FITCH RATES NASSAU COUNTY, NY'S TANS 'F1' & AFFIRMS GOS AT 'A'; OUTLOOK STABLE

Fitch Ratings-New York-03 December 2015: Fitch Ratings assigns an 'F1' rating to the following Nassau County, NY short-term debt:

--Approximately $200 million tax anticipation notes (TANs), 2015 series A.

The notes are scheduled to be sold by negotiation the week of Dec. 8 and are due on Sept. 15, 2016.

In addition, Fitch affirms the following ratings:

--Approximately $2 billion in outstanding Nassau County general obligation (GO) bonds at 'A';
--Approximately $230 million in outstanding Nassau Health Care Corporation (NHCC) county-guaranteed bonds at 'A';
--Approximately $7.3 million in outstanding Nassau Regional Off-Track Betting Corporation (NROTBC) revenue bonds series 2005 at 'A-'.

The Rating Outlook is Stable.

SECURITY
The GO bonds, TANs, and NHCC bonds carry the county's faith and credit and taxing power, subject to a 2011 state statute limiting property tax increases to the lesser of 2% or an inflation factor (tax cap law). This limit can be overridden annually by a 60% vote of the county legislature.

The NROTBC bonds are backed by the county's covenant under a support agreement with the NROTBC to make loans to NROTBC equal to debt service on the bonds from legally available funds of the county as appropriated for such purpose. The county has committed to transfer funds to the trustee to pay debt service not later than 15 days prior to any debt service payment date. The obligations of the county under the support agreement are unconditional and irrevocable, and the support agreement is not subject to cancellation or termination.

KEY RATING DRIVERS

STRONG UNDERPINNINGS, WEAK OPERATIONS: The county's legal ability to raise revenues from a diverse and wealthy base and demonstrated ability to quickly reduce spending keep the rating solidly investment grade. However, aggressive budgeting practices, reluctance to utilize the strong revenue-raising ability, and the lack of operating reserves are unusual for a Fitch-rated local government and keep the county's rating well below the 'AA' average for the sector.

LIMITED CUSHION TO PERSIST: Fitch expects the county to continue to operate with minimal reserves even with the infusion of a moderate amount of bond proceeds for operating expenses. Expenditure reductions over the last several years have been sizable, but budgeting practices tend to expose the county to revenue shortfalls that will require mid-year adjustments to reach break-even results.

SHORT-TERM MARKET RELIANCE; SOUND COVERAGE: The 'F1' short-term rating corresponds to the long-term rating and further reflects sound note repayment coverage from projected 2016 revenues, borrowable funds, and expected additional note proceeds. Fitch assumes in its rating the county's continued demonstrated strong market access. The county relies on borrowing for note repayment and a moderate portion of its liquidity needs.

STRONG ECONOMIC FUNDAMENTALS: The county maintains a diverse economy and tax base, and has a population with high income levels.

MANAGEABLE LONG-TERM LIABILITIES; DEFERRALS: The sizable and wealthy tax base supports a manageable debt burden with above-average amortization. Capital needs are moderate, and the county expects to eliminate reliance on long-term debt for property tax refunds and employee termination pay by 2017. State pension plans are well funded. Other long-term liabilities, including accumulated tax refunds and potential litigation settlements, are notable but appear manageable.

CONTROL BOARD A POSITIVE: Nassau County Interim Finance Authority's (NIFA) use of its oversight board powers is a credit positive. NIFA recently rejected the county's multi-year plan due to optimistic revenue projections and has signaled the possibility of imposing spending cuts on the county. However, so far NIFA's ability to instill conservatism into the county's financial practices appears limited.

RATING SENSITIVITIES

CONTINUED THIN MARGINS: The 'A' long-term rating and Stable Outlook incorporate Fitch's expectation that the county's financial operations will continue to generate roughly break-even results and minimal reserves with reduced reliance on non-recurring items and deferrals. Improved margins and the accumulation of even modest reserves, along with the expected elimination of reliance on debt and other non-recurring items to fund recurring expenses, could result in rating improvement. Increased reliance on such funding or a trend of annual deficits of more than a minimal amount could result in a downgrade.

CREDIT PROFILE

Nassau County is located on Long Island, just east of New York City. The population of approximately 1.3 million has remained steady since 2000.

WEAK FINANCIAL RESULTS CONTINUES

Audited 2014 results show an operating deficit of $20.9 million (0.6% of spending) over the county's major operating funds (general, police district, and debt service) compared to a $53.1 million surplus in the year prior. Results according to NIFA's accounting show a high $191 million operating deficit (6% of spending) compared to a $78.6 million deficit in 2013 on a spending base of about $3 billion. NIFA's accounting removes bond proceeds used for operations (including termination pay, tax refunds, judgments and workers' compensation) and is thus more conservative than GAAP. Under standard GAAP accounting, the unrestricted balance among major funds at the end of 2014 was a minimal $255,000.

