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New York City; General Obligation; Joint Criteria

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Credit Profile		
US$850.0 mil GO bnds fisca 2014 ser J&K due 08/01/2036		
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 J and K fixed-rate general obligation (GO) bonds. At the same time, Standard & Poor's affirmed its 'AA' long-term rating on the city's GO debt. The outlook 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 proceeds to refund various bond series for interest rate savings.

The 'AA' rating reflects our view of New York City's:

- Strong, broad, and diverse economy, given its status as the nation's largest city and economic center;
- Adequate budgetary flexibility through fiscal 2014 despite limitations on the city's ability to maintain general fund reserves under the Financial Emergency Act, offset by its historical trend of using surplus to prepay subsequent-year expenditures;
- Adequate budgetary performance, based on fiscal 2013 operations and the city's projections for a decreased fiscal 2014 prepayment and increased gaps in the city's financial plan based on the outcome of union negotiations (though the gaps are still at or below historical averages);
- Very strong liquidity when considering highly liquid investments and exceptional access to external support;
- Very strong management conditions given the city's well-established policies and practices;
- Very weak debt and contingent liabilities profile, pressured by significant unfunded pension and other postemployment benefit (OPEB) liabilities; and
- Very strong institutional framework.

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 projected per capita effective buying income is 106.2% of the national average while market value per capita is $108,279 based on the 2014 market value.

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 8.8% in 2013--exceeding both the state and national rates--but down from 9.4% in 2012. The city's labor force totaled 4.08 million in 2013, a 0.7%

increase from 2012.

Contrary to national economic trends, New York City's full taxable real estate value 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 benefited the city's revenue base since the start of the recession, with personal income rebounding to pre-recessionary levels at $472.3 billion in 2012 and taxable retail sales at $41.4 billion in 2012. When considering all taxable purchases (including retail, utility and communication sales, services, and manufacturing), collections exceed their pre-recession highs, at $126.2 billion as of fiscal 2012 (the most recent date available).

Adequate budgetary flexibility

In our opinion, the city's budgetary flexibility is adequate. The Financial Emergency Act limits the city's ability to maintain reserves from current-year revenue, translating into zero dollars in available general fund balance at year end. In response, New York City has historically used its surplus in the fourth quarter of each year to prepay subsequent-year 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.

The city is currently projecting a $1.2 billion reduction in the fiscal 2014 prepayment of subsequent-year expenditures to $1.6 billion, representing 2.1% of expenditures. The reduction is due, in large part, to the city's recognition of restructured payments to retirees based on the ratified United Federation of Teachers (UFT) contract, which accelerated $725 million of payment recognition to fiscal 2014 in accordance with generally accepted accounting principals. We understand that the funds will be set aside in a labor reserve fund.

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 a lower hurdle than direct voter approval. In addition, we believe the city has historically made these revenue requests sparingly and, as a result, demonstrated success in obtaining legislative approvals or otherwise making adjustments when needed. While the state did not agree to Mayor de Blasio's proposed tax increase of 0.534% for households earning over $500,000 per year, it did provide funding for the city's universal pre-kindergarten initiative, which we believe supports this assessment.

Adequate budgetary performance

We consider New York City's budgetary performance adequate, with nearly balanced general fund operations in 2013 and a slight, 1.9% surplus 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 local economy. The results also factor nearly $2.8 billion in expenditure prepayments. The city's continued utilization of midyear adjustments based on budget performance data also helped to ensure operational balance, in our view.

Based on the May 2014 financial plan forecast provided to the control board, officials anticipate a $1.2 billion reduction in the fiscal 2014 budget-stabilization contribution to $1.64 billion, reflecting the recognition of certain contract settlement costs. The 2014 prepayment consists of $274 million in discretionary transfers to the general debt service fund and a $1.36 billion Transitional Finance Authority grant for debt service in 2015. This is an increase of $1.5 billion since the start of the fiscal year but $1.2 billion less than the $2.8 billion provided by the fiscal 2013 budget stabilization. Projections also show the city replenishing the full appropriated balance of the retiree health benefits trust fund.

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

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 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 shared with the public, annual audit reports, and frequent reporting to the city council and state authorities. We believe 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 considering its significant pension and OPEB costs, especially given that officials do not currently have a formal plan in place to address the OPEB liability. Total governmental funds debt service represented 9.9% of governmental funds expenditures in 2013, while net direct debt is 102% of total governmental funds revenue. Amortization is average, with just under 50% of debt retiring in 10 years. We estimate overall net debt at 8.4% of market value.

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, including 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 is approximately $72 billion, resulting in 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 May 2014 financial plan projects the city's pension expenses for fiscal years 2014 through 2018 at $8.27 billion, $8.35 billion, $8.45 billion, $8.55 billion, and $8.72 billion, respectively. The city's share of pension costs in fiscal 2013 totaled $8.18 billion, or 11% of governmental fund expenditures, an increase of over 400% since fiscal 2002. Although New York City projects an annual leveling of these costs in fiscal 2014 and 2015, it demands a larger share of tight budget resources.

