Moody's
INVESTORS SERVICE

New Issue: Moody's assigns Aa2 to $750M of NYC TFA Building Aid Revenue Bonds; outlook stable

Global Credit Research - 12 Jun 2015

$7.4B of BARBs outstanding, including current issue

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

Moody's Rating

ISSUE	RATING
Building Aid Revenue Bonds, Fiscal 2015 Series S-2	Aa2
Sale Amount $750,000,000	
Expected Sale Date 06/15/15	
Rating Description Lease Rental: Appropriation	

Moody's Outlook

NEW YORK, June 12, 2015 --Moody's Investors Service has assigned a Aa2 rating to the New York City Transitional Finance Authority's (TFA) $750 million Building Aid Revenue Bonds, Fiscal 2015 Series S-2. The bonds will be sold over a three-day period starting June 15, 2015.

SUMMARY RATING RATIONALE

The Aa2 rating on the TFA Building Aid Revenue Bonds (BARBs) is one notch below New York State's Aa1 rating and reflects the state's strong commitment to provide building aid payments to New York City (Aa2 stable). The rating also reflects the subject-to-appropriation nature of the state aid payments securing the bonds, 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.

OUTLOOK

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

WHAT COULD MAKE THE RATING GO UP

*Stronger protection for the pledged revenues

* State rating upgrade

WHAT COULD MAKE THE RATING GO DOWN

* Significant decrease in debt service coverage

* State rating downgrade, which could be triggered by growing structural budget gaps and reliance on non-recurring resources for recurring expenses.

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

RECENT DEVELOPMENTS

Recent developments are incorporated in the detailed rating rationale.

DETAILED RATING RATIONALE

ECONOMY

While by 2012 New York regained all the jobs lost during the recession, the state's economy has settled into a pattern of slightly underperforming the US. In calendar year 2014, the state's job growth was about 1.7%, compared to 1.9% nationwide. The state's unemployment rate remained consistently below the US average during the recession, but has not fallen as rapidly during the economic recovery and has been about on par with the US rate. In April 2015, the state's unemployment rate was 5.7%, versus 5.4% in the US.

The performance of the financial industry is important to New York's credit profile because the state's finances are highly sensitive to income tax payments from the wealthy and to employment in the high-paid securities industry. While accounting for 6.6% of total employment in 2013, financial activities generated nearly 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 2014). Despite the state's better job performance during the recession, personal income declined more than in the US.

The financial activities sector in New York flatlined in 2012 and 2013 while growing nationally, but has regained some momentum recently. The state has also lagged the nation in adding jobs in business and professional services. This underperformance has contributed to softening personal income growth. State personal income growth averaged 3.7% from 2010 to 2014 compared to 4.3% for the US. The state's per capita personal income remains very strong at nearly 121% of the US level.

FINANCES AND LIQUIDITY

GAAP-based financial results show that the state continued to carry negative available balances (unassigned plus other available reserves) in fiscal 2014. Available balances at year end of -$3.019 billion, or about 5% of adjusted revenues, were deeper into negative territory than the -$2.207 billion registered at the end of fiscal 2013. The negative balances include the state's rainy day fund of $350 million and the tax stabilization reserve of $1.1 billion. Fiscal 2015 results will more than likely swing to positive territory because of significant legal settlement proceeds.

New York State's fiscal 2015 ended March 31 with a healthy cash balance of $7.3 billion, primarily reflecting extraordinary revenues from monetary settlements with financial institutions. Fiscal 2015 spending grew 4% on a general fund budgetary basis, excluding transfers, and 2% on a state operating funds basis. State operating funds include the general fund and certain other expenditures, excluding capital and federal funds.

The fiscal 2016 budget, enacted April 1, continues to conform to the executive's budgetary framework, with state operating funds spending of $94.25 billion growing 2% from fiscal 2015. General fund spending excluding transfers is projected to grow 6.6% and all fund spending, including off-budget capital, to grow 3.1%.

