MOODY'S INVESTORS SERVICE

New Issue: Moody's assigns Aa2 to $650M of NYC(NY) general obligation bonds; outlook stable

Global Credit Research - 28 Feb 2014

Ratings also affirmed on $40.8B of outstanding GO debt and $4.4B of outstanding appropriation-backed debt

NEW YORK (CITY OF) NY
Cities (including Towns, Villages and Townships)
NY

Moody's Rating

ISSUE	RATING
General Obligation Bonds, Fiscal 2014 Series I, Subseries I-1	Aa2

Sale Amount	$650,000,000
Expected Sale Date	03/05/14
Rating Description	General Obligation

Moody's Outlook STA

Opinion

NEW YORK, February 28, 2014 --Moody's Investors Service has assigned a Aa2 rating to the City of New York's $650 million General Obligation Bonds, Fiscal 2014 Series I, Subseries I-1. Proceeds of the bonds, scheduled to price on March 5, will be used to finance a portion of the city's capital plan. We have also affirmed the Aa2 ratings assigned to $40.8 billion of outstanding general obligation bonds, the Aa3 ratings approximately $4.4 billion of city appropriation-backed bonds issued through the New York City Educational Construction Fund, the New York City Industrial Development Agency, the New York City Health and Hospitals Corporation, and the Dormitory Authority of the State of New York, and the A2 ratings assigned to $3 billion of outstanding Hudson Yards Infrastructure Corporation revenue bonds. The outlook is stable.

The general obligation affirmation includes $45 million Fiscal 2004 Series A, Subseries A-6, currently weekly mode variable rate demand bonds, which are expected to be converted to fixed rate mode on March 25. It also includes $50.3 million Fiscal 2004 Series A, Subseries A-6; $100 million Fiscal 2008 Series J, Subseries J-9 and $100 million Subseries J-11. Those bonds are also currently weekly mode variable rate demand bonds and are expected to be reoffered as index rate mode bonds on March 25. After their reoffering, the bonds will bear interest at a rate equal to SIFMA plus a spread determined at pricing. If the bonds are not remarketed or refunded prior to a "step-up date" (April 3, 2017 for Subseries 2008 J-9; April 2, 2018 for Subseries 2004 A-6 and April 1, 2019 for Subseries 2008 J-11) the owners will continue to hold the bonds and the interest will increase to a step-up rate (which is graduated based on the number of days after the step-up date and cannot exceed 9%).

SUMMARY RATING RATIONALE

The ratings reflect the city's large and resilient economy, its extraordinarily large tax base, its institutionalized budgetary and financial management controls, its proactive responses to budget strain during economic downturns; its reliance on a volatile financial services sector; and a high budgetary burden from the combination of debt service, pension, and employee and retiree health care costs.

STRENGTHS

-- Exceptionally large and diverse economy driven by its position as an international center of the high income financial services industry

-- Strong governance and financial best practices, tested through periods of fiscal stress

-- Conservative budgeting that have resulted in shrinking budget gaps

CHALLENGES

-- Cyclical economic base driven by the financial services industry

-- The ongoing need to close outyear budget gaps

-- High and growing burden from debt service, pension and retiree health care costs

DETAILED CREDIT DISCUSSION

BUDGET GAPS CONTINUE TO DECREASE BUT POTENTIAL LABOR SETTLEMENT COSTS ADD FORWARD UNCERTAINTY

The city has a strong multi-year budget forecasting process that it updates quarterly and uses to identify out year budget gaps and develop plans to mitigate them. The February 2014 financial plan iteration includes updates to the current fiscal year and forecasts through fiscal 2018. Reflecting its approach to future year budget pressures, the city had closed a nearly $2 billion fiscal 2015 budget gap last fall. The new plan continues to reflect no gaps to close in fiscal 2014 of fiscal 2015. The gaps in fiscal 2016, 2017 and 2018 - $1.1 billion, $530 million and $370 million, respectively - continue to be smaller than prior estimates and are manageable given the time horizon the city has to deal with them. By comparison, annually projected gaps at the height of the economic downturn exceeded $5.5 billion.

