

Rating Update: Moody's upgrades New York State GO and PIT bonds to Aa1; outlook stable

Global Credit Research - 16 Jun 2014

Also upgraded are state appropriation, intercept and moral obligation bonds; state has approximately \$62B in debt outstanding

NEW YORK (STATE OF)
State Governments (including Puerto Rico and US Territories)
NY

Opinion

NEW YORK, June 16, 2014 --

Moody's Investors Service upgraded New York State's general obligation bond rating to Aa1 from Aa2 and moved the state's outlook to stable. Also upgraded to Aa1 from Aa2 are the state's personal income tax revenue, sales tax revenue, Local Government Assistance Corporation (LGAC), New York City Sales Tax Asset Receivable Corporation (STARC) and NYS Thruway Highway and Bridge Trust Fund bonds. Other appropriation-backed debt, state intercept programs, and state moral obligation bonds were upgraded by one notch to Aa2 or Aa3 or A1 and are listed at the end of this report.

SUMMARY RATING RATIONALE

The Aa1 rating reflects New York's sustained improvements in fiscal governance, the strength of the recent economic recovery, a strong financial position reflected in improved reserves, and reduced spending growth in line with growth in the state's economic capacity. The rating also recognizes New York's expensive business environment, reliance on financial services and other NYC-based economic drivers, high state debt burden offset by below-average net pension liabilities, and a history of structural budget gaps requiring reliance on non-recurring resources to achieve budget balance.

The stable outlook reflects our expectation that the state will preserve and improve upon the gains it has made in governance and its financial position.

STRENGTHS

- * Broad-based, mature, and wealthy state economy that attracts a highly-educated and global workforce, and has shown above-average resilience during the recovery
- * Long track record of closing annual budget gaps, and more recently, with more structurally balanced solutions
- * Accumulated rainy day reserves have remained stable for 10 consecutive years, providing cash flow flexibility, although at comparatively low levels
- * State pension system is well funded compared to other states and unfunded liability is modest, placing state's fixed costs at the 50-state median relative to total revenues
- * Recent reversal of history of political gridlock, reflected in timely budgets, implementation of spending controls and move toward structurally balanced budgets.

CHALLENGES

- * Revenue volatility stemming from the state's dependence on the financial services sector and income taxes combined with limited flexibility in use of budgetary reserves
- * Relatively low fund balances provide minimal protection against revenue volatility
- * Persistent structural budget gap

DETAILED CREDIT DISCUSSION

REVERSAL OF HISTORIC PATTERNS ELEVATES NEW YORK'S CREDIT PROFILE

New York has reversed historic financial management patterns and now benefits from a sustained record of on-time budgets, contained spending growth, and lack of reliance on external borrowing for liquidity purposes. These accomplishments in combination with the state's highly productive economy, low unfunded pension liabilities which mitigate high levels of outstanding debt, and adherence to best practices such as multi-year financial planning and constraints on the further growth of bonded debt create a credit profile consistent with the Aa1 rating category, the average for US states.

MODERATE SPENDING GROWTH, OUTYEAR GAPS IN ENACTED 2015 BUDGET

For the fourth consecutive year, the state adopted a timely budget for fiscal 2015. From the mid-1970s until 2004 the state's budget was more than 30 days late 14 times, and exceeded the 30 day threshold in all but one year from 1994 to 2004. Since 2005, state budget adoption exceeded that threshold only in 2010.

State operating fund spending growth has been contained by Governor Andrew Cuomo's target 2% growth cap. The fiscal 2015 state operating budget of \$92.2 billion increases 1.8% from fiscal 2014. Adjusting for fiscal 2014 prepayment of 2015 expenses, which artificially increases 2014 and reduces 2015 disbursements, the growth rate rises above the cap but parallels projected receipts growth of 2.8%. This growth contrasts with previous periods of economic expansion. For example, from 2003 to 2009, state operating fund disbursements grew at a 6.7% compound rate. The shift to more moderate spending increases signals a more sustainable approach to state finances.

The financial plan accompanying the 2015 budget shows general fund gaps growing from \$1.8 billion in fiscal 2016 to \$3.4 billion in 2018. These gaps are manageable within the state's \$63 billion general fund budget, although the budget benefits from a number of non-recurring actions and resources, notably the personal income tax surcharge expiring in 2017 and a \$1 billion transfer from the State Insurance Fund.

If state spending adheres to the 2% growth policy throughout 2018, the budget office estimates that the state will produce budgetary surpluses each year. Among the risks to this outcome are the potential for a macroeconomic downturn and an unfavorable outcome of a federal audit of certain categories of Medicaid spending.

