INDEPENDENT THINKING

A NEW PERSPECTIVE

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NEW YORK CITY: LOVE IT OR LEAVE IT?

New York City will remain a global center for finance, education, healthcare, technology and culture, but not without changes to its prior established position. Investment exposures should be allocated and managed accordingly.

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THE NEW STANDARD IN WEALTH MANAGEMENT

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Introduction

There are as many opinions about the future of New York City as there are New Yorkers. The city, which was the early U.S. epicenter of the pandemic, is now the focus of discussions around the future of urban life. Some have voted with their feet; others are certain that the city's best days are ahead. From a fiscal point of view, the future of the largest municipality in the United States matters to investors well beyond the five boroughs. The key will be to distinguish between short-term disruptions and lasting change.

Let's consider recent developments in that context, to include migration, remote work, and the city's fiscal health – all of which will represent big challenges for the next mayor. It is our view that New York City will remain a global center for finance, education, healthcare, technology and culture, but not without changes to its prior established position. Investment exposures should be allocated and managed accordingly.

Employment

Historically, New York City is where ambitious people from across the United States and around the world came and stayed. The diverse talent and money emanating from the city in turn drew global companies and institutions to the area, helping to generate spending, jobs and business opportunities. Even after the city's near bankruptcy in the 1970s, the horrors of September 11, 2001, and after the global financial meltdown of 2008-2009 and Superstorm Sandy in 2012, New York was still the place to be. This time feels different, as illustrated below.

From an employment standpoint, the COVID-19 recession has differed from the recessions in 2001 and 2008-09 in important ways:

Steeper and Quicker Private Sector Job Losses

2001 Recession & 2008-09 Great Recession	COVID-19 Pandemic
• During the Great Recession, the city lost 127,300 jobs (3.9%) over 15 months, while the 2001 Recession led to 217,100 jobs lost (6.8%) over 33 months.	• The city lost 820,000 jobs in six months, representing 20% of private sector employment, and wiping away 85% of the prior decade's growth.[2]
• About 20% of the job losses during the Great Recession and 2001 Recession were in leisure and hospitality, trade, transportation, utilities and other services.	• 59% of job losses were in leisure and hospitality, trade, transportation and utilities, and other services.
• Education and health care continued to grow.	• Education and health care lost 120,700 jobs (15%).
• In the Great Recession and 2001 Recession, financial activities, professional and business services, and information accounted for about 70% of the losses.	• Financial activities, professional and business services, and information represented 18% of job losses.
	• More job losses in sectors requiring face-to-face interaction; less in office-using sectors.

There are other factors at play, of course. The need to social distance and the shift to remote work has coincided with improved communications technology and a significant demographic change as two giant population groups, Millennials and older Baby Boomers, transition to family and retirement life, respectively – and from the costs and other stressors associated with high-density living.

Migration

Based on change-of-address requests to the U.S. Postal Service in 2020, migration patterns during the pandemic have looked a lot like earlier moves. Some smaller, regional metro areas and vacation hubs benefited. But in general, areas that were already attracting new residents kept attracting them. Those that were losing migrants lost more.[3]

The New York metro area, as well as other vibrant, affluent areas such as Washington D.C., Seattle, San Francisco, Denver and San Diego reported declining net migration in 2020 because their usual influx of new residents dwindled during the pandemic.[4] The people who moved around the New York region were more likely to stay local: Almost 79% of people who made permanent moves didn't leave the central metro area.[5]

The demographic cohort of young, highly educated urban dwellers had a greater propensity to move during the pandemic (10% increase in 2020, with four in 10 households changing addresses vs. three in 10 in 2019.)[6] This segment is highly mobile since they work within professional services that are conducive to remote work. Higher income can help to absorb the cost of a relocation, and many in this group are childless, allowing for flexibility to quickly change address. This flexibility may facilitate a return to city living as vaccinations rise. In fact, in the first quarter of 2021, real estate firm Corcoran Group reported the strongest start, as far as signed contracts, to any year since 2007, even beating out 2013 by 6%.[7]

Remote work

Even before the pandemic, nonresidents, many in New Jersey and Connecticut, represented about a quarter of New York City's college-educated workforce, and accounted for a similar proportion of income earned in the city. (The spread of the virus itself showed just how interconnected this region is.) Now their ranks appear to have swelled, as evidenced by soaring real estate prices and rising traffic in the tri-state area.

