rapidly deflate asset prices and lead to a bear market or (in the worst case) recession. The challenge facing monetary policymakers is the primary risk to IBO's economic outlook.

Both IBO and the Mayor's Office of Management and Budget are expecting U.S. economic growth to accelerate in 2018, though OMB forecasts somewhat slower growth of 2.7 percent, compared with 2.9 in the IBO forecast. Both IBO and OMB project that real GDP will rise 2.6 percent in 2019; unlike OMB, however, IBO expects that continued strong growth in 2019 will be accompanied by a considerably higher rate of inflation and higher interest rates. Although IBO and OMB both forecast slower growth in 2020, IBO is anticipating a steeper decline.

New York City Economy

New York City is in the ninth year of an employment expansion like no other in its modern (post-World War II) history. As of the fourth quarter of 2017, total payroll employment is up 750,000 (20.3 percent) over the trough it hit in the fourth quarter of 2009. Total private employment gains are even stronger (24.1 percent), including cumulative gains approaching or exceeding 50 percent in such industries as building construction, computer and technical services, elementary and secondary education, ambulatory health care, and food services.

Nevertheless, over the past two years the city expansion

has been losing steam. The New York City economy added 67,000 jobs in 2017 (measured on a seasonally adjusted fourth quarter-to-fourth quarter basis), the slowest pace since the first year of the current expansion.

Trade has been a notable weak spot for the city economy in recent years. The "retail apocalypse" striking many brick-and-mortar selling establishments struggling against e-commerce competition has not bypassed New York City, where seasonally adjusted retail employment has shrunk in 10 of the past 12 quarters and as of the fourth quarter of 2017 was 10,400 below its fourth quarter 2014 peak. Clothing, sporting goods, and department stores have been especially hard hit. Wholesale trade peaked later than retail (first quarter 2016), but has since shed 5,100 jobs. Over 2017 alone wholesale and retail trade employment dropped by a combined 8,800 jobs.

More unexpectedly, the information sector has also been shedding jobs for five consecutive quarters, with cumulative losses of 7,000. Professional and business services employment fell by 4,000 in Q4 and was up only 14,400 for the year. This was by far the weakest growth for this sector in the current expansion.

Education employment also dropped in the fourth quarter, though this was in part an artifact of unusual patterns of the data. For the year, education employment was up only 2,300. Over the past 25 years, only twice (1999 and 2004) has this sector performed worse in terms of job growth.

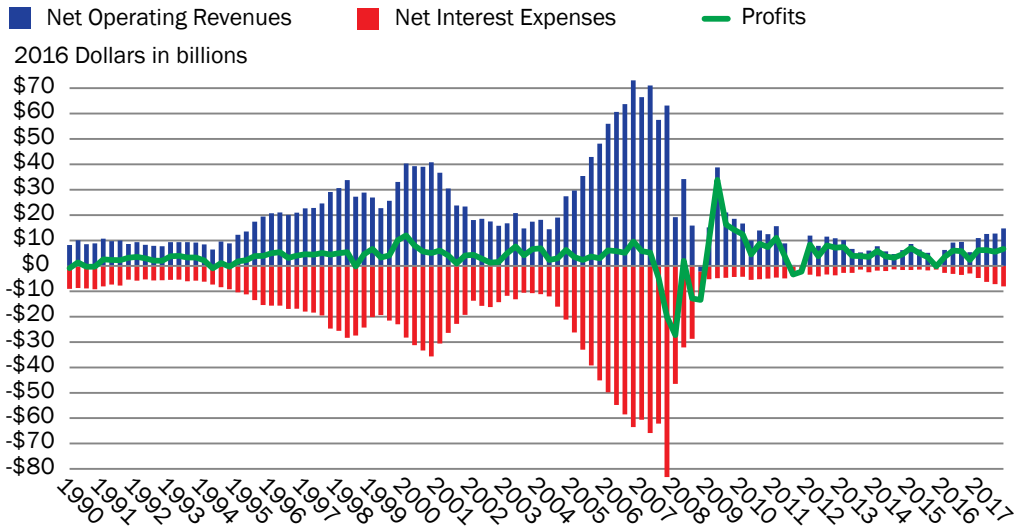
The bright spots for city employment growth in 2017 were health care services (+22,700), accommodation and food services (+12,800), construction (+10,000), and finance and insurance (+9,500). The latter includes an increase of 7,500 jobs in the securities sector. For accommodation and food services, 2017 marked a return to form after weak growth in 2016. The increase in securities sector employment is the largest since before the 2008-2009 financial crisis.

IBO projects a continuing deceleration of employment growth over the next five years, with gains ranging from 62,400 in 2018 and 50,000 in 2019 declining to 36,900 by 2022. Our forecast anticipates modest 2018 increases in trade, information, and business services employment but otherwise weakening growth across all sectors of the city economy this year and through the remainder of the financial plan period.

New York City's unemployment rate stood at 4.3 percent as of December, close to the record low (4.0 percent)

IBO versus Mayor's Office of Management and Budget Economic Forecasts						
	2017	2018	2019	2020	2021	2022
National Economy						
Real Gross Domestic Product Growth						
IBO	2.3	2.9	2.6	1.6	1.9	2.2
OMB	2.2	2.7	2.6	2.0	1.8	2.0
Inflation Rate						
IBO	2.1	2.5	2.5	2.5	2.3	2.2
OMB	2.1	1.7	1.9	2.8	2.6	2.4
Personal Income Growth						
IBO	3.1	4.7	5.1	4.0	3.8	4.1
OMB	3.1	4.4	5.2	5.0	4.6	4.4
Unemployment Rate						
IBO	4.4	3.8	3.6	4.2	4.8	4.9
OMB	4.4	3.9	3.7	3.8	4.1	4.3
10-Year Treasury Bond Rate						
IBO	2.3	3.1	4.0	4.0	4.1	4.3
OMB	2.3	3.0	3.5	3.7	3.7	3.7
Federal Funds Rate						
IBO	1.0	1.9	3.4	3.7	3.3	2.8
OMB	1.0	1.8	2.5	3.1	3.4	3.4
New York City Economy						
Nonfarm New Jobs (thousands)						
IBO (Q4 to Q4)	67.0	62.4	50.0	44.4	39.6	36.9
IBO (annual average)	72.7	65.3	51.7	48.5	41.2	36.1
OMB (annual average)	61.8	55.3	49.7	44.3	34.2	31.3
Nonfarm Employment Growth						
IBO (Q4 to Q4)	1.5	1.4	1.1	1.0	1.0	1.0
IBO (annual average)	1.7	1.5	1.2	1.1	0.9	0.8
OMB (annual average)	1.4	1.3	1.1	1.0	0.8	0.7
Inflation Rate (CPI-U-NY)						
IBO	2.0	2.2	2.8	2.7	2.6	2.5
OMB	2.0	1.7	2.0	2.8	2.6	2.4
Personal Income (\$ billions)						
IBO	565.3	587.4	608.2	630.5	654.4	676.2
OMB	568.2	593.1	617.8	643.5	669.0	694.3
Personal Income Growth						
IBO	3.2	3.9	3.5	3.7	3.8	3.3
OMB	3.8	4.4	4.2	4.2	4.0	3.8
Manhattan Office Rents (\$/sq.ft)						
IBO	78.1	78.7	80.6	82.3	83.8	85.1
OMB	79	79.9	83.5	83.9	85.7	87.1
SOURCE: Mayor's Office of Management and Budget						
NOTES: Rates reflect year-over-year percentage changes except for unemployment, 10-Year Treasury Bond Rate, Federal Funds Rate, and Manhattan Office Rents. The local price index for urban consumers (CPI-U-NY) covers the New York/Northern New Jersey region. Personal income is nominal.						
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Quarterly Net Operating Revenues, Net Interest Expenses, And Profits of New York Stock Exchange Member Firms



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touched in March. Last year also saw the city’s labor force participation rate climb to record highs. But over the last two years the city’s labor force data have been roiled by extreme swings in estimated household employment and unemployment. Data for 2016 (and earlier) were smoothed in a year-end revision. IBO anticipates another revision to reduce the noise in the 2017 data.

In our forecast, moderate growth in the working age population along with the weakening pace of job creation

combine to keep the projected city unemployment rate within a narrow band (4.2 percent to 4.5 percent) over the next five years.

Preliminary data indicate that inflation-adjusted (real) average wages declined again in New York City in 2017. This would make it the third year in a row and fifth in the last six to see declining real wages. In 2017 dollars, last year’s average wage (\$87,142) was 11.1 percent below the pre-recession 2007 peak. Over most of this past decade

Average Wages in New York City Continued to Decline in Real Terms

In 2017 dollars

Year	All Jobs		Financial Investments		All Other	
	Wage	% Change	Wage	% Change	Wage	% Change
2007	\$98,007		\$474,993		\$78,152	
2008	96,505	-1.5%	463,500	-2.4%	77,477	-0.9%
2009	88,913	-7.9%	376,303	-18.8%	75,136	-3.0%
2010	92,792	4.4%	428,053	13.8%	77,116	2.6%
2011	93,987	1.3%	418,990	-2.1%	78,534	1.8%
2012	92,196	-1.9%	406,218	-3.0%	77,890	-0.8%
2013	89,758	-2.6%	389,744	-4.1%	76,709	-1.5%
2014	91,627	2.1%	423,016	8.5%	77,471	1.0%
2015	90,348	-1.4%	395,417	-6.5%	77,377	-0.1%
2016	88,172	-2.4%	377,000	-4.7%	75,771	-2.1%
2017	87,142	-1.2%	373,126	-1.0%	74,923	-1.1%
2007-2010	\$(5,215)	-5.3%	\$(46,940)	-9.9%	\$(1,036)	-1.3%
2010-2017	(5,650)	-6.1%	(54,927)	-12.8%	(2,194)	-2.8%
2007-2017	(10,865)	-11.1%	(101,867)	-21.4%	(3,229)	-4.1%

NOTE: Based on IBO re-estimates of Bureau of Economic Analysis-definition industry employment and wages, excluding private household workers. 2017 is preliminary.

