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## New York City; General Obligation

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# New York City; General Obligation

## Credit Profile

US\$375.0 mil GO bnds (Tax-exempt) ser A-1 due 08/15/2033

*Long Term Rating* AA/Stable New

US\$125.0 mil GO bnds ser A-2 due 08/19/2033

*Long Term Rating* AA/Stable New

## Rationale

Standard & Poor's Ratings Services assigned its 'AA' long-term rating to New York City's series 2014 series A (A-1 tax-exempt and A-2 taxable) general obligation (GO) bonds. Standard & Poor's also affirmed its 'AA' rating on the city's GO parity bonds. The outlook is stable.

The ratings reflect our view of the city's:

- Substantial and diverse economic base. After a period of economic retrenchment resulting from the national recession, which affected employment, income, and the overall real estate market, economic trends have improved. On a percentage basis, the city has recovered all of the private-sector jobs lost in the recession and has been recovering at a faster pace than the nation as a whole. Although it is unclear what the long-term effects of Superstorm Sandy will be, we anticipate robust rebuilding activity. The magnitude and pace of the recovery will depend on federal, state, and private insurance funding.
- Comprehensive financial planning process, which has helped it effectively balance forecast revenue declines and ongoing spending pressures. The city's recent budgets and financial plan updates incorporate slower economic and revenue growth than has actually occurred, and we believe the city has historically moved swiftly and successfully to address projected budget gaps.
- Prudent use of surplus revenue, which has enabled it to prepay expenses for subsequent budget years and reduce future debt and expenditures.

Partly offsetting the above strengths, in our view, are the city's:

- Above-average (but lessening) reliance on the financial services sector for resident income and tax revenue, which has translated into volatility over time;
- High debt burden by most measures and significant capital funding requirements;
- Significant pension and other postemployment benefit (OPEB) liabilities, which we believe, absent changes in funding mechanisms or changes in obligations, will exert an ever-increasing burden on budgets.

The city's full faith and credit secures the bonds. Proceeds will be used to fund a portion of the city's ongoing capital improvement plan. 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.

Along with the sale of these bonds, New York City plans to convert certain maturities of series 1994A-8; A-9; A-10; 1994B-3; 199H-3; and 2006E-2, E-3 and E-4 bonds from adjustable rate to fixed rate (fiscal 2014 subseries 1). Upon

successful conversion, Standard & Poor's will assign the city GO rating to the converted bonds.

On June 27, 2013, the city submitted its financial plan for fiscal years 2014 through 2017 to the control board along with a modification to the fiscal 2012 financial plan with respect to the fiscal 2013 year. The plan projects balanced operations for fiscal years 2013 and 2014 in accordance with generally accepted accounting principles (GAAP), except for the application of Governmental Accounting Standards Board (GASB) Statement No. 49 (landfill closure costs).

As has historically been the case with the city's financial plans, the current plan projects out-year gaps. The projected gaps in the financial plan submitted in May are approximately \$2.0 billion, \$1.8 billion, and \$1.4 billion in fiscal years 2015 through 2017, respectively. The outlying gaps are more modest than in recent plans, the result of ongoing gap-closing actions and more recently, better-than-budgeted revenues in certain categories due to an improving economy. The June 2012 financial plan projected higher gaps of approximately \$2.5 billion, \$3.1 billion, and \$3.1 billion in fiscal years 2014 through 2016, 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 New York City Health and Hospitals Corp., is about \$4.5 billion. We anticipate 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 adversely 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 successfully 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 by \$7 million in fiscal 2013 and \$141 million in fiscal 2014. The economic implications of the range of federal tax increases could be much more substantial.

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

## **Outlook**

The stable outlook reflects our view that New York City will continue to effectively balance its budget despite a range of risks to its financial plan. We anticipate that Superstorm Sandy and economic and budget implications associated with federal sequestration could translate into financial plan adjustments, but the city's strong, long-term-focused planning and proactive budget management practices mitigate these risks, in our view. We believe the well-developed budget management framework has provided New York City with the flexibility to align revenue and expenditures through various economic cycles and events.

## Finances

### Fiscal 2013 update

As of the June 2013 financial plan update, management projects fiscal 2013 total revenue to increase by \$4.3 billion from the fiscal 2012 revenue forecast. New York City did budget the use of \$2.4 billion in surplus funds accumulated in previous years to help balance the fiscal 2013 budget. Use of surplus revenue represents the exhaustion of prior-year accumulated surpluses, a cost-offsetting option that New York City will likely lack in the near term.

### Adopted fiscal 2014 budget

New York City's fiscal 2014 expense budget totals \$69.9 billion, about 3.0% less than the fiscal 2013 budget. It represents the 34th consecutive budget that is balanced under GAAP, except for the application of GASB 49. The budget does not contain tax increases. Controllable spending levels are basically flat from the prior fiscal year, largely because of the \$6.6 billion cumulative savings from 12 gap-closing actions taken since 2007 during the Bloomberg Administration. Fixed-cost spending (non-controllable spending), which includes pension, health care, and Medicaid, rose by \$1.7 billion and, in our view, remains a significant, rising, ongoing cost pressure that, absent changes, will test the city's ability to balance operations in the future.