One of the greatest financial risks facing the city is the possibility that at least a sizable minority of well-paid nonresident former commuters – and their new neighbors – will continue working at home[8], and that their employers will find ways to establish local offices to free them from New York City's personal income tax obligations. (In a similar situation, the state of New Hampshire is asking the U.S. Supreme Court to review taxation of its work-at-home residents by neighboring Massachusetts, where their employers are based.[9]) The $7.4 billion in New York state personal income taxes generated by nonresidents in 2019 represented 15% of the city's total personal income tax receipts at last count, so there's a lot at stake. Moreover, that's before considering all the economic activity these commuters generated. From the restaurants that fed them, to the theatres and concert halls that entertained them at the end of the day, to the conveyances provided by the MTA, Port Authority, taxis, Ubers and Citi Bikes that transported them, a permanent potential full or partial loss of a sizable number of commuters will ripple through the New York City economy.

On a positive note, in its latest survey, the Partnership for New York City found that 62% of Manhattan office workers were expected to return to the workplace by the end of September, a significant increase from the group's March survey, in which 45% of employees were expected back by the same time.[10] However, the study finds that at least initially, there is the expectation of a hybrid model, where employees would be required in the office for only a portion of the week. This should further stimulate real estate in the city.

Real Estate

Soaring real estate prices in the suburbs and south Florida have come at New York City's expense. The 2022 tentative roll released by the Department of Finance on January 15 showed a decline of 5.2% in market values, with Class 2 (multifamily residential) values declining by 8% on average, and Class 4 (commercial) property values dropping at almost double that rate, at 15.8% on average. Although Class 1 (one- to three-family homes) property values remained relatively flat, with a slight increase of 0.8%, property tax revenues as a whole were reduced by about $2.5 billion annually.[11]

The Toughest Job in the Country?

New York City Mayor Bill de Blasio took office in 2014 amid an economic expansion and immediately increased spending – granting raises to tens of thousands of workers, adding new programs, and increasing the size of the city workforce by tens of thousands of new positions. He will leave office amid a slew budget issues, thanks to the rapid growth of the city budget and the economic slowdown caused by COVID-19. It will be up to the next mayor to get the city's budget back on stable fiscal ground.

The next scheduled citywide election is November 2021, with the ranked choice primaries coming up. The new mayor must show very specific plans for how growth can benefit all New Yorkers – particularly those that felt a disproportionate negative impact from the Coronavirus. That includes focusing rezoning on building affordable housing, embracing technology that reduces greenhouse gas emissions, and improving the walkability and transit options in neighborhoods.

There is a need for an inclusive recovery, which will depend on addressing the following questions: Will the city budget reflect changes from the long-term impact of the Coronavirus, including potential declines in the city's tax base due to negative reassessments in office and commercial space and the decline in population? How will the city confront disparity; is the recovery fair, and does it address inequities directly? Were people that were hardest hit offered greater opportunities? Will there be additional investments in apprenticeship programs, workforce development and job training? How will city government partner with employers to ensure that all New Yorkers have equitable access to those new jobs?

The city's financial role in making the recovery more inclusive is critically important in whether or not New York City maintains structural balance in its budget. As federal funds from the American Rescue Plan (ARP Act) dissipate and the commitment by the state to help confront economic disparity can waiver, what is the city's recurring financial and political obligation to maintain these programs? We will be judging the city's commitment and budget within the context of changes in the overall economy and tax base.

Policing and Public Safety

New York City mayoral races often turn on the issues of policing and public safety, and this race is no exception. The recent incidents of violent crime are nowhere near the levels of earlier eras in New York, and while shootings and homicides are up, other crimes have been down this spring.[12] A year after the rise of the Defund the Police movement amid an outcry over racial injustice, mayoral candidates will have to confront how much to fund police resources and oversee police practices vs. reallocating monies to achieve overall public safety goals.

Fiscal Health

In addition to the risk that fewer commuters will come into the central business district daily and generate economic activity, some partial or full remote work arrangements may become permanent. That, plus the recent state approval to raise taxes on higher earners[13], could increase the risk of migration out of New York City or New York State, possibly dampening personal income tax and unincorporated business tax revenues. While revenues could be lower, spending could be higher. Collective bargaining agreements with the city's unions are beginning to expire, while a few contracts from the prior round remain unsettled.