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the securities sector has been the main source of drag on overall wage growth, and estimated average Wall Street wages in 2017 (\$373,126) remain 21.4 percent below their 2007 peak—and indeed appear to have fallen below the nadir reached during the crisis and recession in 2009.

But annual average wage growth has been very weak throughout much of the city economy. At least in part this is a composition effect, a result of the fact that workforce growth has been much slower in the 35-54 age bracket—the peak earnings years—than it has been among both younger (22-34) and older (55 and up) workers. The ongoing decline in average hours worked over the past decade has likely also cut into annual wage growth.

IBO projects growth in average real wages to turn positive in 2018 and to sustain small inflation-adjusted gains over the forecast period. These modest gains are attributable to upward pressure on wages stemming from the combination of the prolonged expansion and slower labor force growth.

New York Stock Exchange member-firm broker-dealer profits surged to \$24.5 billion in 2017, the best year since 2012. Net interest expenses topped \$26.4 billion, more than double the level of 2016—which itself more than doubled the level of 2015. But the growth in net operating revenues has more than kept pace. Both revenues and expenses are still far below the norms that prevailed before the crisis of 2008 (see figure, page 7), but the trend has been away from the extremely low levels of recent years.

IBO currently projects more slowly growing net interest expenses and net operating revenues over the next five years, yielding Wall Street profit estimates in the \$17 billion to \$20 billion range over this period. But all these forecasts may have to be revised upward if the current momentum in broker-dealer activity is sustained.

Real Estate. Taxable real estate sales in New York City were \$93.2 billion in 2017, the lowest level since 2012. Commercial sales have dropped sharply since peaking in 2015, while residential sales have continued a steady climb. IBO expects residential sales to drop slightly in 2018, while commercial sales begin a modest recovery. By 2019 commercial sales will again surpass residential sales. However, through 2022 annual total sales will still lag behind the 2015 peak of \$126.6 billion.

Commercial real estate sales have been much more volatile than residential sales in the last 13 years, a period which includes the run-up to the financial crisis, the crisis itself, and the years of recovery. The decline in commercial

sales in recent years coincides with slower growth in office-using employment as well as significant amounts of new office space (including the World Trade Center and Hudson Yards) becoming available. Weakness in bricks and mortar retailing is likely a contributing factor as rents for retail spaces adjust.

Residential real estate has experienced steady growth in recent years, and total taxable sales of \$55.4 billion were the highest on record in nominal terms. (Sales in the boom years of 2006 and 2007 were higher in inflation-adjusted terms.) Manhattan sales have lagged behind those of other boroughs in recent years, a reflection of a weakening market at the high end of the price scale.

Taxes and Other Revenues

IBO's forecast of revenue from taxes and other sources including fines, fees, and state and federal aid totals \$88.3 billion for fiscal year 2018, an increase of \$4.8 billion (5.7 percent) over 2017. (All years in this section are fiscal years unless otherwise noted.) Tax revenues, which are projected to grow by 6.8 percent from 2017 to 2018 account for much of the growth in total revenue. The city's total own source revenue—excluding state, federal, and other grants—is projected to grow by 5.1 percent.

For 2019, IBO anticipates a smaller gain of 1.2 percent in total revenue to \$89.3 billion, pulled down by declines in city revenue from miscellaneous sources and federal grants. Tax revenue growth is expected to outpace total revenue growth with \$60.2 billion in tax revenues projected for 2019, a \$2.2 billion (3.8 percent) increase over the forecast for the current year. The city's own non-tax revenues (primarily fees, fines, and sales) are projected to fall by 3.7 percent from 2018 to 2019, to \$6.7 billion. Non-city revenues in 2019 are expected to be 4.7 percent lower than in 2018, largely the result of an anticipated decrease in federal grants, which are expected to shrink by 13.8 percent. Much of the drop is due to the winding down of Sandy-related recovery aid.

Following 2019, IBO projects that total revenues will grow in a more typical pattern, increasing to \$92.2 billion in 2020 and \$98.1 billion by 2022. Annual growth of total revenue will average 3.2 percent over the last three years of the financial plan period, driven by city tax revenues growing at an average annual rate of 4.1 percent over that period, with other city revenues nearly flat (0.2 percent). Growth in non-city revenue sources is projected to average 1.1 percent annually in 2020 through 2022.

IBO Revenue Projections						
<i>Dollars in millions</i>						
	2018	2019	2020	2021	2022	Average Change
Tax Revenue						
Property	\$26,347	\$28,183	\$29,773	\$31,335	\$32,861	5.7%
Personal Income	12,352	12,405	12,867	13,371	13,761	2.7%
General Sales	7,332	7,539	7,926	8,127	8,384	3.4%
General Corporation	3,562	3,739	3,829	3,988	4,159	3.9%
Unincorporated Business	2,131	2,217	2,324	2,462	2,607	5.2%
Real Property Transfer	1,343	1,461	1,535	1,572	1,606	4.6%
Mortgage Recording	1,004	965	987	1,013	1,052	1.2%
Utility	380	401	400	404	410	1.9%
Hotel Occupancy	555	593	601	617	627	3.1%
Commercial Rent	851	856	878	915	949	2.8%
Cigarette	36	35	34	33	32	-2.9%
Other Taxes and Audits	2,078	1,806	1,471	1,471	1,477	-8.2%
Total Taxes	\$57,971	\$60,199	\$62,625	\$65,307	\$67,926	4.0%
Other Revenue						
STAR Reimbursement	\$189	\$185	\$182	\$180	\$178	-1.5%
Miscellaneous Revenue	6,995	6,736	6,957	6,990	6,794	-0.7%
Unrestricted Intergovernmental Aid	-	-	-	-	-	n/a
Disallowances	85	(15)	(15)	(15)	(15)	n/a
Total Other Revenue	\$7,269	\$6,906	\$7,124	\$7,155	\$6,957	-1.1%
Less: Intra- City Revenue	\$(2,132)	\$(1,757)	\$(1,749)	\$(1,754)	\$(1,754)	
TOTAL CITY-FUNDED REVENUE	\$63,108	\$65,349	\$68,000	\$70,708	\$73,129	3.8%
State Categorical Grants	\$14,733	\$14,979	\$15,474	\$15,851	\$16,265	2.5%
Federal Categorical Grants	8,621	7,431	7,238	7,220	7,204	-4.4%
Other Categorical Aid	1,115	912	902	897	897	-5.3%
Interfund Revenue	674	670	606	605	605	-2.6%
TOTAL REVENUE	\$88,252	\$89,341	\$92,220	\$95,281	\$98,100	2.7%

NOTES: Remaining banking corporation tax revenues reported with general corporation tax. Figures may not add due to rounding.

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Tax Revenue. IBO's tax revenue forecast for 2018 is \$58.0 billion, 6.8 percent above the total for 2017, reversing what had been a two-year trend of slowing growth of tax revenues. The personal income tax (PIT) is driving much of this renewed growth thanks to one-time boosts pushing annual growth up to 11.6 percent. Growth for the city's other major taxes is expected to be at a more moderate pace, with the property transfer taxes continuing the decline that began in 2017. As the PIT jolt fades away, total tax revenue growth is expected to slow for 2019 to 3.8 percent, with collections equaling \$60.2 billion. Tax revenues are expected to grow by 4.0 percent to \$62.6 billion in 2020 and reach \$67.9 billion in 2022. Annual growth over the final three years of the financial plan period will average 4.1 percent.

The strong PIT revenue in 2018 reflects a change in how the benefits under the state's STAR program are

received by taxpayers and changes in taxpayer behavior in response to the federal tax legislation. While taxpayers will not have their STAR benefit reduced, it will no longer flow through the city's PIT, which has the effect of raising PIT revenue. Anticipation of federal tax changes has also altered PIT collections since the fall of 2016, culminating in a burst of estimated tax payments in December 2017 and January 2018. Continued strength in withholding and a strong bonus season in the securities industry are also contributing to PIT growth in 2018. Because some revenue was shifted from 2019 to 2018 as taxpayers tried to time their payments, the outlook for PIT growth in 2019 is much lower (0.4 percent).

Over the financial plan period, only the property tax, the business income taxes, and the real property transfer tax are expected to average annual growth of more than 4

percent. In dollar terms, the real property tax will account for much of the additional tax revenue. Property tax revenue is expected to total \$26.3 billion in 2018, \$28.2 billion in 2019, and \$32.9 billion in 2022, an average annual growth rate of 5.7 percent over that period.

