FITCH RATES NASSAU COUNTY (NY) GOS 'A'; RATES BANS & RANS 'F1'

Fitch Ratings-New York-25 May 2016: Fitch Ratings has assigned ratings to the following Nassau County, NY general obligation (GO) debt:

--Approximately $147,445,000 general improvement bonds 2016 series C 'A';
--Approximately $5,300,000 bond anticipation notes (BANs) (tax-exempt) 2016 series B 'F1';
--Approximately $35,030,000 BANs (federally taxable) 2016 series C 'F1'; and
--Approximately $120,000,000 revenue anticipation notes (RANs) 2016 series A 'F1'.

In addition, Fitch has affirmed the following ratings:

--Approximately $2.1 billion in outstanding GO bonds at 'A';
--Approximately $237 million in outstanding Nassau Health Care Corporation (NHCC) county-guaranteed bonds at 'A', and;
--Approximately $7.3 million in outstanding Nassau Regional Off-Track Betting Corporation (NROTBC) revenue bonds series 2005 at 'A-'; and
--The county's Long-Term Issuer Default Rating (IDR) at 'A'.

The Rating Outlook is Stable.

The bonds and notes are scheduled to be sold on June 8, 2016. The bonds will be sold competitively; the BANs and RANs will be sold on a negotiated basis. Bond and BAN proceeds will fund capital projects and refinance outstanding BANs. The RANs are issued in anticipation of the receipt of sales taxes in 2016.

SECURITY
The GO bonds, BANs, RANs, 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 (the 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. The bonds are rated one notch below the county's IDR, reflecting the slightly higher degree of optionality associated with payment of appropriation debt.

KEY RATING DRIVERS

The county's legal ability to raise revenues from a diverse and wealthy base and demonstrated ability to quickly reduce spending, in conjunction with a moderate liability burden, keep the rating solidly investment grade. However, aggressive budgeting practices and a policy choice to maintain minimal operating reserves are unusual for a Fitch-rated local government and keep the county's rating well below the 'AA' average for the sector.

Economic Resource Base
Nassau County is located just east of New York City, with a population of approximately 1.3 million that has remained steady since 2000. Growth prospects are limited as the county is built out, but there are modest re-development opportunities.

Revenue Framework: 'a' factor assessment
Dependence on sales and property taxes is expected to continue to yield modest revenue growth given limited prospects for economic growth. The county has unlimited independent legal ability to control property tax rates, although property tax levy increases above the lower of CPI or 2% require a supermajority vote of the county legislature.

Expenditure Framework: 'a' factor assessment
Despite generous terms of labor contracts relative to historical revenue growth and management's limited ability to control the ultimate outcome of negotiations, the county has demonstrated an ability to reduce its workforce and other spending when needed and additional savings appear possible. Carrying costs for debt, pensions, and other post-employment benefits are sizable.

Long-Term Liability Burden: 'aa' factor assessment
Reported overall debt levels are understated as data on aggregate school district debt are not available. Fitch assumes overall debt levels are approximately double the reported level given that school districts generally contribute significantly to the debt burden on a typical municipal tax base. New York State pensions are well-funded but the OPEB liability is considerable and the county has taken minimal steps to control its growth.

Operating Performance: 'bbb' factor assessment
Fitch expects the county to continue to manage its performance consistent with historical results and throughout economic cycles - keeping minimal reserves, with a mix of recurring and non-recurring solutions involving staffing reductions, asset sales, and minor recurring revenue increases to address cyclical declines. The county has committed to discontinue the use of bond proceeds for operating costs. The presence of a control board whose approval is required for such borrowing reinforces this expectation.

Short-Term Ratings Mapped: The 'F1' ratings on the BANs and RANs are based on the long-term credit characteristics that result in the county's 'A' IDR.

RATING SENSITIVITIES
OPERATING 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 as the economic recovery continues. Improved margins and the accumulation of a meaningful level of reserves during periods of economic recovery, 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

Economic indicators show diversity and strength, including market value per capita of $151,000, per capita income at 160% of the U.S., and a poverty rate of less than one-half the U.S. average. Top taxpayers include a mix of utilities, corporate facilities, and retail. The unemployment rate is consistently below state and national averages, although employment levels are on a declining trend. The latter may be influenced by demographic trends, as the proportion of residents over age 64 exceeds the U.S. average.

