



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

Fitch Ratings-New York-06 April 2018: Fitch Ratings has assigned a 'AA' rating to approximately \$1.1 billion New York City general obligation (GO) bonds, fiscal 2018 series F consisting of the following:

- Approximately \$850,000,000 tax-exempt bonds, subseries F-1;
- Approximately \$133,490,000 taxable bonds, subseries F-2;
- Approximately \$116,510,000 taxable bonds, subseries F-3.

In addition, Fitch has affirmed the city's Issuer Default Rating (IDR) and outstanding GO bond ratings at 'AA' and the ratings on the following obligations, which the city supports through its commitment to appropriate for debt service at 'AA-':

- 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.

The Rating Outlook is Stable.

The subseries F-1 bonds are scheduled to price via negotiation with the institutional order period on April 11. Subseries F-2 and F-3 bonds are scheduled to be sold via competitive bid on April 11. Proceeds of series F bonds will be used for capital projects and to pay costs of issuance.

On the April 19 conversion date, the city expects to reoffer \$64,000,000 of outstanding fiscal 2004 series A, subseries A-2 adjustable rate bonds in the 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, 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 U.S. census-estimated population is 8.6 million as of 2017 and it continues to grow moderately. The economic profile of the city provides for 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 62.8 million visitors in 2017. Financial activities employment has shown some growth over the last four years and is now slightly above 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, and is projected to grow 6.4% in fiscal 2019. 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 an estimated 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. 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 District Council 37 of AFSCME and 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. 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.

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, in Fitch's view. 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. However, 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 \$2.6 billion in prepayments mentioned above.

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 moderate revenue growth, largely generated by employment gains, and only modest employee wage increases through the financial plan period may be somewhat optimistic, resulting in a possible understatement of future budget gaps. Fitch's rating assumes that any budgetary gaps will be addressed promptly and in a fiscally sustainable manner, as they have been historically.

The state's enacted budget for fiscal 2019 (adopted on March 31, 2018) includes a requirement for the city to provide \$418 million in operating and capital funds to the Metropolitan Transportation Authority and provides \$140 million less in education aid than the city anticipated in fiscal 2019. Fitch believes that the impact will be modest for the city's budget.

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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.

### **Applicable Criteria**

U.S. Public Finance Tax-Supported Rating Criteria (pub. 03 Apr 2018)  
(<https://www.fitchratings.com/site/re/10024656>)

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