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New York City; Appropriations; General Obligation

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New York City; Appropriations; General Obligation

Credit Profile		
US$700.0 mil go rfdg bnds fiscal 2014 ser G, H due 08/01/2033		
Long Term Rating	AA/Stable	New
New York City GO		
Long Term Rating	AA/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AA' rating and stable outlook to New York City's fiscal 2014 series G and H general obligation (GO) bonds. At the same time, Standard & Poor's affirmed its 'AA' rating, with a stable outlook, on the city's existing GO debt. The ratings are pursuant to our recently released local GO criteria.

The city's faith, credit, and unlimited ad valorem pledge secure the bonds. Bondholders benefit from the security of the general debt service fund established by state statute, with city real estate tax revenue deposited into the fund and retained under a statutory formula in an amount sufficient to cover debt service.

We understand that officials plan to use bond proceeds to redeem selected maturities on various series of GO bonds outstanding.

The 'AA' rating reflects our assessment of the following factors for New York City:

- Its broad and diverse economy considering its status as the nation's largest city and economic center;
- Strong budgetary flexibility, given limitations on the city's ability to maintain general fund reserves under the Financial Emergency Act, offset by the city's historical trend of using surplus to prepay subsequent years' expenditures;
- Adequate budgetary performance in the general and total governmental funds in fiscal 2013;
- Very strong liquidity when highly liquid investments and exceptional access to external support are considered;
- Very strong management given the city's well-established policies and practices;
- Very weak debt and contingent liability position pressured by significant unfunded pension and other postemployment benefit (OPEB) liabilities; and
- Very strong Institutional Framework.

Outlook

The stable outlook reflects what we view as New York City's deep and diverse economy and status as the nation's largest employment center. Strong and tested financial management policies and practices further support the rating. We view these factors, together with the city's very strong liquidity position - but offset by its very weak debt and contingent liability profile -- as stable over the two-year outlook horizon. We believe that the incoming administration could have either a positive or negative effect on these factors if it pursues significant structural changes. Upward rating potential is limited to one notch given New York City's very high debt burden, but could occur based on strong and concrete evidence of structural improvement in the city's general and governmental fund positions. Conversely, downward rating pressure could stem from weaker structural alignment and diminished budgetary flexibility, although we view this as unlikely due to New York City's track record of budgetary balance.

Strong economy

With an estimated population of 8.17 million residents, New York City is the most populous city in the nation, and continues to experience growth. Its major employment sectors continue to comprise trade, financial activities, professional services, education, health services, and government. The financial sector continues to play a major role in the city economy, representing 27.3% of total city wages and 11.3% of total employment in 2012. New York City's unemployment rate averaged 9.4% in 2012, which was higher than both state and national rates. However, year-to-date data through October 2013 suggest that the city's labor force grew to 4.07 million, an increase of approximately 1.2% from October 2012.

Contrary to national economic trends, the full value of New York City taxable real estate has increased in each of the past four fiscal years, to $901.5 billion in 2014 from $725.0 billion in fiscal 2010. Assessed values have also increased, contributing to a broadening of New York City's tax base. Personal income and retail sales growth have also benefitted the city's revenue base since the start of the recession, with personal income rebounding to pre-recession levels at $472.3 billion in 2012 and taxable retail sales at $34.6 billion in 2011. When all taxable purchases (including retail, utility and communication sales, services, manufacturing, and other sales) are considered, collections have exceeded their pre-recession highs, at $116.3 billion in 2011.

New York City's per capita effective buying income is what we consider good at 103.3% of the national average, while market value per capita is strong, in our view, at $101,848.

Strong budgetary flexibility

In our opinion, the city's budgetary flexibility is strong due to the Financial Emergency Act's limits on maintaining reserves from current year revenue, which translates to zero dollars in available general fund balances year after year. In response, New York City has historically used its excess surplus in the fourth quarter each year to prepay subsequent years' expenditures (primarily debt service). Fiscal 2013 contributions totaled $2.8 billion, despite payment of Superstorm Sandy-related expenses during the year, compared with $2.4 billion in fiscal 2012. We view these prepayments, which totaled $2.8 billion or 4.3% of expenditures in 2013, as a form of reserve balance. Similarly, a significant reduction in prepayments could put pressure on the rating.

