FitchRatings

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

Ratings Endorsement Policy

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Fitch Ratings-New York-17 May 2013: Fitch Ratings assigns an 'AA' rating to the following New York City general obligation (GO) bonds:

--Approximately $950,000,000 GO bonds, fiscal 2013 series I and J.

In addition, Fitch affirms its 'AA' rating on the city's $42 billion in outstanding GO bonds.

The Rating Outlook is Stable.

The bonds are expected to be sold via negotiation on May 22.

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

HIGHLY EFFECTIVE BUDGET MANAGEMENT: The city's sound approach to budget development features conservative revenue and expenditure forecasting and effective budget monitoring. Management is thus able to react quickly to changing conditions through periods of economic stress, constrained state aid, and rising spending pressures.

CONSISTENT RESOLUTION TO OUT-YEAR GAPS: Fitch expects the city's long history of effectively eliminating annual budget deficits to continue. Currently forecasted gaps are well within historical norms, but notable risks to the forecast continue given the number and magnitude of variables involved.

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 although the unemployment rate remains elevated. Income levels are high.

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.

HIGH DEBT LEVELS: 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.

RATING SENSITIVITIES

BUDGET GAPS: An inability to close current year budget gaps with mostly recurring measures, or notable growth in the magnitude of out-year imbalances, could lead to negative rating action.

LONG-TERM LIABILITIES: A change in the city's long-term liability profile could affect the rating. Given the above average burden of debt and post-employment benefits, Fitch believes positive rating movement is unlikely in the near to medium term.

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 executive budget for fiscal 2014 (released on May 2) totals $69.8 billion, 2.9% below estimated fiscal 2013 spending. The drop mainly reflects $1.5 billion spending in fiscal 2013 to repair damage from Superstorm Sandy and related federal reimbursements. Timing of both spending and reimbursement for these repairs is somewhat uncertain, but Fitch believes that at least the large majority of costs will ultimately be reimbursed.

Fiscal 2013 revenues and spending are now each forecast to be about 2% higher than in the January 2013 forecast. The out-year forecast (fiscal 2015-2017) remains similar to the January presentation, with both revenues and expenditures slightly higher.

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 this cushion. The current forecast assumes fiscal 2013 will end with a minimal $270 million operating deficit (1.9% of spending), which will be funded with a portion of the $2.4 billion in surplus rolled forward from fiscal 2012. The remaining $2.2 billion will be carried forward and largely spent in fiscal 2014.

Consistent with most recent fiscal years, Fitch believes that this is a somewhat conservative forecast. Fitch expects the city to eliminate if not reverse the annual deficits in the near to medium term and retain a modicum of accumulated surplus.

DOWNWARD TREND IN OUT-YEAR GAPS

Somewhat offsetting Fitch's concern about recurring 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 executive budget for fiscal 2014 shows gaps of $1.4 billion-$2.2 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 706 in fiscal 2013 and 1,338 in fiscal 2014, nearly all through attrition. The reductions are modest relative to the city's overall headcount of more than 255,000. 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

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

In addition to tax forecast variations, areas of revenue risk include proceeds from the sale of taxi medallions, which total $1.5 billion over the plan period; $1.7 billion in state and federal aid related to agreement on a teacher evaluation plan; 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.

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.

MODERATE USE OF NON-RECURRING MEASURES

The city uses a limited amount of one-time resources to balance its annual operating budget. The fiscal 2014 executive budget includes $300 million from the sale of taxi medallions. This amount is in question given a state court ruling that the legislation authorizing the sale of additional medallions was unconstitutional. The city has filed an appeal and assumes the matter will be resolved in its favor in fiscal 2014. The financial plan includes $1.2 billion in additional funds from new taxi medallions in fiscal 2015-2017.

Another non-recurring resource in fiscal 2014 is 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 to help cover the cost of annual retiree benefits.

LONGER-TERM SPENDING PRESSURES

The budget includes neither retroactive payments for most expired labor contracts not yet settled nor salary increases for fiscal 2013. A modest reserve for collective bargaining assumes increases for most bargaining units of 1.25% per year. Fitch believes the resolution of expired contracts, which appears unlikely in the current fiscal year, might result in 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 $8.8 billion, respectively, in the fiscal 2014 budget. The rapid escalation in pension costs (from $1.5 billion in fiscal 2002) is projected to moderate through fiscal 2017 despite changes in actuarial assumptions including a drop in the expected investment return rate to 7% from 8% and actual investment returns for fiscal 2012 of only 1.4%.

During this period employee benefits are projected to continue to rise an additional $2.3 billion. 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 14.6% of total funds. Adding debt service, carrying costs rise to 23% of spending, which Fitch considers to be on the high end of the moderate range.

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

ELEVATED DEBT WITH MANAGEABLE VARIABLE-RATE EXPOSURE

Debt metrics remain high. Fitch-calculated net tax-supported debt including Transitional Finance Authority (TFA) future tax secured bonds equals approximately $8,943 per capita, and 8.6% of fiscal 2013 full value. 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. Forecasted debt issuance is similar to the amount of outstanding principal scheduled to amortize during the same period.

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 the city's sophisticated management, diversity of liquidity providers, and strong demonstrated access to the capital markets.

ECONOMY HAS INHERENT STRENGTHS BUT IS 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. The city attracted 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 indicate 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 overall 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 9.3% in 2012 from 9% in 2011. The April 2013 rate of 7.7% compares favorably to the April 2012 rate of 8.8%. The improvement was due primarily to employment growth, with slight labor force contraction.

The city anticipates a large 14.6% 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 10.4%, 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 4.2% in fiscal 2014, after 4.4% 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 is projected to grow by a healthy 5.3%. Despite recent weakness in the commercial market, growth is driven by office and commercial properties (class 4) and to a lesser extent multi-family homes (class 2). The city anticipates a moderate adjustment in the final roll for damage related to hurricane Sandy, and expects market value to grow moderately in the out-years.

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 11.9% and 2.9% 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).

Applicable Criteria and Related Research
Tax-Supported Rating Criteria
U.S. Local Government Tax-Supported Rating Criteria

Additional Disclosure

Solicitation Status