MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aa2 to $900M of NYC GO bonds; outlook stable

Global Credit Research - 09 Mar 2015

$39.8 billion of GO debt outstanding

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

Moody's Rating

ISSUE		RATING
General Obligation Bonds, Fiscal 2015 Tax-Exempt Bonds, Series C		Aa2
Sale Amount	$750,000,000	
Expected Sale Date	03/12/15	
Rating Description	General Obligation	
General Obligation Bonds, Fiscal 2015 Tax-Exempt Bonds, Series D		Aa2
Sale Amount	$50,000,000	
Expected Sale Date	03/12/15	
Rating Description	General Obligation	
General Obligation Bonds, Fiscal 2015 Taxable Bonds, Series E		Aa2
Sale Amount	$100,000,000	
Expected Sale Date	03/12/15	
Rating Description	General Obligation	

Moody's Outlook STA

NEW YORK, March 09, 2015 --Moody's Investors Service has assigned Aa2 ratings to the City of New York's $750 million General Obligation Bonds, Fiscal 2015 Series C, $50 million Series D and $100 million Series E. The bonds are scheduled to price March 12.

SUMMARY RATING RATIONALE

The rating reflects 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, the key but diminishing role of the volatile financial services sector, and a high budgetary burden from the combination of debt service, pension, and employee and retiree health care costs.

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, high 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

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

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

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 well-established fiscal practices

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

STRENGTHS

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

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

-- Strong liquidity

CHALLENGES

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

-- Cyclical economic base driven by the financial services industry

-- Ongoing need to close out-year budget gaps

DETAILED RATING RATIONALE

RECENT DEVELOPMENTS

The preliminary budget released February 9 continues to reflect notably smaller budget gaps than in recent years, even after the costs of recent labor settlements. The new plan reflects budget gaps in fiscal years 2017 through 2019 of $1.0 billion, $1.4 billion, and $2.1 billion, respectively, or a manageable 1.8%, 2.3% and 3.3% of city funds revenue.

REVENUE GENERATING BASE

New York City's economy is notably large, with real GDP in 2013 larger than all but four US states. The city's labor market has recovered remarkably well. Private sector employment as of January 2015 was 10.9% greater than the pre-recession peak in August 2008 and between 2013 and 2014 it increased by 3.3%. By comparison, national private employment has recovered more slowly, now 2.8% higher than its pre-recession peak. The city's unemployment rate had remained high as residents re-entered the labor force to seek jobs, but it has decreased in recent months, to 7.1% in January compared to the US rate of 5.7%.

The important financial services sector, which accounts for 10.9% of the city's employment, played a key role in helping the city regain jobs following the early 2000s recession, but employment performance more recently is lackluster. Jobs in the sector are just beginning to grow again, but remain weak in the securities industry sub-sector - which accounts for nearly 19% of wages in the city (see Exhibit 2). The overall number of financial services jobs is only at levels that it was in 2005 and securities employment is at 2009 levels. More positively, tourism in the city has reached record levels, with 56.4 million visits in 2014, 4% more than the prior year, and which the city's tourism bureau estimates generated $9.7 billion in tax revenue. 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 and as employment continues to diversify, dependence on securities wages is decreasing.

Similar to the size of the city's economy overall, New York's real property tax base is the largest of any US city, with a fiscal 2014 full value of $989 billion. State law that limits the amount of real property tax that a municipality may levy in any year do not apply to New York City.

FINANCIAL OPERATIONS AND POSITION

Amid strong fiscal 2014 ending budgetary results, the city has taken active measures to increase its budgetary reserve position. In a prior update to its financial plan, the city reversed the planned use of $1 billion from the Retiree Health Benefits Trust Fund, a fund for prepaying OPEB expenses that effectively serves as a rainy day fund. The enacted fiscal 2015 budget adds an additional $864 million to the fund, bringing its balance to $2.4 billion or 3.4% of city-funds revenue. The city also increased its General Reserve from $300 million to $750 million, or 1% of the total budget. Even with adding to reserves, the city's GAAP-basis available fund balance of 6.1% of revenue is low compared to the Aa2 large local government median of 12.3%

Starting last May the city announced a new contract agreements with its labor unions that include retroactive 4% pay increases each for 2009 and 2010 for employees who remain with the city during fiscal years 2015-2021 and for retirees during that period, which will be paid between fiscal 2016 and fiscal 2021. The contract also includes a 10% total base wage and salary increase through fiscal 2018 and a $1,000 per employee "ratification bonus". Since then, nearly every civilian bargaining unit has settled with the same terms. In recent months, the city has also settled with its uniformed superior officers unions and with the police sergeants; rank and file police officers and fire fighters remain unsettled.

The city has a history of "pattern" bargaining in which for the total net costs of the first contract settled in a round of bargaining set the pattern, or maximum cost, for the others in that round, and the financial plan assumes that outstanding civilian and uniformed contract settlements will reflect those already settled. Including amounts that already had been reflected in the city's financial plans as a "labor reserve", the city estimates that when the same pattern settlement is applied to all municipal workers the net cost is $9.2 billion through fiscal 2018. That net figure reflects the use of $1 billion from the Health Stabilization Fund that offsets healthcare premium costs for employees, in addition to savings anticipated from agreements between the city and labor to reduce employee healthcare costs by $3.4 billion between fiscal 2015 and 2018. Although the city has negotiated the right to enforce the health savings through arbitration, there could still be roadblocks to reaching its targets in the years and amounts it expects, although we note labor's overall agreement to the targets and provisions that would share savings greater than $3.4 billion between labor and the city as an inducement to work towards the targets.

