FitchRatings

Fitch Rates New York City's $800MM GOs 'AA'; Outlook Stable

Fitch Ratings-New York-13 May 2016: Fitch Ratings assigns a 'AA' rating to New York City, NY's general obligation (GO) bonds as follows:

--Approximately $775 million general obligation bonds, fiscal 2016 series E;
--Approximately $25 million general obligation bonds, fiscal 2016 series F.

The series 2016 E and F bonds are expected to be priced via negotiation with the institutional order period on May 18. Proceeds will be used to refund outstanding general obligation bonds and pay costs of issuance.

Fitch affirms the following ratings at 'AA':

--Approximately $38.1 billion in outstanding city GO bonds;
--the city's Issuer Default Rating (IDR).

Fitch also affirms the 'AA-' rating, one notch below the city's IDR, on the New York City Industrial Development Agency (IDA) approximately $62.5 million special revenue bonds (New York City-New York Stock Exchange Project) series 2009A and bank bonds associated with $30 million in IDA special revenue bonds (New York City-New York Stock Exchange Project) series 2004B. The 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 IDA bonds were originally issued to expand the NY Stock Exchange building; the project did not go forward.

The Rating Outlook on all debt 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.

KEY RATING DRIVERS

Exceptionally strong budget monitoring and controls have been in place since the city's fiscal crisis in the 1970s. Strong revenue-raising ability and positive economic prospects also contribute to sound overall credit quality and the expectation that the liability burden will not increase notably. The large long-term liability burden for the current rating level is an ongoing concern. Changes to the pension plan for newer employees should over time cause the pension liability to moderate. Fitch expects debt levels to be controlled by the city's longstanding policy cap on debt service to tax revenues.

Economic Resource Base:
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 contributed to its relative employment stability during the recession and sound growth in recent years. The local economy (and operating budget) is still strongly linked to the financial sector, which accounts for approximately 27% of earnings according to 2013 data.

Revenue Framework: 'aaa' factor assessment
Revenue growth has been strong and shown little volatility. Future growth rates may be less robust given the slow shift of job growth away from the high-wage financial services sector to a more diverse mix, but Fitch expects revenue performance to remain strong. The city has strong ability to adjust property tax rates and a variety of fees and charges, although other important revenue sources (mainly income and sales taxes and state aid) are not within management's control.

Expenditure Framework: 'a' factor assessment
Carrying costs are sizable and many labor contracts are subject to binding arbitration, but the city has demonstrated adequate expenditure flexibility. Fitch expects the pace of spending growth to be similar to that of revenue growth over time.

Long-Term Liability Burden: 'a' factor assessment
Debt and pension liabilities are sizable and represent an elevated but still moderate burden in relation to the resource base. Debt needs will likely continue to remain significant and exceed the amount of outstanding debt that amortizes each year. The future trajectory of the liability burden will depend in part on whether economic growth matches the increase in debt levels, as Fitch expects pension liabilities to remain fairly stable. Large OPEB liabilities are likely to grow.

Operating Performance: 'aaa' factor assessment
The 'aaa' assessment reflects the city's tight budget monitoring and control as demonstrated by its ability to achieve consistent balance and manage out-year gaps. Growing budgetary reserves and expense prepayments along with adequate accumulated reserves and solid budgetary flexibility provide protection against cyclical downturns and unforeseen conditions. Budget oversight from a number of outside parties supplements the city's own careful and thorough planning and monitoring.

RATING SENSITIVITIES

STRONG BUDGET MANAGEMENT CRUCIAL: The rating is sensitive to the city's ability to continue to address budget imbalances and demonstrate financial flexibility through budgetary reserves and prepayments of future years' expenditures. Fitch expects financial flexibility to increase while the economy and revenues remain strong.

LONG-TERM LIABILITY CONTAINMENT: Fitch expects the burden of long-term liabilities 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

The city's population, 8.5 million as of 2014, continues to grow moderately. The economic profile of the city benefits from good wealth levels; per capita personal income is 128% of the U.S. and market value per capita is over $100,000. However, the above-average individual poverty rate of 20.6% in 2014, compared to 14.8% for the U.S., indicates significant income disparity. The city's tourism sector is performing exceptionally well, attracting a record 58.3 million visitors in 2015, the sixth record year in a row. Financial activities employment has shown solid growth in the last two years but remains below the pre-recession peak. Overall resident employment has also been increasing, and is well above pre-recession levels. The unemployment rate continues to show steady improvement, decreasing to 5.7% as of March 2016, a significant improvement from 6.1% in March 2015.

Revenue Framework
The city has a diverse revenue profile, in part because it serves the functions of a city, county, and school district. Property tax revenues are the largest source, and are limited to 2.5% of the average full value of taxable real estate of the current and last four fiscal years. This phase-in process both

stabilizes the maximum tax levy and provides good visibility on future year revenue growth and limitations. Sales and income taxes are also substantial components of revenues; their rates are controlled by the state.

Revenue growth has been quite strong for such a dense, mature city. As financial services jobs remain fairly steady, growth comes from a more diverse mix including technology and a variety of services that are generally not as high-paying. However, the strength of revenue growth over the last 10 years despite the financial crisis, well above the rate of national GDP, indicates fundamental resilience.

The city's operating levy is generally below the 2.5% cap and a portion of debt service (payable from an unlimited tax) is often paid from available margin under the operating cap, providing additional revenue-raising flexibility. The state legislature must vote to maintain the current sales tax rate every two years, and components of the income tax rate are also subject to periodic legislative renewal. Fitch considers such approval pro forma, although modest changes to certain components (such as increases in exclusions) are expected.

