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

Fitch Ratings-New York-05 December 2013: Fitch Ratings assigns an 'AA' rating to the following New York City general obligation (GO) bonds:

--Approximately $700 million fiscal 2014 series G and H.

In addition, Fitch affirms the 'AA' rating for the city's approximately $40.8 billion in outstanding GO bonds.

The Rating Outlook is Stable.

The bonds are expected to be priced via negotiation on Dec. 10. Proceeds of series G and H bonds will be used to refund outstanding GO bonds.

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 through fiscal 2017 are modest, 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 sizable share of the city's budget and are highly vulnerable to variability in the financial services industry. Recent performance shows a trend of sound growth with some year-to-year variability.

RATING SENSITIVITIES

BUDGET GAPS: Despite recent reductions in the magnitude of out-year imbalances, other credit risks make improvement in the rating unlikely. However, notable growth in these gaps 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 for controlling this growth is through retiree healthcare benefits, although pressure to control wage and salary costs may make obtaining savings in benefits 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 fiscal 2014 budget, reflecting the November financial plan modification (the November modification), totals $72.7 billion. The budget is 2.4% above audited fiscal 2013 spending and 4.0% above the adopted fiscal 2014 budget. The increase from the adopted budget reflects additional prepayments of fiscal 2015 expenses supported by a somewhat improved tax revenue forecast.

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. Between fiscal years 2009 and 2012, annual operating deficits eroded the amounts available for future years' budgets, but fiscal 2013 again reversed the trend, showing a moderate operating surplus. A similar surplus is forecast for fiscal 2014.

Fitch expects the city to retain a modicum of accumulated surplus and continue the practice of prepaying out-year expenses. Fitch would view negatively the elimination of this surplus.

DOWNWARD TREND IN OUT-YEAR GAPS

The November modification continues to show meaningful reductions in projected future deficits. As recently as fiscal 2012, the 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 November modification shows no gap in fiscal 2015 and 1%-2% in fiscal 2016-2017.

The improvement in out-year gaps is a result of both revenue strength and the city's continual efforts to control spending and enhance revenue through its programs to eliminate the gap (PEGs).

HIGHLY DETAILED ESTIMATES OF DIVERSE REVENUE MIX; RISKS REMAIN

The city benefits from a diversity of revenue sources, although many are subject to economic volatility. 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 27% of forecasted fiscal 2014 funds, followed by personal income tax at 11% and sales tax at 9%. Intergovernmental sources are primarily for education and social services programs, and make up 29% of forecasted fiscal 2013 revenue. Combined taxes make up 63% of total revenue. The city has a modest amount of room to increase the property tax levy under the cap. The full value of real estate grew by a healthy 6.2% in fiscal 2013 and an even stronger 10.7% in fiscal 2014, following modest growth the prior two fiscal years. The five-year phase-in of market value changes should promote solid property tax performance for at least the next few fiscal years.

Areas of revenue risk beyond forecast tax 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 the new administration as of Jan. 1, 2014.

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 $364 million (and another $1.2 billion through fiscal 2017) from the sale of taxi medallions and the transfer of the remaining $1 billion from a trust established for retiree healthcare costs.

LONGER-TERM SPENDING PRESSURES

One of the biggest budgetary uncertainties as well as a challenge for the incoming administration is the potential cost of expired labor contracts. The budget includes no retroactive salary adjustments, but a modest reserve of 1.25% per year beginning in fiscal 2014. Fitch is concerned that the resolution of expired contracts, likely sometime next year, might result in sizable spending pressures going forward. A fact-finding procedure with the UFT is expected to conclude on Dec. 11, but the timing of recommendations, which are non-binding, is uncertain.

Debt service consumes $6 billion or 8.3% of the fiscal 2014 budget. Debt service is forecast to increase to $7.6 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 post-employment benefits (OPEB), which total $8.3 billion and $2.2 billion, respectively (a combined 14.4% of expenditures), in the fiscal 2014 budget. The city projects that following rapid escalation in pension costs (from $1.5 billion in fiscal 2002), costs will decline slightly in fiscal 2015 and grow slowly thereafter. OPEB payments, while lower, grow more quickly and reflect funding on a pay-as-you-go basis.

Fitch believes cost pressures associated with pensions will continue despite some improvement due to strong investment returns. Pension funded ratios are low at an aggregate of 60.7%, and the unfunded liability is a large $72 billion. 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 unfunded OPEB liability is even higher, at $92.5 billion, and there is no indication of an effort to reduce it either by adding to the recently-depleted trust or reducing benefits. Fitch believes that the latter will be difficult as the new administration negotiates with labor units that have not had contractual wage increases in several years.

HIGH AND RISING DEBT IS 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. If unfunded pension and OPEB obligations were included, the long-term obligation burden would more than triple. Carrying costs for debt service, pensions and OPEB rose to 21.2% of spending in fiscal 2013, which Fitch considers to be in the moderate range.

The city's capital commitments are extensive, totaling $36.5 billion for fiscal 2014-2017, including $7.5 billion for self-supporting water and sewer projects and $8.4 billion for education. Tax-supported issuance plans for fiscal 2014-2017 include $9.8 billion of city GOs and $10.5 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 HAS INHERENT STRENGTHS BUT 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, 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 dropped 0.2% in 2012. The high-earning securities and commodities component of the sector showed similar trends in 2012 after shedding roughly 2,500 jobs or 1.5%.

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 9.2% in 2012 from 9% in 2011. Recent data are more encouraging - the October 2013 preliminary rate of 8.9% is slightly improved from the October 2013 rate despite a solid 1.3% increase in employment. However, the most recent rate is more than a percentage point above both the state and U.S. averages.

Personal income tax revenue grew by 14.6% 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 8.6%, which would bring revenues moderatelyabove the fiscal 2012 level.

The city assumes continued strong visitor-related spending and moderate economic growth will yield sales tax growth of 3.9% in fiscal 2014, after 5.5% growth in fiscal 2013. The latter recognizes the temporary slow-down, and then acceleration, in spending following Hurricane Sandy.

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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, CoreLogic Case-Shiller Home Price Index, and Global Insight.

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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