

CREDIT OPINION

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New Issue
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Hudson Yards Infrastructure Corporation, NY

New Issue - Moody's assigns Aa3 to HYIC, NY's \$2.1B second indenture bonds, upgrades senior bonds to Aa3; outlook stable

Summary Rating Rationale

Moody's Investors Service has upgraded to Aa3 from A2 Hudson Yards Infrastructure Corporation, NY's (HYIC) Senior Revenue Bonds, Fiscal 2012 Series A, and assigned Aa3 ratings to its \$2.1 billion Second Indenture Revenue Bonds Fiscal 2017 Series A and \$33.4 million Fiscal 2017 Series B.

The second indenture bonds are being issued to current and advance refund nearly all of HYIC's \$3 billion outstanding Fiscal 2007 Series A and Fiscal 2012 Series A debt. After closing, \$609 million of first indenture Fiscal 2012 Series A bonds will remain outstanding and the first indenture will be closed. The bonds were issued to finance expansion of the Number 7 subway to Hudson Yards to spur economic growth there and for other infrastructure improvements. The original bonds were issued with a 40-year final maturity and no principal amortization. With the refunding, bonds under both indentures will begin to amortize with a level debt service structure and a 2047 final maturity.

The bonds are paid primarily by payments in lieu of taxes (PILOTs) collected by HYIC from commercial properties in the Hudson Yards area and tax equivalency payments (TEPs) from residential properties and hotels collected by the city and appropriated to HYIC. In addition, the [City of New York](#) (Aa2 stable) has pledged to cover interest, subject to appropriation, for the life of the bonds if those revenues are insufficient. The ratings, therefore, are derived from the city's credit quality.

The Aa3 rating on both liens is one notch lower than the city's general obligation rating. The one notch distinction reflects our determination of the essential nature of the transportation and other infrastructure projects financed by the bonds, the strong legal structure that obligates the mayor to include the TEPs and an amount sufficient to cover interest in the annual budget, the need for appropriation of those amounts, and potential real estate market volatility that could affect assessed values in the district. The ratings also reflect closure of the first indenture and the relatively small amount of debt left outstanding under it. That effectively means that the city's subject to appropriation interest support benefits second indenture bonds as much or more than first indenture bonds.

Credit Strengths

- » Strong legal commitment of the City of New York to cover interest payments for the life of the bonds if necessary, subject to appropriation
- » Essential nature of the projects financed, primarily extension of a subway line
- » Large and diverse project area adjacent to the midtown central business district, and limited alternative space to develop large commercial or residential projects in Manhattan, which has led to strong real estate development expected to generate healthy revenue

Credit Challenges

- » Potential volatility in New York City's real estate markets could weaken demand for commercial, hotel or residential properties in the Hudson Yards area and/or materially reduce assessed values there

Rating Outlook

The outlook for the Hudson Yards Infrastructure Corporation is stable, based on the City of New York's general obligation rating and outlook, the importance of the project to the city and its strong support of the project's financing.

Factors that Could Lead to an Upgrade

- » Upgrade of the city's general obligation rating
- » Additional development well in excess of current forecasts
- » Significant growth in revenues that do not require appropriation

Factors that Could Lead to a Downgrade

- » Downgrade of the city's general obligation rating
- » Weakened political support for the city to pay interest if it is required
- » A prolonged real estate recession that leads to material declines in assessed values in the district or materially slows additional development and construction there

Key Indicators

Exhibit 1

		2012		2013		2014		2015		2016
PILOT	\$	-	\$	-	\$	1,950	\$	4,577	\$	7,994
TEP	\$	27,679	\$	32,647	\$	38,554	\$	48,563	\$	58,656
Non-recurring Revenues	\$	2,951	\$	11,922	\$	15,515	\$	284,199	\$	166,833
City Interest Support Payments	\$	234,942	\$	-	\$	38,130	\$	28,047	\$	-

Dollars in thousands. Fiscal 2012 includes \$156 million prepayment of future year debt service.