Finally agreeing to what those costs are and incorporating them into the city's budget is significant because personnel costs drive city spending: salaries and wages average 31% of the city's total budget, while total personnel costs, which include pension contributions, fringe benefits such as employee and retiree health care and social security contributions, average 55% of total revenue.

Liquidity

The city's liquidity position has been strong in recent years and it continues to strengthen. Ending cash balances increased by 114.1% between fiscal 2010 (the lowest cash balance of the last five years) and fiscal 2014. The fiscal 2013 average daily cash balance and ending balance had been the largest the city had ever recorded, but fiscal 2014 outperformed: the $7.8 billion average daily cash balance was $1.8 billion greater than 2013 and the ending cash balance of $9.9 billion was $2 billion more. In the last several years, the city's net cash as a percentage of operating revenue has trended just lower than the median level for cities with populations greater than 500,000, but was greater in fiscal 2014. City cash balances year-to-date in fiscal 2015 continue to be higher than the prior year, even after making most of the various retroactive raise payments and ratification bonus payments required by the recently settled labor contracts.

DEBT AND OTHER LIABILITIES

Debt Structure

New York City, through general obligation, Transitional Finance Authority (TFA) and other debt issuance vehicles uses variable rate debt to lower its borrowing costs. 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 is manageable in the context of the city's $75 billion fiscal 2015 all-funds budget, its strong liquidity, and the favorable terms of its bank liquidity facilities and interest rate agreements. The city has $5.4 billion of general obligation variable rate demand debt outstanding, and the Transitional Finance Authority (TFA) has a total of $3.2 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: 20 banks provide liquidity support for general obligation variable rate debt and 20 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 the city must refinance them at specific dates or interest rates will step up to higher levels; those risks are manageable given the city's record of market access. The city currently has $1 billion of general obligation index mode bonds outstanding and $371 million outstanding issued through TFA.

Debt-Related Derivatives

The city has 9 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, 2014, the combined outstanding notional amount of the swaps was $1.9 billion, with a mark-to-market value of -$168.0 million.

Pensions and OPEB

Unlike most other large cities, no separate school district or county government exists that also finances New York City's capital costs, which results in a relatively greater bonded debt load when compared to similarly-rated local governments: New York City net debt as a percentage of full value is 8.0% compared to 3.1% for Aa2-rated large local governments, although unlike most property-tax dependent local governments, New York City's revenue base includes personal income taxes, sales taxes and other taxes. Based on the current financial plan, fixed costs for debt service, pensions and retiree health benefits (OPEB) are high, equal to 33% of fiscal 2015 estimated tax revenue and 21% of total revenue.

The city's pension system includes three multi-employer cost-sharing plans (the New York City Employees Retirement System, Teachers Retirement System, and Board of Education Retirement System), and separate plans for fire and police. The city's shares of the multi-employer plans is 55.5%, 97.3% and 99.9%, respectively. Reflecting those plans, the city's fiscal 2014 Moody's-adjusted net pension liability (ANPL) is $98.5 billion, or 1.36 times operating revenues. Moody's adjustments improve comparability of reported pension liabilities, but the adjustments are not intended to replace the city's reported liability information. In 2012, the New York City Retirement Systems reduced the assumed investment rate of return to 7.0% from 8.0% and replace the frozen initial liability actuarial funding method with the more commonly used entry age normal method. The change increases the city's pension expense, but over the long run will lead to greater stability, since using the 7% rate will mitigate market volatility in actuarial calculations of the city's pension liabilities

MANAGEMENT AND GOVERNANCE

The city's financial management is characterized by strong, institutional financial management practices that emerged from the 1970s fiscal crisis. These include four-year financial planning and quarterly updates, which must be submitted to a state oversight board; the segregation of real property tax revenue into a General Debt Service Fund, held by the state comptroller, and the state's covenant not to impair the rights of city bondholders to be paid when due; a statutory requirement to phase-in changes in property tax billable assessed value over five years evens out ups and downs in the city's real estate market; quarterly interest rate derivatives reporting, submitted to a state oversight board; and oversight by a state control board and by the state comptroller.

KEY STATISTICS

- Estimated full valuation: $989 billion

- Estimated full valuation per capita: $117, 650

- Estimated median family income as % of the US: 126.4%

- Fiscal 2014 available operating fund balance / operating revenue: 6.1%

- 5-year change in available operating fund balance / operating revenue: -3.2%

- Fiscal 2014 operating net cash / operating revenue: 16.4%

- 5-year change in operating net cash / operating revenue: 8.7%

- Institutional framework score: A

- 5-year average operating revenue / operating expenditures: 90.1%

- Net direct debt burden: 8.0% of full valuation; 0.95 times operating revenue

- 3-year average Moody's adjusted net pension liability: 15.8% of full valuation; 1.36 times fiscal 2013 operating revenue

OBLIGOR PROFILE

In addition to the notable size of its economy discussed above, New York City has a population of 8.2 million people and personal income per capita that is 128% of the US level.

LEGAL SECURITY

The bonds are general obligation, full faith and credit obligations of the city, secured by a real property tax levied without limitation as to rate or base.

USE OF PROCEEDS

Proceeds of the bonds will be used to refund outstanding general obligation bonds for debt service savings and to finance portions of the city's capital plan.

RATING METHODOLOGY

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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