

ECONOMIC NOTES

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Economic Growth Tapering Off

Overview: *New York City's real gross product outpaced the nation in 2006, but the rate of growth decelerated in the second half of the year. Although Wall Street enjoyed a record year, a sluggish national economy exerted a drag on the City's economic expansion.*

· Real Gross City Product (GCP), a measure of the City's overall economic output, grew 3.6 percent in 2006, the second consecutive year in which the City outpaced the nation. The year-over-year GCP increase nearly matched the 3.7 percent gain in 2005. The local economy should get a boost from end-of-year Wall Street bonuses, but with turbulence in stock and mortgage markets, 2007 began on an uncertain note.

· Real GCP grew 1.9 percent in 4Q06, the smallest gain in three years and below the 2.5 percent U.S. rate for the quarter. The City's economic growth has been decelerating since 1Q06. Apparel manufacturing, wholesale trade, motion pictures and telecommunications are among the sectors that weakened during the year.

· NYC payroll jobs grew at a seasonally adjusted annualized rate of 0.8 percent, or 7,300 jobs, in 4Q06, as the private sector added 5,400 jobs. The pace of job growth in 4Q06 was the weakest in two years, while national job growth also slowed. For all of 2006, total NYC payroll jobs increased by 1.7 percent or 62,200, the largest annual gain since 2000. The largest job gains were in finance and insurance, professional and business services, hotels and restaurants, and health care.

· NYC's unemployment rate fell to 4.4 percent in 4Q06, the lowest since 1970 and less than the U.S. rate for the first

time since 3Q88. The number of unemployed declined by 12,300, while the number of employed residents increased by 14,100. The City's labor force participation rate rose to 59.3 percent in 4Q06, its highest since 4Q02, but remains below the U.S. rate of 66.3 percent.

· Personal income taxes withheld from paychecks rose 14.6 percent in 4Q06, compared to the three previous months. Income tax withholdings typically jump in the fourth quarter due to year-end bonuses and high seasonal employment. In the fourth quarter of 2005, income tax withholdings increased 15.0 percent.

· General sales tax collections rose 7.4 percent in 4Q06 compared to 4Q05 and were up 4.3 percent for the calendar year. Retail store employment was up 1.2 percent in 4Q06, compared to 4Q05, while employment in restaurants and bars rose 3.1 percent over the corresponding quarter of 2005.

· The Manhattan office vacancy rate fell to 6.7 percent in 4Q06, the lowest since 2Q01, according to Cushman & Wakefield, while the average asking rent in Manhattan office buildings rose to \$50.56 per square foot (psf). Commercial property values remained strong, with several office buildings selling for over \$1,000 psf.

· Manhattan apartment sales prices were down 5 percent in 4Q06 from the previous quarter, according to Miller Samuel, Inc., and were off by 0.4 percent on a year-over-year basis. Area home prices increased 0.7 percent in 4Q06, and rose 6.1 percent on an annual basis, according to OFHEO. Building permits issued for new residential units declined 14 percent in 4Q06 from a year earlier and were down 5 percent in early 2007 from the prior year.

INSIDE FOCUS:

Big City Building Boom

Summary Table. *Five Key Economic Indicators, NYC and U.S., 4Q06 vs. 3Q06 and 2006 vs. 2005*

		1. GCP/GDP Growth, SAAR	2. Payroll-Jobs Growth, SAAR	3. PIT Withheld, Growth, NSA	4. Inflation Rate, NSA	5. Unemployment Rate, SA
4Q06 vs. 3Q06	NYC	1.9% Worse	0.8% Worse	0.9% Worse	2.8% Better	4.4% Better
	U.S.	2.5% Better	1.5% Worse	8.3% Better	1.9% Better	4.5% Better
2006 vs. 2005	NYC	3.6% Worse	1.7% Better	3.2% Worse	3.8% Better	4.9% Better
	U.S.	3.3% Better	1.8% Better	8.2% Better	3.2% Better	4.6% Better

NSA: Not Seasonally Adjusted. SA: Seasonally Adjusted. SAAR: SA Annualized Rate. PIT: Personal Income Tax. Comparisons for "Better" or "Worse" are with the prior quarter.

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Building Boom Puts New York in Good Company

Summary: New York City has experienced its biggest residential construction boom in three decades. Is this just an effect of a nationwide housing bubble or is there something unique about the City's residential renaissance? An analysis of building permits in the nation's 25 largest cities shows that the City's housing construction boom is part of a broader national revival in central-city construction.

