New Issue: Moody's assigns Aa2 Ratings to $813 million of New York City General Obligation Refunding Bonds

Global Credit Research - 21 May 2012

$41.2 Billion of G.O. Debt Outstanding; Outlook is Stable

NEW YORK (CITY OF) NY
Cities (including Towns, Villages and Townships)
NY

Moody's Rating

ISSUE		RATING
General Obligation Bonds, Fiscal 2012 Series I		Aa2
Sale Amount	$750,000,000	
Expected Sale Date	05/23/12	
Rating Description	General Obligation	
General Obligation Bonds, Fiscal 2012 Series J		Aa2
Sale Amount	$13,200,000	
Expected Sale Date	05/23/12	
Rating Description	General Obligation	
General Obligation Bonds, Fiscal 2012 Series H		Aa2
Sale Amount	$50,000,000	
Expected Sale Date	05/23/12	
Rating Description	General Obligation	

Moody's Outlook N/A

Opinion

NEW YORK, May 21, 2012 --Moody's Investors Service has assigned Aa2 ratings to the City of New York's $50 million General Obligation Bonds, Fiscal 2012 Series H, $750 million Series I, and $13.2 million Series J. Proceeds of the bonds, scheduled to price on May 23, will be used to refund various series of outstanding general obligation bonds for upfront savings.

SUMMARY RATING RATIONALE

The ratings reflect the city's institutionalized budgetary and financial management controls and a series of proactive responses to budget strain during the financial downturn; its reliance on a volatile financial services sector; and a high budgetary burden from the combination of debt service, pension, and employee and retiree health care costs. The outlook is stable.

STRENGTHS

-- Large, diverse economy driven by the high income financial services industry

-- Strong governance and financial best practices, tested through periods of fiscal stress

-- Conservative budgeting

CHALLENGES

-- Cyclical economic base driven by the financial services industry

-- The need to close significant outyear budget gaps

-- High and growing burden from debt service, pension and retiree health care costs

DETAILED CREDIT DISCUSSION

TAX REVENUE GROWTH SLOWS LATE IN FISCAL 2012 BUT TREND STILL REFLECTS OVERALL GOOD GROWTH

The budget revision released earlier this month illustrates the impact of weaker financial services industry profits on the city's employment and revenues. While total fiscal 2012 taxes are expected to increase by 4.3% compared to fiscal 2011, growth in personal income taxes (19% of forecast fiscal 2012 tax collections) has been revised downwards by $205 million in fiscal 2012 and by $125 million in fiscal 2013. Those changes result in a forecast personal income tax decrease of 2.1% in fiscal 2012, followed by an estimated 6.4% increase in fiscal 2013. Similarly, the forecast for business tax collections (13% of fiscal 2012 taxes) was revised downwards by $351 million in fiscal 2012 and $370 million in fiscal 2013, but overall those taxes are estimated to increase by 1.9% in fiscal 2012 and by 1.6% in fiscal 2013. Estimates of real property taxes (43% of tax revenue) continue to reflect overall health in the city's real estate market, with growth of 4.8% and 2.5% in fiscal 2012 and 2013, respectively. Through the fiscal 2012-2016 budget forecast period, property taxes are estimated to increase annually by an average of 2.5% and reflect in part the five-year phase-in of changes in assessed value, a stabilizing factor in city total tax collections. Total city tax collections are forecast to increase by 4.3% in fiscal 2012 and 3.5% in fiscal 2013, and by an average of 3.1% annually between fiscal 2012 and 2016.

CITY CONTINUES PROACTIVE BUDGET RESPONSES, SOME ONE-TIME RESOURCES USED TO BALANCE FISCAL 2012 AND 2013

The city's strong multi-year budget forecasting process routinely identifies large outyear budget gaps, a trend that continues even with forecasted revenue growth. To close small gaps in the fiscal 2012 and 2013 budgets that resulted from the downwards revision in tax collections, the city will use some one-time resources, including funds from a legal settlement and $1 billion from the sale of new taxi medallions; overall, however, those one-time resources reflect only 2% of the city's budget. As it has throughout the downturn, we expect the city to continue to identify recurring expenditure solutions to budget gaps. Reflecting the city's proactive approach, the budget enacted last June had forecasted a gap of $4.6 billion in fiscal 2013 which it successfully closed, a gap of $4.8 billion in fiscal 2014 and a $4.9 billion gap in fiscal 2015. The current budget revision reflects gaps that now total $3.0 billion, $3.7 billion and $3.2 billion in fiscal years 2013 through 2016, respectively.

ECONOMY CONTINUES TO IMPROVE BUT UNCERTAINTY IN THE FINANCIAL SECTOR AND EUROPE STILL POSE CHALLENGES

New York City's economy continues to recover well, although at a slightly slower pace than it had been earlier last year. The city's private employment increased by just less than 1% in 2010 compared to a decline of just less than 1% nationally, and increased by 1.4% in 2011 compared to the U.S. rate of 1.8%, and has regained the jobs lost during the recession. Similarly, the city's unemployment rate decreased to 8.9% in 2011 from 9.5% in 2010, about the same as what occurred nationally. Since then, however, the city's unemployment rate has increased steadily, rising to 9.5% in April compared to the U.S. rate of 8.1%. The important financial services sector, which accounts for 12.5% of the city's employment, played a key role in helping the city regain jobs. Following three consecutive years of declines in financial sector employment in 2008, 2009 and 2010, jobs increased in 2011 by 1.6%. Overall financial services employment (12.5% of city jobs) increased by 2.8% in 2011 following decreases of 0.5%, 1,3% and 6.7% in 2008, 2009 and 2010, respectively. Employment in the securities industry sub-sector - which accounts for 25% of wages in the city - increased by 4.0% in 2010 after declining by 10.0% in 2009 and 1.9% in 2011. Despite that recent recovery, however, the overall number of financial services jobs is only at levels that is was in 2005 and securities employment is at 2009 levels. Amid weak profits at financial institutions and pressure on U.S. and European banks, the financial services industry could contract more and will remain volatile. The economic recovery nationally remains tentative and other challenges that could slow the city's economy still remain. Weak consumer confidence nationally and globally could impact tourism in the city, which through the downturn was a bright spot, or its real estate markets, which in recent years attracted significant foreign investment.