STATE'S FINANCIAL POSITION ON A POSITIVE TREND WITH BOOST FROM SETTLEMENTS

New York finished fiscal 2014 with a \$2.2 billion budgetary general fund balance (4.2% of receipts and net transfers), up from a \$1.6 billion closing balance the previous year. The closing balance included \$1.1 billion in the Tax Stabilization Reserve, \$350 million in the Rainy Day Reserve, slightly more than \$100 million in other reserves and \$646 million in unrestricted reserves, most of which (\$500 million) is administratively designated for debt management with the balance targeted for settling prior year labor agreements and other miscellaneous items. The state operating funds closing balance increased to \$4.8 billion (4.3% of receipts and net transfers) from \$4.3 billion in fiscal 2013. State operating funds include the General Fund, state-financed special revenue funds and debt service funds. The increase in ending balances reflect better-than-expected receipts, the first time in many years that receipts have exceeded projections.

The state's revenue performance was helped by the inclusion in the state's 2014 fiscal year of extraordinary April 2013 personal income tax settlements. Personal income tax collections for the 2012 federal tax year were boosted nationwide because of taxpayer actions to move income into 2012 before "fiscal cliff" tax increases at the federal level took hold. Because of the timing of fiscal year ending dates, many other states benefited from this shift in fiscal 2013 but are experiencing fiscal 2014 revenue shortfalls because the magnitude of the shift of income (through capital gains timing for example) has proved greater than expected.

The state used additional revenues to strengthen its financial position, adding funds to the Rainy Day Reserve for the first time since 2007 and prepaying certain 2015 expenses. The prepayments provide a cushion for the 2015 budget.

GAAP-based financial results are not yet available for fiscal 2014 but we expect them to improve and turn positive for the first time in 6 years. Based on GAAP fiscal 2013 figures (ending 3/31), New York's financial position improved from the previous year but remained slightly negative and well-below pre-recession levels. Available operating fund balances (general fund and debt service fund unassigned balances plus the rainy day reserves) increased to negative \$2.2 billion (-3.6% of revenues and net transfers) in fiscal 2013, marking significant

improvement from the negative \$5.1 billion low in fiscal 2010.

IMPROVING ECONOMY AND REVENUES EASE LIQUIDITY

The state's liquidity position is about average compared to its peers and has improved due to the economic recovery and favorable revenue trends. The state has not borrowed externally for cash flow needs since fiscal 1994. The lowest General Fund monthly cash balance grew to \$2.2 billion in fiscal 2014 from negative \$87 million in fiscal 2011, and average end of month general fund cash balances were 41% greater in 2014 than 2013. The state managed its thin liquidity during the downturn by deferring school aid in fiscal 2010 and by other payment deferrals and borrowing internally from its short-term investment pool. The state has not engaged in deferrals or internal borrowing to address general fund liquidity issues since fiscal 2012.

ECONOMY MODERATES IN 2014

As of 2012, New York had regained all the jobs lost during the recession, ahead of many of its peers and the US as a whole, but state employment trends appear to be settling back into historical "middling" patterns. Through the 12 months ending in April 2014, the state's job growth was a muted 0.9% compared to US growth of 1.7%. This period included the impacts of unusually cold winter weather on the northeast. Furthermore, although the state's unemployment rate remained consistently below the U.S. average during the recession, it has proved more stubborn in the economic recovery. In April 2014, the state's unemployment rate was 6.7%, versus 6.3% in the US.

STATE DISPROPORTIONATELY EXPOSED TO FINANCE INDUSTRY

New York's finances are highly sensitive to income tax payments from the wealthy and to employment in the high-paid securities industry. While accounting for 7.6% of total employment in 2013, financial activities generated about 20% of the state's total wages in that year, demonstrating the economic power of the sector. This feature of the state's revenue structure means that New York's total employment trends are not as fiscally meaningful as elsewhere. For example, the state's loss of over 69,000 financial activity jobs from peak to trough during the downturn affected the state finances disproportionately given the progressive tax structure and the high percentage of total tax revenue coming from income taxes (60% in fiscal 2012). Despite the state's better job performance during the recession, personal income declined more than in the US. More recently, personal income growth has been slightly slower than the US, growing 2.0% in 2013 compared to 2.6% for the US. The state's per capita personal income remains very strong at 121% of the US level.

WELL-FUNDED PENSION MITIGATES HIGH DEBT POSITION

New York State bonded debt position is the fifth highest in the nation on a per capita basis. Total net tax supported debt (NTSD) of \$61.5 billion comprises 6% of personal income, compared to the 2.6% national median. Debt per capita is \$3,200, compared to the median \$1,054. The state's outstanding debt has been relatively flat in for several years and has declined as a percent of personal income.

