S&P Global Ratings

RatingsDirect®

Summary:
New York City; General Obligation

Primary Credit Analyst:
Anne E Cosgrove, New York (1) 212-438-8202; anne.cosgrove@spglobal.com

Secondary Contact:
Rahul Jain, New York 212-438-1202; rahul.jain@spglobal.com

Table Of Contents

Summary:

New York City; General Obligation

Credit Profile		
US$800.0 mil GO bnds Fiscal ser 2018 A due 08/01/2028		
Long Term Rating	AA/Stable	New
US$60.0 mil GO bnds Fiscal ser 2012 A-10 dtd 08/10/2017 due 11/01/2021		
Long Term Rating	AA/Stable	New

Rationale

S&P Global Ratings assigned its 'AA' long-term rating to New York City's fiscal 2018 series A general obligation (GO) bonds. Concurrently, the city is converting $60 million of taxable fiscal 2002 series A, subseries A-10 bonds to fixed rate from variable-rate; S&P Global Ratings is affirming its 'AA' rating on these bonds. The outlook is stable.

The city's faith, credit, and unlimited ad valorem pledge secure the GO bonds.

We understand the city plans to use proceeds to refund existing GO bonds.

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

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Adequate budgetary performance, with break-even operating results in the general fund but an operating deficit at the total governmental fund level in fiscal 2016;
- Very strong management and historically conservative budgeting practices;
- Strong budgetary flexibility despite limitations on the city's ability to maintain general fund reserves under the Financial Emergency Act, which New York City has adjusted for by using surplus to prepay subsequent-year expenditures and fund a reserve for future retirees' health insurance costs;
- Very strong liquidity with access to external liquidity we consider exceptional;
- Very weak debt and contingent liability profile; and
- Very strong institutional framework score.

The city's very weak debt profile and its large pension and other postemployment benefit (OPEB) obligations offset these strengths, in our view.

On June 6, 2017, the New York City Council voted to adopt the city's fiscal 2018 budget, which totals $85.2 billion. Some highlights include $382 million of incremental savings under the Citywide Savings Program as well as growth of $300 million in city reserves. There is uncertainty about New York City's estimated $7 billion of federal funding, which makes up more than 8% of spending and is higher relative to that of other large U.S. cities. Officials cite police, health and hospitals (H+H), education, environmental protection, and housing as areas where federal funding changes could affect the budget. We believe the risk to funding associated with sanctuary city federal funds to be slight in the near term, but the potential risks to the Affordable Care Act and associated Medicaid funding are slightly greater.

On June 7, 2017, New York City submitted to the Control Board the financial plan for fiscal years 2018-2021, which is consistent with its capital and expense budgets as adopted for fiscal 2018. In addition, the June 2016 financial plan was modified with respect to fiscal 2017. The plan reflects increases in projected net revenues of $1.03 billion and $110 million in fiscal years 2017 and 2020, respectively; and decreases in projected net revenues of $413 million and $217 million in fiscal years 2018 and 2019, respectively. The plan also reflects a decrease in projected net expenditures of $3.14 billion in fiscal 2017 and increases in projected net expenditures of $940 million, $311 million and $591 million in fiscal years 2018-2020, respectively. These increases reflect increased in agency expenses and City Council initiatives.

New York City intends to navigate through this with cautious forecasting and savings. Furthermore, the city's landmark agreement with the Municipal Labor Committee is creating the first significant structural changes to its health plans, saving $3.4 billion through fiscal 2018 and $1.3 billion a year after that. New York City's active management of its expenses is a credit positive, in our view, and underpins its stable credit profile.

Strong economy

We consider New York City's economy strong. With an estimated population of 8.5 million, the city is the most populous in the nation and continues to grow. It also anchors the broad and diverse New York-Newark-Jersey City MSA and has a projected per capita effective buying income of 105.1% of the national level. New York City's full valuation increased 5.5% year-over-year to $1.04 trillion in fiscal 2017, resulting in a per capita market value of $123,928. The city's weight-averaged unemployment rate was 5.2% in 2016.

Adequate budgetary performance

We consider New York City's budgetary performance adequate, with balanced general fund operations in fiscal 2016 after discretionary transfers--complying with the Fiscal Emergency Act, with a small total governmental funds deficit of less than 2%. Year-end results reflected a $4.0 billion prepayment for fiscal 2017 budget stabilization (significantly higher than the 2014 prepayment of $2 billion for 2015 budget stabilization) and a $500 million increase in the reserve for retirees' health insurance costs.

The city derives its revenue stream largely locally; New York City projects local revenue (including real estate, personal income and sales tax receipts, user charges, and miscellaneous revenues) will provide roughly 72.6% of the total in fiscal 2017 and state aid about 17%. The city projects $85.325 billion in expenses for fiscal 2017, which we believe supports increased near-term flexibility by including a set-aside of $1.2 billion in the general reserves in fiscal 2018, and $1 billion in general reserves in fiscal years 2019-2021 and $250 million in the capital stabilization reserve, which are included in every year of the financial plan, fiscal years 2018 through 2021. The adopted budget includes an increased prepayment of nearly $4.2 billion for fiscal 2018 expenses. We believe debt service costs are conservative based on New York City's interest rate assumptions. We expect fringe benefits ($10.1 billion) to make up a larger share of expenses than pensions ($9.6 billion) in fiscal 2018, a trend we believe could continue. We believe that the city's historically strong and proactive management will remain an important component of balancing its operations as it implements its fiscal 2018 budget.

