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# New York City Market Shows No Alarm on Election Eve: Muni Credit

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New York City's next mayor takes office in January and will face expired contracts for 300,000 workers, rising health-care costs and a budget that's relied on one-time revenue.

Investors in debt of the most populous U.S. city aren't concerned, as the yield penalty on some of the metropolis's securities has shrunk 17 percent in 2013, data compiled by Bloomberg show. A diversified, expanding economy will help the new administration overcome the challenges, said John Flahive, director of fixed income at BNY Mellon Wealth Management in Boston.

The metropolitan area's \$1.3 trillion economy, larger than Mexico's, has grown about 5.6 percent since 2008, according to the U.S. Conference of Mayors. Manhattan condo prices are the highest in more than four years, and this year the area's employment surpassed peak levels seen in 2008.

"When I look at New York, I'm not worried at all," said Flahive, who oversees \$22 billion of munis, including New York debt. "The bigger influence on the credit is the economy, and what's going on with the economy, not the administration."

## Primaries Loom

Residents in the city of 8.3 million are less than two months away from voting in the mayoral primary, followed by the general election on Nov. 5. Mayor Michael Bloomberg, 71, took office in January 2002, months after the Sept. 11 terrorist attacks.

Moody's Investors Service and Standard & Poor's grade New York two steps below top-rated bonds, after both companies boosted its rating three times during Bloomberg's tenure. New York has about \$42 billion of general obligations, according to Moody's. The city plans to sell \$635 million of the debt as soon as next week.

Investors are demanding less extra yield on some borrowings. Bonds maturing in August 2020 were valued yesterday by BVAL analysis at a yield spread of about 0.39 percentage point, down from 0.47 percentage point at the start of the year.

Tourism is among industries that have helped broaden the city's economy. A record 52 million tourists visited in 2012, according to NYC & Co., the city's marketing and tourism office. Cornell University will begin construction next year on a new engineering campus on Roosevelt Island in the East River. The development may generate \$23 billion in economic activity over the next three decades, Bloomberg has said.



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## Diversification Move

"Any diversification really helps as being counter to the cyclicity of Wall Street," said Peter Hayes, who manages \$114 billion as head of munis at New York-based BlackRock Inc. (BLK)

While New York City's 8.3 percent May jobless rate exceeded the 7.6 percent national average, total employment in the area in the first quarter surpassed the peak in the first three months of 2008, according to the Conference of Mayors.

"Over the past 11 1/2 years, we've faced some of the most difficult fiscal challenges our city has ever seen," Bloomberg said last month upon sealing a budget deal with the city council. "As cities and states across the nation experienced large-scale layoffs and severe service cutbacks, our own fiscal discipline and pro-growth economic strategies prevented that from happening here."

The mayor, an independent, is founder and majority owner of Bloomberg News parent Bloomberg LP.

## Poll Placement

Former U.S. Representative Anthony Weiner, 48, leads Democrats campaigning for mayor, according to a Quinnipiac University poll released yesterday. He received 25 percent, compared with city council Speaker Christine Quinn's 22 percent. On the Republican side, a NBC 4 New York/Wall Street Journal poll released June 25 has Joe Lhota, former head of the Metropolitan Transportation Authority, leading two other candidates.

Challenges await the next mayor, who assumes office midway through the fiscal year. Contracts have expired with city workers -- in some cases since 2008 -- and the budget contains no money for back pay in the event bargaining results in salary increases. The cost of retroactive raises would exceed \$7 billion, Bloomberg has said.

Negotiating the labor contracts is the biggest hurdle the next mayor will face, with future recurring labor costs reaching almost \$3 billion annually on top of the retroactive pay, according to Carol Kellermann, president of Citizens Budget Commission, a non-partisan business-funded fiscal watchdog.

## Health Cost

The cost of worker and retiree health insurance, now about \$6 billion, will rise to \$8.3 billion by 2018, unless workers begin paying part of the premiums they now get for free, Bloomberg has said. Left unchecked, the increasing expense will leave the city with less for other services, according to the Citizens Budget Commission.

While the city is no different from other localities with growing retirement costs and sometimes contentious labor agreements, a change in leadership after 12 years means investors must wait to see how the new administration will deal with its finances.



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"It's not unusual for a group of analysts to become comfortable with a management team, and in this instance, one that has performed quite well over an extended period," said Joseph Rosenblum, director of muni credit research in New York at AllianceBernstein LP, which manages \$31 billion of local-government bonds.

## **Bond Penalty**

Buyers are asking for more additional yield on the city's longer maturities. General obligations maturing May 2036 and callable in May 2019 were valued July 15 by BVAL analysis at a spread of about 2 percentage points, up from 1.7 percentage points on Jan. 2.

Bloomberg used one-time revenue and refinancing for savings to help balance budgets, options the next mayor may not have.

The \$70 billion budget approved by the mayor and city council last month benefited from a court case allowing it to sell 2,000 taxi medallions, which will provide \$1.46 billion in revenue over the next four years, including \$300 million in the fiscal year that began July 1.

The city also took advantage of falling interest rates to refinance bonds. With yields on benchmark 30-year munis rising last week to the highest in more than two years, refunding may be less economical.

Budget Director Mark Page, who first joined the city's Office of Management and Budget as a deputy counsel in 1978, hasn't said whether he would stay in the job even if Bloomberg's successor asked him to. Page declined to be interviewed.

## **Rating Risk**

The city's Aa2 rating could weaken if there is an "inability to manage rapidly rising costs in non-discretionary spending such as debt service, personnel costs, and pensions," and if New York diverged from "well-established fiscal practices" Nicholas Samuels, a Moody's analyst, wrote in a May report.

The city's history of balancing budgets is encouraging for investors no matter who wins the election, Flahive said.

"There's not one person or one administration that can come in and derail the checks and balances on the budget process," Flahive said.

Texas's Grand Parkway Transportation Corp. plans to sell \$2.86 billion of debt this week, the biggest offer in more than a year, to finance a toll road in the Houston area. The issue leads almost \$10 billion of long-term borrowings this week, the most in three months.

At 2.81 percent, yields on top-rated munis maturing in 10 years are down from a two-year high of 2.96 percent last month. The yield compares with 2.54 percent for similar-maturity Treasuries.



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The ratio of the interest rates, an indication of relative value, is about 111 percent, compared with a five-year average of 100 percent. The higher the ratio, the cheaper municipal securities are against federal debt.