Source: Hudson Yards Infrastructure Corporation

Recent Developments

Recent developments are incorporated in the Detailed Rating Considerations.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Detailed Rating Considerations

Economy: Hudson Yards Project Area Was Underutilized Section of Manhattan's West Side

The Hudson Yards Financing District (HYFD) is a 45 square block area on the west side of Manhattan. It includes Madison Square Garden, Penn Station, and Farley Post Office. Until recently, this area was underutilized and consisting of open parking lots, warehouse and industrial buildings, small commercial and residential buildings, access roadways and plazas for the Lincoln Tunnel and approximately 26 acres of open rail yards belonging to the [Metropolitan Transportation Authority](#) (MTA, Transportation Revenue Bonds A1 stable) for its Long Island Rail Road.

In 2006 and 2011 HYIC issued a total of \$3 billion of bonds primarily to extend the Number 7 subway line from Times Square to the Hudson Yards area, and other infrastructure improvements. The subway project was a complex one, requiring tunnel boring machines to carve the new route, and opened in September 2015. In transit-dependent New York City, the subway extension is a crucial component of development in Hudson Yards.

Since the Hudson Yards area was rezoned in 2005 to spur development, substantial new construction has been completed or is underway, nearly 25 million square feet. Most of the completed development is residential, 67% of completed square footage. New office space and new hotels are 17% and 16% of completed development, respectively. Office space dominates current construction, at 55% of the total, with residential (27%) and hotels (17%) following.

Finances and Liquidity

See Legal Security below for discussion of coverage and the nature of the city's interest support obligation.

LIQUIDITY

See our [report](#) dated February 2, 2017 for a discussion of the city's liquidity.

Debt and Pensions

DEBT STRUCTURE

With the refunding, all of HYIC's debt will begin to amortize, with level debt service. All of the debt is fixed rate.

DEBT-RELATED DERIVATIVES

HYIC is not party to any interest rate derivatives.

PENSIONS AND OPEB

See our [report](#) dated February 2, 2017 for a discussion of the city's pension and OPEB position.

Governance

HYIC is a local development corporation organized under state law, governed by a five member board of directors, a majority of which are appointed by the mayor of the City of New York. See our [report](#) dated February 2, 2017 for a discussion of the city's governance.

Legal Security

The bonds are expected to be paid with a mix of major recurring revenue sources and certain one-time ones. The recurring revenues are PILOTs and similar TEPs. Nonrecurring revenues include payments in lieu of mortgage recording taxes; density bonus payments; and certain future development revenue derived from the development potential of the eastern rail yards owned by the MTA. Through the life of the bonds, the recurring sources are estimated to be 96% of all pledged revenue.

