ERIC C. NAUGHTON
DIRECTOR
OFFICE OF LEGISLATIVE
BUDGET REVIEW

NASSAU COUNTY LEGISLATURE
ONE WEST STREET
MINEOLA, NEW YORK 11501
(516) 571-6292

Inter-Departmental Memo

To: Hon. Judith A. Jacobs, Presiding Officer
Hon. Peter A. Schmitt, Minority Leader
All Members of the Nassau County Legislature

From: Eric C. Naughton, Director ECN
Legislative Budget Review

Date: December 21, 2007

Re: Sales Tax Downturn

In response to a request from the Presiding Officer we have prepared a report titled the Economic Factors Contributing to the Sales Tax Downturn. This report will be made available on OLBR's website, http://www.nassaucountyny.gov/agencies/OLBR/reports.html.

2007 SPECIAL EDITION

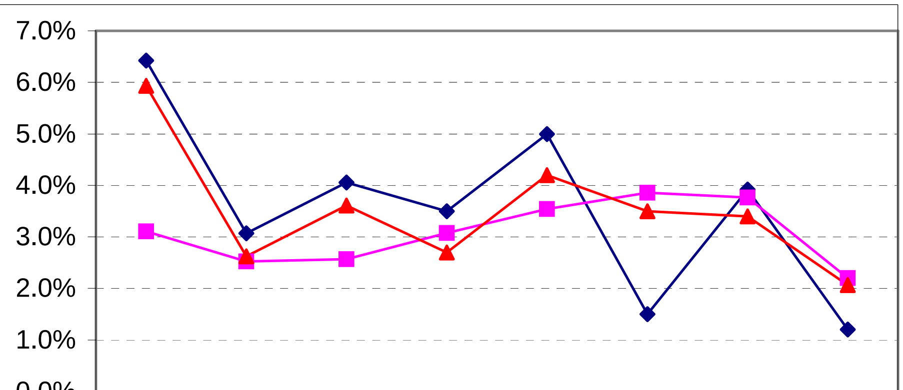
ECONOMIC FACTORS CONTRIBUTING TO THE SALES TAX DOWNTURN

NASSAU COUNTY
OFFICE OF LEGISLATIVE BUDGET REVIEW

The FY 07 sales tax budget of $1.03 billion was based on the assumption that the FY 06 budget of $995.8 million would be achieved, and that collections would grow by 3.4%. When the 2006 actual receipts of $991.1 million fell short of budget by $4.7 million, it became necessary to achieve growth of 3.9% in FY 07. Year-to-date collections have grown by only 1.2%. This report highlights the major economic factors negatively impacting the County's largest revenue source. It should be noted that historical sales tax collections have been inflated by home equity spending and substantial Wall Street bonuses. Since these revenues sources have diminished, sales tax collections have followed suit.

Historically, the growth recorded in County sales tax collections has typically exceeded the annual growth seen in the regional consumer price index, CPI, and the national gross domestic product, GDP. However, with year-to-date collections growing 1.2%, 2007 County sales tax collection growth may repeat the trend registered in 2005 when sales tax collection growth fell short of regional consumer price growth. The chart below details theses growth rates and the 2007 forecast.