Expenditure Framework
The city's responsibilities are very broad, as it provides city, county, and education services to a population exceeding 8 million. In addition, New York State counties are responsible for a portion of Medicaid spending, and the city's public hospital system (Health and Hospitals, or H + H) is a component unit that receives ongoing general fund support. Fitch has some concerns about recent increases in the city's contribution to H+H due to the adverse impact of overall changes in health care delivery methods and funding support at the federal level. A substantial increase in the city's ongoing financial support for H+H, whose budget is about 10% the size of the city's, could increase the pace of expected spending growth and/or reduce the city's flexibility to reduce spending in an economic downturn.

Overall, spending should continue to grow at a similar pace to revenues. Carrying costs (debt service, pension ARC and OPEB actual payment) are relatively high at about 24% of spending but should be fairly stable as the city consistently pays the pension ARC (and continues to do so under GASB 68), a new pension tier was instituted in 2012 for new employees, and robust capital planning and debt projections should keep debt service beneath the city's policy cap of 15% of tax revenues (about 10% of total spending). Long-term labor contracts have fairly modest wage increases. A two-year binding arbitration cycle for the police union (PBA) presents some uncertainty, but the pattern set by other public safety unions and the PBA's recent retroactive settlement point towards manageable increases that are at least partially included in the city's financial plan. As part of the labor agreements, the city and its civilian union umbrella organization have committed to sizable health care savings by fiscal 2018, although a portion of the savings target to date has been met by incorporating favorable market conditions relative to projections.

Fitch believes if conditions warranted the city could institute an effective deficit reduction program. While the workforce framework itself is rather inflexible, the most recent labor negotiations indicate a reasonable amount of flexibility to contain spending growth on employee compensation. Since the city has not done a layoff program in some time Fitch believes there is some room to reduce headcount if needed.

Long-Term Liability Burden
Debt, pensions, and OPEB liabilities are all sizable, and the long-term liability burden assessment reflects debt and pension liabilities of $124 billion, or 24% of the city's personal income. Relative to fiscal 2016 market value of over $900 billion, the ratio is 13.6%. Fitch expects debt to increase more or less with local revenue growth given management's cap on debt service to tax revenues and state restrictions on debt amortization rates. Fitch recognizes that the age and size of the city's infrastructure make capital needs nearly insatiable. However, Fitch assumes 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.

A recent experience study for the city's pension plans both updates the mortality table and includes an assumption that life expectancies will continue to increase over time. This will have the result of increasing the liability but also likely putting the city ahead of other jurisdictions in accurately assessing the size of the liability.

Without action, the OPEB liability (currently 16.8% of personal income) is likely to grow more quickly than either debt or pensions as it is funded on a pay-go basis. The city's only effort to date to control this liability is the health care savings included in the labor agreements.

Operating Performance
Fitch believes that the combination of the city's strong revenue control, adequate spending flexibility, and available financial cushion leave it well positioned to address the impact of a moderate economic downturn. Due to the city's practice of prepaying future year expenses to afford budgetary flexibility, Fitch does not believe reported CAFR numbers provide a complete picture of financial cushion. Prepayments are generally in the range of 5% of spending. Fitch expects the city to maintain the practice of prepayments, with the amounts varying somewhat with the economic cycle. Fitch considers the city's OPEB reserve (currently $3.6 billion) to be an operating reserve rather than an offset to the OPEB liability since it has been used that way in the past. At the end of fiscal 2015, Fitch calculates operating cushion to be about 9% of spending (OPEB reserve + prepayments). In addition, the city has recently built in a $1.5 billion budgetary reserve, which if included in the cushion (not Fitch's standard practice) would bring it to about 11% of spending.

Fitch believes budget monitoring and control is a key strength of the city's operating environment. Fiscal discipline instilled following the city's financial crisis in the 1970s is institutionalized. The city is required to present a balanced budget on a GAAP basis, publish a four-year financial plan which is updated three times per year, and present a biennial 10-year capital strategy. Plans are thorough and highly detailed, and tend to be based on conservative assumptions. Outside monitors who regularly report on the city's budget and financial plan include the financial control board (first set up by the state in the 1970s), the state comptroller, the city's charter-required independent budget office, and the privately-funded citizen's budget commission.

The fiscal 2017 executive budget is balanced and totals $85.6 billion before consideration of the prepayments of fiscal 2017 expenses from prior year surplus. The fiscal 2017 budget is 4.4% above fiscal 2016 forecast spending (net of prepayments and a fiscal 2016 increase in the OPEB reserve of $250 million) and includes budgetary reserves of $1.5 billion. Fitch expects fiscal 2016 results to be positive, as were fiscal 2015 results. Taxable assessed value is expected to grow 6.7% in fiscal 2017

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In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis and InvestorTools.

Applicable Criteria
U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016) (https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=879478&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOjE0NjMyMDE2NzYsInNlc3Npb25LZXkiOiJMTklHSkMxV1A3VEpYWlZGREVBVkVTSUMzWF

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form (https://www.fitchratings.com/creditdesk/press_releases/content/ridf_frame.cfm?pr_id=1004494&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOjE0NjMyMDE2NzYsInNlc3Npb25LZXkiOiJMTklHSkMxV1A3VEpYWlZGREVBVkVTSUMzWF
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