In contrast to its high bonded indebtedness, New York has a well below-average leverage position with respect to its pension liabilities. The total liabilities reported in the state's financial statements for the NYS Employees Retirement System and the Police and Fire Retirement System, which include the liabilities attributable to local governments, was \$21.4 billion in 2013.

The state's adjusted net pension liability, under our methodology for adjusting reported pension data, was \$21.1 billion or 16.5% of all governmental fund revenues in 2012, well below the state median of 63.9%.

Due to the state's amortization of pension contributions, which we view as a form of deficit borrowing, state contributions to its pension plans were 72% of the required contribution in 2014. According to the state's amortization payment schedule, it will contribute an increasing percentage of the annual required contribution (ARC) until 2016, at which point its contributions will exceed the required amount. Contributions are forecast to peak at 140% of annual required contributions in 2018 and gradually decline to the ARC by 2026.

The state recently implemented pension reforms for new employees that raise the retirement age, increase employee contributions to their pension plan, and increase the number of years included in the calculation of final average salary, upon which pension benefits are based.

The state's liabilities for Other Post-Employment Benefits (OPEB), which consist primarily of retiree health benefits, was \$66.5 billion in 2012, including SUNY-related liabilities. The state funds its OPEB liabilities on a pay-as-you-go basis, contributing \$1.4 billion, or 1.1% of total governmental fund revenues, in 2013. The state has

recently reduced its OPEB liabilities from \$72 billion in 2012 by negotiating benefit changes, including greater retiree premium contributions and co-payments.

EXPOSURE TO VARIABLE RATE DEBT AND INTEREST RATE DERIVATIVES MODEST

As of March 31, 2013, New York had \$2.3 billion of variable rate debt outstanding, which comprised a modest 4% of net tax supported debt. The state has approximately \$2.1 billion in swaps outstanding, with a combined mark-to-market of negative \$267 million at mid-March 2014.

OUTLOOK

The stable outlook reflects our expectations that the state's will preserve and improve upon the gains it has made in governance and its financial position.

WHAT COULD CHANGE THE RATING UP

- * Accumulation of significant GAAP fund balances that would offset risks related to volatile personal income tax collection volatility and protect against unfavorable macroeconomic events.
- * Maintaining relationship between spending growth and growth in economic capacity
- * Continued achievement of timely adoption of budgets
- * Elimination of structural imbalance and reliance on one-time and temporary balancing actions

WHAT COULD CHANGE THE RATING DOWN

- * Economic downturn resulting in lower revenues and larger budget gaps
- * Decline in reserves and liquidity measures reflected in GAAP balances or a return to large payment deferrals to manage cash flow
- * Return to reliance on deficit financing or greater reliance on non-recurring budget solutions to fund current operations
- * Depletion of Rainy Day Fund without plans to replenish
- * Sharp increase in debt issuance leading to increased debt ratio measures or significant deterioration in pension funding levels

LIST OF AFFECTED RATINGS:

Upgrade to Aa1:

NYS General Obligation

Personal Income Tax Revenue Bonds

Sales Tax Revenue Bonds

Local Government Assistance Corporation (LGAC) Bonds

NYC Sales Tax Asset Receivable Corporation

NYS Thruway Highway & Bridge Trust Fund (1st and 2nd lien)

Upgrade to Aa2:

Service Contract Bonds (Appropriation)

NYS Certificates of Participation

MTA dedicated tax fund bonds

UDC Project Revenue Bonds

NYS Medical Care Facilities Finance Agency Mental Health Service Facilities Bonds
Tobacco Settlement Financing Corp Asset-Backed Revenue Bonds (State Contingency Contract Secured)
NYS HFA State University Construction Bonds
NYS Thruway Local Highway & Bridge Service Contract
NYC Transitional Finance Authority (TFA) Building Aid Revenue Bonds (BARBs)
DASNY Upstate Community Colleges Revenue Bonds
DASNY Mental Health Facilities
DASNY Office Facilities Lease Revenue Bonds (Dept. of Audit and Control)
DASNY Educational Facilities Revenue Bonds
DASNY Revenue Bonds
DASNY City University System
DASNY Master BOCES Intercepts (Program rating)
DASNY School District Revenue Bond (Program rating)
DASNY OMRDD Intercept (Program rating and financing rating)
DASNY Court Facilities Intercept Program (Program rating and financing rating)
DASNY Muni Health Facilities Intercept Program (Program rating and financing rating)
Upgrade to Aa3:
DASNY 4201 School Facilities Program Revenue Bonds
NYS Medical Care Facilities Financing Agency Hospital & Nursing Home Project Bonds (MO)
NYS HFA Moral Obligation
Upgrade to A1:
DASNY NYS Rehabilitation Association, Pooled Loan Program (OMRDD Intercept Program)