In the late 1990's, a relatively good period for New York City's economy, new residential building permits were issued at a rate of about 11,000 dwelling units per year. Then, despite a stock-market bust, a severe recession, and the 9/11 attacks, the housing production pipeline ratcheted further upwards; in the three years ending in 2002, permits for over 18,000 units were issued annually. But during the past three years, permits for new housing have soared. The number reached 31,599 in 2005, the most in over thirty years, and remained above the 30,000 unit level in 2006. Although the permit total dipped by 14 percent in the fourth quarter of 2006, they were still running at a very high level into 2007. New housing developments seemed to be rising everywhere in the City, and analysts began asking whether something fundamental had changed, or if the boom was merely the local manifestation of a nationwide housing bubble.

The Comptroller's Office analyzed residential building permits in the nation's 25 largest cities.¹ We tracked permits in the central-city jurisdictions, rather than in entire metropolitan regions, because we were particularly interested to see whether there has been a nationwide trend toward housing development in large central cities. At the beginning of the decade, those cities were home to about 33.6 million people, or 12 percent of the U.S. population.

The analysis suggests that housing development in the nation's largest central cities has indeed exhibited a resurgence during this decade and that New York has had one of the strongest revivals. The pattern among the cities is surprisingly complex, however, and the star performers are not necessarily those that intuition or basic economic indicators would lead one to expect.

Central City Comeback

Although the soaring home prices of recent years were unique in the post-war era, the concurrent national construction boom was not quite of such historic proportions. Total residential building permits topped

2,000,000 in 2004 and 2005, but did not exceed the all-time peak recorded in 1972. Actual housing starts also topped 2,000,000 in 2005, but the total of starts during the boom period of 2004-2006 fell well below the record housing construction of the 1971-1973 cycle.²

One of the distinguishing features of the recent boom, however, was the impressive revival of central-city construction. From 1997 to 2006, new residential permits in the top 25 cities nearly doubled to 179,961 units. As a share of nationwide permits issued, they increased from 6.5 percent to 9.8 percent. That is especially surprising since, given the strong price appreciation and consequent investment incentives for home ownership, construction of single-family homes has been more buoyant than multi-family housing throughout the boom. A surging demand for single-family homes would be expected to advantage suburban jurisdictions, where land is more plentiful, over central-city locations.

Table 1: New Residential Building Permits Issued in 25 Largest Cities

Year	Large City Total	US Total	Large City %
1997	93,515	1,441,136	6.49
1998	117,134	1,612,260	7.27
1999	118,810	1,663,533	7.14
2000	120,177	1,592,267	7.55
2001	128,633	1,636,676	7.86
2002	134,459	1,747,673	7.69
2003	146,673	1,889,214	7.76
2004	157,467	2,070,077	7.61
2005	179,933	2,155,316	8.35
2006	179,961	1,837,300	9.79

Source: US Census Bureau

The growing share of permits in central-city locations is not simply a statistical by-product of New York's boom (the City accounts for nearly one-quarter of the population residing in the nation's 25 largest cities). When New York is subtracted from the total, the share of national permits issued by the remaining 24 large cities still increased, from 6.9 percent in 1997 to 8.1 percent in 2006.

Similarly, it might be thought that the rising central-city share is attributable to the rapid growth of the younger sunbelt cities which have an essentially suburban

¹ Charlotte, North Carolina was excluded because current permit data were not available.

² In New York City, about 95 percent of housing permits issued eventually become construction starts. Nationally, the figure is about 97 percent. For more information on the relationship between permits and starts, go to <http://www.census.gov/const/>

character. Once again, however, the data tell a different story. The share of growth of the older of the largest cities (those cities already among the top 25 in 1940) has actually been greater than the newer group, which includes such notable growth towns as El Paso, Austin, Phoenix, and Jacksonville. The older group increased their share of the 25-city total from 41 percent in 1997 to 56 percent in 2006.

The nation's older cities, which typically experienced their most rapid growth prior to the automobile age, are generally more densely developed. New York is by far the most densely populated, measured by residents per square mile of land area. Chicago and, perhaps surprisingly, Los Angeles are also among the densest. Of the 25 largest cities, San Diego has the median population density at 3,771 residents per square mile. From 1997 to 2006, the 12 most-dense cities saw residential permit activity increase 221 percent, while San Diego and the less-dense cities saw permits increase only 45 percent. There seems to have been a general rebound of residential construction in the country's older and most densely-developed cities.

