FitchRatings

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

Fitch Ratings-New York-16 February 2016: Fitch Ratings has assigned an 'AA' rating to New York City, NY general obligation (GO) bonds as follows:

-- Approximately $750 million fiscal 2016 series C;
-- Approximately $50 million fiscal 2016 series D.

Fitch has also affirmed approximately $40.6 billion in outstanding city GO bonds at 'AA'.

The bonds are expected to be priced via negotiation with the institutional sale on February 23 and a retail order period beginning February 19. Proceeds will be used to refund outstanding general obligation bonds and pay costs of issuance.

The Rating Outlook 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

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

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 ECONOMIC UNDERPINNINGS: 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 burden of debt and other long-term liabilities given the city's significant expected future tax-supported issuance and large post-employment obligations. Fitch expects the burden on the budget of long-term liabilities will remain elevated but fairly stable.

RATING SENSITIVITIES

BUDGET BALANCE CRUCIAL: Given the modest level of fund balance, the rating is sensitive to the city's ability to continue to address budget imbalances and demonstrate financial flexibility through sizable 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 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

SOUND BUDGETARY PRACTICES, MODERATE FINANCIAL RESERVES

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.

The fiscal 2017 preliminary budget is balanced and totals $84.4 billion before consideration of the prepayments of future year expenses or of current year expenses from prior years. The fiscal 2017 budget is 1.8% above fiscal 2016 forecast spending (net of prepayments) and includes budgetary reserves of $1.5 billion. Fitch expects fiscal 2016 results to be positive, as were fiscal 2015 results. Prepayments of future year expenses made from fiscal 2015 surplus exceeded by $1.5 billion the benefit to fiscal 2015 results of prepayments made in prior years.

The city is required by the New York State Financial Emergency Act to present budgets on a GAAP basis, and maintains only a nominal general fund balance. Instead, management consistently uses accumulated surpluses to prepay debt service and other expenses in subsequent years. Total available cushion is moderate relative to the size of the budget (9% of fiscal 2015 spending, including the $3.4 billion OPEB reserve and budgetary surplus of $3.6 billion) and Fitch views the city's efforts to increase it positively. Including the $1.5 billion budgetary reserve, Fitch calculates the cushion going into fiscal 2016 to be 10.9% of spending.

In recent years strong revenue growth and continued expenditure management have allowed the city to increase the OPEB reserve (held in a revocable fiduciary fund) by $2.4 billion and increase budgetary reserves by $1.2 billion. Fitch expects an increase in the financial cushion (including budgetary reserves, OPEB and other accumulated reserves, and prepayments) during the current period of solid revenue and economic growth. Fitch would view a variation from this expectation as a credit negative.

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 2020 (which accompanied the fiscal 2017 executive budget) includes out-year gaps ranging from a fairly modest 2.6% - 3.2% of spending.

CONTINUED PROGRESS ON CONTRACT SETTLEMENTS

The city continues to make progress in settling outstanding labor contracts with affordable terms. Management has reached agreement with 95% of its workforce (including the Patrolmen's Benevolent Association, or PBA, as discussed below), with most contracts extending through fiscal 2018. The financial plan includes a reserve for small 1% salary increases in fiscal 2019 and 2020. The largest remaining labor uncertainty is the PBA, whose contract was settled through fiscal 2012 through binding arbitration but is still undetermined beginning in fiscal 2013.

The city and its citywide civilian union umbrella organization (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. 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 savings incorporate favorable market conditions relative to projections in addition to efforts to control costs, increasing the likelihood that the targets will be reached but reducing the financial value of the agreement. The benefit of any additional healthcare savings beyond the amount currently negotiated would be shared between the city and employees.

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 2016 projected 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 16% and 11% of fiscal 2016 revenue, respectively. The city has a moderate amount of room to increase the property tax levy for operations under the cap.

Property tax revenues are forecast to grow 5.8% in both fiscal 2016 and 2017 and 5.1% annually in fiscal 2018 - 2020, based on strong billable assessed value increases. Since assessment increases must be phased in over five years for most classes of property, Fitch believes these projections are realistic.

The financial plan assumes minimal PIT growth in fiscal 2017 after 3.8% growth in the current fiscal year. The fiscal 2017 projection includes moderate growth in wage rates and improved private sector bonuses but a decline in non-wage income. In fiscal 2018 - 2020 personal income tax revenues are projected to resume growth of 3.8% annually. The budget assumes continued strong visitor-related spending and moderate economic growth will yield annual sales tax growth in the 4% range. Fitch believes these tax revenue growth forecasts are reasonable but vulnerable to downside risk.

Fitch's rating assumes that the overall funding relationship between the city and state will not change significantly, although some areas of city spending may receive more or less state support than in the proposed budget.

CARRYING COSTS, HOSPITAL SUBSIDIES CREATE PRESSURE

Carrying costs for debt service, pensions and OPEB are a sizable and increasing burden on the budget given large capital and fringe benefit pressures. They totaled 23.6% of governmental spending in fiscal 2015, which Fitch considers sizable but in the moderate range. Fitch recognizes the city's conservative budgeting of debt service and its ability to achieve sizable interest rate savings from debt refinancing over the last several years.

