

## **FITCH RATES NEW YORK CITY'S \$1.1B GOS 'AA'; OUTLOOK STABLE**

Fitch Ratings-New York-28 July 2016: Fitch Ratings assigns a 'AA' rating to New York City, NY's general obligation (GO) bonds as follows:

- Approximately \$1,050,000,000 GO bonds, fiscal 2017 series A, consisting of:
  - \$800,000,000 tax-exempt bonds, subseries A-1;
  - \$174,185,000 taxable bonds, subseries A-2;
  - \$75,815,000 taxable bonds, subseries A-3;
- Approximately \$55,510,000 GO bonds, fiscal 2017 series 1.

The series A, subseries A 1 and series 1 bonds are expected to be priced via negotiation with the institutional order period on Aug 2. The series A, subseries A-2 and A-3 bonds are scheduled to price competitively on Aug. 2. Proceeds of series A bonds will be used to fund various capital projects and pay costs of issuance. The series 1 bonds will be a reoffering, reflecting the conversion of outstanding fiscal 1994 series C and series E, subseries E-2 adjustable rate bonds to the fixed rate mode.

### **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 2014 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, 8.6 million as of 2015, continues to grow moderately. The economic profile of the city benefits from good wealth levels; per capita personal income is 130% 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.

#### 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 the tax rate for operations is 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. 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 as 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 in 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 adopted budget is balanced and totals \$86.1 billion before consideration of the prepayments of \$4 billion in fiscal 2017 expenses from prior year surplus. The fiscal 2017 budget is about 5% above fiscal 2016 forecast spending (net of prepayments and a fiscal 2016 increase in the OPEB reserve of \$500 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 grew 6.9% in fiscal 2017 and is forecast to grow by 5.8% in fiscal 2018.

## Contact:

### Primary Analyst

Amy Laskey  
Managing Director  
+1-212-908-0568  
Fitch Ratings, Inc.  
33 Whitehall Street  
New York, NY 10004

### Secondary Analyst

Eric Kim  
Director  
+1-212-908--0241

### Committee Chairperson

Laura Porter  
Managing Director  
+1-212-908-0575

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: [elizabeth.fogerty@fitchratings.com](mailto:elizabeth.fogerty@fitchratings.com).

Additional information is available at 'www.fitchratings.com'.

In addition to the sources of information identified in the 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](https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=879478)

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTP://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](http://fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEBSITE 'WWW.FITCHRATINGS.COM'. PUBLISHED RATINGS, CRITERIA AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE 'CODE OF CONDUCT' SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2016 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001