IBO's forecast does not include double-digit tax revenue growth, something that did occur each of the boom years from 2004 through 2007 prior to the last recession. Nor does IBO's forecast assume growth faster than the average in the recent past. Indeed, the average annual growth we project for 2019 through 2022—4.2 percent—is somewhat below the 4.9 percent average that prevailed during the preceding four years (2014 through 2017).

IBO's latest tax revenue forecast differs somewhat from OMB's, particularly for 2018 and 2022. For 2018, IBO's forecast is \$866 million (1.5 percent) higher than OMB's estimate in the preliminary budget; for 2019 the difference is \$386 million (0.6 percent). Much of the difference in the first year is due to our higher forecast for PIT revenue, with the property tax accounting for much of the difference in the second year. The gap between the two forecasts widens somewhat in 2020 and 2021. There is a much larger divergence in 2022 when the gap is \$2.5 billion (3.9 percent) with much of the difference found in the property tax forecasts. OMB's property tax growth rate from 2021 to 2022 is particularly low (0.9 percent).

There is much greater uncertainty regarding the tax revenue forecast than typically prevails. This results not only from IBO's expectation of slower local employment growth, but also uncertainty regarding the ultimate consequences for the national and local economy and the city's fiscal condition stemming from the federal tax changes and the embrace of more expansionary fiscal policies. Other ongoing policy debates in Washington regarding trade policy, regulation in the financial services sector, the size and nature of infrastructure initiatives, and immigration policy all are likely to directly affect the economy and residents of the city, making revenue forecasting even more uncertain than usual.

Real Property Tax

IBO projects the city will collect \$26.3 billion in real property tax (RPT) revenue in 2018; an increase of \$63.9 million over our December forecast.

Based on the Department of Finance's tentative 2019 assessment roll that was released in January 2018, IBO anticipates stronger property tax revenue growth in 2019

and for each subsequent year through 2022. Revenues are now forecast to total \$28.2 billion next year and reach \$32.9 billion by 2022 an average growth of 5.7 percent a year. By comparison, OMB projects property tax revenue of \$26.1 billion for the current year, \$27.7 billion for 2019, and \$30.7 billion in 2022, with annual growth averaging 4.2 percent. Much of the growth in our forecast is attributable to increases in assessed value of multi-family residences; for example, the aggregate taxable assessed value of Brooklyn rental properties on the tentative assessment roll increased by about 21 percent over the 2018 final value. More than half of this increase can be attributable to new rental construction coming on to the tax roll.

Background. The amount of tax owed on real property in New York City depends on the type of property, its value for tax purposes, and the applicable tax rate. Under New York State's property tax law, there are four classes of property in the city: Class 1 consists of one-, two-, and three-family homes; Class 2 comprises apartment buildings, including cooperatives and condominiums; Class 3 is exclusively real property owned by utility companies; and Class 4 consists of all other commercial and industrial properties. Each class's share of the levy is determined under state law that allows only small year-to-year shifts in the share of the overall property tax borne by each class. The apportioned citywide levy is then divided by the taxable assessed value of property for each class, resulting in a class-specific tax rate that determines how much a taxpayer in a particular class owes per \$100 of their property's taxable value.

The assessed value of a property for tax purposes (taxable assessed value) is established by the Department of Finance. The Department estimates each property's fair market value and then applies an assessment rate or percentage that reduces the amount of the property's value subject to the property tax. For Class 1 property, no more than 6.0 percent of fair market value is taxable, while 45.0 percent of fair market value is taxable in Classes 2, 3, and 4. The assessment rates for each class are set by the Finance Commissioner. A property's resulting assessed value is then further reduced by any property tax exemptions in order to reach taxable assessed value.

Because of differences in assessment percentages, exemptions, and assessment practices across property types, the share of the levy borne by each class is not proportional to its share of market value. One critical difference in assessment practices affects taxable assessed values for coops and condos in Class 2. Under the state law, the city is required to value coops and condos

as if they were income-producing properties rather than based on sales values as they are for Class 1 properties. IBO estimates that valuing coops and condos based on income results in market values for tax purposes that are discounted by roughly 80 percent compared with sales-based estimates.

Tentative Assessment Roll for 2019. On the Department of Finance's tentative assessment roll for 2019, total market value for tax purposes increased 9.4 percent from 2018 to total \$1.3 trillion. Class 1 and Class 2 saw the biggest increases at 10.4 percent and 10.7 percent, respectively, while Class 4 grew 7.4 percent. Class 2 assessed value for tax purposes increased by 11.5 percent and for Class 4 the increase was 7.9 percent, in both cases fairly close to the increase in market values. However, Class 1 taxable values grew by only 4.1 percent, less than half the market value increase for the class.

After a period for appeals and review, a final roll for 2019 will be released in May 2018. Based on historical trends, IBO anticipates the final roll will show \$241.4 billion in total taxable value with Class 4 property making up 47.7 percent of the property tax base and Class 2 making up 37.2 percent. Class 1 properties, despite being nearly half of the city's total market value, are anticipated to only account for 8.6 percent of total taxable value and 15.5 percent of the levy.

Revenue Outlook. IBO anticipates property tax revenue will total \$26.3 billion in the current fiscal year and \$28.2 billion in 2019—an increase of 7.0 percent. Growth is expected to gradually slow over the forecast period, averaging 5.7 percent annually to reach \$32.9 billion in 2022.

IBO's and OMB's property tax revenue forecasts differ somewhat on projected growth in market values and assessments, most strikingly for 2022. But much of the difference between the two forecasts stems from other elements of the property tax system. The amount of property tax revenue the city collects in any fiscal year is determined not just by the assessment roll, but also by the delinquency rate for current year tax bills, abatements granted, refunds for disputed assessments, and other property tax debits and credits. Collectively these elements of the RPT revenue are known as the property tax reserve. Some reserve components, such as delinquencies, are counted as debits, as they reduce expected tax revenue in the current year. Other components, such as payments made in a given fiscal year for liabilities from prior years,

are counted as credits because they increase current-year tax revenue. Because the dollar value of the debits generally exceeds the dollar value of the credits, the net value of the reserve is nearly always negative, which is why anticipated property tax revenue is almost always less than the property tax levy.

Much of the difference between IBO's and OMB's property tax revenue projections is attributable to differences in forecasting items included in the reserve. For 2018, since the levy for this year has already been finalized, nearly the entire gap between the two forecasts (97.9 percent) is due to differences in the projections of four reserve components: prior-year collections, refunds, delinquent accounts, and cancelled taxes. For 2019, less of the forecast gap (76.9 percent) is due to the reserve because the assessment roll has not yet been finalized and other factors also come into play, such as differences in how much IBO and OMB expect taxable values to change between the tentative and final roll. In later years, differences in reserve forecasts continue to account for much of the difference in the overall forecast, but the share of the difference attributable to the reserve declines over time as differences in the levy forecasts become more significant. For the 2022 forecasts, when OMB is projecting levy growth of only 0.9 percent in contrast to IBO's 4.9 percent, the four reserve components account for less than a quarter of the variation.

Federal Tax Reform. IBO expects the changes in federal taxes enacted in December to have a negative impact on housing prices in New York City, although the magnitude of the effect is still uncertain. Beginning with the 2018 liability year, taxpayers who itemize deductions to reduce their federal income tax liability will be allowed to deduct only a maximum of \$10,000 of property and income or sales taxes, raising the net cost of homeownership. Another feature of the new federal law lowers the cap on mortgage interest deductions, raising the cost of homeownership for some taxpayers who use mortgage financing. A third change will make it more likely that taxpayers use the standard deduction in calculating their federal taxes, further reducing the value of the state and local tax and mortgage deductions. These changes will make home ownership more expensive for many and, in turn, put downward pressure on housing prices—which will ultimately be reflected in property tax assessments and revenues. At present, IBO has not explicitly included any of these effects in our property tax forecast.

Property Transfer Taxes

IBO's current year forecast of revenues from the real property transfer tax (RPTT) and the mortgage recording tax (MRT)—collectively referred to as the transfer taxes—is \$2.3 billion with a total of \$2.4 billion expected in 2019. IBO's forecasts have been revised downward in response to recent collections being slightly lower than expected and the anticipated negative impact on property markets of recent extensive changes in federal income taxes. Forecasts for both taxes were adjusted downward, especially the MRT. The projected sum of the two taxes for 2018 is \$186 million (7.3 percent) below 2017 collections and 28.7 percent below the all-time peak of \$3.3 billion reached in 2007. After adjusting for inflation, the total for both taxes is 41.1 percent below the peak.

Real Property Transfer Tax. RPTT collections reached just over \$1.4 billion in 2017, down from a record level in nominal terms of almost \$1.8 billion in 2016. In inflation-adjusted terms, however, the 2016 peak was 11.2 percent below the record set in 2007, just before the financial crisis exploded.

Based on actual collections through January and the expected negative impact of the tax changes, IBO has lowered its projection of RPTT revenues compared with the forecast in our December outlook. However, the underlying trends remain unchanged. The forecast for 2018 has been adjusted downward by around 3.0 percent, while forecasts for the remaining years have been lowered between 0.5 percent and 2.0 percent.