New York City receives about $5.6 billion in direct federal aid from the American Rescue Plan Act of 2021, in addition to about $1.15 billion in Federal Emergency Management Agency, or FEMA, reimbursement. This substantial funding is more than enough to wipe out the fiscal year 2023 projected $5.3 billion gap, but it will not fill the city's gaps over the long term. It is essential that this Mayoral Administration makes prudent use of these one-time resources to provide the COVID-19 related services New Yorkers need and ensure a stable fiscal future.

Federal funding is needed to:

- Support COVID-19 response expenditures not covered by FEMA;
- Fund additional costs and supports necessitated by the pandemic, such as expenditures related to school reopening or test and trace efforts;
- Temporarily backfill shortfalls in tax revenues due to the pandemic, appropriately with a post-federal support fiscal stability plan; and
- Support residents and businesses negatively affected by the pandemic and recession, to the extent that resources are available and only if needed on top of American Rescue Plan investments.

As a one-time revenue infusion, federal funds should not be used to support new programs or hiring that requires ongoing funding. If federal aid is sufficient and flexible, the city should spread these funds over multiple years to support a glide path toward stability as the economy and tax revenues recover and the city increases the efficiency of its operations.

(For more information of the American Rescue Plan Act and its potential impact on New York, see the notes pages.[14])

Bond Market and Credit Spreads

New York Issuer Spreads: 10-Year Yields vs Triple-A Benchmark

	2019	2020					2021									
	Dec 31	Mar 31	May 29	Jun 30	Sep 30	Dec 31	Jan 29	Feb 26	Mar 12	Mar 31	Apr 28	May 28	Jun 7	Jun 9	YTD Change	Change since 5/29/20
State of New York G.O.	-6	-6	+42	+19	+14	+3	+16	+16	+19	-5	-2	0	0	0	-3	-42
LIPA	+27	+31	+70	+38	+27	+22	+17	+25	+16	+17	+8	+13	+9	+12	-10	-58
Nassau County	+23	+24	+92	+76	+69	+60	+47	+48	+54	+50	+49	+47	+48	+53	-7	-39
NY Dorm Sales Tax	+9	+7	+54	+55	+36	+34	+22	+27	+25	+27	+31	+37	+33	+14	-20	-40
NY MTA	+33	+83	+304	+222	+324	+158	+97	+78	+87	+71	+57	+51	+42	+50	-108	-254
NY MTA Dedicated Tax	+9	+49	+188	+109	+100	+32	+33	+43	+40	+38	+28	+30	+29	+31	-1	-157
NYC	+15	+17	+66	+44	+56	+34	+32	+28	+33	+30	+25	+27	+22	+18	-16	-48
NYC TFA	+14	+27	+48	+45	+45	+25	+22	+30	+13	+39	+24	+18	+16	+17	-8	-31
NYC W&S	+9	+11	+18	+14	+20	+10	+9	+23	+18	+17	+10	+9	+4	+3	-7	-15
NYS Housing	+69	+71	+111	+106	+97	+93	+90	+88	+17	+69	+73	+77	+72	+73	-20	-38
NYU	+1	+5	+31	+27	+37	+23	+19	+17	+14	+15	+14	+4	+3	+3	-20	-28
Port Auth of NY & NJ	+9	+32	+91	+54	+58	+33	+28	+23	+24	+27	+14	+13	+10	+7	-26	-84
Westchester County	-26	+3	+7	+4	+1	-9	-22	-13	-11	-9	-6	-1	-2	+2	+11	-5

Spreads in basis points.
Sources: CreditSights, Bloomberg BVAL benchmark yield curves.

Spreads are the difference in bond yield between an issuer and gilt-edged AAA rated debt. As the chart above depicts, after peaking in the spring of 2020, spreads for various New York issuers have narrowed, reflecting the benefits of various federal programs that hastened economic stability. In 2020, most current New York issuer spreads listed above were wider than pre-pandemic levels at the end of 2019, and reflected both how hard hit the region was to COVID-19 and in hindsight, represented good value and a buying opportunity. However, due to the implementation of an effective vaccination distribution and the strong economic recovery that has followed, spreads further narrowed in 2021. We will continue to monitor the pace of the economic recovery and the spreads on these New York credits to determine whether there are attractive buying opportunities.

