FitchRatings

Fitch Rates NYC Transitional Finance Auth's $1.5B FTS Sub Bonds 'AAA'; Outlook Stable

Fitch Ratings-New York-28 August 2018: Fitch Ratings has assigned a rating of 'AAA' to the following New York City Transitional Finance Authority (TFA) future tax secured (FTS) subordinate bonds fiscal 2019 series B:

--Approximately $750,000,000 subseries B-1 tax-exempt bonds;
--Approximately $186,430,000 subseries B-2 taxable bonds;
--Approximately $313,570,000 subseries B-3 taxable bonds;
--Approximately $200,000,000 subseries B-4 tax-exempt bonds (adjustable rate bonds);
--Approximately $75,000,000 subseries B-5 tax-exempt bonds (adjustable rate bonds).

The subseries B-1 bonds are expected to sell via negotiation, and the subseries B-2 and B-3 bonds are expected to sell via competitive bid, the week of Sept. 3. All series B bonds are scheduled to close the week of Sept. 24. Fitch will assign short-term ratings on the subseries B-4 and B-5 bonds based on liquidity support provided by JP Morgan Chase Bank and U.S. Bank National Association, respectively, closer to closing. Proceeds of the fiscal 2019 series B bonds will be used to fund city capital projects and costs of issuance.

Simultaneously with the closing of the fiscal 2019 series B bonds, TFA FTS subordinate fiscal 1999, subseries A-2 bonds and fiscal 2007, subseries A-3 bonds (currently rated 'AAA' by Fitch) will be converted to a fixed rate mode. The bonds will be reoffered as multi-modal bonds in the fixed rate mode, and are not subject to further conversion prior to maturity. Pricing through negotiation is expected the week of Sept. 3.

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

--$35 billion subordinate bonds;
--$682 million recovery subordinate bonds;
--$788 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 net tax revenue for the 12 consecutive calendar months preceding authorization is at least 3x the maximum 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 maximum annual subordinate debt service, including debt service on the bonds to be issued.

KEY RATING DRIVERS

STRONG LEGAL FRAMEWORK: The bankruptcy-remote, statutorily defined nature of the issuer pursuant to state legislation 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, pro forma coverage through fiscal 2022 is expected to remain highly resilient in 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 New York City economy contributed to its relative employment stability during the great recession and sound growth in recent years. The local economy (and operating budget) is still strongly linked to the financial activities sector, which accounts for approximately 24% of earnings compared to 9% for the U.S. according to 2016 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 census-estimated population is 8.6 million as of 2017 and it continues to grow moderately. The economic profile of the city provides for good wealth levels; per capita personal income is 130% of the U.S., and market value per capita is over $130,000. However, median household income is close to the U.S. average and the above-average individual poverty rate indicates significant income disparity. The city's tourism sector is performing exceptionally well, attracting a reported record 62.8 million visitors in 2017. Financial activities employment has shown some growth over the last four years and is now slightly above the pre-recession peak. Overall resident employment is well above pre-recession levels. 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] 'AA'). The rating reflects the bankruptcy-remote, statutorily defined nature of the issuer pursuant to state legislation, 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. The state's implementation of an optional payroll tax could reduce employees' taxable income. Fitch will evaluate the effect of any change in the level or direction of PIT revenues on the structure's resilience resulting from the state policy change once it becomes clearer.

Sensitivity and Resilience of Pledged Revenues through Economic Declines

Debt service coverage (DSC) on all FTS bonds from fiscal 2017 pledged revenue was 8.8x. 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 16-year pledged revenue history, Fitch's analytical sensitivity tool (FAST) generates a 6.8% 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 2017 pledged revenues could withstand about an 84% decline in FTS revenue, or 12.4x the scenario output and 4.7x the largest historical decline, and still cover maximum annual debt service coverage (MADS). With issuance to the ABT, the structure could withstand a revenue decline of about 9.9x 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 billion of FTS bonds through 2022. Fiscal 2018 FTS revenues are projected to increase by 15% due largely to non-recurring factors affecting PIT collections including the conversion of the city's school tax relief (STAR) rate cut to a state credit, the federally-required repatriation of deferred compensation from overseas accounts and prepayments triggered by the implementation of the Tax Cuts and Jobs Act (TCJA). The city forecasts a 3% decline in fiscal 2019, and moderate growth thereafter through fiscal 2022. Coverage in fiscal 2022 would be 5.8x based on this forecast and additional debt issuance plans. Assuming planned issuance but no revenue growth over audited fiscal 2017 levels, coverage would still be a high 4.7x.

Strong Pledged Revenue Growth Prospects

Total FTS revenues grew at a compound annual growth rate of about 4% in the 10 fiscal years ended 2017, 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 totaled approximately 61% of fiscal 2017 FTS revenues and are expected to provide most of the growth as well as volatility in pledged revenue at least in the near term, due to the non-recurring factors mentioned above. Fitch also views growth in PIT revenues as more uncertain than the sales tax given the potential impact of the TCJA.

For fiscal years 2007 through 2017, 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 were 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 in the highly unlikely scenario of failure to reauthorize the surcharge, the coverage cushion remains sound assuming continued issuance and moderate growth in base PIT and sales tax revenues.

As the TFA legal structure insulates bondholders from any operating risk of the city, 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. 03 Apr 2018) (https://www.fitchratings.com/site/re/10024656)

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