IBO expects RPTT collections to drop 5.1 percent in 2018 compared with the preceding year, to a level slightly over \$1.3 billion. Moderate growth will resume in 2019 through 2022, with collections expected to reach \$1.6 billion. This is well below the 2016 peak of \$1.8 billion in nominal

terms, and 23.1 percent below the inflation-adjusted peak of 2007.

Trends in RPTT revenue during the past decade and a half have been driven largely by commercial property markets, which have experienced much greater fluctuations in sales than residential properties. In addition, commercial buildings are subject to higher RPTT rates than residential properties and thus have an outsized influence on revenue. Commercial sales fell much more sharply than residential sales in the wake of the 2008-2009 (calendar years) financial crisis, and rose more quickly as the real estate market began to recover in 2010. In every fiscal year from 2012 through 2016, the value of commercial sales exceeded the value of residential sales. In 2017, however, residential sales exceeded commercial sales (54.2 percent compared with 44.8 percent of total sales value), and IBO expects this pattern to be repeated in 2018. Beginning in 2019, faster recovery in the commercial sector will lead commercial sales to once again exceed residential sales.

IBO forecasts that the value of residential sales will grow at a moderate rate from 2019 through 2022. Since the financial crisis, the average value per transaction has grown much faster than the number of sales. In 2016 the number of taxable residential sales in New York City was just over 56,000, an increase of 4.3 percent over 2015, but well below the peak of 78,000 sales recorded in 2006. The number of sales in 2017 increased in every borough except Manhattan, where transactions were down 4.2 percent. This decline is related to weakness at the very high-end of the residential market. The average price of Manhattan residential properties sold increased 4.7 percent in 2017, the smallest increase among the five boroughs.

Mortgage Recording Tax. MRT revenue reached unprecedented levels during the housing bubble of

Differences Between OMB's and IBO's Property Tax Revenue Forecasts Are Largely Due to Differences in Forecasting the Reserve
Dollars in millions

	2019	2020	2021	2022
Major Reserve Components: OMB Less IBO				
Prior Year Collections	(\$4.1)	\$15.1	\$30.2	\$51.3
Refunds	117.6	90.4	71.1	102.8
Delinquencies	134.5	128.5	139.6	174.0
Cancellations	143.6	186.1	192.3	181.6
Total Major Reserve Components	\$391.61	\$420.12	\$433.13	\$509.74
Total Forecast Difference: IBO less OMB	\$508.98	\$619.35	\$896.63	\$2,139.82
Share of Difference due to Major Reserve Components	76.9%	67.8%	48.3%	23.8%

SOURCE: Mayor's Office of Management and Budget
NOTE: Figures may not add due to rounding.

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calendar years 2005-2007, and then fell more sharply than RPTT collections in the wake of the financial crisis. From a high of almost \$1.6 billion in 2007, MRT revenue plunged to just \$366 million in 2010. MRT revenue reached \$1.2 billion in 2016, the highest level since 2007, but then dropped 9.4 percent, to \$1.1 billion, in 2017, as interest rates began to rise, refinance activity fell, and a sharp drop in commercial sales led to an overall decline in the total value of real estate sales.

MRT revenue does not follow the value of real estate sales as closely as revenue from the RPTT, because not all sales are financed using a mortgage, and not all mortgage activity involves a sale. Loans to purchase coop apartments are not considered mortgages under New York State law because technically the buyer is purchasing shares in a corporation rather than real property. Sales of luxury residences can involve a large cash component and/or financing from overseas, meaning that most, or all, of the sales price will not be subject to the mortgage tax. Finally, refinanced mortgages, which do not involve the purchase of property, may or may not be subject to the MRT.

The Federal Reserve's monetary policy kept interest rates low for much longer than most economic forecasters ever anticipated. This provided an incentive for borrowing to finance real estate purchases, as well as for refinancing existing mortgages. On the other hand, stricter lending standards in the wake of the financial crisis put a damper on mortgage activity. While credit availability has improved in recent years, rising interest rates will constrain borrowing for real estate purchases, and particularly for mortgage refinancing. One year ago IBO anticipated that the benchmark 30-year mortgage rate would exceed 5.0 percent by the end of 2018. We now forecast that this level will be reached by the middle of 2019.

As is the case with RPTT, IBO's projections of MRT have been revised downward since our December forecast in light of an observed decline in current year collections, and changing expectations of mortgage rates. Under IBO's latest projections, mortgage rates peak in 2020, at a lower rate than was forecast a year ago. However, because mortgage rates during the past year have been lower than originally forecast, the expected increase in rates between 2018 and 2020 is now steeper than previously anticipated.

IBO's downward revisions to our MRT forecasts are proportionally greater than our revisions to RPTT. Compared with the December forecast, IBO's MRT forecast is down 3.7 percent for 2018, 11.6 percent for 2019, and between

10 percent and 13 percent in 2020 through 2022. Whereas our December forecast projected a decline in revenue in 2018 and a recovery in 2019, we now expect declines in both 2018 and 2019, 10.2 percent and 3.9 percent, respectively. A slow recovery is forecast beginning in 2020, and by 2022 MRT revenue is projected to be slightly under \$1.1 billion—essentially a return to the level of 2017.

IBO's projection for RPTT is 3.9 percent (\$55 million) below OMB's in 2018, essentially equal to OMB's in 2019, and 3.0 percent to 4.0 percent higher than OMB's in 2020 through 2022. Despite the downward revision with respect to the December forecast, our MRT forecasts are still above OMB's: around 4.0 percent higher in 2018 and 2019, increasing to 8.0 percent higher by 2022.

Commercial Rent Tax

IBO's forecast for 2018 commercial rent tax (CRT) revenue is \$851 million, 4.2 percent higher than the total collected in 2017. Average annual growth from 2019 through 2022 is projected at 2.8 percent. Collections in 2022 are forecast at \$949 million, 16.3 percent above 2017.

The CRT is a tax imposed on tenants renting space for business, professional, and commercial purposes in much of Manhattan below 96th Street. Not-for-profit organizations, subtenants, tenants located in the World Trade Center area, and tenants located in the Commercial Revitalization Program abatement zone are all exempt from the tax, as are most retail tenants south of Chambers Street. Over time both the tax rate and the geographic area subject to the tax have been reduced. Currently, tenants with annual gross rents of less than \$250,000 are exempt, and a sliding scale tax credit is applied to tenants with annual or annualized rents between \$250,000 and \$300,000. For those tenants who are subject to the tax and pay annual or annualized rent of over \$300,000, the effective tax rate is 3.9 percent of gross rent.

The intense sales activity in the commercial real estate market in recent years reflected a strong underlying demand for space which led to higher rents. However, as brick and mortar retail faces increasing challenges from online commerce and growth in office-using employment slows, IBO expects annual growth in CRT revenue to slow. In addition, legislation passed by the City Council in November 2017 will reduce the scope of the tax beginning in 2019.

The bill passed by the City Council in November 2017 seeks to reduce or eliminate the CRT for small businesses. The

bill creates a new credit that eliminates the tax for tenants paying from \$250,000 to \$499,999 in annualized rent, provided their total income is \$5 million or less. Tenants paying rents of \$250,000 to \$499,999 but with income of \$5 million to \$10 million are eligible for a partial tax credit, as are tenants paying from \$500,000 to \$550,000 whose income does not exceed \$10 million. OMB estimates that the new regulations will reduce CRT revenues by around \$40 million a year starting in 2019.

IBO's CRT forecasts for this year and the next are almost identical to those of OMB. Over the 2018 through 2022 period, IBO's forecasts are just \$27 million (less than 1 percent) higher.

Personal Income Tax

Though the provisions of the Tax Cuts and Jobs Act (TCJA) enacted by Congress in December did not take effect until January 1 of this year, they began swelling personal income tax (PIT) collections in the last days of December and first days of January. As a result, IBO has raised its forecast of PIT revenue in the current year by \$252 million, to \$12.4 billion—almost \$1.3 billion (11.6 percent) greater than collections in 2017. The jump in revenue this year results from both the recent surge in estimated payments as well as changes enacted last spring in the state's School Tax Relief (STAR) program. Both of these factors produce one-time boosts in 2018 revenue, leaving PIT growth to slow to just 0.4 percent in 2019—the slowest growth since the current economic expansion began in 2010. IBO expects growth in PIT revenue in 2020 through 2022 to average 3.5 percent a year.

IBO now forecasts a nearly \$1.0 billion (54.5 percent) increase in quarterly estimated payments from 2017 to 2018. These payments—the second largest component of PIT revenue—are made quarterly by taxpayers who are self-employed or who anticipate realizing capital gains from the sale of real property and financial assets. (Estimated payments are also made by taxpayers filing for extensions beyond the April 15th deadline, though extension payments are not included in the following discussion.) Part of the surge in estimated payments was anticipated—with equities markets reaching new highs in the past year, many investors chose to realize gains in calendar year 2017, particularly if they had deferred realizing gains during 2016 in anticipation of federal tax cuts in 2017. Because the first three quarterly payments against calendar year 2017 liability were low, the fourth quarterly payment, due in mid-January 2018, was expected to be high.