Revenue Framework

The county's major operating funds (general and police district) rely heavily on sales tax revenues, which have shown growth over time in line with with economic performance. Small property tax revenue increases have been due to modest policy actions, as the tax base showed slight growth in 2015 and 2016 after declining for several consecutive years.

Resources include proceeds of bonds issued for employee termination pay (accumulated vacation and sick leave) and tax refunds. The county is responsible for paying refunds to taxpayers who successfully appeal their assessments for underlying jurisdictions, which creates an unusual burden for a local government. Officials have been working to reduce the financial impact of this arrangement. Fitch anticipates that the impact will be further alleviated in 2017, when a new disputed assessment fund is implemented.

Historical revenue growth has been slower than national CPI growth. Fitch expects this trend to remain consistent as the economy continues to mature.

New York State law requires property tax revenue increases be limited to the lesser of CPI or 2% annually, unless a supermajority of the local governing body vote for a larger increase. This provides substantial legal flexibility to raise revenues without state or voter approval. Any increase in the sales tax rate would require state approval, and maintenance of the existing local portion of the sales tax rate is subject to biennial state approval. Fitch considers such approval pro forma.

The recently-enacted disputed assessment fund will require commercial taxpayers who file appeals to deposit the amount of disputed taxes into a dedicated fund, reducing AV by the amount under appeal. Successful appeals are expected to be repaid from the fund, not from county resources. This should alleviate the need for borrowing to finance these refunds.

Expenditure Framework

Typical of local governments, public safety is one of the county's main spending items at about 35% of the total. New York State requires counties to share in Medicaid spending, although the state now covers all annual spending increases. Health and social services spending equaled about 26% of spending in 2014, but this percentage has been declining given the state Medicaid cap.

The county generally agrees to long-term labor contracts for its employees that include fairly generous terms given slow revenue growth expectations. For example, current contracts extend from April 1, 2014 to Dec. 31, 2017 and call for cumulative cost of living increases of 12.75%. For the Civil Service Employees Association, which includes about one-half of county employees, 0.75% of the increases are deferred until termination at then-prevailing rates. With the current contracts, new employees pay a portion of health care premiums.

Fitch believes pressure to provide sizable salary increases even in downturns is tempered a bit by the Nassau Interim Finance Authority's (NIFA, the county's control board) ability to impose a wage freeze after 2017, as it did in 2011-2013. Law enforcement unions challenged this action, and salary increases in current labor contracts reflect a partial settlement of this challenge.

The pace of spending growth absent policy actions is likely to be modest given the slow-growth environment and limited needs of a relatively affluent population, although the natural pace of spending growth is still likely to be above that of revenues. The county is both deferring some pension costs and repaying prior deferrals that were authorized by the state. In the near term annual pension requirements should be fairly level. Over time they may increase, but the rolling off of deferral repayments should keep annual increases moderate for some time.

The collective bargaining framework in New York makes adjustments to personnel spending difficult, although as mentioned above NIFA's powers provide some level of offset. If the county is successful in eliminating bond issuance for tax refunds, and with the roll-off of NIFA debt in 2025, currently elevated carrying costs may decline as a portion of spending over time.

The county has a notable amount of outstanding litigation (approximately $345 million by the county's estimates), and much of it is related to large commercial tax appeal cases. In addition, a sizable amount of outstanding tax refunds is likely to be repaid with operating funds, as NIFA appears unlikely to approve any more bonding for this purpose after 2017. The potential liability for the remaining challenge to the wage freeze is $101 million. While these would add significantly to the expenditure base ($2.7 billion in the general and police district funds in 2014), if they were paid over time they would add only minimally to the long-term liability burden.