The disposition of $4.67 billion in proceeds from monetary settlements with financial institutions was one of the biggest question marks in finishing 2015 and shaping of the 2016 budget. The bulk of the money will be transferred from the general fund into a new "Dedicated Infrastructure Investment Fund" (DIIF) account and from there is expected to be used for various infrastructure and economic development projects of a one-time nature. Although there is the risk that the account could be used to imprudently fund recurring operating expenses, this is mitigated by the potential for unspent funds in the account to function as an informal rainy day fund if needed. The enacted budget includes receipt of an additional $1.348 billion in settlements in fiscal 2016, and the financial plan reflects another $1.3 billion in expected receipts that have not been budgeted.

Other notable aspects of the enacted budget include:

--Deposit of an additional $316 million into the state's rainy day reserves and prepayment of more than $900 million of fiscal 2016 debt service;

--From the monetary settlement proceeds, funding of $850 million of a federal Medicaid disallowance that had loomed as a major risk to the budget. Additional payments of $100 million annually to resolve the dispute with the federal Centers for Medicare and Medicaid (CMS) have been included in the multi-year financial plan;

--Outyear general fund budget gaps grow to $4.2 billion in fiscal 2019 but there would be a surplus if state operating fund spending continues to adhere to the target 2% cap. Adjusted for amortization of the state's pension contributions, which we view as deficit spending, a slightly larger gap of $4.3 billion would emerge in fiscal 2019. This amount is manageable given the scope of the state's budget, and would be more than offset if the state continues to adhere to the spending cap.

New York continues to face challenges. Labor contracts covering approximately 60% of the state's employees expire in fiscal 2016, while the financial plan does not reflect any reserve for the costs of new contracts. A spending guideline meant to contain K-12 education to the growth in state personal income has been ineffective, with school year 2016 school aid spending growth of 6.1% after 5.3% growth in 2015. In order for the state to continue to meet the 2% state operating funds spending cap, it must rely on continued offsetting cost containment elsewhere in the budget, which may prove more challenging over time and may create incentives to additionally exploit opportunities to move funds off budget or engage in other actions designed to evade the spending constraint.

Revenue projections assume continued economic growth nationally. Total state taxes grow 5% in fiscal 2016 and the projected growth rate diminishes in later years of the financial plan.

Liquidity

The state's liquidity position has been 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 extraordinary legal settlement proceeds in fiscal 2015 have contributed to higher end of month cash balances than year-ago levels: in March, the General Fund cash balance exceeded $7 billion, compared to $2.2 billion in March 2014. The state projects that end-month general fund cash balances will diminish through fiscal 2016 as the monetary settlements are spent or transferred to other funds. Projected year-end general fund cash is $3.5 billion.

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.

DEBT AND PENSIONS

Debt Structure

Our measure of the state's net state tax-supported debt outstanding has remained fairly stable at about $62 billion since 2010, during which time NTSD has declined from 6.7% to 6.0% of personal income. Our measure of the state's debt includes about $8 billion in certain securities issued by the City of New York but backed by state aid payments.

Variable rate debt is limited by statute to up to 15 percent of outstanding State-supported debt. The state had $2.1 billion in variable rate debt outstanding as of March 31, 2015. The state has no current plans to issue additional variable rate debt.

Debt-Related Derivatives

Most of the state's VRDO debt is hedged with a swap portfolio of $2 billion. State VRDO and swaps have declined significantly, with the swap portfolio falling from $6.72 billion in 2008.

Pensions and OPEB

New York has a well below-average leverage position with respect to its pension liabilities. The unfunded 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 $19.8 billion in 2014.

Our most recent state pension medians report, covering fiscal year 2013, shows that the state's adjusted net pension liability was $32.192 billion or 24.2% of all governmental fund revenues in 2012, well below the state median of 60.3%. Our methodology for adjusting reported pension data includes allocating cost-sharing liabilities among pension plan sponsors and discounting liabilities using the Citigroup Pension Liability Index.

Due to the state's amortization of pension contributions, which we view as a form of deficit borrowing, in 2015 the state contributed 84% of the required contribution to its pension plans, plus an additional payment for amortization of previous contributions. The state budget office has projected continued amortization of pension contributions through fiscal 2020, borrowing an additional $1.06 billion from the pension system that it will repay on a set schedule at interest rates determined by the state comptroller. Through fiscal 2015, the state has borrowed $3.2 billion from the system since 2011, of which it has repaid about $650 million.