Out-year gaps are manageable at $3.5 billion for 2019 (3.8% of budget), and $2.8 billion for 2020, and $2.3 billion for 2021, and we note these out-year gaps include the capital stabilization and general reserves. However, they could be problematic if economic conditions deteriorate given the city's fixed-cost structure. In addition, New York City has presented a plan for H+H that relies on the execution of planned efficiency savings and increased revenues. Without these changes, operating deficits will approach $1.8 billion in fiscal 2020. Despite increased operating subsidies and debt service relief in the adopted budget, the H+H corporation might require additional support if the plan does not close the gap to cover shortfalls in projected federal and state revenue.

Another notable development came on Jan. 31, when New York City reached a tentative five-year agreement with the Patrolmen's Benevolent Association (PBA), bringing more than 99% of its union workforce under current contracts. We believe this will reduce uncertainty associated with labor costs. The PBA tentative agreement is retroactive to 2012, and the agreement's cost over the contract period is consistent with that of other uniformed unions.

Very strong management

We view New York City's management as very strong, with strong financial policies and practices under our Financial Management Assessment methodology, indicating financial practices are strong, well embedded, and likely sustainable. The city's budgets and four-year financial plan are prepared with conservative revenue and expenditure projections that are based on historical data and incorporate information from outside resources, including private economists and economic forecasting services. Monthly financial statements and cash flows identify major variances from the financial plan. The city publicly reports on cash balances and investments at least quarterly. Its three-tiered capital planning process is comprehensive and regularly updated, and its ability to issue debt is limited by both the Financial Emergency Act and New York State Constitution.

Strong budgetary flexibility

New York City's budgetary flexibility is strong, in our view. The Financial Emergency Act limits the city's ability to maintain reserves from current-year revenue, translating into zero dollars in the available general fund balance at fiscal 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). We view these prepayments as a form of reserve balance and a source of budgetary flexibility. The city also funds a discretionary reserve for retirees' health insurance costs, and we view this amount as available for operations, if necessary, based on historical use of these funds in previous years. Combined, the fiscal 2016 unrestricted budget stabilization contribution and prepayments ($4.0 billion) and the reserve for retirees' health insurance costs ($4.0 billion) represented 10% of adjusted general fund expenditures.

Very strong liquidity

We view New York City's liquidity position as very strong. Total governmental cash and unrestricted U.S. government securities and agencies, due within a year, were 11.4% of adjusted total governmental fund expenditures in fiscal 2016.

Very weak debt and contingent liability profile

In our view, New York City's debt and contingent liability profile is very weak. Total governmental fund debt service is 9.7% of total governmental fund expenditures, and net direct debt is 85.3% of total governmental fund revenue. While we understand there are no term-out provisions on variable-rate bonds, we believe the city has some exposure to interest-rate risk given maximum bank rates on its variable-rate debt of up to 25%. Additional debt plans over the next two years (including the GO bonds and New York City Transitional Finance Authority future tax-secured bonds) total $15.5 billion, and about $6.75 billion will be retired over this period. We believe the city's pledge to fund $2.49 billion of the Metropolitan Transportation Authority's 2015-2019 capital plan, which remains partially funded at $657 million in the authority's current capital plan, could create additional financing needs. We note that about $700 million of the city's GO debt is in private placements with four financial institutions; however, there are no acceleration provisions or restrictive covenants in the loan documents.

In our opinion, a credit weakness is New York City's large pension and OPEB obligation, and the lack of a plan we think will sufficiently address this, notably the OPEB. Required pension and actual OPEB contributions totaled 14.3% of total governmental fund expenditures in 2016. Of that, 10.9% represented required contributions to pension obligations, and 3.4% represented OPEB payments; this includes the additional $500 million the city deposited into the trust fund, which was not required but is still below the actuarially determined contribution. The city has been paying its full annual required pension contribution for a long period and plans to continue paying the full ARC. In addition, it is paying its unfunded liability over 22 years if all actuarial assumptions are met, having started in fiscal 2012.

The actuarial assumptions used in calculating the pension and OPEB contribution recommendations appear to be up-to-date and conservative. While adverse experience is always possible, we do not expect any large increases to the actuarial recommendation in the near future.

Very strong institutional framework

The institutional framework score for New York City is very strong.

For more information, see the analysis published Feb. 2, 2017, on RatingsDirect.

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 New York City's very weak debt and contingent liability profile--will be stable during the two-year outlook horizon.

Upside scenario

If the economy outperforms expectations in the long term and results in a stronger financial performance and ability to manage costs, while addressing needed infrastructure improvements without unduly increasing the debt profile, we could raise the rating. However, given the city's high debt position and weak contingent liability profile, it is unlikely that this would happen over the two-year outlook horizon.

Downside scenario

In our view, New York City's projected budget gaps in fiscal years 2019-2021 are manageable relative to historically projected gaps if favorable economic conditions continue. However, should economic conditions deteriorate significantly, we believe the city could face problems adjusting its budget to maintain a stable financial position, given its fixed cost structure. An ongoing period of structural misalignment could result in weakened financial flexibility and performance and lead to a lower rating.

Related Research

2016 Update Of Institutional Framework For U.S. Local Governments

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.