FitchRatings

Fitch Rates New York City, NY's GOs 'AA'; Outlook Stable

Ratings Endorsement Policy

20 Sep 2013 4:32 PM (EDT)

Fitch Ratings-New York-20 September 2013: : Fitch Ratings assigns an 'AA' rating to the following New York City general obligation (GO) bonds:

--Approximately $425 million GO bonds, fiscal 2014 series D, consisting of $300 million tax-exempt bonds, subseries D-1, and $125 million taxable bonds, subseries D-2.

In addition, Fitch affirms its 'AA' rating on the city's approximately $42 billion in outstanding GO bonds including the following subseries of bonds which will be converted to the fixed rate mode on Oct. 16, 2013 (the conversion date):

--Approximately $180 million, fiscal 2003 series C, subseries C-4 and C-5 (to be re-designated subseries C-A on the conversion date);
--Approximately $20 million, fiscal 2006 series H, subseries H-1 and H-2 that would have been mandatorily redeemed in the years 2014-2020 (to be re-designated subseries H-A on the conversion date).

The Rating Outlook is Stable.

The bonds are expected to be priced via negotiation on Sept. 25. Proceeds of series D bonds will be used to fund general city capital expenditures.

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

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 and job recovery has been strong, although the unemployment rate remains elevated.

HIGHLY EFFECTIVE BUDGET MANAGEMENT: The city's sound approach to budget development features reasonable revenue and expenditure forecasting, effective budget monitoring, and effective actions to eliminate projected deficits. Currently forecasted budget gaps over the next four years are below historical norms, but notable risks to the forecast continue given the number and magnitude of variables involved.

LABOR SETTLEMENTS UNCERTAIN: Fitch believes one of the biggest near-term risks to continued financial stability is the resolution of long-expired labor contracts. The city's financial plan includes no allowance for retroactive payments, although some contracts have been expired since 2009, and minimal funding for collective bargaining agreements going forward.

HIGH & GROWING LONG TERM LIABILITIES: Fitch anticipates a continued high debt burden given the city's significant capital commitments and future tax-supported issuance plans. Post-employment liabilities are also sizable.

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. Recent performance shows moderate revenue growth following a modest recessionary decline in fiscal 2009.

RATING SENSITIVITIES

BUDGET GAPS: Fitch believes the city will be increasingly challenged to close current year budget gaps with mostly recurring measures. Notable growth in the magnitude of out-year imbalances could lead to negative rating action.

LONG-TERM LIABILITIES: An increase in the city's long-term liabilities could negatively affect the rating. Fitch believes the most likely avenue to control this growth is through retiree healthcare benefits, although pressure to control wage and salary costs may make this difficult.

CREDIT PROFILE

EXPECTATION FOR CONTINUED BUDGET BALANCE

Fitch views positively the city's tight monitoring and control of revenues and expenses, including monthly reporting and three full budget updates annually. Fiscal year-end results generally show modest, positive variation from budget.

The adopted budget for fiscal 2014 totals $70 billion, 3.4% below estimated fiscal 2013 spending. The drop incorporates prepayment of $2.8 billion in fiscal 2014 debt service and other expenses in fiscal 2013. It also reflects $1.5 billion spending in fiscal 2013 to repair damage from Hurricane Sandy and related federal reimbursement. Timing of both spending and reimbursement for these repairs is somewhat uncertain, but Fitch believes that at least the large majority of, if not all, costs will ultimately be reimbursed.

The city's inability to carry a fund balance somewhat limits financial flexibility. Management has offset this constraint by using operating surpluses to prepay debt service and other expenses in subsequent years. Prior to the economic downturn, with several consecutive years of operating surpluses the city had accumulated a surplus of $8 billion to roll forward. Since fiscal 2009, however, annual operating deficits have eroded the amounts available for future years' budgets.

Fitch believes the size of the recent operating deficits is manageable (1%-2% of spending) but would view negatively the elimination of the accumulated cushion. The current forecast for fiscal 2013 indicates the tide has shifted to the positive, ending with about a $360 million operating surplus, an improvement from the $270 million deficit anticipated when the executive budget was proposed in May. Fitch expects the city to retain a modicum of accumulated surplus and continue the practice of prepaying out-year expenses.

