Fitch Ratings

FITCH RATES $2.2B HUDSON YARDS INFRA CORP SER 2017 BONDS 'A+'; UPGRADES OUTSTANDING

Fitch Ratings-New York-17 May 2017: Fitch Ratings has assigned 'A+' ratings to the following Hudson Yards Infrastructure Corp. (HYIC) revenue bonds:

--Approximately $2.15 billion second indenture revenue bonds fiscal 2017 series A (tax-exempt);

--Approximately $33.4 million second indenture revenue bonds fiscal 2017 series B (taxable).

Fitch has also upgraded the outstanding Hudson Yards Infrastructure Corp. revenue bonds fiscal 2007 Series A and 2012 series A to 'AA-' from 'A' (in anticipation of the closing of the lien under which these bonds were issued, which will occur upon the refunding of all of the fiscal 2007 series A bonds and a portion of the fiscal 2012 series A (series 2012A) bonds with proceeds of the series 2017 bonds).

The Rating Outlook is Stable.

The 2017 series A bonds are expected to sell via negotiation and the 2017 series B bonds are expected to be sold by competitive sale, both on May 23, 2017.

SECURITY

The bonds are special obligations of HYIC (or the corporation) payable from a combination of recurring and non-recurring revenues expected to be generated from development in the Hudson Yards area of Manhattan after payment of HYIC's operating expenses. Bond interest is further payable from interest support payments (ISPs) from the City of New York, subject to annual appropriation, if project revenues are insufficient. The city is not obligated to pay principal on the bonds.

Recurring revenues include payments in lieu of taxes (PILOTs) under agreements between owners of newly-developed large-scale commercial properties in the project area and the New York City Industrial Development Agency (NYCIDA) or Metropolitan Transportation Authority (MTA), with respect to the Eastern and Western Railyards, and tax equivalency payments (TEPs) representing an amount equal to real property taxes on new and substantially completed residential, hotel and other properties not covered by PILOTs. PILOTs flow directly to the bond trustee and TEPs must be appropriated by the city.

Non-recurring revenues include payments in lieu of mortgage recording taxes (PILOMRTs) which are made as part of PILOT agreements, district improvement fund bonus payments (DIBs) made in exchange for approval of greater density than base zoning allows, and proceeds from the sale of the transferrable development rights (TDRs) of the eastern rail yards.

The outstanding bonds were issued under what is now the first indenture, and have a first lien on recurring and non-recurring pledged revenues. This lien will be closed with the issuance of the series 2017 bonds. The series 2017 bonds will be issued under the second indenture, with a subordinate lien on the pledged revenues. The second indenture allows another $500 million in parity debt as "supported bonds", including up to $150 million in completion bonds. The completion bonds can be issued as supported bonds or "unsupported bonds," which are not eligible for ISPs.

KEY RATING DRIVERS

LINK TO NEW YORK CITY RATING: The 'A+' rating on the series 2017 bonds, two notches below the city's Issuer Default Rating (IDR), is based on the support provided by New York City's obligation to pay interest on the bonds if project revenues are insufficient for this purpose, subject to appropriation. The two notch distinction from the IDR, wider than the standard one notch for appropriation-supported obligations, is based on the limitation of the city's support to interest payments only.

The rating on the outstanding bonds is one notch below the city's IDR, and reflects that the TEPs that currently provide most of the pledged recurring revenues are subject to city appropriation. The upgrade of the rating on these bonds reflects the significant development in the project area since the bonds were issued, the limited amount of debt to be repaid upon closure of this lien, and the resilience of the first lien structure given expected low revenue volatility and solid debt service coverage from recurring revenues. With the issuance of the series 2017 bonds, the indenture under which the outstanding bonds were issued (the first indenture) will be closed.

SOUND AREA AND BROADER ECONOMY: The project area is near the city's midtown Manhattan central business district, which has limited development capacity for new office building space. Fitch believes the project benefits from the city's unique role as a national and international center for commerce and culture.

