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Summary:

Albany, New York; General Obligation

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Rationale

S&P Global Ratings revised its outlook to stable from negative and affirmed its 'A+' rating on Albany, N.Y.'s general obligation (GO) bonds.

The outlook change reflects our expectation for positive operating results in fiscal 2016, attributable to recent efforts to increase nonproperty tax revenues as well as reduce discretionary expenses, which we expect will boost available reserves to more than \$1 million. Our opinion also reflects a change in New York State's support for the city's budget from an acceleration of payments of lieu of taxes (PILOT) to unrestricted support for "Capital City Funding", which we believe signifies an improved likelihood of continued state support as the city works to resolve continued pressures between city expenses and locally derived revenue sources.

The city's faith and credit GO pledge secures the bonds, including the statutory authorization to levy ad valorem taxes on all real property within the city, subject to applicable statutory limitations.

The rating reflects our view of the city's:

- Adequate economy, with access to a broad and diverse metropolitan statistical area (MSA) and a local stabilizing institutional influence;
- Strong management, with "good" financial policies and practices under our Financial Management Assessment methodology;
- Adequate budgetary performance, with operating results that we expect could improve in the near term relative to fiscal 2015, which closed with operating deficits in the general fund and at the total governmental fund level;
- Very weak budgetary flexibility, with an available fund balance in fiscal 2015 of negative 1% of operating expenditures that is also low on a nominal basis at negative \$1.7 million, as well as limited capacity to raise revenues due to consistent and ongoing political resistance;
- Adequate liquidity, with total government available cash at 5.3% of total governmental fund expenditures and 49.7% of governmental debt service, but access to external liquidity we consider strong;
- Weak debt and contingent liability position, with debt service carrying charges at 10.7% of expenditures and net direct debt that is 55.7% of total governmental fund revenue, and a large pension and other postemployment benefit (OPEB) obligation and the lack of a plan to sufficiently address the obligation, but rapid amortization, with 70.4% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Adequate economy

We consider Albany's economy adequate. The city, with an estimated population of 98,979, is located in Albany County. The city also benefits, in our view, from a stabilizing institutional influence. The city has a projected per capita effective buying income of 79.8% of the national level and per capita market value of \$45,216. Overall, the city's market value grew by 3% over the past year to \$4.5 billion in 2016. The county unemployment rate was 4% in 2016.

Albany is the capital of New York State and serves as the central city of the Albany MSA, which we consider broad and diverse. The presence of state government pervades local incomes and the city's tax base. The state is the city's major employer with 49,314 employees. Approximately 63% of city property is tax exempt, 60% of which is attributable to state tax-exempt property. The level of tax-exempt property adversely affects the city's market value per capita. We believe employment in state government, as well as higher education and health care, stabilizes the local economy.

Management expects continued development of residential property, including private dormitories, to support taxable property value growth in and around the city's downtown, and the city has experienced a 5% increase in market values over the past two years. The city has experienced slight population and employment growth over the past few years, the latter of which is attributable to improvements outside of state government in the manufacturing, health care, and education sectors. We believe the establishment of, and investment in, the Albany NanoTech complex, also helps to diversify the city's economy.

Strong management

We view the city's management as strong, with "good" financial policies and practices under our Financial Management Assessment methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Management utilizes five years of trend analysis for its revenue and expenditure assumptions and makes adjustments based on recent trends in revenues realized or contract considerations. The city's board of estimate monitors revenues and expenditures biweekly. City officials also prepare financials for the treasurer's and budget director's offices for budgetary purposes, and financial updates are presented to common council quarterly.

The city maintains a five-year formal capital improvement plan and its own investment policy, with holdings and performance disclosed in an annual report to the council. While the city currently lacks a formal reserve policy, it does maintain a debt management policy detailing purposes for which debt may be issued and carrying charge targets, excluding debt supported by revenue.