Long-Term Liability Burden

Over $1 billion of the county's $3.4 billion in outstanding net direct debt (GOs and NIFA revenue bonds) was issued for tax refunds. Debt issued by NIFA ($922 million, or 27% of the total), supported by sales tax revenues, is scheduled to be repaid by 2025. The combination of these two leads to rapid amortization. While the debt burden may decrease as the tax refund debt is repaid and no further debt for this purpose beyond 2017 is expected to be issued, amortization is likely to slow. Capital plans indicate new debt will approximate the amount amortizing each year. In the absence of information on school district debt, Fitch assumes they are about equivalent to the amount of reported debt for the county and its underlying cities and towns.

State pensions in which the county participates are well-funded and reform in 2012 should slow the growth in the liability over time. Pursuant to pension relief programs approved by the state, the county reports deferred liabilities totaling approximately $270 million. These should all be repaid within 12 years. Additional deferrals should be modest and are scheduled by the state to be discontinued in 2020.

The OPEB liability is sizable at nearly 5% of personal income and the county has expressed no plans to reduce it.

Slightly more than one-half of NIFA's debt and all of the county-guaranteed NHCC debt is in variable rate demand bonds supported by letters of credit or liquidity facilities. Nearly all of the VRDOs are swapped to fixed rate, with a variety of counterparties. Fitch rates NIFA's debt 'AAA'/Stable and does not view this level of counterparty risk as significant to the county's credit quality.

Operating Performance

Despite minimal reserves, the county has demonstrated adequate financial resilience, with modest annual operating surpluses or deficits throughout economic cycles. Fitch expects this trend to continue. Budgeting is somewhat aggressive (for example revenue estimates sometimes include sources that have not yet received required state approval) but shortfalls are addressed in a timely manner, albeit by a mix of recurring and non-recurring means.

The county's financial operations are fairly consistent, and use of non-recurring revenues and deferral of spending items do not appear to be related to the economic cycle. The county took advantage of state pension funding relief related to market losses, as did many other New York localities. Use of bond proceeds to repay tax refunds has been an annual exercise and has been declining over the last several years due to changes in assessment and appeal procedures rather than economic changes - appeals and required refunds are likely to rise during weak economic periods. Aggressive budgeting is also consistent.

Audited results for 2015 have yet to be released but the county is expecting a general fund surplus of about $55 million. Fitch estimates that would result in an unrestricted fund balance of about 3% of spending, still modest but up from 1% at the end of 2014. The 2016 adopted general fund budget is 4% below the adopted 2015 budget and slightly below actual results projected at the time the 2016 budget was prepared. Other operating funds are budgeted to grow slightly from 2015 spending levels. First quarter 2016 results are reported to be slightly positive relative to budget. Nevertheless Fitch believes that management action during the economic recovery of the last few years has yielded little in the way of financial cushion against the next downturn.

The county relies on short-term borrowing for a moderate portion of its liquidity needs, generally about 15% of operating fund spending. This year management plans to fully repay all outstanding cash flow borrowing just prior to issuing additional notes; in past years note maturities and new issuances have overlapped. This reduces Fitch's previous concern about dependence on external borrowing not just for operations but for short-term debt repayment. Nevertheless, Fitch believes that coverage of RAN principal on the December repayment date will be fairly thin.

NIFA's use of its oversight board powers is a credit positive. NIFA recently rejected the county's multi-year plan due to optimistic revenue projections. NIFA subsequently imposed modifications to the plan and has signaled the willingness to impose spending cuts on the county. However, so far NIFA's ability to instill conservatism into the county's financial practices appears limited.

The county focuses on the property tax levy, rather than the rate (the state cap is also on the levy) and management is notably reluctant to increase the levy more than a marginal amount. This makes finances heavily reliant on sales tax performance and the county's willingness to cut spending, which has been sufficient in recent years, along with minor revenue increases, to offset sales tax volatility.

The county is exploring a public-private partnership for its sewer system. If successful, Fitch expects the impact to general government operations to be limited to the possible modest reduction in GO debt not currently subsidized by sewer operations.

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In addition to the sources of information identified in the applicable criteria specified below, this action was informed by information from Lumesis and InvestorTools.

Applicable Criteria
Rating U.S. Public Finance Short-Term Debt (pub. 17 Nov 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=873508
U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=879478