Fitch Upgrades New York State GO and Related Bonds to 'AA+'; Outlook Stable Ratings Endorsement Policy
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Fitch Ratings-New York-20 June 2014: Fitch Ratings has upgraded the rating for the State of New York's general obligation (GO) bonds, to 'AA+' from 'AA'. The Rating Outlook is Stable.
Fitch's rating action also affects the ratings on related debt linked to the state's GO rating, as detailed at the end of this release.

SECURITY

GO bonds are backed by the full faith and credit of the state of New York.

KEY RATING DRIVERS

SUSTAINABLE BUDGETING PRACTICES: The upgrade reflects the improved fiscal management practices of recent years that have resulted in timely and more sustainable budget-making. Notable recurring actions were taken to close budget gaps in the downturn, and in the recovery the state has limited the growth in spending.

WEALTHY ECONOMY LINKED TO FINANCIAL SERVICES: New York's economy is broad, with substantial wealth and resources. The financial activities sector is significant to the state's economy and finances, although it is prone to above-average cyclicality.

STRONG FINANCIAL PLANNING AND REPORTING: The state stays abreast of changing conditions through comprehensive quarterly updates of a four-year financial plan.

MODERATE LIABILITY BURDEN: New York's debt burden is above average but still in the moderate range, and the burden of debt has declined modestly in recent years. Pensions are well funded, with the unfunded liability below the state median. On a combined basis, the burden of debt and pensions is moderate, matching the national median.

RATING SENSITIVITIES

CONTINUED CAREFUL BUDGET MANAGEMENT: The 'AA+' rating assumes the state's continued commitment to constrained formula funding of key spending items and realistic forecasting of revenues. Ongoing proactive financial management is critical given the state's limited reserve funding position.

CREDIT PROFILE

The upgrade of New York's GO rating, to 'AA+' from 'AA,' is based on the fiscal management improvements made by the state in recent years and Fitch's expectation that the state will continue to adhere to strengthened fiscal management practices going forward. The state has implemented a wide range of beneficial changes to its budgeting, including on-time budget enactment, consensus revenue forecasting, and curbs on expenditure growth, while avoiding significant reliance on one-time resources. These changes have resulted, in Fitch's view, in more sustainable budget performance compared to the state's earlier fiscal practices, in which the state relied on non-recurring actions to cover persistent structural spending pressures and to respond to severe, recession-driven revenue cyclicality.

Recent fiscal management improvements remain untested by a severe recessionary event, but in Fitch's view the state is in a materially improved position to address future economic and revenue cyclicality. Although the state has built only modest reserves, Fitch believes that with proactive budget management New York continues to have a margin of flexibility to respond to unforeseen economic and revenue weakness beyond the level provided by its reserve balances.

The state's substantial wealth and resources and broad economy remain ongoing credit strengths. The rating continues to recognize the outsized role that the financial activities sector plays in the state's economy and revenue system. State net tax-supported debt levels have been relatively stable as a percentage of personal income. Fitch expects the state's debt levels to remain above average but still in the moderate range. Pensions are well funded, and the combined burden of debt and pensions matches the median for U.S. states rated by Fitch.

FINANCIAL MANAGEMENT

The state has made significant positive changes in financial management in recent years, including on-time budgets, a consensus revenue forecasting mechanism, and, over the last four enacted budgets, notable efforts to address longstanding expenditure growth concerns. Although New York's financial position was strained during the recession, its approach to budgeting has become more sustainable and focused on structural solutions than was the case in the past. The fiscal 2012 budget addressed a large budget shortfall primarily through aggressive spending control and policy reform, lowering the cumulative four-year budget gap projected at the time to $10 billion, from $63 billion. Notably, it included ongoing expenditure control mechanisms for Medicaid and school aid, the two largest drivers of state spending.

Budgets enacted since then have remained largely consistent with the framework implemented in fiscal 2012. The enacted budget for fiscal 2014 addressed a modest estimated gap of $1.35 billion by holding down overall state operating fund spending growth and maintaining the established formula funding growth in Medicaid. However, school aid was funded at a level above what the formula would suggest, which affected fiscal 2015, as the fiscal year for schools is different from that of the state. To lower outyear gap estimates, the state extended through calendar 2017 a temporary income tax rate increase on the highest earners that was scheduled to expire after tax year 2014, in addition to some other revenue-raising measures. Extension of the temporary taxes in the recovery contrasts the prior downturn, when temporary taxes expired on schedule. The budget included a tax credit program targeted at middle income families in tax years 2014 through 2016. The fiscal year ended in balance, with higher than expected revenues and lower than expected spending allowing the state to make modest deposits to its reserves and increased prepayments of future year expenses. State operating funds spending grew 2%, consistent with the benchmark established in fiscal 2012.