However, TCJA's \$10,000 limit on the amount of state and local tax payments that can be claimed as an itemized deduction from federal adjusted gross income led to an unanticipated and unprecedented surge of quarterly estimated payments at the end of December and beginning of January. Large numbers of taxpayers across the country—including New York—prepaid state and local taxes by the end of December, giving themselves the full benefit of the deduction one last time before the limits came into effect on January 1. Almost \$1.4 billion in PIT estimated payments were received from city taxpayers in the last week of December and first week of January; the latter were payments that had likely been made before January 1, even though the fourth quarterly payment was not due until later on in January. Combined estimated payment revenue for the two months was \$1.9 billion, which dwarfed collections in previous years.

It is not known to what extent the surge of early estimated payments represents over-payment of calendar year 2017 PIT liability. To the extent that taxpayers have prepaid more taxes than necessary, this spring's final returns payments and estimated payments made by taxpayers filing for extensions are likely to be lower and refunds are likely to be higher than they would be had there been no excess prepayments. Changes to IBO's forecast of these components offset most of the increase IBO has made in its forecast of quarterly estimated payments.

In contrast to estimated payments, withholding revenue in 2018 has been steady and strong, with revenue through February 17.6 percent greater than the comparable period last year. The strength of withholding revenue this year largely results from state legislation that eliminated the remaining component of STAR-related benefits delivered through the city's tax on personal income. Beginning in 1999 the STAR program reduced city marginal PIT tax rates by roughly 6 percent. While this lowered city residents' PIT liability, the city's budget was made whole through a state aid payment equal to the loss in tax revenue. In previous years the state eliminated the lower marginal rates for tax filers with incomes above \$500,000. This year, as part of the state budget for fiscal year 2017-2018, the state eliminated the lower rates for all other filers, effectively raising their PIT liabilities. The state will replace the benefit tax filers had previously received through the lower STAR rates with a credit of equal value against state income tax liability. Though the elimination of lower rates was retroactive to January 1, 2017, there was no impact on city PIT revenue until July 1, the start of the 2018 city fiscal year, when withholding tables were adjusted. The new

withholding tables will boost 2018 withholding receipts by an estimated \$319 million.

Withholding growth so far this year has been further boosted by record-breaking receipts in December and January, the first two months of the traditional bonus-paying season in the securities industry. Total profits of New York Stock Exchange member firms in calendar year 2017 were \$24.5 billion, the largest earnings since 2010, supporting an increase in bonus compensation. With the expectation that withholding receipts will fall back to more modest levels in the coming months, IBO forecasts 14.1 percent withholding growth for fiscal year 2018 as a whole.

IBO forecasts little PIT growth in 2019—revenue is expected to be only \$53.6 million (0.4 percent) above our projection for 2018. With no increases in PIT rates or other policy changes boosting revenue, withholding growth will fall back to 4.7 percent in 2019. The extraordinary level of quarterly estimated payments in 2018 is not expected to recur, and estimated payments are forecast to decline by 35.6 percent. However, estimated payments filed with extensions are projected to increase and refunds are projected to fall, each reverting to more typical levels.

After 2019, PIT growth becomes more stable—3.7 percent and 3.9 percent, in 2020 and 2021, respectively—and then falls back to 2.9 percent in 2022. For the entire forecast period, IBO projects that annual PIT growth will average 4.5 percent, with revenue reaching \$13.8 billion in 2022.

IBO's forecast of PIT collections exceeds OMB's in each year, with the largest difference in the current year forecast (\$495 million, or 4.2 percent). IBO's higher forecast of withholdings and a smaller projected decline in extension payments compared with OMB accounts for most of the difference. After 2018, the differences diminish each year, with IBO's higher forecast of gross collections each year being increasingly offset by our projections of higher refunds. By 2022, IBO's forecast is only \$55 million (0.4 percent) greater than OMB's.

Business Income Taxes

In 2017, total non-audit revenue from the city's general corporation and unincorporated business income taxes (GCT and UBT, respectively) declined for the second year in a row, falling 3.8 percent (\$213 million) from 2016. IBO projects a return to revenue growth in the current and coming fiscal years, rooted in our forecast of continued but somewhat unsteady growth in the U.S. economy. In 2018, business tax revenue is projected to increase by

4.5 percent (\$243 million) and reach a total of \$5.7 billion. Combined revenue growth for these taxes is expected to continue at a similar pace of 4.6 percent in 2019, slow to 3.3 percent in 2020, and then pick up to average 4.8 percent in 2021 and 2022. By the end of the five-year forecast period, IBO projects that total business tax revenues will reach \$6.8 billion, an increase of \$1.3 billion over collections in 2017.

General Corporation Tax. Since state and city business tax reform in 2015, all corporate revenue is now reported and taxed under the general corporation tax (GCT). In 2018, corporate tax revenues are projected to increase by only 1 percent (\$34.5 million). GCT receipts have been weak so far in 2018, but stronger recent results and projections for key variables that are used to predict corporate tax revenue suggest strengthening collections over the next several months. These variables include national corporate profits and the earnings of such major city industries as finance, trade, and information. IBO projects stronger growth in corporate tax revenues of 5.0 percent (\$177 million) in 2019, followed by weaker collections in 2020, with growth slowing to 2.4 percent (\$90 million). Weak revenue growth in 2020 is consistent with IBO's forecast of a slowdown in U.S. GDP growth beginning in the middle of calendar year 2019, as upward pressure on wages and prices leads the Fed to accelerate its planned increases in interest rates and businesses and financial markets adjust to this new environment. Finance, the sector that contributes more than any other to corporate tax collections, is particularly sensitive to such cyclical changes in the broader economy. More rapid growth, averaging 4.2 percent, is expected to return in 2021 and 2022.

Unincorporated Business Tax. Revenue from the city's unincorporated business tax (UBT) is also projected to grow in 2018 and throughout the forecast period. The projected growth comes after a year in which UBT revenues fell by 1.7 percent, a more modest decline than the accompanying 4.9 percent drop in corporate tax revenues in the same year. The decline in UBT revenue was driven in large part by the unusually high level of refunds paid out in 2017, which we do not expect to become a trend. IBO projects revenues to bounce back, growing by 6.3 percent (\$126 million) in 2018 and continuing to grow at slightly lower rates for the rest of the forecast period. A major driver of the UBT forecast is earnings from the professional services sector, which accounts for the largest share of the city's non-corporate businesses (partnerships, sole proprietorships, and limited liability companies) subject to the tax. Professional services earnings have not experienced an annual decline

since calendar year 2009 and have not had a quarterly decline of note since reaching peak growth in calendar year 2015. Despite IBO's forecast of weaker U.S. economic performance in 2020, we expect growth in the professional services sector to continue in a relatively stable fashion through the end of the forecast period, yielding more stable growth for UBT revenue.

IBO's forecast for combined business tax revenue is 2.9 percent (\$161 million) higher than OMB's for 2018. Almost all of this is attributable to differences in expected GCT revenue. In contrast to IBO's forecast of slight revenue growth, OMB projects a third consecutive year of declining revenue—a 3.3 percent (\$117 million) decrease in collections from 2017 to 2018. OMB projects robust 8.0 percent growth in combined collections in 2019, compared with IBO's projection of steady but lower growth at 4.6 percent. As a result, IBO's forecast of 2019 business tax revenues is slightly lower than OMB's by 0.4 percent (\$23 million). Throughout the rest of the forecast period, IBO projects a path of slightly faster revenue growth than OMB, building to a difference of 7.6 percent (\$476 million) in 2022.

The major changes to federal business tax law enacted in December could directly affect revenue from non-federal business taxes, since New York State and New York City, like many state and city governments, use federal definitions of taxable income and other variables as a starting point for calculating their own tax liabilities. IBO's revenue forecasts are based on the assumption that the city and state will modify their tax laws to effectively de-link their taxes from the recent changes in federal law.

The federal tax changes and the large deficit-financed spending increases in the recently approved federal budget legislation will also have substantial impacts on the U.S. economy, financial markets, and business activity, which in turn could affect GCT and UBT revenue. For example, both the federal tax cuts and spending increases will tend to stimulate economic growth. Because the U.S. economy is already operating at or near full-employment, this fiscal stimulus is likely to hasten the onset of inflation and trigger a more aggressive monetary policy. In turn this would have major repercussions in financial markets and the securities industry, whose profits during most of the expansion have depended on access to capital at low interest rates. IBO's current GCT and UBT forecasts do not include any specific assumptions about the impact of this or any other development, as it is still too early to make reliable quantitative assessments.

Spending

Have Planned Expenditures Increased Since Adoption? In the Mayor's latest financial plan for 2018, spending totals \$87.4 billion, an amount that is \$1.5 billion larger than the size of the 2018 budget shown in the November plan and \$2.2 billion above the plan at adoption last June.¹ However, the impression that the current year's budget has actually grown since adoption is a misconception. Expenditures in the February financial plan are inflated by \$2.6 billion of current year resources that will be used to pay next year's expenses. Adjusting for the effect of this prepayment, as well as the \$4.2 billion in 2018 expenses that were paid with 2017 resources and the effect of shifting reserve funds to next year's prepayment gives a more accurate comparison of the current year's budget since adoption. After making these adjustments, the 2018 expense budget has decreased by \$372 million since adoption and by \$1.1 billion since November.

The adjusted 2018 city-funds expenditures in the current plan have decreased by \$1.6 billion since November and are \$1.8 billion less than at adoption last June. What is growing in the 2018 expense budget is non-city spending. Since adoption, the 2018 budget for non-city funded expenditures has increased by \$1.4 billion, driven primarily by the city's recognition of an additional \$840 million of federal and \$357 million of state grants.

