FitchRatings

Fitch Rates New York City's (NY) $915MM GOs 'AA'; Outlook Stable

Ratings
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Fitch Ratings-New York-28 May 2015: Fitch Ratings has assigned an 'AA' rating to New York City, NY general obligation (GO) bonds as follows:

--Fiscal 2015 series F, consisting of the following:
-- Approximately $300 million in tax-exempt subseries F-1;
-- Approximately $105 million in taxable subseries F-2;
-- Approximately $195 million in taxable subseries F-3;

--Approximately $315 million fiscal 2015 series 1.

--Approximately $50 million fiscal 1995 series F, subseries
F-4

The series 2015 bonds are expected to be priced via negotiation on June 2. Series F proceeds will be used for capital projects and costs of issuance.

On June 18, 2015 (the conversion date), outstanding bonds of the following subseries are expected to be converted to fixed rate mode and redesignated as fiscal 2015 Series 1 bonds: Fiscal 1994 series A, subseries A-4, A-6 and A-7, fiscal 1995 series B, subseries B-4 B-8, and B-9, and fiscal 2003 series C, subseries C-2. The fiscal 1995 series F, subseries F-4 bonds are expected to be converted to index rate mode and reoffered on the conversion date.

In addition, Fitch affirms its 'AA' rating on the city's approximately $39.7 billion in outstanding GO bonds, and the 'AA-' ratings on the following debt for which New York City, NY is the obligor.

--New York City Industrial Development Agency (IDA) approximately $60 million special revenue bonds (New York City-New York Stock Exchange Project) series 2009A and $30 million bank bonds associated with special revenue bonds (New York City-New York Stock Exchange Project) series 2004B;

--Dormitory Authority of the State of New York (DASNY) approximately $498 million court facilities lease revenue bonds (New York City issue) series 2003A, 2005A, and 2005B;

--DASNY approximately $530.6 million municipal health facilities improvement program lease revenue bonds (New York City Issue) 1998 series 1, 2001 series 2, and 2008 series 1.

The Rating Outlook on all bonds is Stable.

SECURITY

The GO bonds are secured by a pledge of the city's full faith and credit and the levy by the city of ad valorem taxes (without limit as to rate or amount) on all real property within the city subject to taxation. The city is not subject to New York State's property tax cap.

The IDA bonds are payable under a facility financing agreement, whereby the city agrees to provide for debt service on the bonds, subject to annual appropriation.

The DASNY bonds are secured by lease payments made by the city, subject to annual appropriation, and further secured by state aid intercept mechanisms. The court facilities lease revenue bonds are additionally secured by a master lease. The IDA and DASNY bonds are additionally secured by standard debt service reserve funds, composed primarily of cash and investments.

KEY RATING DRIVERS

HIGHLY EFFECTIVE BUDGET MANAGEMENT: The key credit strength underpinning Fitch's 'AA' rating is the city's tight budget monitoring and control as demonstrated by its ability to achieve consistent balance and manage out-year gaps.

MODEST BUT ADEQUATE CUSHION: While the city does not carry a meaningful fund balance, growing budgetary reserves and expense prepayments provide adequate protection against unforeseen conditions.

SOLID UNDERPINNINGS; CYCLICAL REVENUE: The city has a broad economic base and serves a unique role as a national and international center for commerce, culture, and tourism. The city's diverse revenue structure captures most economic activity but is vulnerable to variability in the financial services industry.

HIGH LONG-TERM LIABILITIES: Fitch anticipates a continued high debt burden given the city's significant capital commitments and expected future tax-supported issuance. Post-employment liabilities are also high. Fitch expects the combined burden on the budget of long-term liabilities will remain elevated but fairly stable.

RATING SENSITIVITIES

BUDGET BALANCE CRUCIAL: Given the modest level of accumulated reserves, the rating is sensitive to the city's ability to continue to address budget imbalances and demonstrate financial flexibility through sizable prepayments of future years' expenditures. Fitch expects these prepayments to grow while the economy and revenues remain strong.