DOWNWARD TREND IN OUT-YEAR GAPS

Somewhat offsetting Fitch's concern about recent operating deficits is the moderating trend in projected gaps in the out-years of the financial plan. The fiscal 2012 executive budget showed gaps of $4.8 billion-$5.3 billion, or 6%-7% of the budget, in each of the out-years of the plan (fiscal 2013-2015). In contrast, the adopted budget for fiscal 2014 shows gaps of $1.4 billion-$2 billion or 2%-3% (fiscal 2015-2017).

The improvement in out-year gaps is a result of both a modestly increased revenue forecast and the city's continual efforts to control spending and enhance revenue through its programs to eliminate the gap (PEGs). Since 2008, these programs have resulted in gap reduction of $6.3 billion in fiscal 2013 and $6.6 billion in fiscal 2014. The most recent PEG, first announced in November 2012, reduces the fiscal 2013 and 2014 gaps by $537 million and $1 billion, respectively.

The program calls for headcount reductions of 1,324 or a modest 0.05% of overall headcount in fiscal 2014, nearly all through attrition. In addition to headcount reductions, a moderate amount of the PEG 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.

HIGHLY DETAILED ESTIMATES OF DIVERSE REVENUE MIX; RISKS REMAIN

The city benefits from a diversity of revenue sources. Fitch believes that the city's revenue estimates, based on a highly detailed and frequently-reviewed analysis, are reasonable.

The property tax is the largest source, at 26% of forecasted fiscal 2013 funds, followed by personal income tax at 13% and sales tax at 8%. Intergovernmental sources are primarily for education and social services programs, and make up 28% of forecasted fiscal 2013 revenue. Combined taxes make up 63% of total revenue. The city appears to have a moderate amount of room to increase the property tax levy under the cap.

A recent State Court of Appeals ruling upholding the legislation authorizing the sale of additional taxi medallions will allow the city to proceed with the sale of 400 medallions in fiscal 2014, anticipated to yield $300 million. Sale of additional medallions requires state administrative approval. The financial plan assumes an additional $1.2 billion in revenue for such sales through fiscal 2017.

Areas of revenue risk beyond tax forecast variations include 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. A teacher evaluation plan implemented in June that allows the city to receive $1.5 billion in state and federal aid will likely be subject to review by a new administration following this November's mayoral election.

Management estimates the gross cost to public sector facilities from Hurricane Sandy to be $4.5 billion, of which $1.5 billion will come from the operating budget and the rest from reimbursable capital spending. The damage cost estimate does not include the cost of enhancements for future damage mitigation.

The mayor recently presented a report analyzing climate risks to the city that proposes $20 billion in funding for protection of the city's assets from the impact of climate change. About one-half of this amount is already included in the city's 10-year capital strategy or federal relief already appropriated by Congress and allocated to the city. A portion of the remainder may come from funds appropriated by Congress but not yet allocated to the city.

MODERATE USE OF NON-RECURRING MEASURES

The city uses a limited amount of one-time resources to balance its annual operating budget, including the sale of taxi medallions and the transfer of the remaining $1 billion from a trust established for retiree healthcare costs. The city transferred out $82 million in fiscal 2010, $395 million in fiscal 2011, $672 million in fiscal 2012, and $1 billion in fiscal 2013, to help cover the cost of annual retiree benefits.

LONGER-TERM SPENDING PRESSURES

One of the biggest budgetary uncertainties is the potential cost of expired labor contracts. The budget includes neither retroactive payments nor salary increases for fiscal 2013. A modest reserve for collective bargaining assumes increases of 1.25% per year. Fitch is concerned that the resolution of expired contracts, likely sometime next year, might result in sizable spending pressures going forward.

Debt service consumes $6.2 billion or 9% of the fiscal 2014 budget. Debt service is forecast to increase to $7.7 billion or 9.8% of total spending by fiscal 2017. 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. Fitch does not view the reduction in the subsidy for federal tax credit bonds such as Build America Bonds as a risk for the city, as the financial exposure is minimal.