DIVERSE PROPERTIES: Recurring revenues are derived from a mix of commercial, residential and hotel properties. PILOTs are currently being generated by one commercial building that is complete and three other large commercial buildings that are under construction. In addition, 21 residential buildings and 19 hotels are complete and providing TEPs.

PROGRESS TOWARDS BUILD-OUT: Several residential buildings and hotels have been completed, along with one large office building, and several buildings are currently under construction. Additional projects are in the planning phase.

STRONG REVENUE GROWTH PROSPECTS: Fitch believes growth prospects for revenues supporting the bonds over time are strong but dependent on continued development. Given the current stage of development, demand for the massive amount of office, residential and hotel space envisioned in the area is still uncertain.

FISCAL 2017 BOND REPAYMENT DEPENDENT ON DEVELOPMENT: HYIC's ability to fully repay the series 2017 bonds relies on successful completion of projects currently under way. Pledged recurring revenues have more than doubled over the last three years but in fiscal 2017 cover only 42% of maximum annual debt service (MADS). Recurring revenues on projects either complete or under construction are projected by the corporation to fully cover MADS on all bonds until fiscal 2022. The series 2017 bonds have a subordinate claim on pledged revenues.

RATING SENSITIVITIES

CHANGE IN CITY RATING: A downgrade of New York City's IDR would lead to a downgrade in the rating on all series of HYIC bonds; an upgrade could result in an upgrade to some or all series.

CONTINUED DEVELOPMENT: Further growth of recurring revenues could lead to an upgrade of all series, although for the remaining outstanding bonds following the refunding the growth would have to come from PILOTs, which do not rely on city appropriation. Indications that development may not be sufficient to provide a satisfactory margin for coverage of growing principal payments would lead to a downgrade of the outstanding bonds. Recurring revenues would have to show a declining trend to trigger a downgrade of the outstanding bonds given their currently sound debt service coverage.

CREDIT PROFILE

The HYIC is a local development corporation created by the city to finance the Hudson Yards project. HYIC does not engage in the development directly, but finances the development, which is managed by Hudson Yards Development Corporation (HYDC) in coordination with the city, the MTA, the New York City Economic Development Corporation (NYC EDC), and the city's Office of Management and Budget (OMB). The majority of the members of the board of directors of both HYIC and HYDC are appointees of the New York City mayor, and the staff of both organizations is largely comprised of members of OMB and former officials of the NYC EDC.

HUDSON YARDS DEVELOPMENT AREA

Bond proceeds funded the construction, now complete, of a subway station that extends the #7 line from Times Square to 34th Street and 11th Ave. The station provides access to an area formerly not served by the subway system. HYIC financed its construction to spur interest in development.

The project area is a roughly 45-square-block area from West 43rd Street, 7th & 8th Avenues, to 30th Street, 11th & 12th Avenues. In 2005 the city re-zoned this area from primarily manufacturing and low- density commercial use to allow for a medium- to high-density (office building, hotel, residential) extension of the midtown central business district. Consistent with the city's demonstrated support of the project, the IDA adopted tax incentives for the area to encourage commercial development.

In 2008 development rights to 11.9 million square feet (msf) of space constituting the east and west rail yards (ERY and WRY) were awarded by the MTA to The Related Companies (Related).

Since that time, the first office tower, 10 Hudson Yards with 1.9 msf, has been completed and has as tenants: Coach, L'Oreal, SAP, the Boston Consulting Group, VaynerMedia and Sidewalk Labs & Intersection. Three additional towers with combined space of 5.9 msf are under construction and a letter of intent has been signed for a fourth, 50 Hudson Yards, which is expected to begin construction this year. Committed tenants and/or commercial condominium purchasers for the projects under way include law firms, financial services firms and media companies, among others. There are currently 21 completed residential buildings with a mix of rentals and condominiums and a total of 7,853 units. Nineteen completed hotels have 4,212 rooms. Another 2,317 residential units and 4,888 hotel rooms are under construction.