AMID HIGH FIXED COSTS PENSION PROPOSAL IS A LONG-TERM CREDIT POSITIVE

The city's combined fixed costs for debt service, pensions and employee and retiree health benefits continue to be a significant source of pressure. Based on the May forecast, those costs amount to 51.4% of current fiscal year tax revenue and 32.0% of total revenue, a high fixed cost burden that reduces the city's flexibility in balancing its budget. Based on the current plan, those combined costs are estimated to increase at an average annual rate of 3.7% through 2016, slightly faster than the city estimated in February.

In February, the city announced several proposed changes in the funding assumptions and methods used by the New York City Retirement Systems, based on the recommendation of the city Office of the Actuary and the systems' independent actuary. Two of the most significant changes of the proposal are to lower the assumed investment rate of return to 7.0% from 8.0%, and to replace the current frozen initial liability actuarial funding method with the more commonly used entry age normal method. To mitigate the increased costs from lowering the investment return assumption, the city proposal reflects recalculating its liabilities based on current market values and amortizing the liabilities over a 22-year period, on average seven years longer than the current funding horizon. Based on the funding method the city currently uses, the funded ratio of the system is 100%. The city has also disclosed in its annual audit that based on the entry age normal method, the funded status of its retirement system at the end of fiscal 2009 was 70.3%. The city expects to issue an average of $2.5 billion of general obligation bonds annually through fiscal 2016.

STATE AND FEDERAL CUTS TO MEDICAID WILL CONTINUE TO BE CHALLENGING

The state budget reduced education aid to the city by $1.2 billion in the current fiscal year. Medicaid changes in the state budget-and federal budget deficit reduction measures that could affect Medicaid going forward-will also pose a significant challenge to the city, especially since that funding reflects the primary source of support for the city's large safety-net hospital system, which is already pressured itself and is receiving increased city subsidy payments.

HEALTHY CASH POSITION CONTINUES

The city's cash position continues to be healthy. The ending fiscal 2011 cash balance was $5.0 billion according to the city's Office of Management and Budget, and the city comptroller reports that the average daily balance during the fiscal year was $5.1 billion. According to the comptroller, the ending cash balance for the first quarter of the city's fiscal year (July-September) was $5.1 billion, with an average daily balance of $5.8 billion. For the January-March 2012 quarter, the comptroller estimated an average monthly ending balance of $6.4 billion.

WELL-MANAGED VARIABLE RATE AND DERIVATIVES PORTFOLIOS

New York City, through general obligation, Transitional Finance Authority (TFA) and other debt issuance vehicles uses variable rate debt as a lower interest cost alternative than fixed rate debt. Currently, variable rate debt (reflecting general obligation, lease and TFA debt) amounts to 15% of the city's total outstanding net tax-supported debt. While that amount is sizeable, the annual interest rate risk it poses should be manageable in the context of the city's $67 billion all funds spending plan. The city has $6.3 billion of general obligation variable rate debt outstanding, and the Transitional Finance Authority (TFA) has a total of $3.3 billion of outstanding variable rate debt. Additionally, the city has $30 million of appropriation-backed variable rate debt outstanding. Counterparty risk is mitigated through the use of a diverse array of liquidity providers: 24 banks provide liquidity support for general obligation variable rate debt and 17 support TFA variable rate demand debt. The city monitors its variable rate portfolio closely and proactively works to renew or replace expiring liquidity facilities or to convert variable rate bonds to fixed rate or other interest rate modes if necessary.

The city has 11 outstanding interest rate swap agreements associated with its general obligation bonds, with five separate counterparties, and two swaps related to city-appropriation backed debt issued through the Dormitory Authority of the State of New York (DASNY) with two counterparties. In our analysis, the swap portfolio's potential risks to the city are manageable: rating triggers that would cause the agreements to terminate early or post collateral are low, ranging between Baa1 and Baa3. As of March 31, 2012, the combined outstanding notional amounts of the swaps was $2.1 billion, with a mark-to-market value of -$203 million.

OUTLOOK

The rating outlook for New York City's general obligation bonds is stable. The city's institutionalized budgetary controls and early responses to the downturn have helped it manage through the current economic downturn, although risks remain, including actions the state could take to balance its own budget. While the city has taken proactive measures that have provided near-term benefits, mounting costs for debt service, pensions and retiree health care will continue to pressure the city, even with recently-enacted changes.

WHAT COULD MAKE THE RATING GO UP

-- Sustained reduction in the growth of the city's debt burden and other fixed costs, and establishment of formal policy for managing debt within prescribed constraints

-- Improved and continuing growth in city employment and the property tax base

-- Establishment of significant formal budget reserves to buffer the inherent volatility of the financial services sector

WHAT COULD MAKE THE RATING GO DOWN

-- Inability to manage rapidly rising costs in non-discretionary spending such as debt service, personnel costs, and pensions

-- Divergence from the city's well-established fiscal practices

-- Emergence of significant liquidity strain and the need for large cash-flow borrowings

The principal methodology used in this rating was General Obligation Bonds Issued by U.S. Local Governments published in October 2009. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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