MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aa2 ratings to $800M of NYC GO bonds; outlook stable

Global Credit Research - 20 Sep 2013

$38.8 billion of GO debt outstanding

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

Moody's Rating

ISSUE		RATING
General Obligation Bonds Fiscal 2003 Series C, Subseries C-A		Aa2
Sale Amount	$180,000,000	
Expected Sale Date	09/26/13	
Rating Description	General Obligation	
General Obligation Bonds Fiscal 2006 Series H, Subseries H-A		Aa2
Sale Amount	$20,000,000	
Expected Sale Date	09/26/13	
Rating Description	General Obligation	
General Obligation Bonds, Fiscal 2014 Series D, Adjustable Rate Subseries D-4		Aa2
Sale Amount	$100,000,000	
Expected Sale Date	09/25/13	
Rating Description	General Obligation	
General Obligation Bonds, Fiscal 2014 Series D, Adjustable Rate Subseries D-5		Aa2
Sale Amount	$75,000,000	
Expected Sale Date	09/25/13	
Rating Description	General Obligation	
General Obligation Bonds, Fiscal 2014 Series D, Tax-Exempt Subseries D-1		Aa2
Sale Amount	$300,000,000	
Expected Sale Date	09/25/13	
Rating Description	General Obligation	
General Obligation Bonds, Fiscal 2014 Series D, Taxable Subseries D-2		Aa2
Sale Amount	$125,000,000	
Expected Sale Date	09/25/13	
Rating Description	General Obligation	

Moody's Outlook

Opinion

NEW YORK, September 20, 2013 --Moody's Investors Service has assigned Aa2 ratings to the City of New York's $425 million General Obligation Bonds, Fiscal 2014 Series D, consisting of $300 million Tax-Exempt Subseries D-1 and $125 million Taxable Subseries D-2. Proceeds of the bonds, scheduled to price on September 25, will be used to finance portions of the city's capital plan. Concurrently, we have assigned Aa2 underlying ratings to two series of adjustable rate general obligation bonds scheduled to be issued on October 16 and supported by letters of credit: $100 million Fiscal 2014 Series D, Subseries D-4 and $75 million Subseries D-5 (variable rate Subseries D-3, supported by a standby bond purchase agreement, will be described in a separate report). Separate reports that describe the terms of the letters of credit are forthcoming. Additionally, on October 16 the city will reoffer certain maturities of outstanding variable rate Subseries 2003 C-4 and C-5 and 2006 H-1 and H-2 as fixed rate bonds. The reoffered bonds will reflect $180 million General Obligation Bonds, Fiscal 2003 Series C, Subseries C-A and $20 million Fiscal 2006 Series H, Subseries H-A. The remaining maturities of the outstanding bonds will continue to be in variable rate mode and the letters of credit that provide liquidity support are expected to be substituted on October 16. Separate reports on those liquidity facilities also are forthcoming.

SUMMARY RATING RATIONALE

The ratings reflect the city's institutionalized budgetary and financial management controls, its proactive responses to budget strain during economic downturns; 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.

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 ongoing need to close outyear budget gaps

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

DETAILED CREDIT DISCUSSION

SMALLER FORECASTED BUDGET GAPS REFLECT ECONOMIC IMPROVEMENT AND PROACTIVE BUDGET MANAGEMENT; POTENTIAL LABOR SETTLEMENT COSTS ADD FORWARD UNCERTAINTY

The city has a strong multi-year budget forecasting process that it updates quarterly and uses to identify outyear budget gaps and develop plans to mitigate them. Based on the most current iteration of the financial plan (June 2013), which reflects the enacted fiscal 2014 budget and forecasts through fiscal 2017, the city has identified gaps of $2.0 billion, $1.8 billion and $1.4 billion in fiscal years 2015, 2016 and 2017, respectively. Those gaps are notably smaller than the ones the city closed at the height of the downturn and indicate the degree to which the city's economy has recovered since then and a brighter revenue picture for the city, and factors that have reduced forecasted expenditures.

Fiscal 2013 tax revenues are estimated to have increased by 8.5% compared to fiscal 2012. The large increase partly reflects strong personal income tax collections, which increased by 14.9% over the prior year. Like many jurisdictions with a concentration of high income individuals, personal income tax collections year-to-date have been robust, reflecting taxpayers' efforts to take gains before the expiration of tax cuts in December 2012. The increase is most likely one-time and the revised fiscal 2014 forecast reflects a 10.6% decline in personal income tax collections, and conservatively a 0.8% decline in tax collections overall. Sales taxes also are estimated to have increased by 5.2% in fiscal 2013, the result of the city's improved employment situation and record high tourism.

In June, the state's highest court upheld the city's sale of new taxi medallions, one-time revenues the city had planned to use to help close budget gaps starting in fiscal 2013. The sales will total nearly $1.5 billion through fiscal 2017 but in each fiscal year reflect less than 1% of forecasted tax revenue. The city lost $273 million in fiscal 2013 state education aid annually and $15 million in federal education aid due to the failure to implement a teacher evaluation system in January 2013. An evaluation system has been agreed on now, which averts the potential loss of about $364 million of state education aid in fiscal 2014. The city's budget gaps could increase, however, and its ability to find balanced solutions to close them could be challenged by the need to settle expired contracts with its labor unions. Depending on when and how those are resolved could be the source of budget strain and an important factor in our rating.