A more notable concern is the cost of pension and other employee benefits which total $8.3 billion and $8.9 billion, respectively, in the fiscal 2014 budget. The city projects that rapid escalation in pension costs (from $1.5 billion in fiscal 2002) should moderate through fiscal 2017 as market losses from the last recession are fully smoothed in. However, Fitch believes cost pressures associated with pensions will continue given the low funded ratios, ranging from 48% to 62% using a standard actuarial method, and large unfunded liability. The city uses an expected investment return rate of 7%. Fitch would be concerned if pension payments increased more than anticipated or unfunded liabilities grew measurably.

The city projects other employee benefits will rise an additional $2.4 billion over the next four years. About $2.2 billion of the fiscal 2014 employee benefit costs are for other post-employment benefits (OPEB). Fiscal 2013 pension and OPEB costs consume 14.1% of total funds.

The city's ability to achieve pension reform or to negotiate pensions with organized labor is dependent on state legislative approval. 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.

HIGH AND RISING DEBT A CREDIT CONCERN

Debt metrics remain high. Fitch-calculated net tax-supported debt including Transitional Finance Authority (TFA) future tax secured bonds grew an average 7.4% per year over the last five years and equals approximately $8,928 per capita, and 9.1% of fiscal 2013 full value. Carrying costs for debt service, pensions and OPEB rose to 22.3% of spending in fiscal 2013, which Fitch considers to be on the high end of the moderate range.

The city's capital commitments are extensive, totaling $42.5 billion for fiscal 2013-2017, including $9 billion for self-supporting water and sewer projects and $10.6 billion for education. Tax-supported issuance plans during fiscal 2013-2017 include $11.5 billion of city GOs and $13.6 billion of TFA future tax-secured bonds.

The city and related issuers have approximately $11.1 billion in outstanding variable-rate debt or 16% of tax-supported debt. Fitch considers this exposure to be manageable given the hedge provided by the city's substantial short-term assets and its sophisticated management, diversity of liquidity providers, and strong demonstrated access to the capital markets.

ECONOMY NOT WITHOUT CHALLENGES DESPITE INHERENT STRENGTHS

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, attracting a record 52 million visitors in 2012, the third record year in a row.

The city's economic profile also benefits from good wealth levels, although census data indicates that per capita and median household income are similar to the U.S. average, market value per capita is over $100,000. However, the above-average individual poverty rate of 19.4% in 2011, compared to 14.3% 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 30% of earnings. Financial activities employment rose only 0.7% in 2012. The high-earning securities and commodities component of the sector showed similar trends in 2012 after adding roughly 500 jobs or 0.3%.

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 resident employment base increased by 1% in 2012, above the state's slight 0.4% growth but behind the U.S. at 1.9%. The unemployment rate increased to an average of 9.3% in 2012 from 9% in 2011. Recent data are more encouraging; the August 2013 rate of 8.7% compares favorably to the August 2012 rate of 9.4%, and the improvement was due to strong employment growth of 2.5%. However, the most recent rate is still a full percentage point above the U.S. average.

The city anticipates a large 14.9% increase in personal income tax revenue in fiscal 2013, largely due to recognition of capital gains prompted by federal tax law changes. Following this increase, fiscal 2014 personal income tax revenue is forecast to decline 10.6%, which would bring revenues to 2.7% above the fiscal 2012 level.

The city assumes continued strong visitor-related spending and moderate economic growth will yield sales tax growth of 3.4% in fiscal 2014, after 5.2% growth in fiscal 2013. The latter recognizes the temporary slow-down, and then acceleration, in spending following Hurricane Sandy.

The market value of real estate grew by a healthy 4.5% in fiscal 2013 and is projected to grow another 6.9% in fiscal 2014. Despite recent weakness in the commercial market, growth is driven by office and commercial properties (class 4) and to a lesser extent by multi-family homes (class 2).

Residential real estate continues to struggle in the region. The most recent release of the S&P/Case-Shiller Index of single-family home prices indicates that New York's performance remains among the weakest of the 20 metropolitan statistical areas (MSAs) in its survey. Given a dearth of single-family homes within the city, however, the S&P/Case-Shiller condo index may be a more relevant indication of trends. This index shows a much more moderate decline from peak to trough, and a stronger recovery. Prices have grown by 13.2% and 7.1% for condos and single-family homes, respectively, from the trough in 2012.

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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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Additional Disclosure
Solicitation Status