Annual Percentage Change



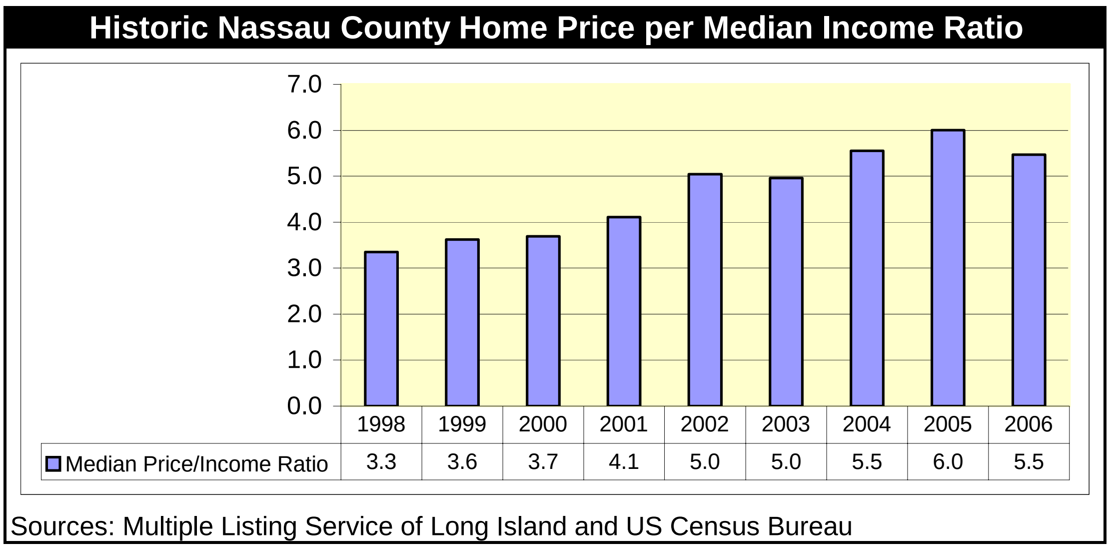
	2000	2001	2002	2003	2004	2005	2006	2007
Sales Tax Collections	6.4%	3.1%	4.1%	3.5%	5.0%	1.5%	3.9%	1.2%
Reg. CPI-U	3.1%	2.5%	2.6%	3.1%	3.5%	3.9%	3.8%	2.2%
US GDP	5.9%	2.6%	3.6%	2.7%	4.2%	3.5%	3.4%	2.1%

Sources: U.S. Bureau of Labor Statistics and U.S. Bureau of Economic Analysis

The primary factor resulting in the current sluggish sale tax collections is the slowdown in the housing market. Declining real estate values, fewer real estate transactions and increased foreclosures translate into decreased County sales tax collections. As real estate values decline, individuals have less equity to tap into for purchases. Fewer purchases result in lower sales tax collections. As real estate transactions decline, individuals make fewer new home purchases such as furniture. When purchases fall, County sales tax collections follow suit. As foreclosures rise, lending institutions are forced to take losses. When lending institutions begin to experience losses, they tighten their underwriting standards. Tighter underwriting standards make it more difficult for individuals to make purchases. As stated previously, fewer purchases translate into less sales tax collections.

Residential Housing Market

The current residential housing market correction may be seen as the primary factor leading to the economic and sales tax decline. Experts have been forecasting a substantial housing market correction for several years. Low interest rates enabled borrowers to finance larger and larger mortgages. This in turn resulted in steep home price to income ratios. According to CNNMoney.com, a rule of thumb is that one can afford to purchase a house that runs about two-and-one-half times your annual salary.[1] The chart below reveals that over the past nine years, the median home price per median income ratio has averaged 4.6 in Nassau County.



Given the steep ratios, it seems that the price level was unsustainable and a correction was inevitable. As mentioned previously, as home values decline home equity spending dries up, the number of closed transactions falls and foreclosures rise. All of these forces result in reduced consumer spending and consequently a drop in sales tax collections.

Personal Consumption

Low teaser interest rates, no-money down and no-credit check financing helped sustain the home price level and enabled home prices to out-pace income for so long. Only now as initial teaser rates adjust and individuals find themselves in foreclosure are home prices falling. As of November 2007, the Multiple Listing Service of Long Island shows that median closed home sale prices in Nassau County