RATING METHODOLOGIES

The principal methodology used to determine ratings for general obligation bonds and all other bonds, with the exception of PIT and sales tax revenue bonds, was US States Rating Methodology published in April 2013. The additional methodology used in rating the lease appropriation and Dedicated Tax Fund debt was The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations published in December 2011. The additional methodology used in rating the Intercept Programs and enhanced ratings was State Aid Intercept Programs and Financings: Pre and Post Default published in July 2013. The additional methodology used in rating the bonds backed by the moral obligation pledge was Moody's Approach to the Moral Obligation Pledge published in June 1999.

The principal methodology used in rating the personal income tax bonds and sales tax revenue bonds was US Public Finance Special Tax Methodology published in January 2014. The additional methodology used in rating the personal income tax and sales tax revenue bonds was The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations published in December 2011. Please see the Credit Policy page on www.moody.com for a copy of these methodologies.

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New Issue: Moody's assigns Aa3 rating to \$850 million NYC TFA Building Aid Revenue Bonds, Fiscal 2013 Series S-1; outlook is stable

Global Credit Research - 09 Jul 2012

\$5.3 billion of parity debt outstanding

NEW YORK CITY TRANSITIONAL FINANCE AUTHORITY, NY
State Governments (including Puerto Rico and US Territories)
NY

Moody's Rating

ISSUE	RATING
Building Aid Revenue Bonds Fiscal 2013, Series S-1	Aa3
Sale Amount	\$850,000,000
Expected Sale Date	07/19/12
Rating Description	Lease Rental: Appropriation

Moody's Outlook

Opinion

NEW YORK, July 09, 2012 --Moody's Investors Service has assigned a Aa3 rating and stable outlook to the New York City Transitional Finance Authority's (TFA) Building Aid Revenue Bonds, Fiscal 2013 Series S-1, in the amount of \$850 million. The TFA plans to price the bonds on July 12. Bond proceeds will finance a portion of New York City school-related capital projects. The TFA has \$5.3 billion of outstanding parity Building Aid Revenue Bonds (BARBs).

SUMMARY RATING RATIONALE

Although the bonds are issued by the TFA and proceeds will be used to finance New York City educational facilities, Moody's views this as a state appropriation credit: debt is secured by a strong state commitment to provide building aid payments to the city, subject to annual appropriation. The rating reflects that need to appropriate, the state's constitutional mandate to fund education aid, a statutory framework that assigns the city's state building aid to the TFA, and non-impairment provisions. The State of New York's general obligation bonds are rated Aa2 with a stable outlook.

STRENGTHS

- Long track record of state payments for New York City education aid
- State non-impairment commitment
- 1 times additional bonds test based on confirmed building aid received in every year
- Healthy coverage in early years, although coverage declines in outyears

CHALLENGES

- Confirmed building aid payments are subject to appropriation
- The city's education aid is subject to certain competing claims

DETAILED CREDIT DISCUSSION

BONDS SECURED BY CONFIRMED STATE BUILDING AID TO NEW YORK CITY, SUBJECT TO ANNUAL APPROPRIATION

In 2006, the TFA enabling act was amended pursuant to the School Financing Act to change the way the state provides support for New York City's educational capital plan. The amended law authorizes the issuance of building aid revenue bonds of up to \$9.4 billion to finance educational facilities; \$5.3 billion of this authorization is currently outstanding, not including this issuance. Under the act, the city assigns to the TFA all of the state building aid payable to the city, under Section 3602.6 of the state education law.

Educational projects in New York City's education capital plan, including new construction, building additions, and rehabilitations, are eligible for state building aid. When a project goes into contract, the School Construction Authority submits it to the State Education Department (SED). The SED approval process establishes an "aidable cost" of the project and creates a 30-year amortization schedule. Once SED has approved the project, the state is statutorily required to provide a 30-year stream of building aid payments, subject to annual appropriation. The stream of building aid payments is a function of both the aidable cost and the current funding ratio, and provides the security for the bonds.