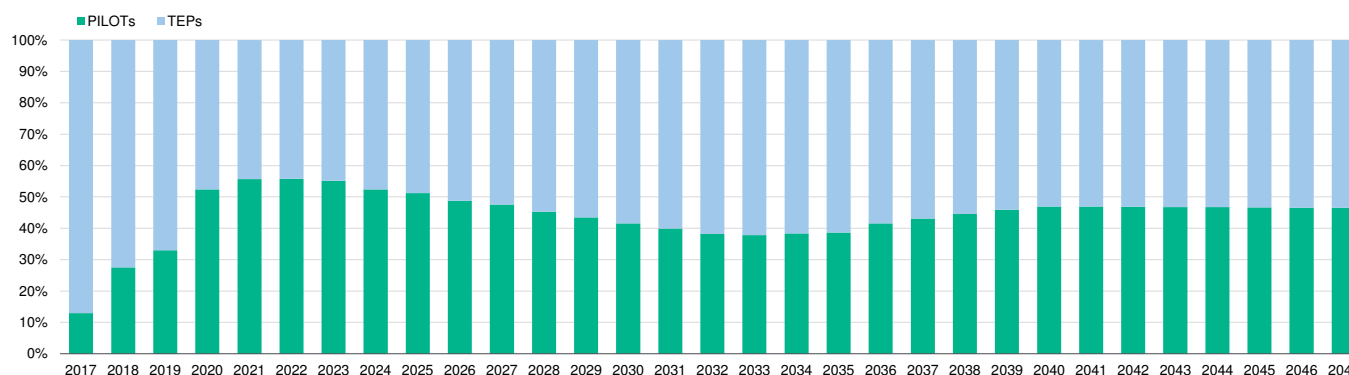
Recurring revenue

- » **PILOTs:** Paid by commercial office property owners directly to HYIC. PILOTs are forecasted to average 44% of recurring revenues through bond maturity in 2047.
- » **TEPs:** Paid by residential, hotel, and other commercial properties. TEP revenues are paid to the city, which has agreed to pay them to HYIC through a support agreement. The city's obligation to pay the TEPs to HYIC is absolute and unconditional, subject to appropriation. TEP revenues average 56% of recurring revenue.

Recurring revenue is estimated by HYIC to grow strongly over time, based on growth in assessed values of existing properties and as new properties are constructed in the Hudson Yards district. Recurring revenues solely from existing development increase from \$104 million in fiscal 2018 to \$908 million in fiscal 2047 when the bonds mature, reflecting average annual growth of 7.5%. Since most existing development is residential but most current construction is office properties, the fastest near-term growth in recurring revenue is office PILOTs.

Exhibit 2

More Than Half the Recurring Revenues Are Subject to Appropriation Shares of Recurring Revenues



Source: Hudson Yards Infrastructure Corporation

The bonds to be refunded were issued with a 40-year final maturity and no principal amortization until the recurring PILOT and TEP revenues for two consecutive fiscal years provide 125% coverage of maximum annual debt service (MADS), 105% of MADS on all outstanding first indenture bonds and 100% of HYIC operating expenses. That benchmark, defined in the first indenture as the "conversion" benchmark will be reached for the senior bonds remaining outstanding after the current transaction. The second indenture refunding bonds will be issued as fully amortizing and both the senior bonds and the second indenture bonds will have level debt service.

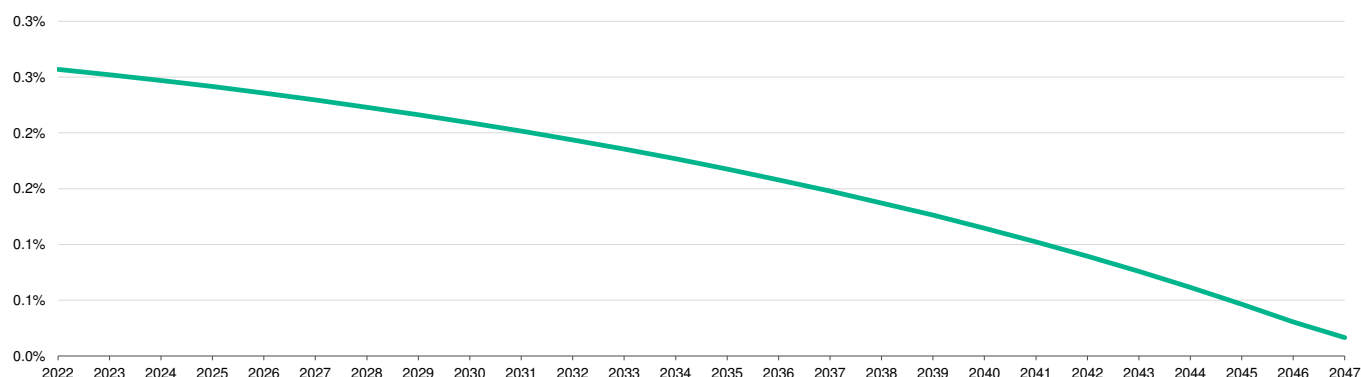
City's Commitment to Cover Interest is A Key Credit Factor and Ties the Rating to the City's Credit Quality

Because of potential real estate market volatility and uncertainty about the speed of development in Hudson Yards, when the original bonds were issued, the city committed to pay interest on the bonds if the underlying Hudson Yards revenues were insufficient. That commitment will remain in place for both the unrefunded senior and the refunding second indenture bonds. The city's obligation to make interest support payments is net of any available HYIC funds, and like the TEPs, is absolute and unconditional, subject to annual appropriation.

