FitchRatings

FITCH RATES NEW YORK CITY, NY'S GOS 'AA'; OUTLOOK STABLE

Fitch Ratings-New York-06 December 2012: Fitch Ratings assigns an 'AA' rating to the following New York City general obligation bonds:

--Approximately $500 million general obligation (GO) bonds, fiscal 2013 series D;
--Approximately $350 million general obligation bonds, fiscal 2013 series E.

The bonds are expected to be sold via negotiation on Dec. 11

In addition, Fitch affirms its 'AA' rating on the city's $41 billion in outstanding GO bonds.

The Rating Outlook is Stable.

SECURITY

The bonds are general obligations of the city 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: The city's sound approach to budget development features conservative revenue and expenditure forecasting and effective budget monitoring. Management is thus able to react quickly to changing conditions and consistently generate operating surpluses through periods of economic stress, constrained state aid, and rising spending pressures.

CONSISTENT RESOLUTION TO OUT-YEAR GAPS: Fitch expects the city's long history of effectively eliminating annual budget deficits to continue. Currently forecasted gaps are well within historical norms, although risks to the forecast are notable.

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. Recession-related job declines have been well under comparable national averages although the unemployment rate is trending upward. Income levels are high.

REVENUE CYCLICALITY: Economically sensitive revenues, including personal income, business, and sales tax, comprise a major share of the city's budget and are highly vulnerable to variability in the financial services industry.

HIGH DEBT LEVELS: Fitch anticipates a continued high debt burden given the city's significant capital commitments and future tax-supported issuance plans.

CREDIT PROFILE

EXPECTATION FOR CONTINUED BUDGET BALANCE

The current forecast for fiscal 2013 spending totals $69 billion, a 3% increase from fiscal 2012 actual spending. The budget includes neither retroactive payments for most expired labor contracts not yet settled nor salary increases for fiscal 2013. A modest reserve for collective bargaining assumes increases of 1.25% per year thereafter.

Fitch believes that the city's revenue estimates, based on a highly detailed and frequently-reviewed analysis, are reasonable. The city benefits from a diversity of revenue sources. The property tax is the largest source, at 38% of budgeted fiscal 2013 city funds, followed by personal income tax at 17% and sales tax at 12%. Intergovernmental sources are primarily for education and social services programs, and make up 29% of budgeted fiscal 2013 . Combined taxes make up 64% of total revenue.

Areas of revenue risk include proceeds from the sale of taxi medallions, which total $1.5 billion over the plan period, $250 million in state aid related to agreement on a teacher evaluation plan, reimbursements for Hurricane Sandy-related costs, state revenue shortfalls that could result in reduced aid to municipalities including New York City, and federal actions that could result in reduced funding to the city.

Management estimates the gross cost to public sector facilities from Hurricane Sandy to be $4.5 billion, but anticipates a high percentage if not all will be eligible for reimbursement. The estimate does not include the cost of enhancements for future damage mitigation.

Despite expense and revenue pressures, Fitch's expectation for continued rating stability is supported by the city's consistently demonstrated ability and resolve to close similarly sized shortfalls in years past.

GAP-CLOSING PROGRAMS ACHIEVE SIGNIFICANT RECURRING SAVINGS

A key element in the city's credit stability is its demonstrated willingness to address budget gaps with primarily recurring solutions, either in the form of increased revenue or reduced agency spending. The out-year gap estimates included in the city's November modification to the financial plan are sizeable at $1.2 billion for fiscal 2014, $2.8 billion for fiscal 2015, and $2.6 billion for fiscal 2016 but below historical standards.

Simultaneously with the recent November budget modification, the city released a gap-closing program of $555 million for fiscal 2013 and $2.6 billion through the plan period. Nearly $1 billion of the program affects the Department of Education. The fiscal 2013 program is primarily to offset the delay in receipt of funds from the sale of additional taxi medallions and new needs of $135 million since the adopted budget. The program calls for headcount reductions of 627 in fiscal 2013 and 1,315 in fiscal 2014. Nearly all are to be through attrition. The reductions are modest relative to the city's overall headcount, which totals more than 255,000.

