Fitch Rates New York City, NY's $800MM GO Bonds 'AA'; Outlook Stable

Fitch Ratings-New York-02 February 2017: Fitch Ratings has assigned a 'AA' rating to the following New York City, NY general obligation (GO) bonds:

Approximately $800,000,000 fiscal 2017 series C and D, consisting of:
--$780,000,000 series C;
--$20,000,000 series D.

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

The Rating Outlook is Stable.

The bonds are scheduled to price via negotiation with the institutional order period on Feb. 7. Proceeds of the bonds will be used to redeem certain outstanding GO bonds and pay costs of issuance.

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 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 according to 2015 data.

Revenue Framework: 'aaa' factor assessment

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 strong independent legal 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 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 debt levels to grow more quickly than pension liabilities. Large other post-employment benefit (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. Sound 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.

https://www.fitchratings.com/site/pr/1018537
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, estimated at 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 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 record 58.5 million visitors in 2015, the sixth record year in a row. 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 growth is slowing to near the U.S. rate. Likewise, improvement in the unemployment rate appears to have stalled.

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. Taxable assessed value grew 6.9% in fiscal 2017 and is forecast to grow by 6.7% in fiscal 2018. 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 ten 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.

Fitch does not believe the recent federal executive order requiring withholding of aid to 'sanctuary cities' 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. Fitch also believes the order is subject to legal challenge. New York generally receives about $7 billion annually in federal aid (about 8% 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 continuing 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 8.6 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. 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.

Overall, spending should continue to grow at a similar pace as revenues. Carrying costs (debt service, pension ADC and OPEB actual payment) are relatively high at about 21% of spending but should be fairly stable relative to spending as the city consistently pays the pension actuarially-required contribution (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).

The Patrolmen's Benevolent Association (PBA) and the city recently reached a tentative labor agreement. If it is ratified, labor contracts with virtually all of the city's bargaining units will be in place until the end of 2017. This would be notable as the city has a history of operating with expired labor contracts. The tentative PBA agreement conforms to the pattern of other uniformed labor units, and management states that the full cost of the contract, which is retroactive to 2012, has been budgeted. If ratified by union...
membership, the agreement would remove a notable uncertainty from the city's budget, in part because it includes a commitment not to pursue litigation related to health care savings or the requirement to wear body cameras. However, Fitch believes the city's assumption in its long-term financial plan of a 1% annual wage increase beyond the current contract period may be difficult to realize.

As part of the current citywide labor agreements, the city and its union umbrella organization have committed to $1.3 billion in annual health care savings by fiscal 2018. Some of the savings target to date has been met by favorable market conditions relative to projections, so Fitch views the savings as only a partial offset to wage increases.

Management has implemented a modest citywide savings program, which 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 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 $137 billion, or about 25% of the city's personal income. Relative to fiscal 2016 market value of $943 billion, the ratio is 14.5%. Market value topped $1 trillion in fiscal 2017. 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.

The 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 other jurisdictions in accurately assessing the size of the liability. Recent weak investment performance has also increased the liability.

Without action, the 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. 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 $4 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 $1.25 billion budgetary reserve, which if included in the cushion (not Fitch's standard practice) would bring it to about 12% 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 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.

The fiscal 2018 preliminary budget totals $84.7 billion, similar to projected fiscal 2017 spending. It includes budgetary reserves of $1.25 billion as well as the use of the $3 billion in projected fiscal 2017 operating surplus to prepay expenses; this amount is lower than the $4 billion in prepayments from prior year surplus included in fiscal 2017 projections. Fitch expects the fiscal 2017 surplus to increase by year-end.

Out-year budget gaps through the financial plan period (ending fiscal 2021) are small at about 2-3% 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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Additional information is available at 'www.fitchratings.com'.

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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