More specifically with respect to the New York credits listed on the table, these entities experienced various revenue and expenditure fluctuations based on the pandemic, and also received different degrees of federal aid under two presidential administrations and benefited from a resurging equity market.

- In the state and local government category, which includes New York State and City, Nassau and Westchester Counties, they have all benefited from indirect federal aid (e.g., enhanced unemployment benefits, direct individual subsidies and the Payroll Protection Program) as well as direct federal aid to deal with both the specific costs of the pandemic and more flexible general aid. The adoption of these federal aid programs caused spreads to narrow.

- More structured securities include the Dormitory Authority State Sales Tax bonds, Metropolitan Transportation Authority (MTA) dedicated taxes and the Transitional Finance Authority (TFA). All have passive (rates or tax % fixed) revenue streams such as taxes on sales, income, petroleum and franchises that, ultimately, did not experience significant declines, with spreads only having spiked briefly and not to the same extremes.

- Essential enterprise systems for housing New York City water and sewer and the Long Island Power Authority also maintained their revenue base without suffering significant expenditure increases. Within this general enterprise category, New York University had to adapt to an online education environment but did receive federal aid and could have relied on its robust balance sheet to see them through. Its spread spike came back to normal trading levels relatively quickly.

- The transportation enterprises listed, the Port Authority and the MTA farebox bonds, experienced the greatest spread widening. Direct revenues from various regional tolls, airports, bus, subway and rail services declined significantly as commuters and tourists stayed home. In addition, there was a less than proportionate decline in expenditures since these services needed to be maintained to keep the region functioning during the pandemic. It could take a few years before passengers resume normal travel patterns. However, recognizing the economic importance to the region's economy in maintaining these services, federal monies are increasingly available, with the added assumption that the states of New York, New Jersey and Connecticut will also provide additional financial support if necessary.

Conclusion

This pandemic has exposed the city to a new set of challenges stemming from the implications of remote work and the inequality of the pandemic on poorer, laboring New Yorkers. There is still a future for densely populated urban areas with a strong and diverse economy and institutional presence in the form of universities, health facilities and culture to attract established and aspiring talent and businesses. While no city in the U.S. has endured the same level of challenges over the past 50 years, New York's resiliency has been proven again and again.

The next mayor will be faced with daunting challenges but, with the financial help from the state and federal governments, many of the short-term financial issues have been ameliorated. Longer term challenges, which have always existed, such as an inclusive economic recovery, the ability for everyone to afford adequate housing and health care, and the need to improve public education, will require shepherding full city resources, including the private sector, to get New York back and better. This is a difficult task, and the value of the municipal bonds associated with the City will rise and fall based on the length and strength of the recovery. We are committed to the city and its various forms of debt and will seek out timely opportunities to invest for our clients.

Notes

1. *Barron's* 2020 Top Independent Advisors; *The Financial Times* 2020 Top 300 Registered Investment Advisors; *Financial Advisor* 2020 RIA Ranking
2. Statistics based on Citizens Budget Commission Report: "NYC Job Loses In Recession, How the COVID-19 Recession is Different," 3/21.
3. *NY Times*: "How the Pandemic Did and Didn't Change Where Americans Move," 4/19/21.
4. *NY Times*: "How the Pandemic Did and Didn't Change Where Americans Move," 4/19/21.
5. Bloomberg City Lab: "More Americans are Leaving Cities, But Don't Call it an Urban Exodus," 4/26/21.
6. CB Richard Ellis (CBRE): "COVID-19 Impact on Resident Migration Patterns," April 2021.
7. New York City Real Estate Market Quarterly Reports: Q1 2021, The Corcoran Group.
8. Nonresidents generated $7.4 billion in New York State personal income taxes, 15% of the total. Most of that came from people who were regular commuters before COVID-19 hit. "The Pandemic Could Take Away Some NY Cash Cows," Empire Center, 12/8/20.
9. Source: Supreme Court of the United States Website New Hampshire v. Massachusetts. Issue: Whether Massachusetts' tax rule – which subjects nonresident earned income received for services performed outside Massachusetts to the state's income taxes – is unconstitutional confiscation.
10. *Crain's New York Business*: "62% of Employees Could Return to Manhattan Offices by September Survey Finds," 6/7/21.
11. NYC Comptroller's Comments on New York City's Preliminary Budget for Fiscal Year 2022 and Financial Plan for Fiscal Years 2021-2025, March 2, 2021.
12. *NY Times*: "Shootings and Subway Attacks Put Crime at Center of N.Y.C. Mayor's Race," 5/11/21.
13. The current top state income tax rate is 8.82% for joint filers of income over $2.2 million. The rate will permanently increase on joint filers of income over $2 million to 9.65%, with temporary (until 2027) increases on $5 million in income to 10.3%; $25 million to 10.9%. When adding the NYC income tax rate of 3.88%, the potential total tax rate is 14.79%, the highest of the 50 states.
14. New York Aid Under the American Rescue Plan Act (includes information from the Rockefeller Institute of Government): "The American Rescue Plan Act: State & Local Fund Breakdown," 3/24/21, and *Crain's New York Business*: "What's in the $1.9 trillion Rescue Package for New York," 3/15/21.