Projections for 2015 indicate close to break-even operations as revenue underperformance is outpacing expenditure savings. Results rely on about $93 million of non-recurring measures, including bonding for termination pay and tax refunds. Fitch expects reserves to remain minimal for the current year and into the future, as the county demonstrates a preference for budgeting uncertain revenues and implementing reductions if they underperform, rather than budgeting conservatively and creating the ability to accumulate reserves.

Current labor contracts extend from April 1, 2014 to Dec. 31, 2017 and call for cumulative cost of living increases of 12.75%. All but about 600 of the county's 7,252 (as of Oct. 31, 2015) employees are unionized. Fitch views the increases as somewhat generous given the recent slow rate of sales tax growth and unlikely prospects for a property tax increase.

The contracts also allow for a small portion of the increase to be deferred until separation, at which time the amount to be paid at the then-prevailing rate. This deferral of current obligations (though representing a very small portion of payroll) is a credit negative. Fitch views similarly a provision that calls for an increase in the number of compensatory hours that can be accrued and paid out upon separation.

VULNERABILITY TO REVENUE OVERPROJECTION
Sales tax revenues make up approximately 38% of major tax-supported fund revenues. In 2014 sales tax revenues were 4.2% below 2013 revenues and 5.8% below the 2014 budget. The county budgeted a 4.7% increase in sales tax for 2015, but year-to-date figures indicated only a 1% increase. The shortfall was likely influenced to some extent by the decline in the price of gas, purchases of which are subject to the sales tax, but is nevertheless symptomatic of the vulnerability the county faces in somewhat optimistically budgeting sales tax revenues.

The adopted 2016 budget includes a 2% increase in sales tax revenues from projected 2015 levels. Given recent history combined with the county's demonstrated reluctance to raise more than modest levels of other recurring revenue sources that could offset underperformance, Fitch views this assumption as aggressive.

The county budgeted a number of revenue sources in 2015 that did not perform as planned, including fines from speed cameras that were not implemented and revenues from video lottery terminals that were delayed. The latter are again included in the 2016 budget, in the amount of $20 million. Fitch believes this, as well as the county's budgeting for real estate transaction-related fees, to be optimistic.

2016 BUDGET THINLY BALANCED

The 2016 budget does little to improve prospects for longer-term balance. Previously modest reserves have been virtually eliminated and there appears little prospect for their rebuilding even though the county is in the midst of an economic growth period. Fitch is concerned with the county's inability to balance the budget on a structural basis at a time of growth.

The 2016 adopted budget of $2.9 billion is down slightly from the 2015 adopted budget but up slightly from projected actual spending. In addition to the 2% sales tax increase, the budget includes a minimal increase in property tax revenues (which make up about 28% of major fund revenues). A somewhat larger but still modest property tax increase did not survive the budget adoption process, as the county legislature overrode the county executive's veto to maintain its elimination. The legislature replaced the property tax revenues with a fine on commercial property owners who do not file certain paperwork on time.

The budget continues to rely on borrowing for tax refunds ($60 million). The budget does not include borrowing for termination pay, but the county considers as a contingency the possibility of issuing $32 million for termination pay if other budgetary items are not achieved. The county has committed to discontinuing use of bond proceeds for operations after 2017. Fitch believes this will be a challenge given the notable reluctance to either increase revenues or cut spending in more than modest amounts, combined with a backlog of tax refund liabilities and employee termination payments (accrued vacation, sick and compensatory time as well as the deferred salary increase) that will need to be cash-funded.

State legislation has structurally reformed commercial property tax refunds by creating a Disputed Assessment Fund (DAF), effective for the 2017 tax roll. The DAF will be funded by commercial property owners who challenge their assessments. This should eliminate the county's need to borrow for future property tax refunds.

NIFA REJECTION OF MULTI-YEAR PLAN; MANAGEABLE OUT-YEAR GAPS

In accordance with the act that created NIFA, the authority recently issued a report finding the county's multi-year plan (MYP) for 2016-2019 unable to meet the requirements of the NIFA act, which requires a budget deficit of 1% or less on NIFA's more conservative accounting basis. NIFA cited the county's inability to achieve GAAP-based structural balance and the slim prospects for doing so going forward, as well as county's need implement larger and more realistic revenue increases and/or expenditure reductions.

In its report, NIFA signaled the possibility of imposing spending cuts on the county. Improved budget discipline, whether imposed by the county or NIFA, would be a positive credit consideration. The county has responded to the NIFA report with few changes from the originally-submitted plan. NIFA is expected to consider approval of the amended plan later this week.

The projected gaps in the county's MYP appear manageable relative to the size of the county's operating budget but Fitch, like NIFA, remains skeptical about the county's ability to implement ongoing gap-closing measures and produce breakeven to positive operations on a consistent basis.

DECLINING CASH-FLOW BORROWINGS

The county generally issues RANs and TANs annually. Proceeds fund operations in anticipation of sales and property tax receipts and maintenance of cash balances sufficient to repay maturing notes.

Note par has declined over the past few years, declining to $379 million (14% of receipts) in 2015 from $476 million in 2012. Note issuance for 2016 is projected at the same amount as for 2015.