In addition to headcount reductions, a moderate amount of the gap-closing program represents revenue assumptions or cost savings that are not within the city's control and therefore uncertain. However, Fitch anticipates that savings not realized in the items presented will be replaced with other reductions or revenue enhancements, and that those actions will largely be of a recurring nature.

FISCAL 2012 OPERATING MARGIN REMAINS SOLID, BUT NARROWED

As prior year surpluses cannot be appropriated in future fiscal periods, the city routinely uses operating surpluses to cover spending in the subsequent budget year by prepaying debt service and subsidies and other such actions.

In fiscal 2013 $2.4 billion, or 3.6% of total spending, will be available for prepayments in fiscal 2013. This amount is somewhat below the fiscal 2011 surplus used for fiscal 2012 prepayments of $3.7 billion. The fiscal 2011 figure is more in line with surplus levels over the past several years. The reduced funds generated in fiscal 2012 reflect a lower amount by which actual tax receipts exceed projections than in past years, although receipts were still ahead of budget. Fitch assumes that by fiscal year-end the surplus available for fiscal 2014 will be at least similar to the level rolled into fiscal 2013.

ONE-TIME MEASURES EMPLOYED IN FISCAL 2013

A limited amount of one-time resources help compensate for the decline in the forecasted operating surplus available at year-end to pre-pay fiscal 2013 expenses. The fiscal 2013 executive budget included $1 billion from the sale of taxi medallions. This amount has been eliminated from the fiscal 2013 budget given a recent state court ruling that the legislation authorizing the sale of additional medallions was unconstitutional. The city has filed an appeal but does not expect any revenue to be available until fiscal 2014 if the appeal is successful. The current financial plan includes $790 million in taxi medallion revenue in fiscal 2014, $447 million in fiscal 15, and $223 million in fiscal 2016.

Another non-recurring resource in fiscal 2013 is the transfer of $1 billion from a trust established for retiree healthcare costs. The trust has a current balance of approximately $2 billion following transfers out of $395 million in fiscal 2011 and $672 million in fiscal 2012 to help cover the cost of annual retiree benefits. The city plans to transfer the remaining $1 billion in fiscal 2014.

LONG-TERM SPENDING PRESSURES

Debt service will consume $6.1 billion or 8.9% of the fiscal 2013 budget. Debt service is forecast to increase to $7.5 billion or 9.7% of total spending by fiscal 2016. Fitch recognizes the city's conservative budgeting of debt service expense and views positively the city's ability to achieve sizable interest rate savings from debt refinancing over the last several years.

A more notable concern is the cost of pension and other employee benefits which total $8.1 billion and $8.4 billion, respectively, in the current fiscal 2013 budget. The rapid escalation in pension costs (from $1.5 billion in fiscal 2002) is projected to level off through fiscal 2016 despite changes in actuarial assumptions including a drop in the expected investment return rate to 7% from 8% and actual investment returns for fiscal 2012 of only 1.4%.

During this period employee benefits are projected to continue to rise an additional $1.7 billion. About $2.1 billion of the fiscal 2013 employee benefit costs are for other post-employment benefits (OPEB). Fiscal 2013 pension and OPEB costs consume 14% of total funds. Adding debt service, carrying costs rise to 23% of spending, which Fitch considers to be on the high end of the moderate range.

The city's ability to achieve pension reform or to negotiate pensions with organized labor is dependent on state legislation. The state legislature has passed pension reform that introduces a new tier for new employees featuring a higher retirement age and increased worker contributions among other changes. The new tier will not yield immediate savings but would provide much needed long-term relief estimated by the city at approximately $21 billion over the next 30 years.