The fiscal 2015 budget addressed a fiscal 2015 budget gap estimated at $1.7 billion and covered a tax reduction package with a first-year impact of $725 million. Including policy actions taken, the four-year gap estimate was lowered to $7.5 billion, from $11.5 billion. The state's own presentation assumes that an additional $10.4 billion in out-year actions will be taken to maintain the 2% state operating-funds spending growth benchmark; assuming that is the case, the state would maintain small surpluses through the fiscal 2018 financial plan period. The tax reduction package noted earlier includes temporary personal income tax (PIT) credits targeting filers in communities outside New York City that maintain a 2% property tax cap, as well as permanent tax changes affecting business and estate taxes,

among other changes. The cumulative impact of the package through fiscal 2018 totals $4.1 billion. Following small deposits made in fiscal 2014, the combined balance of the state's rainy day and tax stabilization reserves is approximately $1.5 billion, a relatively low level considering the state's revenue volatility. Further adding to the state's flexibility, the state has received to date in fiscal 2015 significantly higher than expected settlement funds, totaling $785 million.

Fitch believes that continuing to meet cost control targets in the areas of Medicaid and school aid will remain significant challenges for the state despite some noteworthy successes in curbing spending growth to date. Since fiscal 2012, spending increases in these areas have been linked to formulas that are expected to result in growth of about 4% per year going forward. For Medicaid, the administration has been granted powers that strengthen the ability to remain on budget and targets have proved achievable. As noted, for school aid the state provided additional funding above what the calculation would have dictated in fiscal 2014 and 2015, noting comparatively low levels of growth in the basis for the personal income-linked growth formula.

The state's current revenue forecast assumes base tax receipt growth of 3.2% for fiscal 2015 following increases of 6.3% in fiscal 2014 and 4.8% in fiscal 2013. Base tax growth reflects in part the timing impact on state PIT collections of federal tax changes made in early 2013. PIT extension payments in early fiscal 2015 were lower than originally expected.

ECONOMIC PERFORMANCE

New York's economy is characterized by strong wealth levels and considerable breadth, although there is volatility inherent in the important financial services industry. In contrast to previous downturns, the state's employment decline in the recession was notably less severe than that of the nation. Through the downturn, the state's employment experienced only one year of decline, 2.7% in 2009, compared to a 5.6% drop for the U.S. between 2007 and 2010. Growth in 2011 was ahead of the U.S. pace, and, although state gains lagged the nation's in 2012 and 2013, New York exceeded its pre-recession employment peak in 2012, well ahead of the nation.

The May 2014 year-over-year employment gain of 1.1% for New York was well under the 1.8% U.S. growth rate. The state's current forecast anticipates employment growth of 1.3% in 2014 and 1.2% in 2015. The state's unemployment rate was below the nation's during the recession; however, with labor force growth, the state's unemployment has exceeded the nation's since 2012. Most recently, May 2014 unemployment was 6.7% in New York, compared to 6.3% nationally.

DEBT AND OTHER LONG-TERM LIABILITIES

New York's state net tax-supported debt is above average but still in the moderate range at 5.1% of personal income as of March 31, 2014, about twice the median for U.S. states rated by Fitch. Most of New York's debt has been issued by state public authorities and secured by appropriations (only about 6% are GOs). While this results in a diffuse debt structure, there is strong centralization and oversight within the budget division; and approval by the public authorities control board is required for many of these bond issues.

Reported pension funded ratios for two major statewide systems, covering general employees and police and fire employees, have been sound, at 87.2% for the employees system and 87.9% for the uniformed employees' system. Using Fitch's more conservative 7% return assumption (compared to the

7.5% level assumed by the plans) would lower the funded ratios to a still sound 82.7% and 83.3%, respectively. On a combined basis the burden of net tax-supported debt and adjusted unfunded pension obligations attributable to the state measures 6.1% of personal income, on par with the U.S. state median.

RELATED DEBT

In conjunction with the upgrade of the state's GO rating, Fitch has upgraded the ratings for the following bonds to 'AA+' from 'AA" with a Stable Rating Outlook:

--State PIT revenue bonds issued by the Dormitory Authority of the State of New York (DASNY), the New York State Environmental Facilities Corporation (EFC), Empire State Development/New York State Urban Development Corporation (ESD), the New York State Housing Finance Agency (HFA), and the New York State Thruway Authority; --DASNY state sales tax revenue bonds; --New York Local Government Assistance Corporation (LGAC) senior and subordinate lien bonds; **--New York City Sales Tax Asset Receivable (STAR) Corporation bonds**; and --Thruway Authority Highway & Bridge Trust Fund bonds.

Fitch also has upgraded the ratings on various state appropriation-supported bonds to 'AA' from 'AA-' with a Stable Rating Outlook:

--Service contract bonds issued by state agencies; --DASNY Board of Cooperative Education Services (BOCES) bonds; --DASNY City University of New York (CUNY) revenue bonds; --DASNY Department of Health revenue bonds; --DASNY Fashion Institute of Technology bonds; --DASNY mental health services facilities improvement revenue bonds; --DASNY secured hospitals program revenue bonds; --**New York City Transitional Finance Authority state building aid revenue bonds**; --State of New York Municipal Bond Bank Agency (MBBA) special school purpose revenue bonds (prior year claims); --MBBA special school purpose revenue bonds (prior year claims - The City of New York), 2012 series A; --Tobacco Settlement Financing Corporation (state contingency contract secured) asset backed revenue bonds.

Finally, Fitch has upgraded the rating on DASNY's school districts revenue bond financing program revenue bonds to 'AA-' from 'A+' with a Stable Rating Outlook.

The ratings on all of the related debt listed above are directly linked to the state's GO rating.