FitchRatings

Fitch Rates NYC Transitional Finance Auth's $990MM FTS Sub Bonds 'AAA'; Outlook Stable

Fitch Ratings-New York-13 October 2017: Fitch Ratings has assigned a 'AAA' rating to the following New York City Transitional Finance Authority (TFA) future tax secured (FTS) subordinate bonds:

--Approximately $850,000,000 fiscal 2018 series B subseries B-1 (tax-exempt bonds);
--Approximately $140,000,000 fiscal 2018 series B subseries B-2 (taxable bonds).

The subseries B-1 bonds are expected to sell via negotiation and the subseries B-2 bonds are expected to sell via competitive bid the week of Oct. 16, 2017. Proceeds of the bonds will be used to fund city capital projects and costs of issuance.

Fitch currently rates the following outstanding TFA FTS bonds 'AAA':

--$32 billion subordinate bonds;
--$722 million recovery subordinate bonds;
--$791 million senior lien bonds.

The Rating Outlook is Stable.

SECURITY
The bonds are payable from revenues derived from a personal income tax (PIT) and a sales and use tax imposed by New York City, as authorized by New York State. Payment of the PIT and sales tax revenue to the TFA is not subject to city or state appropriation.

Sales tax revenues will be available for the payment of bonds if PIT revenues are projected to be insufficient to provide at least 150% of the maximum annual debt service (MADS) on the TFA's outstanding bonds.

Senior bonds are subject to a $330 million limit on quarterly debt service. Additional bonds may be issued as senior bonds if tax revenue for the 12 consecutive calendar months preceding authorization is at least 3x the amount of annual senior debt service, including debt service on the bonds to be issued.

The subordinate additional bonds test (ABT) requires that tax revenues for the most recent fiscal year are at least 3x the sum of $1.32 billion plus projected subordinate debt service.

ANALYTICAL CONCLUSION

STRONG LEGAL FRAMEWORK: The bankruptcy-remote, statutorily defined nature of the issuer and a bond structure involving a first-perfected security interest in the PIT and sales tax revenues are key credit strengths. Payment of the PIT and sales tax revenue to the TFA is not subject to city or state appropriation. Statutory covenants prohibit action that would impair bondholders.

ROBUST COVERAGE: Fitch does not make a rating distinction between the liens due to the high coverage levels and strong protections against overleveraging. Even with sizable debt issuance plans over the next four years, pro forma coverage through fiscal 2021 is expected to remain highly resilient to an economic downturn.

SOUND ECONOMIC RESOURCE BASE: Statutory revenues benefit from the city's unique economic profile, which centers on its identity as an international center for numerous industries and a major tourist destination. The character of the city's economy contributed to its relative employment stability during the great recession and sound growth in recent years. The local economy (and operating budget) remain strongly linked to the financial sector, which accounts for approximately 25% of earnings according to 2015 data.

RATING SENSITIVITIES

While TFA revenues are vulnerable to downside risk, Fitch believes the bonds are well protected from a potential rating downgrade by both the conservative ABT and practical considerations. The city relies heavily on residual pledged revenues, whose growth reflects the city's continuing solid economic underpinnings, for its operating budget.

CREDIT PROFILE

The city's population, estimated at 8.5 million as of 2016, continues to grow moderately. The economic profile of the city benefits from good wealth levels; per capita personal income is 131% of the U.S. and market value per capita is over $100,000. However, the above-average individual poverty rate indicates significant income disparity. The city's tourism sector has been performing exceptionally well, attracting a reported record 60.7 million visitors in 2016. Financial activities employment has shown some growth in the past three years but remains below the pre-recession peak. Overall resident employment is well above pre-recession levels although recent growth has slowed. Likewise, the unemployment rate continues to improve.

Strong Legal Framework Protects Bond Repayment
The 'AAA' rating is based on the very strong legal structure which insulates bondholders from any operating risk of New York City (Issuer Default Rating (IDR) of 'AA'). The rating reflects the bankruptcy-remote, statutorily defined nature of the issuer, a bond structure involving a first perfected security interest in revenues that are not subject to appropriation, statutory covenants prohibiting action that would impair bondholders, New York State as collection agent, and the existence of two separately levied cash flow streams (the statutory revenues).

