MOODY'S
INVESTORS SERVICE

# New Issue: Moody's assigns Aa2 ratings to $950 million of City of New York general obligation refunding bonds

Global Credit Research - 17 May 2013

**$41.8 billion of general obligation debt outstanding; outlook is stable**

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

**Moody's Rating**

| ISSUE | | RATING |
|---|---|---|
| General Obligation Bonds, Fiscal 2006 Series I-4 | | Aa2 |
| **Sale Amount** | $125,000,000 | |
| **Expected Sale Date** | 04/07/06 | |
| **Rating Description** | General Obligation | |
| General Obligation Bonds Fiscal 2013 Series I | | Aa2 |
| **Sale Amount** | $230,000,000 | |
| **Expected Sale Date** | 05/22/13 | |
| **Rating Description** | General Obligation | |
| General Obligation Bonds Fiscal 2013 Series J | | Aa2 |
| **Sale Amount** | $720,000,000 | |
| **Expected Sale Date** | 05/22/13 | |
| **Rating Description** | General Obligation | |
| General Obligation Bonds, Fiscal 2006 Series I-5 | | Aa2 |
| **Sale Amount** | $75,000,000 | |
| **Expected Sale Date** | 04/07/06 | |
| **Rating Description** | General Obligation | |
| General Obligation Bonds, Fiscal 2006 Series I-6 | | Aa2 |
| **Sale Amount** | $75,000,000 | |
| **Expected Sale Date** | 04/07/06 | |
| **Rating Description** | General Obligation | |

**Moody's Outlook**

**Opinion**

NEW YORK, May 17, 2013 --Moody's Investors Service has assigned Aa2 ratings to $950 million of City of New York general obligation bonds, consisting of $230 million Fiscal 2013 Series I and $720 million Fiscal 2013 Series J. Proceeds of the bonds, scheduled to price on May 22, will be used to refund outstanding general obligation for debt service savings and to fix out a portion of the city's outstanding variable rate demand bonds. Concurrently, we have assigned underlying ratings to the following three subseries of outstanding city general obligation variable rate demand bonds: $125 million Fiscal 2006 Series I, Subseries I-4; $75 million Subseries I-5; and $75 million

Subseries I-6. The assignments are in conjunction with the substitutions of the letters of credit that support the bonds. A forthcoming report will be published that describes the terms of the new letters of credit.

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 need to close significant outyear budget gaps and near term reliance on one-time gap closing measures

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

DETAILED CREDIT DISCUSSION

BALANCED BUDGETS CONTINUE, WITH SOME RELIANCE ON ONE-TIME MEASURES; FISCAL 2013 TAX REVENUE INCREASES BUT CONSERVATIVELY EXPECTED TO BE FLAT IN FISCAL 2014

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 this forecast, released earlier this month, the city has identified gaps of $2.2 billion, $1.9 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.

Recent versions of the city's financial plan relied in part on one-time resources to balance the budget. An example is the inclusion of one-time proceeds from the sale of new taxi medallions, expected to garner $1.46 billion through fiscal 2017. Revenues from the sale were originally expected to begin to be realized in fiscal 2013 but has been delayed by a court challenge, forcing the city to seek other gap-closing measures. The city has reduced the amount it expects to receive from the medallion sale in fiscal 2014 if it is permitted to go forward, from $600 million to $300 million, with $400 million, $360 million and $400 million expected in each of fiscal years 2015, 2016 and 2017. Those amounts are less than 1% of forecasted tax revenue but would be a gap the city has to close nonetheless. 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. If a teacher evaluation system is not implemented by September 1, 2013, the city could lose an additional $364 million of state education aid in fiscal 2014. A state court judge ruled earlier this year that the state cannot withhold those funds, but there is still uncertainty around the ultimate resolution of the issue. Potential costs that result from outstanding labor settlements also could challenge the budget, depending on when they are resolved.