The smaller gaps reflect the overall improvement in the city's economy and improved revenue outlook. The fiscal 2014 tax revenue forecast has been revised upwards by $890 million based on strong property tax collections (forecasted to increase by 5.5% for the year); personal income taxes that are $339 million greater than the November estimate but that are expected to decline by 5.5% compared to fiscal 2013, when they increased by 15.3%; and a one-time boost in real-estate transaction taxes of $310 million that will push fiscal 2014 growth to 30% greater than fiscal 2013. The budget also assumes $530 million in new personal income tax revenue in fiscal 2015 which would be dedicated to the new mayor's Pre-K and after school program initiatives, although passage of that tax by the state legislature is uncertain.

The fiscal 2015 revenue forecast also was revised upwards by $594 million (excluding the assumed Pre-K tax increase), reflecting $454 million more in property tax collections reflecting a 8.0% ($13.7 billion) increase in billable assessed value, and $106 million more from the personal income tax, expected to increase by 5.6%. The city has also improved its liquidity with a 72.5% increase in its ending cash balance between fiscal 2010, the lowest cash balance of the last five years, and fiscal 2013. The average daily cash balance during fiscal 2013 was $5.9 billion and the ending balance of $7.9 billion was the largest the city has recorded.

Notwithstanding revenue growth and its liquidity position, however, the city's budget gaps could increase and its ability to find balanced solutions to close them could be challenged by how it settles expired contracts with its labor unions. Depending on when and how those are resolved and what the costs are could be the source of budget strain and could create negative rating pressure.

CITY ECONOMY RECOVERS BUT FINANCIAL SECTOR EMPLOYMENT STILL LAGS

The city's economy is notably large, with 2013 real GDP that is larger than all but two US states. Its employment picture has recovered remarkably well. Private sector employment as of December 2013 is 6.3% greater than the pre-recession peak in August 2008 and it continues to increases at an annual rate of about 2.2%. By comparison, national private employment is still 0.3% lower than its pre-recession peak. Nonetheless, as city residents re-enter the labor force and seek jobs, the unemployment rate has increased. The city's unemployment rate for December was 8.1%,compared to the US rate of 6.7%.

The important financial services sector, which accounts for 11.3% of the city's employment, played a key role in helping the city regain jobs. Following three consecutive years of declines in financial sector employment in 2008, 2009 and 2010, jobs increased in 2011 by 2.5% but decreased by 0.2% in 2012 and was flat in 2013. Employment trends remain weak, however, with jobs just beginning to grow again. Employment in the securities industry sub-sector - which accounts for 20% of wages in the city - increased by 3.6% in 2011 after declining by 10.0% in 2009 and 1.9% in 2010, then declined in 2012 by 1.5% and by 0.6% in 2013. The overall number of financial services jobs is only at levels that it was in 2004 and securities employment is at 2009 levels. More positively, tourism in the city has reached record levels, with 54 million visits in 2013, 3% more than the prior year. Additionally, the city's economy continues to diversify, with strong higher education and health care sectors and a burgeoning high tech industry. Growth in those areas will continue to mitigate the volatility of finance.

HIGH FIXED COSTS FOR DEBT SERVICE AND PENSIONS

Unlike most other large cities, no separate school district or county government exists that also finance New York City's capital costs, which results in a relatively greater bonded debt load. Based on the current financial plan, fixed costs for debt service, pensions and retiree health benefits are high, estimated to reflect nearly 35% of tax revenue and 22% of total revenue in the current fiscal year. Including employee healthcare (which the city could find some budget relief by sharing the cost with employees) and certain other payments, the fixed cost ratio is higher at 49% of fiscal 2014 tax revenue and 31% of total revenue. The city's ability to control the growth of those expenses continue to be a key rating factor.