Total contributions including amortization payments are forecast to peak at 123% of annual required contributions in 2022 and gradually decline to the ARC. However, this schedule is subject to change as actuarial contribution rates will be affected by variations in investment returns and periodic changes in actuarial assumptions.

In the enacted fiscal 2015 financial plan, the state had projected an earlier end to its amortization of pension contributions. However, a new contribution schedule, set by the State Comptroller, requires higher state contributions in fiscal 2016 than previously assumed primarily due to the adoption of new mortality tables reflecting greater longevity and higher pension liabilities.

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 unfunded liabilities for Other Post-Employment Benefits (OPEB), which consist primarily of retiree health benefits, was $54.3 billion as of April 1 2012, not including SUNY-related liabilities of about $13 billion. The state funds its OPEB liabilities on a pay-as-you-go basis, contributing $1.2 billion in 2014, placing the state 20th in OPEB contributions relative to total revenues. The state reduced its OPEB liabilities from $59 billion in 2010 by negotiating benefit changes, including greater retiree premium contributions and co-payments and implementing employer group waiver plan to receive federal drug coverage subsidies.

GOVERNANCE

The state follows a number of strong management practices, including multi-year financial planning and consensus revenue forecasting, although the consensus forecast is not binding. The state had a long record of late budget adoption but has adopted its budget on time or close to on-time for almost every year of the last decade.

Some weaknesses in the state's financial management include the lack of robust reserves, given the state's reliance on a progressive personal income tax in the context of volatile capital gains income and very limited executive powers to address mid-year shortfalls.

KEY STATISTICS

Per capita income relative to U.S. average: 121.9%

Industrial diversity (1=most diverse): 0.77

Employment volatility (U.S.=100): 68

Available balances as % of operating revenue (5-yr. avg.): -6.5%

NTSD/total governmental revenue: 46.7%

3-year avg. adjusted net pension liability/total governmental revenue: 19.1%

OBLIGOR PROFILE

New York State is the 3rd largest US state by population. Located in the Northeastern US, New York has a large and diverse economy with high per capita income at 121% of the US average and gross state product of $1.227

trillion.

The TFA was created in 1997 as a vehicle to fund a portion of New York City's capital program. The TFA Building Aid Revenue Bond program was authorized by the School Financing Act of 2006 to finance city educational facilities with the backing of state aid revenues.

LEGAL SECURITY

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 outstanding to finance educational facilities; $6.676 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. 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 averaged 51% from 2005 to 2010. The ratio has generally drifted down since 2010, and the city projects it will be 47.3% in fiscal 2016.

BARBS Subordinate to Pre-2007 Future Tax Secured Bonds

The TFA issues Future Tax-Secured Bonds backed by city personal income and sales taxes. Future Tax-Secured Bonds issued prior to Series 2007 S-1 have a senior claim on state building aid if tax revenues are insufficient to pay debt service. The risk of recourse to building aid to pay the senior claim is slim since the amount of pre-2007 bonds outstanding is a small portion (8%) of total tax-secured bonds outstanding and coverage of the tax-secured bonds by tax revenues approaches 10 times.

State Non-Impairment Covenant Adds Bondholder Protection

The state has covenanted not to impair the rights of bondholders in any way. 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, we believe that given the covenant the state is not likely to reduce its building aid payments below the amortization level initially calculated for each project, with the provision that the interest rate used in the calculation may be reset every 10 years.

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.

Competing Claims to Building Aid

New York City's education aid is subject to certain competing claims, including those from holders of State of New York Municipal Bond Bank Agency Special School Purpose Revenue Bonds. 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.

1.0Times Additional Bond 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 2044 and debt service on outstanding Building Aid Revenue Bonds as well as projected debt service on the Series 2015 S-2 bonds, debt service coverage falls from 2.12x times in 2015 to a minimum of 1.01 times in 2044, reflecting the matching of confirmed state building aid to amortization schedules. 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 secure 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.

USE OF PROCEEDS

Proceeds of the Series 2015 S-2 bonds will be used to pay a portion of the costs of educational facilities for the City of New York.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating 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 this methodology.

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