LONG-TERM LIABILITY CONTAINMENT: Fitch remains concerned about the city's large long-term liability burden but expects the burden on the budget to stay manageable. Notable growth in the budget burden associated with these liabilities would reduce overall financial flexibility and negatively affect the rating.

CREDIT PROFILE

RECENT TRENDS REINFORCE CONTINUED BALANCED BUDGET EXPECTATIONS

The city's sound approach to budget development features detailed revenue and expenditure forecasting, proactive budget monitoring, and effective actions to eliminate projected deficits. Regular reviews by various external financial oversight entities enhance the city's own internal analysis which includes monthly reporting and three detailed budget and four-year financial plan updates annually. Nascent gaps are dealt with quickly, and year-end results tend to be very close to break-even, with positive variation from budget.

Fiscal 2015 revenues are 6.2% above budget, due largely to above-budget personal income tax revenue and receipt of federal disaster recovery funding. Expenditures show a slightly smaller increase, allowing for an increase in prepayments of subsequent year expenditures to $3 billion from $2 billion the year prior.

The recently-released fiscal 2016 executive budget is balanced and totals $81.3 billion before consideration of the prepayments and designation of reserves. The fiscal 2016 budget is 3.3% above fiscal 2015 forecast spending and includes a small increase in reserves. Total reserves remain modest relative to the size of the budget (5% of spending, including the $2.6 billion OPEB reserve) but Fitch views the city's efforts to increase its financial cushion positively.

LOW RESERVES MITIGATED BY STRUCTURAL PREPAYMENTS

The city is required by the New York State Financial Emergency Act to present budgets on a GAAP basis, and maintains only a nominal fund balance. Instead, management consistently uses accumulated surpluses to prepay debt service and other expenses in subsequent years. Fitch expects these surpluses to increase the level of accumulated surplus applied to out-year expenses during the current period of solid revenue and economic growth. A variation from this expectation would be viewed negatively by Fitch.

The city accumulated an $8 billion surplus to roll forward prior to the most recent economic downturn, with several consecutive years of operating surpluses. By fiscal 2014, the roll had eroded to $2 billion. Management expects to roll $3 billion from fiscal 2015 into fiscal 2016, for a net increase of about $1 billion.

FORWARD TREND IN OUT-YEAR GAPS IS KEY

Fitch views the city's long-term planning favorably and expects some level of imbalance in management's projections. Fitch expects that out-year gaps will continue to be moderate and addressed on an annual basis. Evidence of a meaningful trend of increasing gaps relative to spending would lead to negative rating pressure. The financial plan through fiscal 2019 (which accompanied the fiscal 2016 executive budget) includes out-year gaps ranging from 1.9% of spending in fiscal 2017 to a still-modest 3.3% in fiscal 2019.

PROGRESS AND EXPOSURE ON CONTRACT SETTLEMENTS

The city continues to make progress in settling outstanding labor contracts, some open since 2010. Contracts have been settled for about 80% of employees. However, the remaining 20% include police and fire unions, which are subject to binding arbitration for a two-year period (currently fiscal 2011 and 2012).

Salary increase rates in the labor settlements over the past year are fairly modest, at less than 2% annually, and most are now incorporated into the financial plan.

Settlements with several uniformed unions yield similar but slightly more generous wages. The cost of these contracts is modest relative to the budget. Fitch believes the establishment of a pattern with uniformed employees is a significant step, but remains concerned about the potential budget impacts of both retroactive and current-year increases for the remaining unions whose contract are long-expired.
The financial plan includes funding for unsettled uniformed labor contracts that match the pattern set by the USOC, and a reserve for a 1% salary increase in fiscal 2019, after the current contracts have expired.

The city and its citywide civilian bargaining units (the Municipal Labor Council, or MLC) have agreed that the unions will achieve $3.4 billion in healthcare savings through fiscal 2018, and recurring thereafter, which will reduce the net cost of the contracts. Enforcement of the healthcare savings will be subject to arbitration, so the savings appear likely to be realized. Management reports that the $400 million in agreed-upon fiscal 2015 savings have been achieved, and that the $700 million required for fiscal 2016 is on track. The benefit of any additional healthcare savings beyond the amount currently negotiated would be shared between the city and employees.

