



Fitch Rates New York City, NY's \$1.1B GO Bonds 'AA'; Outlook Stable

Fitch Ratings-New York-11 September 2017: Fitch Ratings has assigned a 'AA' rating to the following New York City, NY general obligation (GO) bonds:

- Approximately \$800,000,000 fiscal 2018 series B, consisting of:
 - Approximately \$550,000,000 tax-exempt bonds, subseries B-1;
 - Approximately \$191,470,000 taxable bonds, subseries B-2;
 - Approximately \$58,530,000 taxable bonds, subseries B-3;

- Approximately \$305,560,000 bonds, fiscal 2018 series 1.

The city's Issuer Default Rating (IDR) is 'AA'.

The Rating Outlook is Stable.

The subseries B-1 and series 1 bonds are scheduled to price via negotiation with the institutional order period on Sept. 14. Subseries B-2 and B-3 bonds are scheduled to be sold via competitive bid on Sept. 14. Proceeds of series B bonds will be used for capital projects and to pay costs of issuance.

On the Oct. 3 conversion date, outstanding fiscal 2002 series A, subseries A-6, fiscal 2004 series A, subseries A-3 and fiscal 2004 series H, subseries H-1, H-2, H-3 and H-4 adjustable rate bonds are expected to be converted to the fixed rate mode and redesignated as the Fiscal 2018 series 1 bonds. .

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.

ANALYTICAL CONCLUSION

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 relative to other highly-rated local governments 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 a major tourist destination, to be a credit strength. The character of the New York City economy contributed to its relative employment stability during the great 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 25% of earnings compared to 9% for the U.S. according to 2015 data.

KEY RATING DRIVERS

Revenue Framework: 'aaa'

Revenues have shown strong growth and 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 over time. The city has sound independent legal ability to adjust property tax rates and a variety of fees and charges to offset the modest expected revenue declines in an economic downturn. Rates for other important revenue sources (mainly income and sales taxes and state aid) are not within management's control.

Expenditure Framework: 'a'

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'

Debt and pension liabilities represent an elevated but still moderate burden in relation to the resource base. Debt needs will likely 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, which Fitch expects will grow at least as quickly as pension liabilities. Large other post-employment benefit (OPEB) liabilities are also likely to grow.

Operating Performance: 'aaa'

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. Sound budgetary reserves and expense prepayments along with adequate accumulated reserves and solid budgetary flexibility provide protection against anticipated mild cyclical revenue declines 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 continue to increase while the economy and revenues remain strong.

LONG-TERM LIABILITY CONTAINMENT: Fitch expects the long-term liability burden and its impact 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, estimated at 8.5 million as of 2016, continues to grow moderately. The economic profile of the city benefits from good wealth levels; per capita personal income is 131% of the U.S., and market value per capita

is over \$100,000. However, the above-average individual poverty rate indicates significant income disparity. The city's tourism sector is performing exceptionally well, attracting a reported record 60.7 million visitors in 2016. Financial activities employment has shown some growth in the last three years but remains below the pre-recession peak. Overall resident employment is well above pre-recession levels although recent growth has slowed. Likewise, the unemployment rate continues to improve.

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 levy 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. Taxable assessed value grew 6.8% in fiscal 2017 and 7.5% in fiscal 2018. Property tax revenues made up 29% of fiscal 2016 general fund revenues. Sales and income taxes are also substantial components of revenues at 11% and 23% respectively; their rates are controlled by the state. Intergovernmental revenues made up another 26% of the general fund total in fiscal 2016.

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. The strength of revenue growth over the last 10 years, well above the rate of national GDP despite the financial crisis, indicates fundamental resilience.

The city's operating levy is generally below the 2.5% cap, affording sound flexibility to offset what Fitch assumes would be a modest revenue decline in a moderate recession. Components of the sales and income tax rates are subject to periodic state legislative renewal. Fitch considers such approval pro forma, although modest changes to certain components (such as increases in exclusions) are expected.

Fitch does not believe the recent federal executive order requiring withholding of aid to 'sanctuary cities', if upheld, will have a significant impact on the city's

operating revenues. The order is ambiguous as to both which jurisdictions meet the definition and what federal funding may be affected. New York City generally receives about \$7-8 billion annually in federal aid (about 9% of fiscal 2018 budgeted revenue), all of which is restricted to specific programs. If any portion were withheld, the city would need to make policy decisions on whether to continue to fund the affected programs with local resources. Fitch does not believe such policy decisions materially affect credit quality, as long as they are fiscally sustainable.