Pledged Revenue Overview
PIT and sales tax revenues are imposed by the city and collected by the state. Revenues from the PIT as well as the sales tax, if required, flow directly from the state comptroller to the TFA trustee, and are not subject to state or city appropriation. The city receives residual revenues only after advance quarterly funding of debt service.

The state is able to unilaterally modify or repeal tax law as it relates to the PIT or sales tax, but Fitch believes the risk of this is negligible given the city's dependence on residual revenues for its operations.

Sensitivity and Resilience of Pledged Revenues through Economic Declines
Debt service coverage (DSC) on all FTS bonds from fiscal 2016 pledged revenue was 9.5x. To evaluate the sensitivity of the dedicated revenue stream to cyclical decline, Fitch considers both revenue sensitivity results (using a 1% decline in national GDP stress scenario) and the largest decline in revenues over the period covered by the revenue sensitivity analysis. Based on a 17-year pledged revenue history, Fitch's analytical sensitivity tool (FAST) generates a 7.2% scenario decline in pledged revenues. The largest actual cumulative decline in historical revenues is a sizable 17.9% from fiscal 2001-2003. A slightly smaller decline occurred in fiscal 2009. Both were due in part to recessions; the former was also affected by September 11, and the latter by adjustments for prior-year PIT overpayments.

Scenario results are consistent with a 'AAA' rating. Fiscal 2016 pledged revenues could withstand an 80% decline in FTS revenue, or 11x the scenario output and 4.5x the largest historical decline, and still cover MADS. With issuance to the ABT, the structure could withstand a revenue decline of about 9.3x the scenario output or 3.7x the largest decline. Fitch believes issuance to the ABT is highly unlikely given the city's debt issuance plans and its reliance on residual revenue for its operations.

The authority expects to issue approximately $17.1 billion of FTS bonds through 2021 for general city capital purposes. Unaudited fiscal 2017 FTS revenues show a marginal increase of 0.1%, but the city forecasts approximately 4.8% average annual growth in fiscal 2018-2021. Debt service coverage in fiscal 2021 would be 6x based on these assumptions. Assuming planned issuance but no revenue growth over fiscal 2016 levels, debt service coverage would still be a high 5x.

Strong Pledged Revenue Growth Prospects
Total FTS revenues grew at a compound annual growth rate of about 4.4% in the 10 fiscal years ended 2016, well above the rate of national GDP growth. Fitch believes the city continues to have sound economic growth prospects. Given the sensitivity of both PIT and sales tax revenues to economic activity,

FTS revenue growth is likely to continue to be strong over time despite periodic volatility.

PIT revenues (approximately 61% of unaudited fiscal 2017 FTS revenues) increased 2.8% in fiscal 2017 (up slightly from 1.3% growth in fiscal 2016 but down from 11.6% growth in fiscal 2015), but the city projects that it will grow about 4.5% on average annually from fiscal 2018-2021. Unaudited sales tax revenues declined 3.9% in fiscal 2017 (down from 8.3% growth in fiscal 2016) and are projected by the city to grow about 5.3% on average annually from fiscal 2018-2021.

Since fiscal 2005, an average of 75% of PIT revenue has come from mandatory withholding of wage income, with about 19% from quarterly installment payments on non-wage income and self-employment earnings. The remainder comes from final tax return filings following the end of each calendar year. The PIT consists of a base rate and a 14% surcharge. The PIT rate has changed over time, most recently with a base rate increase in 2010. The base rate and 14% surcharge was most recently extended in June 2017 to Jan. 1, 2021. The authority's projections assume state legislative approval of the extension of the current rate and surcharge.

Fitch believes the possibility of a failure by the state to approve future continuation of both the current base rate and the 14% surcharge is unlikely. The state has consistently reauthorized both a base rate above the minimum and the 14% surcharge. In addition, such reduction in the rate would have a significant, negative impact on the residual revenues upon which the city relies for its operations. Even this highly unlikely scenario, however, results in sound coverage. The base rate alone would result in coverage estimated by TFA at about 3.8x in fiscal 2021, assuming continued issuance and moderate growth in base PIT and sales tax revenues.

The 'AAA' rating is based on the very strong legal structure which insulates bondholders from any operating risk of New York City. As the structure is a securitization specifically authorized by state law, the rating is not limited by the city's 'AA' IDR.

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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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Applicable Criteria
U.S. Public Finance Tax-Supported Rating Criteria (pub. 31 May 2017) (https://www.fitchratings.com/site/re/898466)

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