The February financial plan includes minimal spending increases in the out-years of the financial plan, after adjusting for the effects of prepayments. The current plan includes additional expenditures of \$151 million in 2019, \$205 million in 2020, and \$183 million in 2021 above the expenditure levels presented in the November 2017 Financial Plan. When compared with the expense plan presented at adoption last June, however, total expenditures for each year from 2019 through 2021 have actually declined. These decreases are driven by lower projections of city-funded expenditures in the out-years of the financial plan: \$352 million in 2019, \$425 million in 2020, and \$613 million in 2021.

Year to Year Expense Changes. While expenditures, adjusted for prepayments and discretionary transfers, are declining relative to the November and June plans, spending is still expected to grow on a year-over-year basis. Adjusting for the prepayment of future-year expenses with current-year revenues, IBO estimates the average annual growth in expenditures from 2018 through 2022 is 2.2 percent for all funds and 2.7 percent for city funds.

IBO Expenditure Projections						
<i>Dollars in millions</i>						
	2018	2019	2020	2021	2022	Average Change
Agency Expenditures	\$64,147	\$62,617	\$63,015	\$63,383	\$63,833	-0.1%
Fringe Benefits	9,978	10,516	11,228	11,733	12,243	5.2%
Labor Reserve	586	1,456	1,797	2,270	1,710	n/a
Total Agency Expenditures	\$74,711	\$74,589	\$76,040	\$77,386	\$77,786	1.0%
Other Expenditures						
Debt Service	\$6,361	\$7,051	\$7,664	\$8,127	\$8,815	8.5%
Pensions	9,590	9,802	9,764	9,678	9,882	0.8%
Judgments and Claims	692	707	725	740	755	2.2%
General Reserve	300	1,000	1,000	1,000	1,000	n/a
Capital Stabilization Reserve	-	250	250	250	250	n/a
Expenditure Adjustments	(400)	1	153	261	388	n/a
Fiscal Year 2017 Budget Stabilization Account and Discretionary Transfers	(4,180)	-	-	-	-	n/a
Fiscal Year 2018 Budget Stabilization Account	3,308	(2,584)	(724)	-	-	n/a
Fiscal Year 2019 Budget Stabilization Account	-	283	(283)	-	-	n/a
Subtotal	\$90,383	\$91,099	\$94,588	\$97,442	\$98,876	2.3%
Less: Intra-City Expenditures	\$(2,132)	\$(1,757)	\$(1,749)	\$(1,754)	\$(1,754)	
TOTAL EXPENDITURES	88,252	89,341	92,839	95,688	97,122	2.4%

NOTES: Expenditure adjustments include energy, lease, and non-labor inflation adjustments. Figures may not add due to rounding.
New York City Independent Budget Office

Most city agencies, with the exception of the Department of Education, experience little or no growth across the financial plan period. Instead, nearly all of the year-to-year growth is attributable to increases in non-agency expenditures such as debt service costs, health care expenses, and the centralized costs associated with future labor settlements.

IBO estimates that debt service costs will increase by an average of 8.5 percent annually from \$6.4 billion in 2018 to \$8.8 billion in 2022. Over the last five years the city has paid an average of \$5.8 billion annually through its operating budget to service its outstanding debt, which as of June 30, 2017 totaled \$86.3 billion. The Preliminary Budget projects that over the next five years debt service will cost the city an average of \$7.6 billion annually. The increase is primarily due to higher projected debt service on new debt expected to be issued from 2018 through 2022. While higher interest rate assumptions account for some of the increase, it is primarily the result of the city's aggressive capital plan, which includes a sharp increase in planned expenditures over the next few years. The current financial plan assumes capital expenditures will average \$10.9 billion annually over the next five years, a nearly 58 percent increase over the average annual capital

expenditures for the previous five years. New debt issued from 2018 through 2022 will cost the city a total of \$4.6 billion in debt service during those years.

IBO projects that the city's cost of fringe benefits will increase by an average of 5.2 percent annually from \$10.0 billion in 2018 to \$12.2 billion in 2022. We estimate that health insurance costs, the largest component of fringe benefits, will increase at an even faster rate, averaging 5.7 percent annual growth from \$6.3 billion in 2018 to \$7.9 billion in 2022.

Pension costs, the other major component of non-agency expenditures, are projected to grow somewhat slower than the budget as a whole. Pension costs in 2018 total \$9.6 billion and are forecast to increase to \$9.9 billion by 2022, average growth of 0.8 percent per year.

Labor Reserve. Most city agency budgets have little or no growth in the plan period because their budgets do not include funding for the potential cost of future labor settlements. Instead, the city centrally budgets for these costs, setting aside money in a labor reserve to cover the planned costs of upcoming labor settlements. The current financial plan includes \$586 million in 2018, \$1.5 billion

in 2019, \$1.8 billion in 2020, \$2.3 billion in 2021 and \$1.7 billion in 2022 in the labor reserve, enough to fund increases of 1 percent each year in future settlements.

IBO estimates that currently nearly 104,000 of the city's 307,772 full-time employees, just over one third of the workforce, are working under the terms of expired collective bargaining agreements. Absent any agreements between the city and its labor unions, by the end of 2018 nearly 43 percent of all full-time city employees will be working without a contract. If labor contracts are not agreed to by the end of 2019, nearly the entire city workforce will be working under the terms of expired contracts.

The city typically sets wages through "pattern bargaining," where the first major union to reach a labor settlement sets the pattern for wage increases for the city's other unions. When contract terms are reached, pay increases are usually applied retroactively to the date of the prior contract's expiration.

One uncertainty is the possibility that unions may attempt to negotiate for paid parental leave, which has currently only been implemented for most of the city's managerial-level workers. The United Federation of Teachers, which represents the city's single largest collective bargaining unit, has publicly expressed interest in the benefit; a spokesperson for the City's Office of Labor Relations estimated the cost to provide paid parental leave to teachers at \$250 million a year.

In Reserve. The Mayor continues to include substantial reserves in his financial plan: dollars budgeted as expenses but not attached to any specific need. With less than half of the fiscal year remaining, the current financial plan has drawn down most of the reserves originally budgeted for 2018, leaving \$300 million in reserve funds for the current year. If these funds go unused, they would then become part of the surplus and used to reduce out-year budget gaps. The financial plan also contains reserves of \$1.25 billion in each year from 2019 through 2022.

In addition to these budgeted reserves, the de Blasio Administration has put aside more than \$4 billion in the Retiree Health Benefits Trust, including \$100 million added in 2017. No new funding is budgeted for the trust this year. Funds in the trust can only be used to pay all or part of the cost of retiree benefits in a given year; when the fund is tapped in this way, an equal amount of city funds is freed up for other needs. Given the cost of retiree health benefits—\$1.6 billion in 2018 and \$2.1 billion in 2019—the budget relief available by drawing on the trust can be substantial.

Budget Stabilization Account

As required by the City Charter, the Mayor presented a preliminary budget for 2019 that is balanced (the current year 2018 budget also remains in balance as required), but more so than in recent years, achieving balance relied on drawing down reserves because there were fewer surplus revenues to tap. In order to bring 2019 into balance, the February plan includes the prepayment of certain 2019 expenses with surplus resources from 2018. The Preliminary Budget for 2019 would use \$2.6 billion of excess 2018 funds, also known as the Budget Stabilization Account (BSA), to prepay some of 2019's expenses, typically debt service costs. Without the BSA funds available for prepayment of 2019 expenses, next year's budget would be out of balance and the city would be required to find other means of bringing spending in line with revenues.

In 2017 the city ended the year with an operating surplus for the third consecutive year, as total revenues collected exceeded total expenditures by nearly \$140 million. But because approximately \$4 billion of 2017 expenses were pre-paid with resources from 2016, the city ended 2017 with a surplus of nearly \$4.2 billion. These funds were used to prepay costs of debt service and retiree health insurance and to provide a subsidy to Health + Hospitals for 2018.

IBO estimates that the 2018 BSA will ultimately total \$3.1 billion. While the BSA is comparable in size to prior years, the way in which the city has accrued these funds is different. The current BSA includes just \$1.6 billion of greater-than-expected or surplus tax revenues, accounting for over 51 percent of the BSA for 2018. But upon closer analysis, only \$1.1 billion of this surplus is the result of additional collections of current year taxes, while \$450 million is the result of revenue collected from audits of prior year returns. Adjusting for audit revenue, IBO estimates that unplanned current year tax revenue makes up just over 35 percent of the 2018 BSA. The largest share of the 2018 BSA, approximately \$1.2 billion—nearly 39 percent of this year's total—is derived from reserve funds in the current-year budget that are not expected to be needed. This is the second consecutive year in which the BSA was not comprised primarily of additional tax revenues. In contrast, in 2013 through 2016, excess tax revenues averaged \$2.4 billion a year and accounted for an average of nearly 78 percent of the BSA, while funds released from current-year reserves averaged \$720 million, about 23 percent.