The indenture and a support agreement create a strong legal structure through which the city's interest support payments are budgeted. HYIC is required annually by April 1 to certify to the city's budget director the next fiscal year's net interest obligation (the difference between interest due on senior and second indenture bonds and revenues HYIC expects to have available, up to the total amount of interest due on first and second indenture bonds). The mayor is then obligated to include that amount in the annual budget. In addition, if at any time during the fiscal year the appropriation is not sufficient to pay required TEP and interest support payments, the mayor is required to take any actions needed to seek an increase in the appropriation.

In our opinion the risk of non-appropriation by the city is small due to the essential nature of the subway extension and the small budgetary impact of the interest support payments. Maximum aggregate interest totals only 0.3% of estimated fiscal 2018 total city tax revenue (see exhibit). Of New York City's total outstanding debt, a relatively small amount is appropriation debt, about 2.5% (excluding the HYIC interest support commitment). The city's budget reflects a single line-item for debt service on all of its outstanding securities.

Exhibit 3

Potential Interest Support Payments Reflect a Negligible Percentage of New York City Tax Revenue

Calculation based on fiscal 2018 estimated tax revenue.

Source: Hudson Yards Infrastructure Corporation, New York City Office of Management and Budget

Existing Development in Hudson Yards Provides Good Debt Service Coverage

An important consideration is how the city realizes changes in property values for the rental, co-op, condo, hotel and office properties that make up most of Hudson Yards. Those changes are phased-in over a five-year period, a significant stabilizer for the city's property taxes, which are 44% of total city tax revenue. Based solely on existing development, forecasted annual recurring revenues provide a minimum 5 times coverage of senior bonds debt service. Aggregate total coverage ranges from just more than 1 times, increasing to 5.2 times, including \$150 million of second indenture completion bonds expected to be issued next year. . We stressed recurring revenues on existing development to approximate the early 1990s real estate downturn, the largest of the past 30 years, with recurring revenue smaller by 8.5% each year of the bond term. In that scenario, interest support payments would likely be needed for only two years, when aggregate coverage fell below 1 times. Moreover, subordinate principal coverage—calculated on the basis that revenue is available to pay bond principal before paying interest due to the terms of the city interest support commitment—remained at more than 2.8 times though the life of the bonds.

Use of Proceeds

Proceeds of the bonds will be used to refund most of HYIC's outstanding debt into a structure that amortizes principal.

Obligor Profile

The City of New York has a population of 8.5 million, GDP that at nearly \$800 billion is larger than all but three states, and real estate full value of more than \$1 trillion. Its Aa2 general obligation rating reflects its large and resilient economy, its extraordinarily large tax base, its institutionalized budgetary and financial management controls, its proactive responses to budget strain during economic downturns, the key but diminishing role of the volatile financial services sector, and moderate but growing costs for the combination of debt service, pension, and employee and retiree healthcare.

Methodology

The principal methodology used in this rating was Lease, Appropriation, Moral Obligation and Comparable Debt of US State and Local Governments published in July 2016. Please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

Ratings

Exhibit 4

Hudson Yards Infrastructure Corporation, NY

Issue	Rating
Second Indenture Revenue Bonds, Fiscal 2017 Series A (Tax-Exempt)	Aa3
Rating Type	Underlying LT
Sale Amount	\$2,154,970,000
Expected Sale Date	05/23/2017
Rating Description	Annual Appropriation Obligation (Non Lease)
Second Indenture Revenue Bonds, Fiscal 2017 Series B (Taxable)	Aa3
Rating Type	Underlying LT
Sale Amount	\$33,360,000
Expected Sale Date	05/23/2017
Rating Description	Annual Appropriation Obligation (Non Lease)

Source: Moody's Investors Service

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