STATE NON-IMPAIRMENT COVENANT ADDS BONDHOLDER PROTECTION; COMPETING CLAIMS TO BUILDING AID

The SED determines the amount of confirmed building aid payable annually by applying a building aid ratio to the amount of aidable debt service for the year. The base building aid ratio has varied in past years and could vary in future years. For New York City schools, it has tended to average approximately 51%-54%. For 2011, the ratio was 48.7% however it is projected to increase to 49% and 49.6% in fiscal 2012 and 2013, respectively. Although the state is able to vary the building aid ratio on a year-to-year basis, which alters the amount of confirmed building aid payable to the city, the state has covenanted not to impair the rights of the bondholders in any way. Therefore, we believe that the state is not likely to reduce its building aid payments below the level initially calculated. Further supporting bondholder security is the fact that the state aid intercept provision of Section 99-B of the School Finance Law is available to these bonds. However, since the 99-B program provides for post-default payment, with the state comptroller withholding education aid in amounts required to pay debt service if necessary, it does not add to the credit rating assigned to this transaction.

New York City's education aid is subject to certain competing claims, including from holders of State of New York Municipal Bond Bank Agency Special School Purpose Revenue Bonds, 2003 Series C, as well as state reimbursements for services provided to certain handicapped students. These claims are minimal in amount. There are also contingent competing claims from the 99-B intercept post-default program, holders of New York City Education Construction Fund Revenue Bonds, and possible withholdings by the state if the city fails to provide certain educational services. Through a memorandum of understanding (MOU) between the city, the TFA, the State Education Department, and the New York State Comptroller, the state comptroller has agreed to satisfy such competing claims from other school aid before state building aid. New York City has agreed to pay to the TFA any amounts of building aid that may be diverted for these claims.

1.0 TIMES ADDITIONAL BONDS TEST BASED ON HISTORICAL ANNUAL CONFIRMED BUILDING AID

The additional bonds test (ABT) requires 1.0 times coverage of outstanding state building aid appropriation bond debt service by confirmed building aid revenue in every year. This ABT does not rely on any future approval of New York City education capital projects or on the associated incremental building aid: it relies solely on approved projects for which the state has committed to provide a 30-year stream of building aid payments subject to annual appropriation.

Based on confirmed building aid through 2040 and debt service on outstanding Building Aid Revenue Bonds as well as projected debt service on the Series 2013 S-1 bonds, debt service coverage falls from 2.95x times in 2012 to a minimum of 1.01 times in 2036. As New York City continues to add capital projects for education in the future, incremental associated building aid will be added, increasing coverage and providing more debt capacity.

MOU ESTABLISHES FLOW OF BUILDING AID

Each year the state annually appropriates money to New York City to pay for educational needs of the city's students. A portion of this aid constitutes the state building aid. Until 2006, the state did not distinguish between the payment of education aid and building aid, making one lump sum payment to the city. To securitize the bonds and

separate building aid from the rest of the education aid, pursuant to the MOU the city, TFA, SED and the state comptroller determine the amount included in each general education aid payment that is attributable to state building aid. Prior to each general education aid payment, the TFA is required to calculate and certify to the SED, the comptroller and the state budget director the amount of the building aid payment included in each general education aid payment.

Additionally, a constitutional mandate to fund education supports the inclusion of appropriations for educational aid, including building aid, in the state's annual budget.

STATE FINANCIAL CONDITION A FACTOR IN RATING

Moody's views the building aid revenue bonds as a General Fund appropriation obligation of the State of New York. As such, the payment of state building aid to the TFA is dependent on the financial condition of the state. Moody's rates the state's general obligation bonds Aa2 with a stable outlook.

For the second consecutive year, the state adopted a timely budget for fiscal 2013. The state operating budget increases \$1.7 billion (2%) over fiscal 2012, driven by growth in aid to school districts, medicaid, various local assistance grants and debt service. The \$2 billion general fund budget gap is balanced with spending controls and \$62 million of undesignated fund balance. The state also plans to amortize approximately \$782 million of its fiscal 2013 actuarial recommended pension contribution, which Moody's considers to be a one-time resource. Approximately \$1.5 billion of projected fiscal 2013 gap was closed in advance of the budget process with an income tax reform that will increase state revenues by \$4.3 billion over the next three years (net of new tax credits and a make-whole payment to the Metropolitan Transportation Authority). The largest expenditure cuts are cost control measures through state agencies and elimination of automatic cost-of-living increases for human service providers.

Outlook

The TFA building aid revenue bonds outlook is stable, based on New York State's long history of providing state building aid as a portion of New York City's general education aid.

WHAT COULD MAKE THE RATING GO UP

- Stronger protection for the pledged revenues
- Upgrade in New York State's rating

WHAT COULD MAKE THE RATING GO DOWN

- Deterioration in the state's financial condition
- Significant decrease in debt service coverage

The principal methodology used in this rating was The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations published in October 2004. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

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