We believe that, despite statutory limitations on its major revenue sources, New York City retains strong budgetary flexibility based on its track record of receiving state legislative approval for proposed revenue increases. In our opinion, legislative approval has proven to be a lower hurdle than direct voter approval. In addition, we believe that the city makes these revenue requests sparingly and, as a result, has demonstrated success in obtaining legislative approvals, or otherwise making adjustments where necessary. The recent state authorization of taxi medallion sales (which was further upheld in court) serves as a recent example.

Overall, we consider New York City's revenue stream diverse, albeit with the aforementioned statutory limitations. Historically, real property taxes represent the single largest share of city revenue (27% in 2013), followed by state and federal aid (including education aid) at 29%, and other taxes (primarily personal income taxes, business and franchise taxes, and sales tax) at a combined 38%. The city is at 95% of its constitutional ad valorem taxing margin, though debt service is exempt from the limit.

Adequate budgetary performance

We consider New York City's budget performance strong, with nearly balanced general fund operations in 2013 and a slight surplus of 1.9% in total governmental funds (after reimbursements to the New York City central treasury for capital expenditures). Audited financial statements show a 5.5% budget growth due, in large part, to increases in federal grant spending. The expenditure growth was offset by 8.6% growth in tax receipts from the previous year, reflecting a strengthening of the local economy. The results also take into account nearly $2.8 billion in expenditure prepayments. The city's history of making midyear adjustments based on budget performance data has helped to ensure operational balance, in our view.

However, we believe that the new administration that takes office in January could affect the city's financial projections and future structural position -- either positively or negatively -- depending on the priorities of Mayor-Elect de Blasio and the financial impact of his administrations implementation.

New York City's adopted fiscal 2014 expense budget totals $69.9 billion, about 3.6% lower than the fiscal 2013 budget. It represents the 34th consecutive budget that is balanced under generally accepted accounting principles (GAAP), except for the application of Governmental Accounting Standards Board (GASB) Statement 49. The budget does not contain tax increases. Controllable spending levels are increasing 3% from the previous fiscal year, largely because of the $6.4 billion cumulative savings from 12 gap-closing actions taken since 2007 during the Bloomberg administration. Fixed-cost spending (noncontrollable spending), which includes pension, health care, and Medicaid, rose by $2.0 billion and, in our view these programs remain a significant, rising, ongoing cost pressure that, absent changes, will test New York City's ability to balance operations in the future. Management projects that the portion of the budget the city funds will be $50.3 billion in fiscal 2014. The city will also use $2.7 billion in surplus funds accumulated in previous years to balance the fiscal 2014 budget and $142 million to balance the fiscal 2015 budget. This represents the exhaustion of previous years' accumulated surpluses, and, absent the ability to continue to generate positive results, New York City could lack this additional flexibility in the near term.

The city's current four-year financial plan, prepared under the Bloomberg administration and submitted annually to the control board as required by the financial emergency act and the City Charter, includes capital, revenue, and expense projections, and outlines proposed gap-closing programs for years with projected budget gaps. A pattern of current-year balance and projected subsequent-year budget gaps has been consistent through the entire period since 1982. The financial plan projects balanced revenue and expenses for fiscal years 2014 and 2015 in accordance with GAAP, except for the application of GASB 49.

The November modification projects balanced operations for fiscal years 2014 and 2015, and gaps of approximately $1.5 billion and $951 million in fiscal years 2016 and 2017, respectively. These gaps are reduced from those projected in the June 2013 financial plan, which showed projected gaps of approximately $2 billion, $1.8 billion, and $1.4 billion in fiscal years 2015 through 2017, respectively.

We believe that the plan contains some risks, including the following:

- Although final costs and revenue implications associated with Superstorm Sandy are not fully known at this time, New York City appropriated $500 million in capital funds for schools and hospitals damaged by the storm and an additional $500 million for emergency repairs. The financial plan assumes that those costs are fully funded from non-city sources. Officials estimate damage to city property, including that operated by the New York City Housing Authority and the New York City Health and Hospitals Corp., is about $4.5 billion. We expect that management will make short- and long-term financial plan adjustments related to the storm.
- The pace of economic recovery is uncertain.
- Sequestration (across-the-board spending cuts) and the associated impact of decreased federal aid could negatively affect revenue.
- Collective bargaining agreements could place pressure on expenditures. In addition, state and federal funding could be reduced if a teacher evaluation system is not implemented.
- Funding levels from state and federal sources are always an area of uncertainty for the financial plan. New York City estimates that federal sequestration could reduce federal aid to the city further. The economic implications of the range of federal tax increases could be much more substantial.

