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New York City; General Obligation

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New York City; General Obligation

Credit Profile		
US$650.0 mil GO bnds subseries I-1 ser 2014I-1 due 03/01/2039		
Long Term Rating	AA/Stable	New
US$45.0 mil GO rmktd 3/25/2014 to fixed rate bnds subseries A-6 ser 2004A dtd 03/25/2014 due 08/01/2027		
Long Term Rating	AA/Stable	New
New York City GO		
Long Term Rating	AA/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AA' long-term rating to New York City's fiscal 2014 series I, subseries I-1 fixed rate general obligation (GO) bonds and affirmed its 'AA' long-term rating on the city's existing GO debt. At the same time, Standard & Poor's also assigned its 'AA' long-term rating to $45 million of the city's fiscal 2004 subseries A-6 bonds, which we understand will be converted to the fixed-rate mode in March 2014 under a new CUSIP. The outlook on all ratings is stable.

The city's faith, credit, and unlimited ad valorem pledge secure the bonds. Bondholders benefit from the security of the general debt service fund established by state statute, with city real estate tax revenue deposited into the fund and retained under a statutory formula in an amount sufficient to cover debt service.

Officials plan to use series I-1 proceeds for various capital purposes. We understand that concurrently with these bonds, the city also plans to sell approximately $100 million in variable-rate GO bonds and convert the following series and approximate par amounts to the index-rate mode from the adjustable-rate mode: $50.25 million fiscal 2004 subseries A-6; $100 million fiscal 2008 subseries J-9; and $100 million fiscal 2008 subseries J-11.

The 'AA' rating reflects our assessment of the following factors for New York City:

- Strong economy; New York City's economy is broad and diverse, given its status as the nation's largest city and economic center;
- Adequate budgetary flexibility, given limitations on the city's ability to maintain general fund reserves under the Financial Emergency Act, offset by the city's historical trend of using surplus to prepay subsequent years' expenditures;
- Adequate budgetary performance based on fiscal 2013 operations and the city's projections pursuant to its long-term financial plan;
- Very strong liquidity when highly liquid investments and exceptional access to external support are considered;
- Very strong management conditions, given the city's well-established policies and practices;
- Very weak debt and contingent liability profile pressured by significant unfunded pension and other postemployment benefit (OPEB) liabilities; and
- Very strong Institutional Framework.

Outlook

The stable outlook reflects what we view as New York City's deep and diverse economy and status as the nation's largest employment center. Strong and tested financial management policies and practices further support the rating. We view these factors, together with the city's very strong liquidity position -- but offset by its very weak debt and contingent liability profile -- as stable over the two-year outlook horizon. We believe that the new administration could have either a positive or negative effect on these factors if it pursues significant structural changes, particularly with respect to the city's significant fixed cost burden and open collective bargaining agreements. Upward rating potential is limited to one notch given New York City's very high debt burden, but could occur based on strong and concrete evidence of structural improvement in the city's general and governmental fund positions. Conversely, downward rating pressure could stem from weaker structural alignment and diminished budgetary flexibility, although we view this as unlikely due to New York City's track record of budgetary balance.

Strong Economy

With an estimated population of 8.17 million residents, New York City is the most populous city in the nation, and continues to grow. Its major employment sectors continue to comprise trade, financial activities, professional services, education, health services, and government. New York City's per capita effective buying income is 103.3% of the national average, while market value per capita is $101,848.

The financial sector continues to play a major role in the city economy, representing 27.3% of total city wages and 11.3% of total employment in 2012. New York City's unemployment rate averaged 9.4% in 2012, which was higher than both state and national rates, but decreased to 8.5% in 2013. Year-to-date data through December 2013 suggest that the city's labor force totaled 4.04 million, an increase of approximately 0.8% from December 2012.

Contrary with national economic trends, the full value of New York City's taxable real estate has increased in each of the past four fiscal years, to $901.4 billion in 2014 from $725.0 billion in fiscal 2010, with fiscal 2015 projected to show additional growth. Assessed values have also increased, reflecting a broadening of New York City's property tax base. Personal income and retail sales growth have also benefitted the city's revenue base since the start of the recession, with personal income rebounding to pre-recession levels at $472.3 billion in 2012 and taxable retail sales at $34.6 billion in 2011. When all taxable purchases (including retail, utility and communication sales, services, manufacturing, and other sales) are considered, collections have exceeded their pre-recession highs, at $116.3 billion in 2011 (the most recent data available).