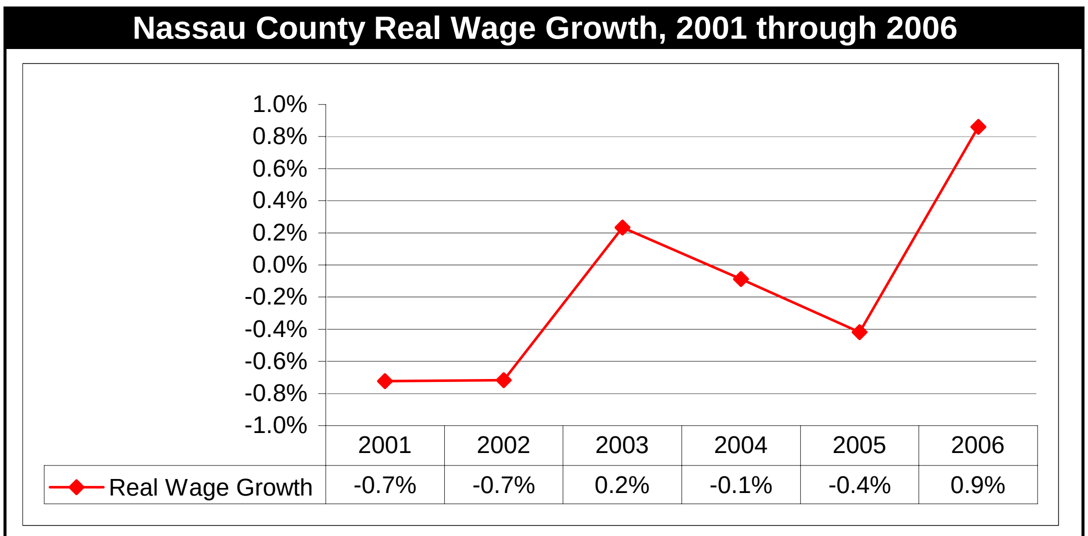
[1] "Money 101 Lesson 8: Buying a Home", CNN/Money.com.

have fallen 4.8% from the prior year. Moreover, as of August 2007, the County Clerk has seen a 13.3% drop in recorded deeds and a 13.6% drop in recorded mortgages.

The stagnation in home prices coupled with escalating mortgage payments has resulted in record foreclosure actions. According to RealtyTrac, Nassau County saw 1,241 foreclosure filings from July to September. That represented a 27.4% increase from the previous three months.[2] Not only are foreclosure actions bad for the individual home-owner who is facing financial difficulty, but they make potential buyers think twice about entering into a neighborhood. Additionally, if you are a seller, foreclosures in your neighborhood will put downward pressure on your own selling price.[3]

Real Wage Growth

Sales tax collections have been stymied by the fact that wages in Nassau County have not kept pace with inflation. The chart below shows that in four of the past six years, real wages have declined. This means that individuals have less money available to make their everyday purchases and less disposable income available for whimsical purchases. Not only has real wage growth been marginal, but Wall Street bonuses this year are expected to be smaller than those seen in 2006. Comptroller DiNapoli is predicting that 2007 Wall Street bonuses will be 10% less than those of 2006.[4]

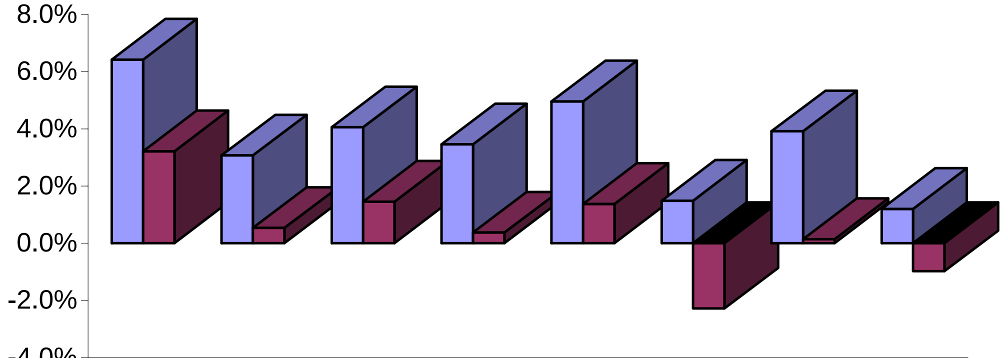


Sources: NYS Department of Labor and US Bureau of Labor Statistics

With less disposable money available for non-essential purchases, real sales tax growth is stymied. The chart on the following page reveals the historic growth rates of real sales tax collections. Viewing sales tax collections in real terms enables one to see the change in the value of purchases made since the price level is held constant. The nominal growth rate, shown below, allows both prices and quantity purchased to adjust. If current trends continue, the County is forecast to experience negative real sales tax growth in 2007.

