MOODY'S
INVESTORS SERVICE

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.moodys.com for a copy of these methodologies.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

Analysts

Marcia Van Wagner
Lead Analyst
Public Finance Group
Moody's Investors Service

Emily Raimes
Additional Contact
Public Finance Group
Moody's Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653

Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
USA