Fitch has reviewed a demand and development report provided by Cushman & Wakefield (C&W), which projects an additional 17.6 msf of office space in Hudson Yards beyond the three buildings already under construction. It forecasts an additional 9,138 residential units and 5,916 hotel rooms and a limited amount of retail space, including projects under way but not completed. Fitch does not rely on C&W's projections in its analysis but views them as helpful context for Fitch's conclusion that recurring revenues along with ISPs from the city should support a solid margin above debt service.

PLEDGED REVENUES INCLUDE RECURRING AND NON-RECURRING COMPONENTS

PILOT payments begin once the developer enters a PILOT agreement with the IDA, which typically occurs near the beginning of construction. For the first three years, PILOTs are based only on the value of the land. In year four, the PILOT on the building is set based on its assessed value net of agreed upon abatements of up to 40% of value. PILOT payments increase by 3%

annually for the next 16 years. In year 20, the PILOT is equivalent to the unabated property tax based on the project's assessed value, with changes in value phased in over five years.

TEPs are not received until a building reaches substantial completion and are based on phased-in assessed value. Residential rental projects that meet the requirements of the city's affordable housing program (previously the 421-a program, now the Affordable New York Housing Program) will have full tax exemptions of up to 35 years. Condominium developments, hotels and retail projects also generate TEPs but are not eligible for this exemption. Residential abatements on certain existing properties will begin to phase out in the next few years.

Fitch recognizes the significant contribution of non-recurring payments (DIBs, TDRs, PILOMRTs) but does not include them in its forward-looking analysis. Future payments may be substantial in some years but will be more sporadic and cannot be relied upon in any given fiscal year to support debt service. As with recurring revenue, once debt service requirements are satisfied they are released from the indentures and flow to the city.

SERIES 2017 BOND RATING DEPENDS ON PROJECT COMPLETIONS AND ISPs

Fitch views the final value of projects under construction as still uncertain, and begins its analysis with actual revenues. Fiscal 2017 recurring revenues cover only 42% of MADS. The rating is therefore dependent on the city's commitment to appropriate ISPs if needed. Consideration of the uncertainty inherent in a project at this stage of development and the limitation of the city's commitment to interest but not principal, combined with the city's demonstrated commitment to the project and history of making ISPs as needed, lead to the 'A+' rating, two notches below the city's IDR. Also considered in the rating are the notable development taking place and and the conversion of the bonds from a long-dated bullet maturity to a set amortization schedule.

Management's projections indicate that development completed and under construction will generate sufficient revenues to fully pay debt service on the series 2017 bonds. The city's interest support commitment provides ISPs up to the lesser of any fiscal year's debt service deficiency and the interest payment on all outstanding supported bonds under both indentures and is for the life of the bonds.

While the city's ISPs provide a cushion in case recurring revenues do not grow as expected, Fitch believes series 2017 principal payments are exposed to future development risk. Coverage of the final combined principal payment requires about 2.8% compound average annual revenue growth from fiscal 2017. Given construction already underway, the increases built into PILOT agreements and the scheduled roll off of tax abatements, Fitch believes this level of growth is achievable even without additional planned development, but not guaranteed. Issuance of authorized completion bonds would not change the required growth rate significantly.

The mechanism for the ISPs is laid out in the support and development agreement among HYIC, HYDC and the city. By April 1st of each year, the corporation notifies the city of the net interest obligation for supported bonds under each indenture for the ensuing fiscal year. At least 15 days prior to each interest payment date, the corporation must notify the city of any interest deficiency that obligates the city to pay ISPs to the corporation, subject to annual appropriation, no later than four business days before the interest payment date. The Mayor must also include in the annual budget sufficient funds to make any ISPs projected to be required for the subsequent fiscal year. The city has conservatively not assumed developer payments until received.

CLOSED INDENTURE BONDS RATED AS DEDICATED TAX BONDS

Prior to this issuance, which will refund all of the series 2007A bonds and $391 million of the outstanding $1.0 billion series 2012A bonds, the HYIC bonds were structured as term bonds with a final maturity of February 15, 2047. No sinking fund installments were to be scheduled until the conversion date, upon which the corporation certifies to the trustee that recurring revenues (net of corporation expenses) for each of the immediately preceding two fiscal periods equal at least 125% of MADS on outstanding senior bonds and 105% of MADS on all outstanding bonds. With the closure of the first indenture and establishment of a second indenture under which the series 2017 bonds will be issued, the first indenture bonds will have reached the conversion date and will now have a set amortization schedule.