[2] Luhby, Tami, "LI Foreclosure Rate Climbs by Double Digits", Newsday.com, November 2, 2007.
[3] Marshall, Randi F. and Tom Mc Ginty, "Home Loan Crisis Threatens LI Economy", Newsday.com, November 11, 2007.
[4] Acitelli, Tom, "So What If Wall Street Bonuses Drop 10 Percent", The New York Observer, October 31, 2007.

Annual Change in County Sales Tax Collections in Nominal and Real Terms



	2000	2001	2002	2003	2004	2005	2006	2007
nominal	6.4%	3.1%	4.1%	3.5%	5.0%	1.5%	3.9%	1.2%
real	3.2%	0.5%	1.5%	0.4%	1.4%	-2.3%	0.1%	-1.0%

Source: US Bureau of Labor Statistics

Local Area Employment Figures

As foreclosures rise and fewer real estate transactions occur, employment in industries which support the real estate market declines. As of October 2007, the number of employed residents in Nassau County had fallen 1.1% from the prior year. When fewer residents are employed, there is less disposable income available for individuals to make purchases. Thus, as employment declines Nassau County sales tax collections move in tandem.

Nassau-Suffolk Non-agricultural Employment

New York State Department of Labor figures reveal that the Nassau-Suffolk area recorded marginal positive 0.4% total non-farm job growth in October 2007. Although the increase was positive, it was substantially below the 1% mark indicative of healthy job growth. The sluggish job loss will result in diminished sales tax collections since individuals will have less money available to make purchases.

Consumer Price Indexes

US Bureau of Labor Statistics figures reveal that as of October 2007, regional gasoline prices have risen 21.2% from the prior year. Gasoline price increases result in fewer total purchases. In an attempt to decrease gasoline usage, individuals make fewer trips to the malls and this leads to fewer total purchases being made. Additionally, as gas prices rise, Nassau County receives less non-resident sales tax payments, since individuals attempt to save on gas by traveling fewer miles. The 5.5% increase in regional medical care and the 3.9% increase in regional food and beverages cost will also have the effect of crowding out disposable purchases. When there is less disposable income available for purchases, the total number of purchases decline, and County sales tax collections move in tandem.

Consumer Confidence Index

The previously detailed economic trends have caused consumers to have less confidence and shy away from making major purchases. Indeed the November 2007 Siena College Research Institute consumer confidence poll shows that regional consumer confidence has fallen 20.4% from this time last year. When individuals are unsure if they are going to have a home or job in the future, they are very hesitant to make purchases. Until consumer confidence is restored, a robust increase in County sales tax collections is unlikely. The decline in consumer confidence is currently impacting U.S. auto sales. In November, U.S. auto sales dropped 2.0%. The decline is forecast to continue in 2008. According to Fitch Ratings, U.S. light vehicles sales will decline 3.0% in 2008.[5]

Conclusion

Not only have sales tax collections stagnated, but since economists do not expect the economy to turn around soon, it is prudent to anticipate slow collections for the next few months. In fact, Martin Cantor, the Director of the Long Island Economic and Social Policy Institute at Dowling College is predicting a very poor holiday season and at least 18 months of problems in the Long Island economy.[6] If collections continue along their current trend, a $20.0 to $30.0 million deficit would result. The FY 08 sales tax budget of $1.043 billion was based on achieving 2.4% growth in FY 07, or $1.015 billion, with 2.5% growth in FY 08. With the FY 07 base falling short, even if the sales tax grows at the optimistic budgeted 2.5% rate, a shortfall of $6.0 - $16.0 million will occur.

Prepared by:
Deirdre K. Calley
Legislative Budget Analyst
Office of Legislative Budget Review
(516) 571-6295

[5] "Analysts Expect 20008 Drop in Auto Sales", Yahoo.com, December 4, 2007.
[6] Harrigan, Susan, "Local Experts: No Quick Relief Likely for Economic Slump", Newsday.com, November 9, 2007.