The changing overall healthcare landscape creates budget uncertainty not only with labor costs but as it relates to the city's subsidy towards the operations of the Health and Hospitals Corp. (HHC. The former may become more of an issue in fiscal 2018, when the Cadillac tax provision of the Affordable Care Act takes effect.

HIGHLY DETAILED ESTIMATES OF DIVERSE REVENUE MIX; RISKS REMAIN

The city benefits from a diversity of revenue sources, although many are subject to economic volatility. Fitch believes that the city's revenue estimates, based on management's highly detailed and frequently-reviewed analysis are reasonable. The property tax is the largest source, at 28% of fiscal 2014 audited funds, followed by personal income tax at 14% and sales tax at 9%. State and federal sources, primarily for education and social services programs, make up 15% and 10% of fiscal 2014 revenue, respectively. Combined taxes make up 66% of total revenue. The city has a moderate amount of room to increase the property tax levy under the cap.

Assessed value (AV) grew by a healthy 6.1% in fiscal 2015, following 5.7% in fiscal 2014. Fiscal 2016 AV is forecast to grow 5.8% followed by 5.2%, 4.8%, and 4.3% in fiscal 2017-2019, respectively. Withholdings make up about 65% of personal income tax revenues, with the rest primarily estimated payments. A recent change in the city's corporate tax structure, including merging the franchise tax with the banking franchise tax, is expected to be revenue-neutral.

Real estate transaction taxes (real property transfer and mortgage recording), which Fitch views as among the most highly volatile and market-sensitive revenues, totaled $2.5 billion or 3.4% of fiscal 2014 revenues and are forecast at a similar amount for fiscal 2015. The large numbers reflect, in part, closing of a few large, high-profile commercial transactions.

Recent budgets have included modest amounts of non-recurring revenue; Fitch would be concerned if such funding sources grew to be significant. In addition to reimbursements for storm damage resulting from Superstorm Sandy that are offset by expenditures, the city expects to receive $896 million from a penalty paid by BNP Paribas, which will be subject to use restrictions and is not budgeted.

Management estimates the gross cost to public sector facilities (including HHC and the New York City Housing Authority) from Hurricane Sandy to be $9.9 billion. Of this amount, $2.2 billion will come from the operating budget and the rest from reimbursable capital spending. The city expects all costs to be reimbursed from non-city sources. The damage cost estimate does not include the cost of enhancements for future damage mitigation.

CARRYING COSTS EXPECTED TO REMAIN SIZABLE BUT MANAGEABLE

Carrying costs for debt service, pensions and OPEB were 21.7% of governmental spending in fiscal 2014, which Fitch considers to be in the moderate range. Overall carrying costs are forecast to remain at similar levels through the financial plan period.

Carrying costs for debt service, pensions and other post-employment benefits (OPEB) remain a stable burden on the budget despite large capital and fringe benefit pressures. Fitch recognizes the city's conservative budgeting of debt service expense and views positively the city's ability to achieve sizable interest rate savings from debt refinancing over the last several years.

Debt service consumes $6 billion, or a moderate 7.5% of fiscal 2015 forecast spending, and is projected to increase to $7.7 billion (8.8% of total spending) by fiscal 2019. Management uses as a guideline a cap on debt service of 15% of city tax revenue. By this measure, which Fitch views as reasonable (most local governments use a more expansive denominator), debt service equaled 11.6% for fiscal 2014, rising to 13.4% by fiscal 2019. Principal amortization is slightly below average.

A more notable concern is spending on pension and OPEB, which total $8.6 billion and $2.1 billion respectively (a combined 12% of expenditures) in fiscal 2015. The city projects that pension costs will remain fairly flat during the financial plan period, showing modest decreases from prior projections for the same years. OPEB payments, while lower, continue to grow and reflect funding on a pay-as-you-go basis.