The city expects fiscal 2013 tax revenue to increase by 7.6% 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. As a result, fiscal 2013 personal income taxes, which reflect 21% of the city's total tax revenue, are expected to increase by 14.6% compared to fiscal 2012. The increase is most likely one-time and the fiscal 2014 forecast reflects a 10.4% decline in personal income tax collections, and conservatively a 0.2% decline in tax collections overall.

CITY ECONOMY RECOVERS BUT CHALLENGES POSED BY FINANCIAL SECTOR, NATIONAL ECONOMY

The city recovered all the private sector jobs it lost during the downturn and growth continues: there were 261,000 more private sector jobs in the city in March 2013 than in September 2009, the nadir of the downturn. Private sector employment increased by 1.8% in March 2013 compared to the same month in the prior year. While the city's unemployment rate had risen to 10% during the summer, it was 8.9% in March compared to the U.S. rate of

7.6%.

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 eleven of the past 16 months. The decline in March 2013 was notable at 1.2%, and by 0.1% in April, indicative of retrenchment still occurring in the industry. 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. The economic recovery nationally remains tentative and other challenges that could slow the city's economy still remain. Weak consumer confidence nationally and globally could impact tourism in the city, although visitation has been strong, or its real estate markets, which in recent years attracted significant foreign investment.

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. It estimates that the cash low point occurred in December, at $2.4 billion, and the forecasted cash ending balance is $8.8 billion.

AMID HIGH FIXED COSTS PENSION CHANGES ARE A LONG-TERM CREDIT POSITIVE

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 May financial plan update, 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.

In January the city enacted several proposed changes in the funding assumptions and methods used by the New York City Retirement Systems, based on the recommendation of the city Office of the Actuary and the systems' independent actuary. Two of the most significant changes are lowering the assumed investment rate of return to 7.0% from 8.0%, and replacing the frozen initial liability actuarial funding method with the more commonly used entry age normal method. To mitigate the increased costs from lowering the investment return assumption, the city recalculated its liabilities based on market values and amortized them over a 22-year period, on average seven years longer than the prior funding horizon. Based on the prior funding method, the funded ratio of the system was 100%. Based on the entry age normal method, disclosed on the city's audit, the funded status of its retirement system at the end of fiscal 2012 was 60.1%.

STATE AND FEDERAL CUTS TO MEDICAID WILL CONTINUE TO BE CHALLENGING

The state budget reduced fiscal 2012 education aid to the city by $1.2 billion and state education aid to the city could be reduced going forward depending on the outcome of implementing a teacher evaluation system. Federal budget deficit reduction measures that could affect the Medicaid program going forward will also pose a significant challenge to the city, especially since that funding reflects the primary source of support for the city's large safety-net hospital system, which is already pressured itself and is receiving increased city subsidy payments. In total, the city estimates that federal deficit reduction measures will cost it $141 million in fiscal 2014, or 0.3% of tax revenue. That figures includes the 7.6% reductions to the federal interest subsidy related to Build America Bonds (BABs) that the White House announced would be included in federal budget sequestration if it is implemented next year as is current law. The city issued $5.0 billion of general obligation BABs in fiscal 2009 and 2010.

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 $69.8 billion proposed fiscal 2014 all funds spending plan. The city has $6.25 billion of general obligation variable rate demand debt outstanding, and the Transitional Finance Authority (TFA) has a total of $3.8 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 March 31, 2013 the combined outstanding notional amount of the swaps was $1.9 billion, with a mark-to-market value of -$194 million.

OUTLOOK

The rating outlook for New York City's general obligation bonds is stable. The city's institutionalized budgetary controls and early recognition of future budget pressure helped it manage through the prolonged economic downturn, although challenges remain, including a tentative national economic recovery. The city's economy is reliant on a volatile financial services sector, but it continues to diversify and its finances will benefit. While the city has taken proactive measures that have provided near-term benefits, its mounting costs for debt service, pensions and retiree health care will continue to be a challenge for the city, even with recent reforms.

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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