FitchRatings

Fitch Rates New York City, NY's $950MM GO Bonds 'AA'; Outlook Stable

Fitch Ratings-New York-16 February 2018: Fitch Ratings has assigned a 'AA' rating to the following New York City general obligation (GO) bonds:

--Approximately $950,000,000 fiscal 2018 series E, consisting of:
--Approximately $700,000,000 tax-exempt bonds, subseries E-1;
--Approximately $188,110,000 taxable bonds, subseries E-2;
--Approximately $61,890,000 taxable bonds, subseries E-3.

In addition, Fitch has affirmed the 'AA' rating on approximately $36.7 billion in outstanding GO bonds.

Fitch has also affirmed the 'AA-' ratings on the following obligations, which the city supports through its commitment to appropriate for debt service:
-- Approximately $733 million in New York City Health and Hospitals Corp (HHC) health system bonds;
-- Approximately $50.4 million special revenue bonds (New York City-New York Stock Exchange Project) series 2009A and bank bonds associated with $30 million in special revenue bonds (New York City-New York Stock Exchange Project) series 2004B, issued by the New York City Industrial Development Agency.

Fitch has also affirmed the city's Issuer Default Rating (IDR) at 'AA'.

The Rating Outlook is Stable.

The subseries E-1 bonds are scheduled to price via negotiation with the institutional order period on February 22. Subseries E-2 and E-3 bonds are scheduled to be sold via competitive bid on February. 22. Proceeds of series E bonds will be used for capital projects and to pay costs of issuance.

On the March 13 conversion date, outstanding fiscal 2004 series A, subseries A-6, fiscal 2008 series J, subseries J-4, and fiscal 2011 series F, subseries F-3 adjustable rate bonds are expected to be converted to a fixed rate mode. These bonds are included in Fitch's affirmation of the city's outstanding GO bonds, as stated above.

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.

The HHC bonds are general obligations of HHC, which include all revenues derived from provision of patient care. Pursuant to the New York City Health and Hospitals Corporation Act, a capital reserve fund equal to maximum annual debt service on all outstanding NYCHH GO debt can only be used for debt service. The act obligates the city to replenish any deficiencies in the capital reserve fund.

The IDA bonds are payable under a facility financing agreement, whereby the city agrees to provide for debt service on the bonds, subject to annual appropriation.

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 moderate the pension liability. Fitch expects debt levels to be controlled by the city's longstanding policy cap on debt service as a percentage of tax revenues. The HHC and IDA bonds are rated one notch below the city's IDR, reflecting the slightly higher degree of optionality associated with lease payments subject to appropriation.

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 tourism 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 activities sector, which accounts for approximately 24% of earnings compared to 9% for the U.S. according to 2016 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 comparable 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, all 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 130% 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. 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 30% of audited fiscal 2017 general fund revenues. Sales and income taxes are also substantial components of revenues at 10% and 22%, respectively; their rates are controlled by the state. Intergovernmental revenues made up another 28% of the general fund total in fiscal 2017.

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.

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 32% of fiscal 2017 general fund spending, followed by health and social services at 22%. Public safety's share is 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 actuarially determined contribution (ADC) and OPEB actual payment) are sizable at about 21% of fiscal 2017 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 about 40% of city employees, including the Patrolmen's Benevolent Association (PBA), had expired by the end of calendar 2017 and nearly all of the remainder will expire by the end of fiscal 2019. The city and the PBA are currently engaged in mediation sessions due an impasse in negotiations. 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 will 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 currently 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 28% 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 the cap on debt service as a percentage of 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 71% on a reported basis, or approximately 64% 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 16% 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 ($4.7 billion at the end of fiscal 2017) 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 2017, Fitch calculates operating cushion (OPEB reserve + prepayments) to be about 10% of spending. In addition, the city has recently built in a budgetary reserve (currently $1.25 billion), which if included in the cushion (not Fitch's standard practice) would bring it to about 12% of spending.

The city's February financial plan forecast for fiscal 2018 totals $87.4 billion, approximately 4% above actual fiscal 2017 spending. The forecast includes an operating deficit at the end of fiscal 2018, with prepayment of future year expenditures of $2.6 billion compared to prepayments into fiscal 2018 from prior years of $4.2 billion. Fitch anticipates the level of prepayments to future years will increase by the end of fiscal 2018 to be consistent with prior fiscal year-end levels.

The fiscal 2019 preliminary budget totals $88.7 billion, approximately 1.4% above projected fiscal 2018 spending. It includes budgetary reserves of $1.25 billion as well as the use of $2.6 billion in projected fiscal 2018 operating surplus to prepay expenses.

Out-year budget gaps through the financial plan period (ending fiscal 2022) are small at about 1%-2% 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.

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
Steve Murray
Senior Director
+1-512-215-3729

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.

Media Relations: Sandro Scenga, New York, Tel: +1 212-908-0278, Email: sandro.scenga@fitchratings.com

Additional information is available on www.fitchratings.com

Applicable Criteria
U.S. Public Finance Tax-Supported Rating Criteria (pub. 31 May 2017) (https://www.fitchratings.com/site/re/898466)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form (https://www.fitchratings.com/site/dodd-frank-disclosure/10019819)

Solicitation Status (https://www.fitchratings.com/site/pr/10019819#solicitation)
Endorsement Policy (https://www.fitchratings.com/regulatory)

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT 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. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY. 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 © 2018 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

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO’s credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

Solicitation Status

Fitch Ratings was paid to determine each credit rating announced in this Rating Action Commentary (RAC) by the obligatory being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated, except for the following:

Endorsement Policy - Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures (https://www.fitchratings.com/regulatory) page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.