Management projects that the portion of the budget funded by the city 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 will likely lack this option in the near term.

### Fiscal 2013-2017 financial plan

As required by act and the City Charter, New York City annually prepares a four-year financial plan, which it reviews and updates quarterly. The financial plan 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 2013 and 2014 in accordance with GAAP, except for the application of GASB 49.

The city projects gaps of approximately \$2.0 billion, \$1.8 billion, and \$1.4 billion in fiscal years 2015 through 2017, respectively, after the implementation of a gap-closing program described below. The June 2012 financial plan had projected gaps of approximately \$2.5 billion, \$3.1 billion, and \$3.1 billion in fiscal years 2014 through 2016, respectively.

Since the June 2012 financial plan submission, updated estimates reflect an increase in projected net revenue of \$1.3 billion, \$98 million, \$625 million, and \$1.08 billion in fiscal years 2013 through 2016, respectively.

Major changes in projected major revenue categories include:

- Increases in real property tax revenue of \$281 million, \$601 million, \$696 million, and \$984 million in fiscal years 2013 through 2016, respectively;
- An increase in personal income tax revenue of \$664 million in fiscal 2013 primarily because of employment gains

and the acceleration of capital gains realization, and decreases of \$352 million, \$84 million, and \$100 million in fiscal years 2014 through 2016, respectively (with the fiscal 2014 decrease primarily resulting from the acceleration of capital gains realization into fiscal 2013);

- An increase in business tax revenue of \$400 million in fiscal 2013, and decreases of \$100 million, \$37 million, and \$210 million in fiscal years 2014 through 2016, respectively;
- Increases in real property transfer and mortgage recording tax revenue of \$284 million, \$92 million, \$153 million, and \$145 million in fiscal years 2013 through 2016, respectively;
- An increase in tax audit revenue of \$337 million in fiscal 2013;
- Decreases of \$635 million, \$65 million, and \$60 million in fiscal years 2013 through 2015 and an increase of \$360 million in fiscal 2016 because of changes in the anticipated timing of, and anticipated revenue from, the sale of taxi medallions. The number of taxi medallions that may be sold and the timing of such sale are subject to litigation and, with respect to medallion sales after 2014, New York State administrative approval.

The financial plan also reflects (since the June 2012 financial plan) decreases in projected net expenditures of \$1.1 billion in fiscal 2013, and increases of \$1.2 billion, \$273 million, and \$450 million in fiscal years 2014 through 2016, respectively.

Changes in projected major expenditure categories include:

- Decreases in employer health insurance costs of \$11 million, \$191 million, \$210 million, and \$232 million in fiscal years 2013 through 2016, respectively, as a result of lower-than-assumed health insurance rates;
- Net increases in agency expenses of \$158 million, \$914 million, \$459 million, and \$457 million in fiscal years 2013 through 2016, respectively;
- Decreases in debt service of \$277 million, \$223 million, and \$126 million in fiscal years 2013 through 2015, respectively, primarily as a result of lower interest rates and debt refinancing, and an increase of \$25 million in fiscal 2016;
- A reduction in the reserve for claims from past periods of \$500 million in fiscal 2013; and
- A reduction in the general reserve of \$260 million in fiscal year 2013 and an increase of \$150 million in fiscal 2014.

In addition, the financial plan reflects increases in required pension contributions of \$124 million, \$203 million, \$320 million, and \$420 million in fiscal years 2013 through 2016, respectively, as a result of the pension funds' realizing a lower-than-assumed actuarial rate of return in fiscal 2012 as well as technical adjustments.

Gap-closing actions to maintain budget balance in fiscal 2013, achieve budget balance in fiscal 2014, and reduce previously projected gaps in fiscal years 2015 and 2016 reflect reduced agency expenditures or increased revenue totaling \$537 million, \$1.05 billion, \$560 million, and \$573 million in fiscal years 2013 through 2016, respectively.

The financial plan also reflects, since the June 2012 financial plan, a fiscal 2013 increase in the provision for the prepayment of \$2.7 billion of fiscal 2014 expenses and \$142 million of fiscal 2015 expenses.

## **Taxi Medallion Update**

On June 6, 2013, the State Court of Appeals (New York State's highest court) unanimously upheld state legislation authorizing the sale of additional taxi medallions by the city. The decision overturned a lower court ruling that such legislation was unconstitutional. As a result of the appellate process, delays in the sale of taxi medallions caused a

revision from the June 2012 Financial Plan requiring revenues previously expected in 2013 into future years. As reflected in the Financial Plan, the city now expects to receive \$300 million, \$400 million, \$360 million, and \$400 million in fiscal years 2014 through 2017, respectively, from the sale of 400, 550, 500, and 550 taxi medallions, respectively, in such years. The number of taxi medallions that may be sold and the timing of such sales, with respect to medallion sales after fiscal year 2014, are subject to state administrative approval.