Although the recent construction surge seems to be most dramatic in the older, denser cities, it should be noted that homebuilding still occurs disproportionately in the less-dense cities. Between 2000 and 2006, housing construction permits issued in the densest cities were equivalent to 4.7 percent of their housing stock at the beginning of the period; in the less-dense cities, new construction equaled 13.3 percent of initial housing stock.

Parallel Lives

By any measure, New York's residential construction boom has been remarkable. The number of new housing units authorized more than tripled between 1997 and 2005 while the national total increased only 50 percent.

New York has not only out-performed the national trend, but that of the large-city group as well. In 1997, the City accounted for 9.6 percent of the new residential units authorized in the 25 largest cities. By 2006, its share had grown to 17.2 percent.

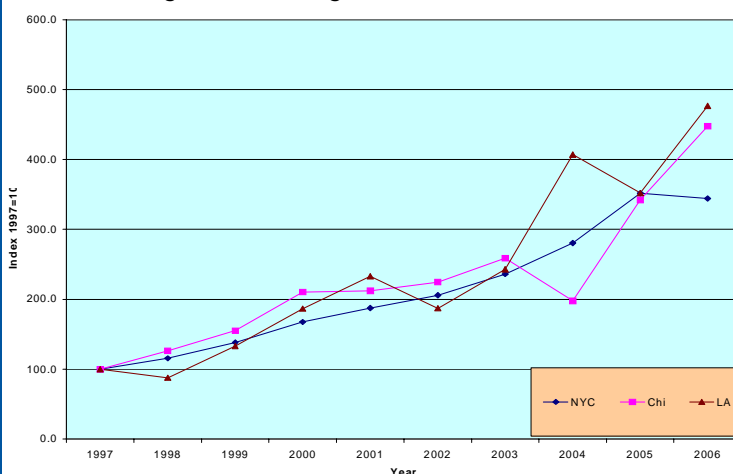
While the City's residential construction activity has been vigorous, it has not been unique among large cities. The list of cities that have had even steeper increases in residential permits includes Chicago, Boston, Los Angeles, Washington, D.C. and Baltimore. Washington, which issued permits for only 15 new housing units in 1997 (and none at all in 1996), averaged over 2,000 permits per year from 2004 to 2006. Baltimore, which issued just 22 housing permits in 1997, has averaged almost 2,500 per year throughout this decade. Even Boston, which was issuing only about 250 residential permits per year during the 1990s, soared to 2,419 in 2006.

Table 2. New York City's Share of Total Large-City Residential Permits

Year	NYC Total	Large City Total	NYC %
1997	8,987	93,515	9.61
1998	10,387	117,134	8.87
1999	12,421	118,810	10.45
2000	15,050	120,177	12.52
2001	16,856	128,633	13.10
2002	18,500	134,459	13.76
2003	21,218	146,673	14.47
2004	25,208	157,467	16.01
2005	31,599	179,933	17.56
2006	30,927	179,961	17.19

Source: US Census Bureau

Chart 1. Comparison of Residential Permit Activity in New York, Chicago and Los Angeles, 1997-2006 (Index, 1997=100)



Source: US Census Bureau: NYC Comptroller

The two cities closest to New York in size also had construction revivals that closely resembled the New York pattern. Between 1997 and 1999, Chicago issued about 4,000 residential permits per year; that number rose to 10,350 per year between 2004 and 2006. Residential construction in Los Angeles was even stronger, rising from 3,200 in the earlier period to 12,500 in the later. Chart 1 shows the similarity in the pattern of new residential permits issued in New York, Chicago and Los Angeles since 1997. Thus, it appears that while New York's construction boom has been significant, it is not fundamentally different from that experienced by its two largest counterparts.

Interpreting the Boom

There is little doubt that the nation's recent construction boom was fueled by the low interest rates enabled by mild inflation and the Federal Reserve's accommodative

monetary policy. Between April 1997 and March 2004, rates on 30-year fixed-rate mortgages fell by more than 250 basis points while LIBOR rates, to which many floating-rate mortgages are indexed, dropped by nearly 5 percentage points. The lower interest rates spurred demand for conventional homes, co-ops and condominiums while making multifamily housing construction less expensive to finance and to build. Even after the Federal Reserve began raising the federal funds rate in 2004, mortgage rates did not increase proportionately.