HIGH LONG-TERM LIABILITIES A CREDIT CONCERN

Debt metrics are expected to remain high relative to the city's vast tax base. Fitch-calculated net tax-supported debt including Transitional Finance Authority (TFA) future tax secured bonds equals approximately $8,932 per capita, and 8.7% of fiscal 2015 full value. If unfunded pension and OPEB obligations were included, the long-term obligation burden would nearly triple.

The city's capital commitments are extensive. The 10-year capital strategy, released with the executive budget, totals $83.8 billion, a 53% increase from the strategy released with the fiscal 2014 executive budget. The city funded portion shows an even greater increase of 90%. The first four years of the capital plan show a lesser but still large 24% increase. A portion of the increase relates to school capital projects, which receive a state building aid subsidy of approximately 50%. While the level of debt and capital spending is significantly higher, a combination of better-than-forecast revenue and lower-than-forecast interest rates yield projections of a slightly lower burden on the budget than previously envisioned.

Fitch recognizes that the age and vast size of the city's infrastructure make capital needs nearly insatiable. However, Fitch assumes in its 'AA' rating that the city will continue to keep a close eye on affordability, and would alter its capital spending plans if conditions made debt more of a burden on resources.

Fitch believes cost pressures associated with pensions will continue given the need to meet annual investment return targets, but views positively the early implementation of GASB Statement 68. The aggregate net pension liability as of June 30, 2014, was $46 billion, down from $60 billion at the close of fiscal 2013. The decline reflects strong market returns in fiscal 2013 and 2014 and the use of market rather than actuarial values for assets. Fitch recognizes that year-to-year variation in the liability will be greater since GASB 68 requires a market rather than smoothed asset valuation method. The city uses an expected investment return rate of 7%.

The city's actuary projects the aggregate funded ratio for all plans will increase to 71% by fiscal 2019, using the actuarial value of assets. Fitch would be concerned if pension payments began to increase by more than a moderate pace or unfunded liabilities showed a trend of measurable growth.

The unfunded actuarial accrued liability for OPEB is a very high $69.9 billion as of June 30, 2014, and the net OPEB obligation is even higher at $89.5 billion. Efforts to reduce the liability appear to be limited to the afore-mentioned contractual healthcare savings.

ECONOMY IS NOT WITHOUT CHALLENGES DESPITE INHERENT STRENGTHS

Fitch considers the city's unique economic profile, which centers on its identity as an international center for numerous industries and major tourist destination, to be a credit strength. The character of the New York City economy has contributed to its relative employment stability during the recession and ability to regain by March 2012 the number of private sector jobs that existed prior to the recession. Population, which grew modestly during the first decade of the century, has increased 2.8% since 2010.

The city's tourism sector is performing exceptionally well, attracting a record 56 million visitors in 2014, the fifth record year in a row. The city estimates that continued strong visitor-related spending and moderate economic growth will yield sales tax growth of 4% in fiscal 2015, after 5.9% growth in fiscal 2014.

The economic profile of the city also benefits from good wealth levels; per capita personal income is 128% of the U.S. and market value per capita is over $100,000. Both per capita money income and median household income have grown more rapidly over the last five years than either the state's or nation's. However, the above-average individual poverty rate of 20.3% in 2013, compared to 15.4% for the U.S., indicates significant income disparity.

The local economy (and operating budget) is strongly linked to the financial sector, which accounts for approximately 11% of total employment but 27% of earnings according to 2013 data. Financial activities employment grew a solid 2.5% in 2014 after declining slightly in 2013 but was still about 4% off its pre-recession peak.

Overall resident employment increased by 2.9% in 2014, well-outpacing the state and nation. The unemployment rate decreased to a still-high 7.3% in 2014, a significant improvement from 8.7% in 2013. Recent data show continued improvement; the February 2015 city unemployment rate (not seasonally adjusted) was 7.2%, down from 8.5% a year prior, with solid 2.1% employment growth. The most recent rate is still well above state and federal averages.

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In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was informed by information from Creditscope and IHS Global Insight.

Applicable Criteria
Tax-Supported Rating Criteria (pub. 14 Aug 2012)
U.S. Local Government Tax-Supported Rating Criteria (pub. 14 Aug 2012)

Additional Disclosures
Solicitation Status
Endorsement Policy