The city does not maintain a five-year long term financial plan but has worked with the state's Financial Restructuring Board and Public Financial Management to draft a three-year plan to improve its financial position. State officials may release the plan within the next two months.

Adequate budgetary performance

Albany's budgetary performance is adequate in our opinion. The city had operating deficits of negative 3.8% of expenditures in the general fund and of negative 2% across all governmental funds in fiscal 2015. Our assessment accounts for the fact that we expect budgetary results could improve from 2015 results in the near term.

Our analysis includes adjustments for recurring transfers out of the general fund, capital outlays funded through bond

proceeds, one-time revenues associated with receipt of a grant from the state's Financial Restructuring Board, and current expenses associated with pensions that were deferred under the state's contribution stabilization program. The city experienced weak results in fiscal 2015, driven by significantly negative revenue variance associated with its new red-light camera program as well as higher-than-budgeted expenses for public safety and debt service costs. The city also received less than expected in one-time revenues from the sale of state-provided land.

Management projects fiscal 2016 will close with an operating surplus of \$3 million, supported by significant adjustments to staffing levels, hiring practices, procurement, and management of worker's compensation and health care costs. The city has used attrition as a means for managing its employee costs, improved consolidation of city services, and used the KRONOS timekeeping system to track and manage employee-related costs such as overtime. We note that while management recognizes the limitations of its tax burden--applied to less than half of all property in the city--officials have also looked to set charges for services, such as increased garbage collection fees, that are commensurate with the cost of provision. We note that the city also received \$12.5 million from the state, which it had budgeted for but was not assured until the adoption of the state budget. The funds (also known as "spin-up" funds) were provided as an accelerated payment for the 19-A program, approved by the legislature, under which the state provides PILOTs to the city for the use of the Empire State Plaza government complex.

In its fiscal 2017 budget, the city once again included \$12.5 million in state support, classified as "Capital City Funds." However, in contrast to fiscal 2016, the adopted state budget included the \$12.5 million not as an accelerated payment for the 19-A program but as unrestricted state support. We believe this change in state funding provided to the city marks a shift in the state legislature's consideration of city finances and the state's role in partnering with the city to support balanced city operations; however, we also note the funding isn't tied to a specific purpose.

The adopted budget also called for a 2% reduction in operating expenditures in fiscal 2017, based on continued oversight of staffing changes and further consolidation of intracity services and intercounty services, where possible. Given this provision of state funds and the city's expectation for reduced expenditures in the current fiscal year, along with an on-track performance year to date, we believe the receipt of these funds will allow the city to further improve its fund balance if expenditure variance remains nominal. As such, we believe the city's performance could improve from a year earlier, to a level we consider adequate.

Very weak budgetary flexibility

Albany's budgetary flexibility is very weak, in our view, with an available fund balance in fiscal 2015 of negative 1% of operating expenditures. In addition, reserves are low on a nominal basis at negative \$1.7 million, which we view as vulnerably low and a negative credit factor. Negatively affecting budgetary flexibility, in our view, is a limited capacity to raise revenues due to consistent and ongoing political resistance.

After years of operating deficits, compounded by uncertainty related to state support from the 19-A program requiring the use of drawdowns on fund balance, available fund balance was about negative 1% of operating expenditures in fiscal 2015. We also believe the city has a limited ability to raise revenues from property taxes, evidenced by the share of state-owned land within its jurisdiction, and the recent reliance on state support to balance its budget. Given these recent developments and our expectations for an operating surplus of approximately \$3 million in fiscal 2016, we believe Albany's budgetary flexibility will remain very weak over the near term even as fund balance rise above a

nominally low level (\$500,000).

Adequate liquidity

In our opinion, Albany's liquidity is adequate, with total government available cash at 5.3% of total governmental fund expenditures and 49.7% of governmental debt service in 2015. In our view, the city has strong access to external liquidity if necessary.