## **Superstorm Sandy**

Superstorm Sandy caused widespread damage to the coastal and other low-lying areas in various parts of New York City, including most of downtown Manhattan. In its November financial plan update, the city included \$500 million in capital funds for schools and hospitals damaged by the storm and \$500 million in expense funds for emergency repairs. Although New York City cannot yet quantify the full, long-term impact of the storm on its economy, a preliminary estimate of property damage to the city infrastructure, the New York City Housing Authority, and the New York City Health and Hospitals Corp. is approximately \$4.5 billion. Of this amount, approximately \$1.5 billion represents expense funding for emergency response, debris removal, and emergency protective measures, and approximately \$3.0 billion represents capital funding of long-term permanent work to repair damaged infrastructure.

The financial plan assumes that most of the city's costs relating to the storm will ultimately be paid from non-city sources, primarily the federal government. We are aware that the federal government has authorized the maximum reimbursement rate from the Federal Emergency Management Agency (FEMA) of 90% of total costs, based on the damage thresholds reached by the state of New York. The city reports that FEMA has begun to make portions of eligible reimbursement payments. Although the financial plan assumes that remaining amounts will be paid from other sources, we have no assurance that New York City will be reimbursed for all of its costs or that such reimbursements will be received within the periods assumed in the financial plan. In addition, the city could incur costs relating to flood insurance that are not reflected in the financial plan, and this could offset some reimbursements. As with most federal appropriations, storm-related funding, including FEMA reimbursement, is subject to federal sequestration.

## **Pensions: Costs Are Growing**

The 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 2012, 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 \$70 billion, the result being a 60.1% 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 2012, the pension funds realized a 1.4% investment return (significantly below the assumed rate of return), which will require additional city contributions of \$98 million, \$197 million, and \$295 million in fiscal years 2014 through 2016, respectively. New York City projects pension expenses for fiscal years 2013 through 2017 at \$8.2 billion, \$8.3 billion,

\$8.3 billion, \$8.5 billion, and \$8.8 billion, respectively. The average annual growth in pension costs in fiscal years 2002 to 2012 was 20%. Pension costs in city funds have increased by more than 500% to \$8.0 billion in fiscal 2013 from \$1.3 billion in fiscal 2002. Management projects pension costs for fiscal 2013 to consume 11.1% of total expenditures. Although New York City projects an annual leveling of these costs in fiscal years 2013 to 2015, it demands a larger share of tight budget resources.

## **Other Postemployment Benefits**

New York City's net OPEB obligation at June 30, 2012 was substantial in our view, at \$88.2 billion. As of the most recent valuation, the city had \$2.6 billion of assets in the fund and the plan was 3.1% funded, leaving an unfunded OPEB accrued liability of \$83.3 billion. The annual OPEB cost in fiscal 2012 was \$5.7 billion, of which the city paid \$1.4 billion. As of June 30, 2011, 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 delete the fund.

## **Economy**

With more than 8 million residents, New York City remains the most populous city in the nation, and continues to see growth. The city's major employment sectors continue to comprise trade, finance, professional services, education and health services, and government, and financial services. As of June 2013, the city reports total city employment at 3.97 million, a 1.9% increase from June 2012. From 2009 to 2012, the city added 205,500 private-sector jobs during the economic recovery, equaling a growth rate of approximately 7%. According to the Bureau of Labor Statistics, the city's unemployment rate was 8.4% in June 2013, similar to the national rate, though it averaged 9.2% in 2012, above the nation's 8.1%. Most of these sectors exhibited job growth in the past year, despite losses in the manufacturing and information sectors. New York City remains particularly reliant on the financial sector, which represented approximately 29.7% of total wages and 11.6% of total employment in 2011.

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 2009. Assessed values have also increased in each of the past five fiscal years, reflecting 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 \$455.5 billion in 2011, while taxable retail sales continue to gain ground at \$34.6 billion. When all taxable purchases (including retail, utility and communication sales, services, manufacturing, and other sales) are considered, total taxable sales have exceeded their pre-recession highs, at \$116.3 billion in 2011.

The city's financial plan assumes modest economic growth for 2013-2017, trending below growth projections for the U.S. economy as a whole. The Office of Management and Budget (OMB) estimates real gross city product increased 2.3% in 2012, and projects 1.1% growth in 2013, followed by a slight 0.7% increase in 2014, then averaging 2.4% through 2017. The wage rate declined 1.1% in 2012 and OMB projects 2.1% growth in 2013 and 1.2% growth in 2014, before returning to growth rates above 2%. Personal income grew 1.6% in 2012 and OMB expects additional growth of 2.0% in 2013 and above 3% through 2017.

## Related Criteria And Research

USPF Criteria: GO Debt, Oct. 12, 2006

Ratings Detail (As Of July 22, 2013)		
New York City GO adj rate (AMBAC) <i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
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<b>New York City GO</b> <i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
<b>New York City GO (CIFG)</b> <i>Unenhanced Rating</i>	AA(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

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