Expenditure Framework

The city's responsibilities are very broad, as it provides city, county, and education services to a population of 8.5 million. In addition, New York State counties are responsible for a portion of Medicaid spending, and the city's public hospital system (NYCHH) is a component unit that receives ongoing general fund support. The largest expenditure category is education, representing 31% of fiscal 2016 general fund spending, followed by health and social services at 22%. Public safety comprises 13% of spending, an unusually low share for a local government.

Fitch has some concerns about recent increases in the city's contribution to NYCHH 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 NYCHH, 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. NYCHH's management has committed to increasing the operation's efficiency.

Overall, spending should continue to grow at a similar pace as revenues. Carrying costs (debt service, pension ADC and OPEB actual payment) are sizable at about 21% of fiscal 2016 spending but should be fairly stable relative to spending as the city consistently pays the ADC using more conservative assumptions than many municipal pension plans. 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).

Labor agreements with most city employees are expiring in 2017. Fitch

assumes that new contracts will include terms that are affordable to the city, but given prior history does not assume that contracts are settled prior to current contract expirations. Fitch believes the city's assumption in its long-term financial plan of a 1% annual net wage increase will be difficult to realize without significant savings in other areas such as healthcare costs.

As part of the most recent citywide labor agreements, the city and its union umbrella organization have achieved the goal of \$1.3 billion in annual health care savings by fiscal 2018. However, a portion of the savings reflect favorable market conditions relative to projections, so Fitch views the savings as only a partial offset to wage increases. Without more dramatic cost savings, OPEB payments will likely grow substantially from their current modest 3% of governmental spending.

Management has implemented a citywide savings program that Fitch believes could be expanded to address projected deficits if conditions warranted. While the workforce framework itself is rather inflexible, the most recent labor negotiations indicate a reasonable amount of flexibility to contain growth in employee compensation. Fitch believes there is some room to reduce headcount if needed.

Long-Term Liability Burden

Debt, pensions, and OPEB liabilities are all large even relative to the city's vast resource base, and the long-term liability burden assessment reflects debt and pension liabilities (adjusted by Fitch to reflect a 6% investment return rate) equal to about 30% of the city's personal income. Liabilities are split fairly equally between debt and pensions. Fitch expects debt to increase more or less in line with local revenue growth given management's cap on debt service as a percent 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.

The city maintains five pension systems, of which two (for police and fire) are single-employer plans. Although the other three are cost-sharing plans, the

city bears the responsibility for the majority of the liabilities, and virtually all for the two education-related plans. On a combined basis, the ratio of assets to liabilities is 66% on a reported basis, or approximately 59% using a 6% investment return assumption. A 2015 experience study for the city's pension plans both updated the mortality table and included an assumption that life expectancies will continue to increase over time. This resulted in an increased liability but also likely put the city ahead of some other jurisdictions in accurately assessing the size of the liability.

Without action, the exceptionally high OPEB liability (currently about 17% of personal income) is likely to grow more quickly than either debt or pensions as it is funded on a pay-go basis. Fitch expects the liability to remain sizable even with the city's efforts to reduce the cost of employee and retiree healthcare.

Operating Performance

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 realistic 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.

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 \$4.2 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 2016, Fitch calculates operating cushion (OPEB reserve + prepayments) to be about 10% of spending. 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 12% of spending. The city forecasts an operating surplus at the end of fiscal 2017, with prepayments to future years modestly exceeding prepayments from prior years.

The fiscal adopted 2018 budget totals \$85.2 billion, similar to projected fiscal 2017 spending. It includes budgetary reserves of \$1.5 billion as well as the use of \$4.2 billion in projected fiscal 2017 surplus to prepay expenses, slightly higher than the \$4 billion in prepayments from prior year surplus included in fiscal 2017 projections. The difference represents what Fitch considers the operating surplus.

Out-year budget gaps through the financial plan period (ending fiscal 2021) are small at about 3-5% of spending annually. Fitch believes the city's expectation of a combination of moderate revenue growth, largely generated by employment gains, and only modest employee wage increases through the financial plan period may be somewhat optimistic. Fitch's rating assumes that any budgetary gaps will be addressed promptly and in a fiscally sustainable manner, as they have been historically.

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Date of Relevant Rating Committee: July 20, 2017

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.

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Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (pub. 31 May 2017)
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