MOODY'S
INVESTORS SERVICE

Rating Action: Moody's assigns Aa2 to NYC TFA Building Aid Revenue Bonds Fiscal 2019 Series S-1 and S-2; outlook stable

12 Jul 2018

New York, July 12, 2018 -- Moody's Investors Service has assigned Aa2 ratings to the New York City Transitional Finance Authority's (TFA) approximately $1.031 billion Building Aid Revenue Bonds, including $500 million of Fiscal 2019 Series S-1 Tax-Exempt Bonds and S-2, which consist of $419.285 million of Subseries S-2A Tax-Exempt Bonds and $111.455 million of Subseries S-2B Taxable Bonds. The Series S-1 and S-2A will be sold via negotiated sale. The Series S-2B bonds will be sold via competitive bid on July 17. The outlook is stable.

RATINGS RATIONALE

The Aa2 rating is one notch below New York State's Aa1 general obligation rating and reflects the state's strong commitment to provide building aid payments to New York City (Aa2 stable), which assigns the payments to the TFA. 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.

RATING OUTLOOK

The bonds carry New York State's stable outlook. The outlook reflects the state's adequate liquidity, adequate combined formal and informal reserves, and continued control of spending growth. The outlook also reflects our expectation that the state will build on its improvements in fiscal management, close budget gaps largely with recurring solutions and contain its structural fiscal imbalance.

FACTORS THAT COULD LEAD TO AN UPGRADE

- Stronger protections for the pledged revenues

- State rating upgrade

FACTORS THAT COULD LEAD TO A DOWNGRADE

- Significant decrease in debt service coverage

- Failure to appropriate education aid payments

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

LEGAL SECURITY

In 2006, the TFA enabling act was amended pursuant to the School Financing Act to alter state 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; $7.944 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 from 52.7% in fiscal 2007 when the BARBs program started, and the city projects it will be 44.7% in fiscal 2019.

The TFA issues Future Tax-Secured Bonds backed by city personal income and sales taxes. Future Tax-Secured Bonds issued prior to Series 07 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 (2.4%) of total tax-secured bonds outstanding and coverage of the tax-secured bonds by tax revenues is projected at 6.70 times in fiscal 2019.

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, 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.

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.

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 2047, debt service on outstanding Building Aid Revenue Bonds and expected debt service on the current issuance of new money bonds, and without factoring in savings expected from lower debt service on the current issuance of refunding bonds, debt service coverage falls from 2.00 times in 2019 to 1.07 times in 2036, rises again and then falls to 1.07 times in 2047, the last year of the current maturity schedule. 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.

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. The state does not distinguish between the payment of education aid and building aid, making lump sum payments to the city. To secure the bonds and separate building aid from the rest of the education aid, the city, TFA, SED and the state comptroller entered into an MOU specifying procedures to 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 payable to the TFA.

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

The proceeds of Series S-1 bonds will be used to fund certain capital needs of the New York City school system. The Series S-2A and S-2B bonds will be used to refund certain outstanding BARBs.

PROFILE

New York State is the 4th 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 $1.547 trillion.

METHODOLOGY

The principal methodology used in these ratings was Lease, Appropriation, Moral Obligation and Comparable Debt of US State and Local Governments published in July 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

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