The savings programs initiated by OMB, which in the prior two years had provided an average of \$818 million annually to the surplus (net of new agency expenditures), only provides \$332 million of additional resources in the current year. This is not enough to offset the \$526 million in additional agency expenditures (\$384 million included in the Preliminary Budget plus \$142 million of additional spending identified by IBO) in 2018.²

The increasing reliance on savings from reserve funds and accounting changes for charges from prior years rather than from the receipt of unanticipated revenue or agency savings could be a troubling sign for future years.

Cost & Savings Re-Estimates

IBO calculates that city-funds expenditures in the Mayor's February financial plan are understated by \$142 million in 2018, \$128 million in 2019, and \$51 million in 2020 and overstated by \$130 million in 2021 and \$241 million in 2022.

While non-city funded expenditures do not affect the city's budget gaps, shortfalls in state and federal revenues to fund such expenditures can result in service reductions if the funds are not replaced with other sources. IBO estimates that the February Financial Plan overestimates non-city funding in 2018 by \$55 million. Conversely, we project that non-city expenditures are under-estimated by \$264 million in 2019, \$318 million in 2020, \$320 million in 2021 and \$322 million in 2022. This is primarily the effect of OMB's customary under-budgeting of out-year Federal and State funding for certain agencies. IBO's higher estimates for non-city funding within these agencies' budgets are based upon an analysis of historical federal and state allocations.

Spending Overestimates in Preliminary Budget. IBO has identified four major areas where our re-estimates indicate that the Mayor's plan over-states city-funded expenses: debt service, health insurance, sanitation and public assistance.

Debt Service: The February financial plan includes an \$89 million reduction of debt service costs for 2018, much of which results from lowering the assumed rate of interest on variable rate debt from 3.4 percent to 2.7 percent. However, IBO expects that these rate assumptions are still above what the actual rates will be for the current year. Taking into account the relationship between the variable interest rates paid by the city and the federal funds rate (the interest rate at which banks lend reserve balances to other banks overnight), IBO projects that the city will pay

1.9 percent on its outstanding variable rate tax-exempt debt in 2018. This would reduce debt service costs by \$51 million in the current year. IBO expects variable interest rates of 3.7 percent for tax-exempt debt in 2019, again below the rates forecast by OMB. These lower rates would reduce the cost of debt service in 2019 by \$38 million.

Health Insurance: IBO estimates that another of the major drivers of city spending—the cost of providing health insurance for city employees and retirees—is also overstated in the financial plan. We project that increases in the city's spending on health insurance will not be as steep as forecast by the Administration. Based on an analysis of historical growth rates and using the federal government's estimates of increases in health care costs, we project that city spending on health insurance will be lower than presented in the February plan by \$163 million in 2019, \$328 million in 2020, \$584 million in 2021, and \$755 million in 2022. For the current year, our estimate of the cost of providing health insurance is just \$6 million below that of the de Blasio Administration.

Sanitation: IBO projects that the city-funded portion of the Department of Sanitation (DSNY) is over-budgeted by \$61 million in 2018, \$49 million in 2019, \$35 million in 2020 and \$7 million in 2021. These estimated savings stem from IBO's expectation that the costs of the Fresh Kills landfill closure and personnel services will be lower than the Administration projects. Increased needs in the department's waste prevention and recycling programs offset a small part of the savings.

Each year DSNY budgets tens of millions of dollars for the cost of the closure of Fresh Kills Landfill. Because of schedule delays and cost re-estimates the department often reduces its budget for these expenses during the year. In addition, DSNY's budget for personnel service costs has greatly exceeded its expenditures in recent years, even after accounting for scheduled wage growth. As a result IBO estimates that the department will accrue savings on personnel services costs in 2018 through 2021.

Public Assistance: The February financial plan includes approximately \$1.6 billion each year of the plan period for public assistance spending. Based on IBO's forecast of public assistance caseloads, we estimate that the Humann Resources Administration will spend \$66 million less in 2018 and approximately \$56 million less in each subsequent year of the financial plan. This would result in lower city-funded spending of \$16 million in 2018 and \$8 million annually in 2019 through 2022.

Spending Underestimates in Preliminary Budget. While IBO identifies some items in the financial plan where the de Blasio Administration has over-estimated spending, these are more than offset by underestimates of city-funded expenditures in other parts of the plan. We expect additional expenditures in several areas: the provision of shelter for homeless individuals and families, charter school funding and Medicaid in the Department of Education, uniformed overtime, Campaign Finance Board and Board of Elections expenses, and supplemental payments for school bus drivers.

Homeless Services: The city continues to underestimate the cost of providing services for homeless families and individuals. In the February plan the city also over-estimates the amount of funding that will be provided by the federal government. Since the city is required to provide shelter to the homeless, any decrease in federal funding would require an infusion of city funds to make up the shortfall. IBO estimates that the city will need to provide an additional \$77 million in 2018, \$96 million in 2019, \$118 million in 2020 and \$127 million in each of 2021 and 2022.

The February plan includes additional funding in each year of the plan for the provision of shelter services for families with children. While IBO considers the current funding levels to be adequate to provide shelter service for all such families in the system, we estimate that the city's share of the total expense is greater than budgeted. Since 2015, OMB has been budgeting under the assumption that the distribution of federal, state, and city funds for the shelter costs of families with children will remain similar to what it was in 2014. This assumption remains in the current plan even as the share of federal Temporary Assistance for Needy Families funding continues to decline. Moreover, state funding has declined as well. Based on the shifts in the distribution of funding, IBO estimates that the city will be required to contribute an additional \$54 million in 2018, \$62 million in 2019 and \$63 million in each year from 2020 through 2022.

Considering recent trends in shelter usage by adult families without minor children, IBO expects that the city's current estimates for adult family shelter services are below the actual need. As a result IBO assumes that the city will have to provide an additional \$16 million in 2018 and \$1 million in 2019 to provide the needed services for this population. As with the funding estimates for shelter services for families with children, IBO believes the city is overestimating the federal and state contribution for adult family shelter services. IBO assumes that the city will need

to provide an additional \$7 million in 2018 to make up for overestimates in federal and state funding for adult family shelters. Similarly, we estimate that in 2019 the city will need to provide roughly an additional \$10 million each year from 2020 through 2022.

Despite continuous efforts made to stem the growth of the city's single adult homeless population, the need for single adult homeless shelter services continues to trend upwards with no indication of a decline in the near future. The city's efforts to move homeless individuals off the streets and into shelter only exacerbates the need for this type of shelter service. IBO's analysis indicates that the city underestimates the need for single adult shelter services by \$22 million in 2019, \$12 million in 2019 and \$11 million in each year from 2020 through 2022. As the state's budget does not include any increase in funding for single adult shelters to meet this increased need, IBO assumes that all additional costs associated with single adult shelters will need to be funded by the city.

Department of Education: IBO estimates the de Blasio Administration will need to provide an additional \$55 million in 2018, increasing to \$125 million by 2022 for expenses in the Department of Education (DOE). These adjustments are attributable to IBO re-estimates of charter school funding and Medicaid reimbursement revenue.

IBO's estimates of charter school enrollment exceed those assumed by the DOE for each year of the financial plan. Our projection is based on the current number of charter seats for this year and expected increases as existing charters reach their full complement of authorized grades in future years. Each additional charter school student results in a per-student payment from the DOE to the charter school. For the current year, we estimate that greater-than-expected enrollment in charter schools will cost the city an additional \$35 million. The differences between IBO's forecast and OMB's forecast of charter school enrollment widen each year, from approximately 2,400 in the current year to over 8,000 in 2022. Incorporating more realistic estimates of enrollment increases the cost to the city by nearly \$52 million in 2019, \$82 million in 2020, \$113 million in 2021, and \$125 million in 2022.

Additionally, IBO projects that DOE's estimates for Medicaid reimbursement from the federal government are overstated in the plan. In previous years IBO has questioned DOE's ability to adequately process claims for federal Medicaid reimbursement to meet the budgeted goals. While the DOE has made progress in obtaining higher levels of Medicaid

reimbursements, there are still questions regarding the department's ability to secure some of the Medicaid reimbursement the city is counting on. The city currently assumes \$20 million in each year of the financial plan for the reimbursement of Medicaid-related transportation expenses, costs that are not currently approved by the state for reimbursement. As a result, IBO's estimate of Medicaid reimbursements is \$20 million less than OMB's in both 2018 and 2019. IBO assumes that by the later years of the plan the city will eventually be able to convince the state to reimburse for these types of expenses.

Police Department: The New York Police Department (NYPD) has historically overspent its overtime budget. While the NYPD has made a concerted effort to reduce overtime, IBO expects that the current budgeted amount will still be inadequate to cover overtime expenses and that the department will require an additional \$50 million in each year of the financial plan.

IBO's analysis of state and federal grant revenue received by the department indicates that the agency will receive more funding in 2018 through 2022 than is currently reflected in the financial plan. In 2015 through 2017, the NYPD received an average of nearly \$290 million in federal funds per year. Assuming that the city will receive comparable levels of federal funding in the coming years, IBO projects an additional \$50 million in federal funds for 2018, \$175 million in 2019, and \$200 million more in federal funding for each year 2020 through 2022. Similarly we estimate that based on the recent historical average of state funding for the department, the NYPD will receive an additional \$50 million annually from 2019 through 2022.

Fire Department: The fire department (FDNY) has historically under-estimated its expenses for overtime. Based upon historical totals and current year trends, IBO estimates that the department will require an additional \$50 million in each year of the financial plan from 2018 through 2022 for overtime expenses.