New York City's net OPEB obligation as of June 30, 2013, was substantial, in our view, at $92.5 billion. The annual fiscal 2013 OPEB cost was $5.5 billion, 21.6% of which the city paid. The Retiree Health Benefits Trust Fund currently maintains a $1.4 billion balance. The city's combined pension and OPEB contributions in fiscal 2013 totaled $10.2 billion, or 14.7% of governmental expenditures. We believe that this represents a substantial share of the city's budget and remains a source of pressure. While the city is fully funding its annual required pension contribution, OPEB costs are funded on a pay-as-you-go basis. Although the health plan modifications could lead to a slight reduction in the OPEB liability, we believe that liability will remain substantial given the level of benefits provided, coupled with volatility in health care costs unless further action is taken.

Very strong institutional framework

The Institutional Framework score for New York City is very strong, reflecting demonstrated success of the state's ad hoc, but tested, support mechanisms during the city's past periods of fiscal stress.

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 believe these factors, together with the city's very strong liquidity position -- but offset by its very weak debt and contingent liability profile – will be stable over the two-year outlook horizon. In our view, while the city's projected budget gaps are growing based on the outcome of the UFT settlement and patterned bargaining with its other major units, the city now has an element of certainty in its financial plan that it lacked in the past, when labor settlements and associated wage and benefit increases were unknown. While we believe that the settlement payments, which will reach $4.6 billion on a gross basis ($2.0 billion on a net basis) in 2018 will be a real pressure on future-year budgets, as reflected in the city's gap projections, the city's history of conservative financial projections and ability to close projected budget gaps partly mitigate the pressure.

However, we believe that a downturn in the local economy or increased expenditure pressure based on the new administration's agenda could lead to a structural misalignment, including a reduction in the city's flexibility, putting downward pressure on the rating. Upward rating potential is limited to one notch given New York City's very high debt burden but would be possible with strong, concrete evidence of structural improvement in the city's general and governmental funds.

Collective Bargaining Agreements

Collective bargaining settlements are contributing to increased financial plan gaps although gaps remain consistent with historical averages. The UFT recently ratified a nine-year settlement with the city for Nov. 1, 2009 through Oct. 30, 2018. The settlement includes restructured pay increases of 4% for fiscal years 2010 and 2011, which the city and the UFT have agreed to structure as lump-sum payments of 12.5% in fiscal 2016, 12.5% in fiscal 2018, and 25% in each of fiscal years 2019 through 2021 (beyond the financial plan period), as well as a phase-in of 2% base increases in fiscal years 2015 through 2018. The gross cost of the lump-sum payments in the city's financial plan is $2.2 billion. In addition, the city also provided increases of 0%, 1%, 1%, 1%, 1.5%, 2.5%, and 3% for the fiscal 2012 through 2018 period. While health care contributions were not part of the deal, the UFT did agree to cumulative health care savings of $1.1 billion through plan modifications. The savings are subject to binding arbitration if they are not realized by their target dates, which provides a level of certainty in the city's projections.

The city is using patterned bargaining for the remaining unsettled union contracts, most of which received the two 4% increases between 2008 and 2010 and which have already agreed to health care savings with the Municipal Labor Committee of an additional $2.3 billion for total savings of $3.4 billion across the entire workforce. The pattern and health care savings have been incorporated into the city's current financial plan, covering fiscal years 2014 through 2018 although the 2019 through 2021 costs will be recognized in future plans.

The gross effect of the agreements is an increase of $13.6 billion over the five-year plan ($1.96 billion in 2014, $1.443 billion in 2015, $2.62 billion in 2016, $2.92 billion in 2017, and $4.6 billion in 2018). After netting out health savings ($3.4 billion), the use of the city's stabilization fund ($1 billion), and the labor reserve built into the existing financial plan ($3.5 billion), the net impact of the agreement decreases to $5.65 billion ($1.83 billion in savings in fiscal 2014, $326 million in 2015, $1.24 billion in 2016, $890 million in 2017, and $2.01 billion in 2018).

In our opinion, the settlements represent substantial cost increases for the city over previous estimates in its long-range plan. However, in our view, the agreements substantially reduce the plan's uncertainty, which we believe has been a major risk factor in the past. In addition, while future-year gaps represent a significant increase over those presented in the February plan, we believe that there is less risk in the city's ability to meet these targets given the certainty over the labor contracts. We also believe that the city has a long history of conservative forecasting (e.g., economic growth rates are projected below those of the overall U.S. economy despite the city experiencing a softer recession than much of the rest of the nation). The conservative assumptions, coupled with the city's history of closing out-year gaps, provide some degree of rating stability. However, we believe that a number of factors could pressure the city's ability to close those gaps, including a reversion in economic growth forecasts, additional mayoral initiatives, or an unwillingness to make midyear adjustments to address current-year gaps.

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

Ratings Detail (As Of June 5, 2014)		
New York City GO bnds subseries I-1		
Long Term Rating	AA/Stable	Affirmed

Ratings Detail (As Of June 5, 2014) (cont.)		
New York City GO fiscal 2004 sub ser A-6		
Long Term Rating	AAA/A-1	Affirmed
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
New York City 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	Affirmed