As a result of the conversion, Fitch now analyzes the first indenture bonds as dedicated tax bonds. The rating is nevertheless limited to the level of city appropriation-supported debt, as TEPs are subject to annual appropriation. Full PILOT revenues are currently derived from a single commercial building, albeit a very large one with a mix of tenants. Three other buildings under construction are generating PILOTs on the land value. The city pays to the corporation TEPs due August 1 and February 1. PILOTs are paid in December and June for each fiscal year in 50% installments.

FIRST INDENTURE STRUCTURE'S SENSITIVITY AND RESILIENCE

Coverage of remaining series 2012A MADS following the planned refunding from fiscal 2017 recurring revenue is 2x. Fitch's rating criteria for dedicated tax bonds consider debt service coverage in relation to the expected volatility of the pledged revenue stream throughout the economic cycle.

To evaluate the sensitivity of pledged revenues to cyclical declines, Fitch considers both the revenue sensitivity results produced by Fitch's analytical sensitivity tool (FAST) assuming a recessionary 1% decline in U.S. GDP, and the largest cumulative decline in revenues since 1999. Given the relatively recent establishment and current ramp-up phase of the project area, historical revenue performance does not provide a basis to inform expectations for potential future volatility. Therefore, in lieu of using the district's revenue history, in considering potential volatility Fitch reviewed the revenue history of Battery Park City, another large-scale, mixed-use development on the west side of Manhattan with pledged revenues derived from PILOTs. BPCA's pledged PILOT revenues exhibit very little volatility; the largest cumulative revenue decline for this period was 5.9%. Fitch believes it is reasonable to assume a similar level of stability for HYIC recurring revenues.

Applying BPCA's revenue sensitivity to the Hudson Yards development, recurring revenue would still provide for payment of debt service on the remaining series 2012A bonds even with a severe decline of 50.9% from fiscal 2017 levels; this cushion is a strong 8.6x the largest historical decline and 50.9x the 1% revenue decline produced by FAST. While the strong cushion could support a higher rating, the rating on the series 2012A bonds is inhibited by the provision that the TEP revenues are subject to appropriation by the city. In fiscal 2017, TEPs are 87% of recurring revenues. The rating on the series 2012A bonds will not be permanently capped at the city's appropriation-supported debt rating of 'AA-'; if office PILOTs, which are not subject to city appropriation, grow and diversify sufficiently to support a sound debt service cushion, the rating could move higher.

LIMITS ON ADDITIONAL DEBT

The first indenture will be closed with the issuance of the series 2017 bonds. The second indenture allows for the issuance of $500 million in additional "supported bonds," which would receive ISPs if needed, including $150 million in completion bonds. The corporation's projections assume the latter will be issued in 2018. The remainder of supported bonds would need city council approval. The second indenture also allows for the issuance of "unsupported bonds" without benefit of ISPs.

Additional bonds beyond the $150 million in completion bonds (other than refunding bonds) must meet the additional bonds test, which requires recurring revenues in the preceding audited fiscal year to equal at least 1.25x MADS on combined first and second indenture debt service. Fitch believes that by the time recurring revenues are sufficient to allow for additional debt, the project area will be significantly more developed and diverse than it is currently, and does not envision that further issuance would erode credit quality.

An external appeal committee decision resulted in a rating on the series 2017 bonds that differed from the rating decided on by the original committee.

For more information on the city of New York's 'AA' IDR, see "Fitch Rates New York City, NY's $800MM GO Bonds 'AA'; Outlook Stable" dated Feb. 2, 2017.

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In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis and InvestorTools.

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Additional information is available on www.fitchratings.com

Applicable Criteria
U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016)
https://www.fitchratings.com/site/re/879478