Despite these risks, we believe that the city has a demonstrated history of adapting its budgets to achieve balance through difficult economic cycles.

Very strong liquidity

We view New York City's liquidity position as very strong, with total governmental cash and liquid investments representing 12.3% of total governmental fund expenditures in fiscal 2013, and 124% of debt service. Furthermore, we believe that due to New York City's revenue diversity, the city maintains a robust and predictable cash flow with at least $3 billion in cash receipts coming in the door each month. In addition, New York City has demonstrated that it has exceptional access to capital markets based on its frequent debt issues backed by multiple security types.

Very strong management

We view New York City's financial management as very strong with strong policies and practices. These practices include detailed long-term financial plans that are shared with the public, annual audit reports, and frequent reporting to the city council and state authorities. We believe that these practices are strong, well embedded, and sustainable over the long term.

Very weak debt and contingent liability profile

In our opinion, New York City's debt and contingent liabilities profile is very weak, based on the city's net direct debt burden and debt service costs. The city's significant and rising pension and other postemployment benefit (OPEB) costs are an additional source of pressure, given that officials do not currently have a formal plan in place to address these liabilities. Total governmental funds debt service was a moderate, in our view, 9.9% of governmental funds expenditures in 2013, while net direct debt represented 99% of total governmental funds revenue.

New York City maintains a number of pension systems that provide benefits for its employees and employees of various independent city agencies. These systems combine features of a defined benefit pension plan with those of a defined contribution plan. As of June 30, 2012, plan membership for the five major New York City retirement systems was approximately 372,000 active employees and 313,000 retirees and beneficiaries. As of fiscal 2013, the funding status of the city's pension systems has been reported under the "entry age actuarial cost method." Under this method, the unfunded liability was approximately $72 billion, the result being a 60.7% funded rate for the pension systems.

The assumed investment rate of return is 7%, with investment gains and losses phased in over six years. In 2013, the pension funds realized a 12.12% investment compared to 1.37% for fiscal 2012. The financial plan projects pension expenses for fiscal years 2014 through 2017 at $8.3 billion, $8.2 billion, $8.3 billion, and $8.5 billion, respectively. The average annual growth in pension costs in fiscal years 2002 to 2012 was 20%. Pension costs have increased by more than 500% to $8.0 billion in fiscal 2013 from $1.3 billion in fiscal 2002. Pension costs for fiscal 2013 totaled $9.46 billion, or 14% of general fund expenditures. Although New York City projects an annual leveling of these costs in fiscal years 2014 and 2015, it demands a larger share of tight budget resources.

New York City's net OPEB obligation at June 30, 2013, was substantial in our view, at $92.5 billion. As of the most recent valuation, the city had $2.1 billion of assets in the fund and the plan was 3.0% funded, leaving an unfunded OPEB accrued liability of $69.3 billion. The annual OPEB cost in fiscal 2013 was $5.5 billion, of which the city paid 21.6%. As of June 30, 2012, the retiree health benefits trust had a balance of $2.6 billion, but drawdowns of $672 million in fiscal 2012, $1 billion in fiscal 2013, and a projected $1 billion in fiscal 2014, will completely deplete the fund.

Very strong Institutional Framework

The Institutional Framework score for New York City is very strong reflecting the demonstrated success of the state's ad hoc, but tested, support mechanisms during the city's past periods of fiscal stress. (See the Institutional Framework score for New York, published Sept. 12, 2013.)

Related Criteria And Research

Related Criteria

- USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013
- Institutional Framework Overview: New York Local Governments, Sept. 12, 2013
- USPF Criteria: GO Debt, Oct. 12, 2006

Ratings Detail (As Of December 6, 2013)		
New York City Educl Const Fd, New York		
New York City, New York		
New York City Educl Const Fd (New York City)		
Long Term Rating	AA-/Stable	Affirmed
New York City Educl Const Fd (New York City) rev bnds (New York City) ser 2011A due 04/01/2041		
Long Term Rating	AA-/Stable	Affirmed

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