Debt service consumes $6.1 billion, or a moderate 7.5% of fiscal 2016 forecast spending, and is projected to increase to $8.2 billion (8.9% of total spending) by fiscal 2020. 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 will remain below the cap through the financial plan period. Principal amortization is slightly below average.

A more notable concern is spending on pensions and OPEB, which total $9.3 billion and $2.2 billion, respectively (a combined 14.1% of expenditures) in fiscal 2016. A recent change to mortality assumptions results in an increase in annual pension payments of about $600 million annually, beginning in fiscal 2016. Fiscal 2015 investment returns of 3.15% were below the plan's assumed 7% rate, which resulted in an additional increase. Total pension payments in fiscal 2019 are now projected at $9.7 billion (10.8% of spending), up 9.4% from the estimate in last year's executive budget. However, they are projected to make up a lower portion of spending in fiscal years 2019 and 2020 than the 11.4% forecast for fiscal 2016. OPEB payments, while lower than pension payments, continue to grow and reflect funding on a pay-as-you-go basis.

An emerging cost pressure is the city's subsidy for the operations of NYC Health and Hospitals (formerly the Health and Hospitals Corp.). The financial plan includes a $1.1 billion, or 47%, increase in funding for Health and Hospitals through fiscal 2020. The subsidy is a small portion of the city's budget but the magnitude of increase is somewhat concerning. Officials expect to provide more detail on the city's support as part of the executive budget this spring.

HIGH LONG-TERM LIABILITIES A CREDIT CONCERN

Debt metrics are expected to remain high even 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 $9,308 per capita, and 8% 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 fiscal 2016 executive budget, totals $83.8 billion. Since the plan was released, major initiatives for housing and transit have been announced but funding plans and sources are not finalized. Fitch recognizes that the age and 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. The aggregate net pension liability as of June 30, 2015 was $52 billion, up from $47 billion at the close of fiscal 2014, reflecting investment returns below the 7% assumption. 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. Fitch believes that the increase in the life expectancy assumption and implementation of a generational mortality table, which assumes life expectancy will continue to increase over time, are prudent measures although they are likely to result in an increased net pension liability.

The net OPEB obligation as of fiscal 2015 was a high $85.5 billion. Efforts to reduce the liability are limited to the aforementioned contractual healthcare savings.

ECONOMY 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 the end of 2011 the number of private sector jobs that existed prior to the recession. The population of 8.5 million as of 2014 continues to grow moderately.

The city's tourism sector is performing exceptionally well, attracting a record 56 million visitors in 2014, the fifth record year in a row. Officials expect final counts for 2015 to exceed the 2014 level.

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 20.9% in 2014, compared to 15.5% 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 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 decreased to 5% as of December 2015 (preliminary), a significant improvement from 6.2% in December 2014, reflecting robust 4% employment growth.

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Fitch recently published exposure drafts of state and local government tax-supported criteria (Exposure Draft: U.S. Tax-Supported Rating Criteria, dated Sept. 10, 2015 and Exposure Draft: Incorporating Enhanced Recovery Prospects into U.S. Local Tax-Supported Ratings, dated Feb. 2, 2016). The drafts include a number of proposed revisions to existing criteria. If applied in the proposed form, Fitch estimates the revised criteria would result in changes to less than 10% of existing tax-supported ratings. Fitch expects that final criteria will be approved and published in the first quarter of 2016. Once approved, the criteria will be applied immediately to any new issue and surveillance rating review. Fitch anticipates the criteria to be applied to all ratings that fall under the criteria within a 12-month period from the final approval date.

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

Applicable Criteria
Exposure Draft: Incorporating Enhanced Recovery Prospects into US Local Tax-Supported Ratings (pub. 02 Feb 2016) (https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=875108&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOjE0NTU4NjA1NDMsInNlc3Npb25LZXkiOiJaWkkwTE9KSUVOVUpSU1dBRU1MM0hSQ0dJM
Exposure Draft: U.S. Tax-Supported Rating Criteria (pub. 10 Sep 2015) (https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869942&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOjE0NTU4NjA1NDMsInNlc3Npb25LZXkiOiJaWkkwTE9KSUVOVUpSU1dBRU1MM0hSQ0dJM
Tax-Supported Rating Criteria (pub. 14 Aug 2012) (https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOjE0NTU4NjA1NDMsInNlc3Npb25LZXkiOiJaWkkwTE9KSUVOVUpSU1dBRU1MM0hSQ0dJM
U.S. Local Government Tax-Supported Rating Criteria (pub. 14 Aug 2012) (https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685314&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOjE0NTU4NjA1NDMsInNlc3Npb25LZXkiOiJaWkkwTE9KSUVOVUpSU1dBRU1MM0hSQ0dJM

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form (https://www.fitchratings.com/creditdesk/press_releases/content/ridf_frame.cfm?pr_id=999555&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOjE0NTU4NjA1NDMsInNlc3Npb25LZXkiOiJaWkkwTE9KSUVOVUpSU1dBRU1MM0hSQ0dJMI
Solicitation Status (https://www.fitchratings.com/gws/en/disclosure/solicitation?pr_id=999555)
Endorsement Policy (https://www.fitchratings.com/jsp/creditdesk/PolicyRegulation.faces?context=2&detail=31)