Since favorable interest rates prevailed nationwide, however, they can't explain the wide variation in the building permit issuance of major cities. Some cities with strong growth records, such as San Jose, San Diego, Denver, Indianapolis and Columbus, actually issued fewer residential permits between 2004 and 2006 than they did in the previous three-year period. Others, including San Francisco, Seattle and Austin, experienced only a modest increase in permits during the past three years. Local factors as well as national financial conditions apparently played a role in triggering the urban construction booms.

Table 3. Issuance of New Housing Permits in 25 Largest Cities, 1997-99 Annual Rate vs. 2004-06 Annual Rate

	Population Density	1997-99 Permits (annual average)	2004-06 Permits	Percent Change
Baltimore	8,057	92	2,087	2168.5
Washington, DC	9,316	376	2,112	461.7
Philadelphia	11,236	562	2,511	346.8
Los Angeles	7,877	3,241	12,485	285.2
New York	26,403	10,598	29,245	175.9
Fort Worth	1,829	4,288	11,475	167.6
Chicago	12,752	4,000	10,354	158.9
Boston	12,169	718	1,551	116.0
Jacksonville	971	5,327	10,702	100.9
Milwaukee	6,212	395	777	96.7
Detroit	6,852	312	603	93.3
San Antonio	2,809	7,840	12,924	64.8
Phoenix	2,782	9,612	14,325	49.0
Seattle	6,710	3,336	4,634	38.9
Nashville	1,154	3,637	4,851	33.4
El Paso	2,264	3,141	3,556	13.2
Houston	3,372	12,156	13,681	12.5
Austin	2,612	7,590	8,152	7.4
San Francisco	16,638	2,296	2,329	1.4
Denver	3,613	3,443	3,482	1.1
Dallas	3,472	6,316	6,008	-4.9
Indianapolis	2,163	5,159	3,943	-23.6
Columbus	3,381	5,465	3,838	-29.8
San Diego	3,771	5,718	3,982	-30.4
San Jose	5,117	4,202	2,848	-32.2

Note: Cities among the largest 25 in 1940 are in bold.

Source: US Census Bureau: NYC Comptroller

According to economic theory and real estate practice, investment in new housing should be affected by the local vacancy rate, the rate of residential property appreciation, the strength of the local economy, and the area's rate of population growth. A simple statistical analysis suggests that the increase in local housing permits issued from 2000 to 2006 was negatively correlated with a city's initial rental vacancy rate but positively correlated with the rate of the metropolitan area's house price appreciation. The strength of the local economic expansion, as measured by the change in a city's unemployment rate, also appears to play a role. New York has had all three factors working in its favor: a low vacancy rate, an above-average rate of home price appreciation, and an unemployment rate that has dropped significantly during the course of the present expansion. Although local population growth affects the underlying rate of housing expansion, it doesn't appear to have affected the amplitude of the recent booms.

New housing construction in a city is also affected by a host of local policies. New York City has the most aggressive affordable housing program in the country, which has contributed directly to the recent housing boom. The City's Department of Housing Preservation and Development and Housing Development Corporation have initiated the construction of over 23,000 new housing units over the past four fiscal years, accounting for over 20 percent of all new housing starts citywide.

Zoning and land use policies are among the most important regulatory factors affecting a city's construction industry. Many cities have reviewed and reformed their zoning policies in recent years, but the efforts are often complex mixtures of pro-development and preservationist objectives. Milwaukee, for example, enacted a major reform of its zoning codes in 2002, but hasn't experienced a major building boom during the past few years. Chicago implemented a comprehensive zoning reform in 2004, and housing construction subsequently surged. In New York, there has been an ongoing effort to create more opportunities for housing development by rezoning underutilized industrial areas to residential use, while at the same time strengthening rules intended to protect existing neighborhoods from over development.

The most favorable interpretation of the boom is that, because the economic environment and quality of life in New York City have improved so much, many more people are willing to pay for new housing here. Certainly, there are indicators that support that interpretation. Our analysis of big-city construction activity, however, indicates that New York's housing boom has been paralleled by other large cities. If that means that older, dense cities are enjoying a resurgence in popularity nationwide, that's good news just the same. •