CITY ECONOMY RECOVERS BUT FINANCIAL SECTOR EMPLOYMENT LAGS

The city's employment picture has recovered remarkably well. Private sector employment as of August 2013 is 6.0% greater than the pre-recession peak in August 2008 and it continues to increases at an annual rate of more than 2%. By comparison, national private employment is still 1.2% lower than its pre-recession peak. Nonetheless, as city residents reenter the labor force and seek jobs, the unemployment rate has increase. As of August the city's unemployment rate was 8.6% compared to the US level of 7.4%.

The important financial services sector, which accounts for 12.0% 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 3.3% but decreased by 0.3% in 2012. However, industry employment trends remain weak, with jobs declining in twelve of the past 16 months. Employment in the securities industry sub-sector - which accounts for 21% of wages in the city - increased by 3.6% in 2011 after declining by 10.0% in 2009 and 1.9% in 2010, and declined in 2012 by 1.5%. The overall number of financial services jobs is only at levels that it was in 2005 and securities employment is at 2009 levels. More positively, tourism in the city has reached record levels, with 52 million visits in 2012, 2.2% more than the prior year.

CITY ECONOMY AND FINANCES WITHSTAND HURRICANE SANDY

While certain areas of the city were hard hit by Hurricane Sandy, most notably coastal areas of Brooklyn, Staten Island and Queens, the storm's impact did not impair the city's Aa2 general obligation rating or its stable outlook. A key rating factor for the city is its resilient economy, demonstrated again by the overall fast recovery from the affects of flooding and nearly week-long power outages , especially in the financial center of lower Manhattan. Outright property destruction was limited to a small part of the city. While some commercial and residential properties have substantial repairs to make to their internal infrastructure, the impact on the city's $814 billion taxable full value overall was minimal, although we expect some property values to decline.

The city estimates $4.5 billion of direct losses to city agencies and assumes that the federal government will reimburse nearly all of that, mostly through the Federal Emergency Management Agency (FEMA). FEMA typically reimburses state and local governments for not less than 75% of their emergency response, clean up and repair costs and based on that amount the city estimates it could have $1.1 billion of unreimbursed costs. Actual reimbursements are likely to be higher, however, since FEMA approved 100% reimbursements for costs associated with emergency power restoration and emergency public transportation during the period between October 31 through November 14; and over a defined 30 day period for the reimbursement of regular time salaries and benefits to perform debris removal operations. Additionally, the city has been awarded Community Development Block Grant Disaster Recovery funds that it is able to use to help match FEMA funds, which would reduce the city's overall out of pocket costs.

Cash balances before and immediately after the storm were healthy: on the day after the storm, the unrestricted cash balance was $4.9 billion, according to the city comptroller, equal to 7.2% of estimated fiscal 2013 total revenue and 10.2% of estimated city funds revenue. Cash balances were temporarily bolstered during the week after the storm as most agencies were closed and some outlays were delayed. Since the storm, federal legislation was enacted to provide an additional $51 billion of funds to storm-affected areas, and at least $1.8 billion of federal reimbursements have flowed to the city already. The city's cash balances have continued to be healthy overall, and it ended fiscal 2013 with the largest cash balance on record, according to the city comptroller, of $7.9 billion.

HIGH FIXED COSTS FOR DEBT SERVICE AND PENSIONS

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 current financial plan, those costs amount to 51.7% of estimated fiscal year 2014 tax revenue and 33.5% 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 5.4% between fiscal 2014 and 2017. The city's ability to control the growth of those expenses continue to be a key rating factor.

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. 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 $69.9 billion proposed fiscal 2014 all funds spending plan. The city has $6.0 billion of general obligation variable rate demand debt outstanding, and the Transitional Finance Authority (TFA) has a total of $3.5 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. More recently, in an effort to reduce its overall borrowing costs and mitigate bank exposure, the city has converted various variable demand bonds to floating rate index modes. Those bonds do not have the put risk associated with demand debt but do have refinancing risk, which is manageable given the city's record of market access. The city currently has $323 million of general obligation index mode bonds outstanding and $269.2 million outstanding issued through TFA.

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 July 1, 2013 the combined outstanding notional amount of the swaps was $1.9 billion, with a mark-to-market value of -$171 million.

OUTLOOK

The outlook for New York City's general obligation bonds is stable. The city's institutionalized budgetary controls and early recognition of future budget pressure help it maintain a balanced financial position and weather economic downturns. The city's economy is reliant on a volatile financial services sector, but it continues to diversify and its finances will benefit. Despite its strong budgetary controls, mounting costs for debt service, pensions and retiree health care will continue to be a challenge for the city.

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 US Local Governments published in April 2013. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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