In our opinion, the city's strong market access is evidenced by its regular GO debt and bond anticipation note issuances. Though the state allows for what we view as permissive investments, the city holds its funds in deposit accounts and money market funds, which we do not consider aggressive. Albany issued \$6 million in revenue anticipation notes in fiscal 2015, its first such issuance since 2009, but it did not issue revenue anticipation notes in fiscal 2016. The city's recent contract settlement with its firefighters union did not include retroactive pay, and should current negotiations with its police union follow a similar pattern, we do not believe there would be a significant impact on the city's liquidity. However, if the police union were to receive significant retroactive pay, we could revise our opinion of the liquidity profile. Currently, we expect the city's liquidity to remain adequate.

Weak debt and contingent liability profile

In our view, Albany's debt and contingent liability profile is weak. Total governmental fund debt service is 10.7% of total governmental fund expenditures, and net direct debt is 55.7% of total governmental fund revenue. Approximately 70.4% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor.

The city expects to issue up to \$30 million in additional debt, commensurate with its rolling five-year capital plan, with nearly \$25 million in principal amortizing over the same period.

In our opinion, a credit weakness is Albany's large pension and OPEB obligation, without a plan in place that we think will sufficiently address the obligation. Albany's combined required pension and actual OPEB contributions totaled 15.7% of total governmental fund expenditures in 2015. Of that amount, 10.2% represented required contributions to pension obligations, and 5.5% represented OPEB payments.

The city participates in the Employees' Retirement System (ERS) and Police and Fire System (PFRS), which are part of the New York State and Local Retirement System. The fiduciary net position as a percentage of total pension liability was 90.7% for ERS and 90.2% for PFRS as of March 31, 2016.

As of Dec. 31, 2015, the city owed about \$13.1 million to the New York State Retirement System as a result of deferred contributions. The city deferred \$1.2 million in pension costs in fiscal 2016 and may defer the same amount in fiscal 2017. Despite the state pension plans' strong funded levels, we note the city will eventually have to catch up with its deferred pension contributions, in addition to annual contributions, through at least fiscal 2025.

Albany also provides OPEBs to eligible employees, which are funded on a pay-as-you-go basis. As of Dec. 31, 2015, the city's unfunded OPEB liability was \$268.8 million. The city contributed 72.2% of its annual OPEB cost in 2015. The city's large pension and OPEB costs, and lack of a plan for funding its OPEB obligations--which we recognize as limited under state statute--are negative credit factors in our opinion.

Strong institutional framework

The institutional framework score for New York cities (other than the New York City) is strong.

Outlook

The stable outlook reflects our view of the city's adequate economy, supported by the stabilizing presence of state government and other educational and health care institutions. The stable outlook also reflects our opinion of an anticipated improvement in budgetary performance, which should restore the available fund balance to a positive level for fiscal 2016 and beyond in light of recent efforts to reduce departmental expenses. We do not expect to revise the rating in the next two years.

Downside scenario

If the city's efforts to generate additional revenues through service charges, continued state support, and the consolidation of city services for expense savings are not successful in decreasing future budgetary gaps, we could revise the rating downward. Additionally, if the city's outstanding contracts were settled with significant retroactive payments, pressuring the city's liquidity position, we could lower the rating.

Upside scenario

If the effort to improve operating performance can be maintained, allowing the city to rebuild its fund balance while improving liquidity without requiring more state aid, we could raise the rating.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015

Ratings Detail (As Of May 4, 2017)		
Albany GO (serial) bnds		
<i>Long Term Rating</i>	A+/Stable	Outlook Revised
Albany GO (serial) bnds		
<i>Long Term Rating</i>	A+/Stable	Outlook Revised
Albany GO (AGM)		
<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Outlook Revised
Albany GO (BAM)		
<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Outlook Revised
Albany GO (BAM) (SECMKT)		
<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Outlook Revised
Albany GO		
<i>Long Term Rating</i>	A+/Stable	Outlook Revised

Many issues are enhanced by bond insurance.

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