Adequate Budgetary Flexibility

In our opinion, the city's budgetary flexibility is adequate due to the Financial Emergency Act's limits on maintaining reserves from current year revenue, which translates to zero dollars in available general fund balance. In response, New York City has historically used its excess surplus in the fourth quarter each year to prepay subsequent years' expenditures (primarily debt service). Fiscal 2013 contributions totaled $2.8 billion, or 4.3% of audited general fund expenditures, despite payment of Superstorm Sandy-related expenses during the year, compared with $2.5 billion in fiscal 2012. We view these prepayments as a form of reserve balance. As a result, a significant reduction in prepayments could put downward pressure on the rating.

We believe that, despite statutory limitations on its major revenue sources, New York City retains a degree of additional budgetary flexibility based on its track record of receiving state legislative approval for proposed revenue increases. In our opinion, legislative approval has proven to be a lower hurdle than direct voter approval. In addition, we believe that the city has historically made these revenue requests sparingly and, as a result, demonstrated success in obtaining legislative approvals, or otherwise making adjustments where necessary. We believe that Mayor de Blasio's fiscal 2015 budget will provide an early test of the new administration's ability to obtain legislative support for its agenda: The proposed budget includes a personal income tax increase of 0.534% for households earning more than $500,000 per year (estimated to add $530 million per year in revenue) dedicated to universal pre-kindergarten education.

Adequate Budgetary Performance

We consider New York City's budget performance adequate, with nearly balanced general fund operations in 2013 and a slight surplus of 1.9% in total governmental funds (after reimbursements to the New York City central treasury for capital expenditures). Audited financial statements showed 5.5% budget growth due, in large part, to increases in federal grant spending. Tax receipts increased by 8.6% from the previous year, reflecting a strengthening in the local economy. The results also take into account nearly $2.8 billion in expenditure prepayments. The city's history of making midyear adjustments based on budget performance data has helped to ensure operational balance, in our view.

Overall, we consider New York City's revenue stream diverse, albeit with the aforementioned statutory limitations. Historically, real property taxes represent the single largest share of city revenue (27% in 2013), followed by state and federal aid (including education aid) at 29%, and other taxes (primarily personal income taxes, business and franchise taxes, and sales tax) at a combined 38%. The city is at 95.8% of its constitutional ad valorem taxing margin, though debt service is exempt from the limit.

New York City's adopted fiscal 2014 expense budget totals $69.9 billion, about 3.6% lower than the fiscal 2013 budget. It represents the 34th consecutive budget that is balanced under generally accepted accounting principles (GAAP), except for the application of Governmental Accounting Standards Board (GASB) Statement 49. Fixed-cost spending (noncontrollable spending), which includes pension, health care, and Medicaid, rose by $2.0 billion. In our view these programs remain a significant, rising, and ongoing cost pressure that, absent changes, will test New York City's ability to balance operations in the future. The budget did not include any tax increases. Based on the financial plan forecast provided to the control board in February 2014, officials anticipate $1.77 billion in fiscal 2014 budget stabilization contributions (2.3% of projected expenditures), consisting of $970 million in discretionary transfers to the general debt service fund and an $800 million Transitional Finance Authority grant for debt service in 2015. This is an increase of $1.63 billion since the start of the fiscal year, but less than the $2.8 billion provided by the fiscal 2013 budget stabilization and discretionary transfer. Projections also show maintenance of $1 billion in the retiree health benefits trust fund, which was previously budgeted to be drawn down in fiscal 2014 for healthcare contributions.

In February 2014, Mayor de Blasio released his preliminary fiscal 2015 budget and financial plan. In addition to the tax increase for universal pre-kindergarten education, it assumes the use of $1.77 billion in fiscal 2014 prepayments but maintains the $1 billion balance in the Retiree Health Benefits Trust Fund.

The city's current four-year financial plan, submitted annually to the control board as required by the Financial Emergency Act and the City Charter, includes capital, revenue, and expense projections, and outlines proposed gap-closing programs for years with projected budget gaps. A pattern of current-year balance and projected subsequent-year budget gaps has been consistent through the entire period since 1982. The February modification projects balanced operations for fiscal years 2014 and 2015, and gaps of approximately $1 billion and $530 million in fiscal years 2016 and 2017, respectively. These gaps are reduced from those projected in the November 2013 financial plan, which showed projected gaps of approximately $1.5 billion and $951 million for fiscal years 2016 and 2017, respectively.