The city's four largest pension plans include the New York City Employees Retirement System (NYCERS), a multi-employer cost-sharing plan, and single-employer plans for fire, police and teachers. Reflecting those plans, the city's adjusted net pension liability, under Moody's methodology for adjusting reported pension data, is $68.9 billion, or 1.06 times operating revenues. Moody's uses the adjusted net pension liability to improve comparability of reported pension liabilities. The adjustments are not intended to replace the county's reported liability information, but to improve comparability with other rated entities.

WELL-MANAGED VARIABLE RATE AND DERIVATIVES PORTFOLIOS

New York City, through general obligation, Transitional Finance Authority (TFA) and other debt issuance vehicles uses variable rate debt as a lower interest cost alternative than fixed rate debt. Variable rate debt (reflecting general obligation, lease and TFA debt) amounts to 14% of the city's total outstanding net tax-supported debt. While that amount is sizeable, the annual interest rate risk it poses should be manageable in the context of the city's nearly $74 billion all funds budget, its strong liquidity, and the favorable terms of its bank liquidity facilities and interest rate agreements. The city has just less than $6.0 billion of general obligation variable rate demand debt outstanding, and the Transitional Finance Authority (TFA) has a total of $3.4 billion of outstanding variable rate debt. Additionally, the city has $30 million of appropriation-backed variable rate debt outstanding. Counterparty risk is mitigated through the use of a diverse array of liquidity providers: 24 banks provide liquidity support for general obligation variable rate debt and 17 support TFA variable rate demand debt. The city monitors its variable rate portfolio closely and proactively works to renew or replace expiring liquidity facilities or to convert variable rate bonds to fixed rate or other interest rate modes if necessary. More recently, in an effort to reduce its overall borrowing costs and mitigate bank exposure, the city has converted various variable demand bonds to floating rate index modes, as it is continuing to do with the current transaction. Those bonds do not have the put risk associated with demand debt but do have refinancing risk, which is manageable given the city's record of market access. The city currently has $369 million of general obligation index mode bonds outstanding and $377 million outstanding issued through TFA.

The city has 11 outstanding interest rate swap agreements associated with its general obligation bonds, with five separate counterparties, and two swaps related to city-appropriation backed debt issued through the Dormitory Authority of the State of New York (DASNY) with two counterparties. In our analysis, the swap portfolio's potential risks to the city are manageable: rating triggers that would cause the agreements to terminate early or post collateral are low, ranging between Baa1 and Baa3. As of December 31, 2013 the combined outstanding notional amount of the swaps was $1.9 billion, with a mark-to-market value of -$150.7 million.

OUTLOOK

The outlook for New York City's general obligation bonds is stable. The city's institutionalized budgetary controls and early recognition of future budget pressure help it maintain a balanced financial position and weather economic downturns. The city's economy is reliant on a volatile financial services sector, but it continues to diversify and its finances will benefit. Despite its strong budgetary controls, mounting costs for debt service, pensions and retiree health care will continue to be a challenge for the city.

WHAT COULD MAKE THE RATING GO UP

-- Sustained reduction in the growth of the city's debt burden and other fixed costs, and establishment of formal policy for managing debt within prescribed constraints

-- Improved and continuing growth in city employment and the property tax base

-- Establishment of significant formal budget reserves to buffer the inherent volatility of the financial services sector

WHAT COULD MAKE THE RATING GO DOWN

-- Inability to manage rapidly rising costs in non-discretionary spending such as debt service, personnel costs, or pensions

-- Divergence from the city's well-established fiscal practices

-- Emergence of significant liquidity strain and the need for large cash-flow borrowings

RATING METHODOLOGY

The principal methodology used in rating the general obligation bonds was US Local Government General Obligation Debt published in January 2014. The additional methodology used in the appropriation-backed bonds was The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations published in December 2011. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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