The decline in cash flow borrowing and strong market access are credit positives, but Fitch remains concerned about the county's dependence on short-term funding, particularly as the borrowings overlap each other requiring additional issuance to repay outstanding notes from tax-supported operating funds.

SOUND NOTE REPAYMENT COVERAGE

The county's cash flows along with proceeds of outstanding notes generally provide substantial coverage for notes with funds for their repayment fully set aside comfortably in advance of maturity. The current TAN issue matures in September 2016. Coverage is sound at 2.2x and increases to 2.5x with consideration of borrowable balances in enterprise-related funds. Coverage appears weaker than in prior years because there is a single repayment rather than making repayments over two months, as in prior years. Fitch does not view this as a credit consideration.

STRONG TAX BASE AND ECONOMIC CHARACTERISTICS

The county benefits from a broad, diverse economy and well above-average economic indicators, including market value per capita of $151,000 and 2013 per capita income and medium household income at 151% and 184%, respectively, of the U.S. The tax base showed slight growth in 2015 after several consecutive years of decline. Fitch believes weak performance of the property and sales tax bases reflect, in part, the built-out nature of the county. Redevelopment of the Nassau Coliseum site might infuse a modest level of growth potential.

Fitch believes the county is unlikely to use its ample ability to increase property tax revenues even with the state's limit on levy growth of the lower of CPI or 2% annually (absent a supermajority vote of the legislature), but it remains an option that Fitch considers a strong credit positive.

The county's unemployment rate remains lower than the rates for New York State and the nation. For August 2015, the county's unemployment rate was 4.3% compared to 5% and 5.2% for the state and nation, respectively. The year-over-year unemployment rate dropped from 4.8% in August 2015 despite solid labor force growth of 1.3%, as employment grew 1.9%, slightly faster than the nation's 1.8%.

INCREASING BUT MANAGEABLE DEBT LEVELS

The county's debt ratios appear manageable in relation to its wealthy tax base. Overall debt, excluding school district data which are not available, is moderate at $3,580 per capita and 2.4% of market value. The inclusion of school district debt could increase the debt burden statistics significantly but would be unlikely to raise them to a level that would cause credit concerns for Fitch.

Debt ratios should remain fairly stable given manageable capital needs and above-average amortization with 66% (including debt issued by the NIFA) retired in 10 years.

WELL-FUNDED STATE PENSION PLANS

The county participates in the well-funded New York State pension plans. At March 31, 2014, the state and local employees' plan and the state and local police and fire plan had funded ratios of 88% and 89%, respectively. Using Fitch's more conservative 7% discount rate assumption, the plans' funding levels would still be sound at an estimated 84% and 85%, respectively.

County pension payments in 2014 made up a moderate 6% of governmental spending. The county has taken advantage of the ability granted by the state to amortize most of the increase in annual pension payments for 2012 and 2013 over 10 years and for 2014 and 2015 over 12 years. This amortization option provides some near-term budget relief but the cumulative deferred pension contribution is significant at $270 million through 2016. The county began paying for prior deferrals in 2013, and in 2016 the repayment of $25 million in past deferrals is close to the amount deferred to future years of $41 million.

OTHER LIABILITIES SIZABLE

The moderate pension liability is somewhat offset by a high unfunded actuarial accrued liability for other post-employment benefits (OPEB) at $4.6 billion or 2.2% of market value as of Dec. 31, 2014. Carrying costs for debt service, pension and OPEB pay-go equaled a high 22.3% of 2014 total governmental fund spending, with the county's amortization of part of the pension payment somewhat offsetting above-average debt repayment.

Other long-term liabilities include $307 million in tax refund payments. This amount is likely to grow slightly over the next couple of years until the DAF takes effect in 2017. The county is also involved in a variety of litigation, including suits regarding property tax payments with utilities and underlying jurisdictions that result in significant potential liabilities, estimated by the county at nearly $400 million. In addition there is litigation regarding NIFA's imposition of a wage freeze in 2011 with a potential liability estimated at $101 million.

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Fitch recently published an exposure draft of state and local government tax-supported criteria (Exposure Draft: U.S. Tax-Supported Rating Criteria, dated Sept. 10, 2015). The draft includes a number of proposed revisions to existing criteria. If applied in the proposed form, Fitch estimates the revised criteria would result in changes to less than 10% of existing tax-supported ratings. Fitch expects that final criteria will be approved and published by Jan. 20, 2016. Once approved, the criteria will be applied immediately to any new issue and surveillance rating review. Fitch anticipates the criteria to be applied to all ratings that fall under the criteria within a 12-month period from the final approval date.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from CreditScope, IHS Global Insight, and Zillow Group.

Applicable Criteria
Exposure Draft: U.S. Tax-Supported Rating Criteria (pub. 10 Sep 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869942
Rating U.S. Public Finance Short-Term Debt (pub. 17 Nov 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=873508
Tax-Supported Rating Criteria (pub. 14 Aug 2012)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. Local Government Tax-Supported Rating Criteria (pub. 14 Aug 2012)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685314