ELEVATED DEBT WITH MANAGEABLE VARIABLE-RATE EXPOSURE

Debt metrics remain high. Fitch-calculated net tax-supported debt including Transitional Finance Authority (TFA) future tax secured bonds equals approximately $8,026 per capita, and 8.1% of the five-year average of full value. The city's capital commitments are extensive, totaling $34.3 billion through fiscal 2016, including $7.0 billion for self-supporting water and sewer projects and $8.4 billion for education. Tax-supported issuance plans during fiscal 2013-2016 include $9.5 billion of city GOs and $11.2 billion of TFA future tax secured bonds. Forecasted debt issuance is similar to the amount of outstanding principal scheduled to amortize during the same period.

The city and related issuers have approximately $9.7 billion in outstanding variable-rate debt or 15% of tax-supported debt. Fitch considers this exposure to be manageable given the hedge provided by the city's substantial short-term assets and the city's sophisticated management, diversity of liquidity providers, and strong demonstrated access to the capital markets.

ECONOMY HAS INHERENT STRENGTHS BUT IS NOT WITHOUT CHALLENGES

Fitch considers the city's unique economic profile, which centers on its singular 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 March 2012 the number of private sector jobs that existed prior to the recession. The city's tourism sector is performing exceptionally well. The city attracted 50.5 million visitors in 2011, above the record of 48.8 million visitors set in 2010.

Another area of recent strength is the commercial real estate market. According to Cushman and Wakefield, the city recorded 30.1 million square feet of leasing activity in 2011, the highest volume since 2000, although the city reports this activity has recently slowed. The city's economic profile also benefits from its strong wealth, with per capita income 130% of the national average. However, the well above-average individual poverty rate of 20.1% in 2011, compared to 15.2% for the U.S., indicates significant income disparity.

The city's economy (and operating budget) is strongly linked to the financial sector, which accounts for approximately 12% of total employment but 31% of earnings. Financial activities employment rose only 0.1% in 2011. The high-earning securities and commodities component of the sector shed 1,900 jobs or 1.1% during the year. Tightening financial reforms and regulation, reduced bank profits, evidence of a shift in bonus and compensation practices away from cash, uncertain economic recovery, and concerns in Europe are among several factors that figure to weigh on financial sector prospects over the near-to-intermediate term.

The city's employment base expanded by a modest 0.2% in 2011, less than the 0.6% growth for the U.S., although the magnitude of the city's job losses during the prior two years was less. The unemployment rate of 9.2% in October 2012 matched the October 2011 rate and remained above the state and federal rates, while year-over-year employment growth was below both.

Residential real estate continues to struggle. The most recent release of the S&P/Case-Shiller Index of home prices indicates that New York's performance is among the weakest of the 20 metropolitan statistical areas (MSAs) in its survey. It was one of only two MSAs, along with Chicago, to post annual declines in September 2012. New residential permits are increasing but still far below pre-recession levels. This data may not be representative of the city's activity given the large number of rental units. The city's 2011 Housing and Vacancy Survey indicates that rental units comprise 65% of the city's 3.4 million housing units. Since 2008 the number of rental units has increased1% while owner units have declined 3%. About 8% of total units are vacant.

Several of the sectors experiencing solid growth, including retail, health care and social assistance, transportation, and leisure and hospitality, are generally associated with lower wages. This may mute growth in economically sensitive revenues, which account for about one-half of budgeted fiscal 2013 city funds revenue.

Contact:

Primary Analyst
Amy Laskey
Managing Director
+1-212-908-0568
Fitch, Inc.
One State Street Plaza
New York, NY 10004

Secondary Analyst
Karen Wagner
Director
+1-212-908-230

Committee Chairperson
Karen Krop
Senior Director
+1-212-908-0661

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

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In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, University Financial Associates, S&P/Case-Shiller Home Price Index, IHS Global Insight, National Association of Realtors, and Property and Portfolio Research.

Applicable Criteria and Related Research:
--'Tax-Supported Rating Criteria' (Aug. 14, 2012);
--'U.S. Local Government Tax-Supported Rating Criteria' (Aug. 14, 2012).

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Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. Local Government Tax-Supported Rating Criteria
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