As with the NYPD, the amount of federal funding received by the FDNY is typically under-estimated in the budget, particularly in the later years of the financial plan. IBO estimates that the department will receive \$50 million more in federal funding in 2018 and \$75 million more each year from 2019 through 2022. These additional funds bring federally-funded spending over the plan period more in line with the recent average of \$139 million a year.

Department Correction: As with the NYPD and FDNY, the city's Department of Correction often under estimates its

overtime expenditures. Based on historical and current year overtime usage, IBO estimates that the department will require an additional \$25 million to cover overtime expenses in each year of the financial plan.

Board of Elections: The Board of Elections (BOE) current year budget often greatly exceeds the agency's annual budget in the out-years of the financial plan. While the agency's 2018 city funds budget is currently \$141 million, its budget for each of the out-years of the plan is below \$100 million. Over the last three years the BOE averaged \$129 million of city-funds expenditures. Based on the average spending levels for previous years, IBO estimates that the agency will require an additional \$35 million in each year from 2019 through 2022.

School Bus Personnel: In 2014 the de Blasio Administration established a grant program to reverse sharp reductions in the wages of certain school bus drivers, attendants, dispatchers and mechanics. Initially the grant was intended to exist for one year and was capped at \$42 million, but funding for the program has been allocated every year since its implementation. In the Preliminary Budget, the administration once again added \$42 million for this program in 2018, but did not add funds for the remaining years of the plan. Assuming the program continues beyond 2018, IBO estimates that an additional \$42 million will be allocated to the Department of Small Business Services (SBS) in each year from 2019 through 2022.

Campaign Finance Board: The Campaign Finance Board (CFB) incurs much larger costs in citywide election years than in other years. With 2018 being a citywide election year, the Board's budget is currently \$44 million. Although the next city-wide election will occur in 2022, the financial plan for that year budgets only \$14 million for the CFB. IBO estimates that an additional \$40 million will be required in that year.

Citywide Savings Program

Over the last few years the de Blasio Administration has formalized an internal budgetary process that invites agencies to propose initiatives to save funds or raise revenues for inclusion in the Citywide Savings Program (CSP). Agencies are encouraged to generate savings by identifying efficiencies in their operations. The CSP presented in the Preliminary Budget financial plan augments the savings plan put forward last November. The February CSP identifies \$432 million of new reductions in expenditures and increased revenue for 2018 and \$469 million for 2019. The combined total of the Citywide

Savings Program across both the November and February financial plans is \$666 million in 2018, \$707 million in 2019, \$659 million in 2020, \$697 million in 2021 and \$583 million in 2022. The current savings program is considerably smaller than the program released last year. The CSP issued with the Preliminary Budget one year ago included \$2.1 billion of savings in the first two years of the financial plan, \$726 million or 53 percent more than the first two years of the current savings plan.

Based on IBO's analysis, much of the savings presented in the CSP would have occurred as part of the typical budget process and did not require any efficiency or productivity improvements by the agencies. IBO estimates that 15 percent of the total savings presented in the CSP for 2018 and 2019 are the result of such improvements (23 percent for the plan period as a whole). In contrast, 27 percent of the CSP for 2018 and 2019 results from realizing new revenue, funding swaps (primarily replacing city funds with funds from state and federal sources), and spending re-estimates. An additional 22 percent of the \$1.4 billion in savings presented for 2018 and 2019 is the result of modifications to debt service cost estimates or technical accounting adjustments.

A large share of the difference between this year's savings program and the program issued last year is attributable to reduced savings for [debt service](#). Debt service savings in the first two years of the current CSP totals \$298 million, \$603 million less than anticipated in the first two years of the CSP issued with the Preliminary 2018 Financial Plan. Debt service savings are likely to make up less of the CSP in the future as interest rates continue to rise from their recent historical lows, narrowing the spread between rates assumed in the budget and actual rates paid on city debt. In addition, recent federal tax policy changes eliminating the tax-exemption of certain advanced refunding bond issuances could affect the city's ability to utilize refundings to reduce financing costs.

Many agencies have budgeted for positions that have not or will not be filled in 2018 and 2019. The savings from not filing these positions totals over \$146 million (10.6 percent) of the total savings presented in the first two years of the current CSP.

Another \$143 million (10.4 percent) of the savings in the first two years of the CSP are the result of re-estimates of fringe benefit reimbursements to the city by the federal government. Each year the city negotiates with the federal government to set a fringe reimbursement rate for city

employees whose salaries are paid with federal funding. The city has consistently assumed reimbursement rates well below the actual rates ultimately agreed upon in the past. While agencies must actively pursue these savings each year, such diligence has long been part of the annual process of applying for federal reimbursement, rather than an example of improved productivity or efficiency.

Budgeting in Times of Fiscal Uncertainty

Based on IBO's revenue and expense estimates, the city's fiscal outlook looks manageable, with surpluses in some years of the financial plan and modest gaps in others. Moreover, the city has stockpiled reserve funds in each year of the plan as well as funds in the Retiree Health Benefit Trust. In the event of a major economic or financial disruption, massive cuts in federal aid, or the need to provide substantial new resources to affiliated entities such as NYCHA, H+H, or the MTA, these reserves would give the city a cushion to provide time for city leaders to take necessary steps to implement a combination of spending cuts and/or tax increases to bring the budget back into balance. IBO is not currently forecasting any such occurrence, but the city should always be wary of its possibility.

Labor Contracts: One of the first accomplishments of the de Blasio administration was negotiating a collective bargaining contract with the teachers union which established a pattern for settling contracts with the rest of the city workforce, all of whom had been working under expired contracts. The unions made concessions in order to secure contracts, particularly in regards to health care costs. Many of those first-term contracts are now expiring. The city has budgeted for 1 percent annual raises, while indicating that adding additional benefits such as paid parental leave would require new concessions. If the city moves away from this stance as contracts are settled, it would be necessary to find millions of additional dollars not currently budgeted.

Federal and state funding: The city's budget relies on a greater amount of funding from the state and federal governments than the total budgets of nearly half of all the states. The uncertainty surrounding this aid looms large over the city's budget. With combined federal and state aid approaching \$24 billion in the current year, even a relatively small reduction in percentage terms would cost the city many millions of dollars and/or result in the elimination of services on which many New Yorkers depend.

The current political environment in which fiscal policy makers are operating is unlike any other time in recent

memory. At the federal level serious consideration is being given to major cuts in programs relied on by many of the city's most vulnerable residents, including Section 8 housing, Community Development Block Grants, food stamps (SNAP), and Medicaid.

Meanwhile the relationship between the Mayor and Governor has become increasingly antagonistic. This year's state Executive Budget would provide less money than the city has counted on for school aid and child welfare, while proposing to shift fiscal burdens onto the city in areas such as charter school rental payments and support for the MTA.

NYCHA: The de Blasio Administration recently announced a \$200 million effort to update and replace outdated boiler systems in 20 NYCHA developments. This program was only initiated after a winter in which many residents of the city's public housing spent weeks without adequate heat and hot water. While historically NYCHA's budget has been largely funded by the federal and state governments, years of disinvestment and underfunding by all levels of government have compromised much of the agency's infrastructure. But failing boilers are only one of the many major infrastructure issues that NYCHA will face in the next few years. And in the event of catastrophic failures that endanger the safety of NYCHA residents, the city could find itself funding hundreds of millions of dollars of critical repairs.

Health and Hospitals: New York City Health + Hospitals (H+H) provide care regardless of a patient's ability to pay, relying primarily on Medicare and Medicaid to cover the cost of service provision. But these programs do not provide sufficient reimbursement to fully cover the cost of patient care, and with relatively few clients covered by private insurance, the corporation is dependent on additional subsidies, mainly from the city. Considering all sources, IBO estimates that the city provides over \$1.9

billion annually to H+H. The fiscal future of H+H is also highly dependent on the outcome of the health care debate in Washington. Recent actions by Congress, including the extension of funding for the Children's Health Insurance Program and the delay of any cuts to the Disproportionate Share Hospital payments have provided H+H with some near-term fiscal relief. But the potential for changes to the Affordable Care Act, Medicaid, and Medicare would still have major impacts on H+H's efforts to bring its revenues and expenses into balance. Any such changes could well require increased funding by the city.

MTA: The recent debate between the Governor and the Mayor over management of the city's mass transit system seeks to fundamentally alter the fiscal relationship between the various levels of government and the city's mass transit system. Historically the city's transit system has been managed by the MTA, which is an entity of the state. While MTA budgets have been supplemented by city funding, the Governor's recent budget plan calls for the city "to provide in full all funding required to meet the capital needs of the New York City Transit Authority." Had the governor's plan been in effect in 2015, when the MTA's current five-year capital plan was adopted, the city would have been responsible for at least \$16.5 billion—\$14 billion more than the city actually committed and an amount greater than the city's entire 2019 capital plan. In addition, the Governor insists that the city fund half of the MTA's \$836 million short-term emergency stabilization plan for the subway system.

ENDNOTES

¹Total citywide expenditures does not include expenses paid by one agency to another.

²IBO's estimate of additional resources resulting from the savings program does not include \$89 million of debt service savings and \$11 million of non-tax revenue enhancements.

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