President Joe Biden signed the American Rescue Plan Act (ARP Act) into law on March 11, 2021. The $1.9 trillion spending package is designed to support the distribution of vaccines and accelerate the post-COVID-19 economic recovery. The ARP Act is the sixth federal relief package through which the federal government has allocated a total of $5.7 trillion to directly address the COVID-19 pandemic and related economic fallout. The ARP Act includes $350 billion in funding for state and local governments – the largest allocation to localities to date.

The Coronavirus Aid, Relief and Economic Securities, or CARES, Act in late March 2020 allocated $150 billion to states, local governments, U.S. territories, and tribal governments through the Coronavirus Relief Fund. The funding was limited to finance expenditures incurred in 2020 while addressing the public health emergency. Each state received a minimum of $1.25 billion, and the amount was scaled up based on population. This funding could not be used to offset lost tax revenues or other non-health related expenses.

Besides the additional positive effects of the various stimulus programs on tax receipts such as the extension of unemployment insurance and direct subsidies, the ARP Act designates $350 billion for the Coronavirus State and Local Fiscal Recovery Funds. The funding will flow to states, counties and individual municipalities, but the ARP Act explicitly prohibits the use of these funds for pensions or tax cuts. (This prohibition on tax cuts may, however, be challenged in court by states' attorneys general as being unconstitutional.) Identified allowable usages have so far included, but are not limited to:

- addressing the COVID-19 emergency and its negative impacts;
- assistance to households, businesses, nonprofits and impacted industries;
- restoring government services that were reduced in response to revenue losses;
- investments in water, sewer or broadband infrastructure;
- support for public transit; and
- offering premium pay to first responders and essential workers or grants for workers.

On average, states received 233% more funding from the APR Act as compared to the CARES Act. New York saw its funding triple, experiencing one of the highest increases of any state. These differences in distribution between the two relief packages are due to the fact that the CARES Act funding was allocated by population, while the ARP Act funding will be distributed based on the Community Development and Block Grant formula.

ARP Act's Coronavirus Local Fiscal Recovery Funds will be distributed to 39 metro cities in New York. New York City will receive $4.3 billion. The next largest allocations are to Buffalo ($350 million), Rochester ($207 million) and Syracuse ($126 million). Buffalo and Niagara Falls are expected to receive the largest per capita allocations. The state will receive $12.5 billion in direct aid to help close a budget gap and pay for essential services and general funding. New York City will receive $6.1 billion, while $4.1 billion will be divided among New York counties and municipalities.

The troubled Metropolitan Transportation Authority – which already received $8 billion in CARES Act funds – will get $6.5 billion allocated under the ARP's $30.5 billion carve-out for transit relief. The MTA faced a $17.1 billion projected shortfall through 2024 before the federal measures were passed.

Local K–12 schools will receive $9 billion in funding, while the state's colleges and universities are eligible to use $2.6 billion to pay for reopening and financial aid.

About the Author

Howard Cure is a Partner and the Director of Municipal Bond Research for Evercore Wealth Management. He has over 30 years of experience in analyzing municipal securities.

Prior to joining Evercore in 2009, he was for 11 years a director at the Public Finance Department of Financial Guaranty Insurance Company. He previously was a vice president with the investment banking firm of Prager, Sealy & Co. and, earlier, a vice president at Moody's Investors Service. He began his career as an economist with the New York State Senate Finance Committee in Albany, New York.

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