We believe that the plan contains some risks, including the following:

- Collective bargaining agreements could place significant pressure on expenditures in light of the city's already sizable pension and OPEB burden, given that all of the city's approximately 150 units covering more than 300,000 workers are out of contract, and the mayor has indicated that retroactive settlements (going back as far as 2008) are a possibility;
- The federal regulatory and budgetary environment, while stabilizing, remains uncertain. Of particular note are tax reforms and banking regulations (given Wall Street's contributions to the city and state's revenue base) that could affect taxable revenue;
- The city's reliance on the state legislature for funding (especially with respect to education) and revenue-raising capacity to fund out-year gaps. In addition, state and federal funding could also be reduced if a teacher evaluation system is not implemented;
- Despite the recent recovery, the pace of economic growth remains uncertain;
- Although final costs and revenue implications associated with Superstorm Sandy are not fully known at this time, New York City appropriated $500 million in capital funds for schools and hospitals damaged by the storm and an additional $500 million for emergency repairs. The financial plan assumes that those costs are fully funded from non-city sources. Officials estimate damage to city property, including that operated by the New York City Housing Authority and the New York City Health and Hospitals Corp., is about $4.5 billion. We expect that management will make short- and long-term financial plan adjustments related to the storm.

Despite these risks, we believe that the city has a demonstrated history of adapting its budgets to achieve balance through difficult economic cycles.

Very Strong Liquidity

We view New York City's liquidity position as very strong, with total governmental cash and liquid investments representing 12.3% of total governmental fund expenditures in fiscal 2013, and 124% of debt service. Furthermore, we believe that due to New York City's revenue diversity, the city maintains a robust and predictable cash flow with at least $3 billion in cash receipts coming in the door each month. In addition, New York City has demonstrated that it has exceptional access to capital markets based on its frequent debt issues backed by multiple security types.

Very Strong Management Conditions

We view New York City's management conditions as very strong, with strong policies and practices. These practices include detailed long-term financial plans that are shared with the public, annual audit reports, and frequent reporting to the city council and state authorities. We believe that these practices are strong, well embedded, and sustainable over the long term.

Very Weak Debt And Contingent Liabilities Profile

In our opinion, New York City's debt and contingent liabilities profile is very weak, when the city's significant and rising pension and OPEB costs are considered, especially given that officials do not currently have a formal plan in place to address these liabilities. Total governmental funds debt service represented 9.9% of governmental funds expenditures in 2013, while net direct debt was 99% of total governmental funds revenue.

New York City maintains a number of pension systems that provide benefits for its employees and employees of various independent city agencies. These systems combine features of a defined benefit pension plan with those of a defined contribution plan. As of June 30, 2012, plan membership for the five major New York City retirement systems was approximately 372,000 active employees and 313,000 retirees and beneficiaries. As of fiscal 2013, the funding status of the city's pension systems has been reported using the "entry age actuarial cost method." Under this method, the unfunded liability was approximately $72 billion, the result being a 60.7% funded ratio for the pension systems.

The assumed investment rate of return is 7%, with investment gains and losses phased in over six years. In 2013, the pension funds realized a 12.12% investment gain compared with 1.37% for fiscal 2012. The February 2014 financial plan projects pension expenses for fiscal years 2014 through 2018 at $8.2 billion, $8.2 billion, $8.3 billion, $8.4 billion, and $8.6 billion, respectively. Pension costs for fiscal 2013 totaled $9.46 billion, or 14% of general fund expenditures, an increase of more than 600% since fiscal 2002. Although New York City projects an annual leveling of these costs in fiscal years 2014 and 2015, it demands a larger share of tight budget resources.

New York City's net OPEB obligation at June 30, 2013, was substantial in our view, at $92.5 billion. The annual OPEB cost in fiscal 2013 was $5.5 billion, of which the city paid 21.6%. The Retiree Health Benefits Trust Fund currently maintains a balance of $1 billion for future benefit payments..

Very Strong Institutional Framework

The Institutional Framework score for New York City is very strong reflecting the demonstrated success of the state's ad hoc, but tested, support mechanisms during the city's past periods of fiscal stress. (See the "Institutional Framework Overview: New York Local Governments," published Sept. 12, 2013.)

Related Criteria And Research

Related Criteria

USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Institutional Framework Overview: New York Local Governments, Sept. 12, 2013