

Rating Action: Moody's downgrades New York City GO bonds to Aa2 from Aa1; outlook remains negative

01 Oct 2020

New York, October 01, 2020 -- Moody's Investors Service has downgraded the City of New York's \$38.7 billion of outstanding general obligation bonds to Aa2 from Aa1 and assigned a Aa2 rating to the City's \$900 million General Obligation Bonds, Fiscal 2021 Series C. We have also downgraded to Aa3 from Aa2 approximately \$4.5 billion of appropriation-backed debt issued through the Hudson Yards Infrastructure Corporation, NY (HYIC), the New York City Health and Hospitals Corporation (HHC), the New York City Industrial Development Agency (IDA), New York City Educational Construction Fund, NY (ECF) and the Dormitory Authority of the State of New York (DASNY). The downgrade also effects the reoffering of \$219 million of outstanding variable rate demand bonds as fixed rate bonds taking place concurrently with the new money sale. The outlook remains negative.

We have also downgraded from Aa2 to Aa3 the enhanced rating on the DASNY Municipal Health Facilities Improvement Program bonds.

Concurrently we have also affirmed the Aaa senior and Aa1 subordinate ratings on \$39 billion of outstanding Future Tax Secured Bonds issued by the New York City Transitional Finance Authority (TFA). The outlook on those bonds also remains negative.

We have also affirmed the VMIG 1 ratings assigned to GO and TFA variable rate demand bonds with conditional liquidity support.

RATINGS RATIONALE

The downgrade reflects the substantial financial challenges New York City faces caused by the economic response to the coronavirus pandemic and our expectation that New York City is on a longer recovery path than most other major cities. The public health response to the pandemic brought the city's infection rate down to among the lowest of big cities. The lasting economic consequences, however, will likely be amongst the most severe in the nation and require significant fiscal adjustments. The city regularly identifies and closes future year budget gaps, but has delayed implementing more recurring savings and relied primarily on reserves, the possibility of direct federal fiscal aid, and a request for deficit financing authority from the state. The current budget assumes \$1 billion in savings will come from labor concessions or headcount reductions but those savings have not been formalized. Favorably, current year revenue is tracking ahead of forecast. The city also faces additional fiscal pressure from potential actions the State of New York may take to balance its own budget and as the state tries to help the Metropolitan Transportation Authority, the state entity that operates the city's mass transit system.

The Aa2 GO rating incorporates the city's competitive advantages which include a young and highly skilled labor pool, access to higher education and medical centers, normally strong domestic and international transportation links, and low crime rates relative to other large cities. The rating also reflects the city's strong institutional budgetary and financial management and the breadth and diversity of its revenue base. The city's financing responsibilities are broader than most local governments, since it is a city, five counties and the nation's largest school district, and its debt burden is above-average due to this operational scope. Despite those responsibilities, the city's fixed costs for debt service, pensions and retiree health care are below the median for the largest local governments and in the bottom five among the nation's largest cities.

The downgrade to Aa3 for the Hudson Yards Infrastructure Corporation bonds 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 tax equivalency payments and an amount sufficient to cover interest shortfalls, if any, in the annual budget, the need for appropriation of those amounts, and potential real estate market volatility that could affect assessed values in the Hudson Yards district. The ratings also reflect the closed nature 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.

The downgrade to Aa3 for the Health and Hospital Corporation's health system bonds reflects the essential city services it provides; the strong relationship between HHC and the City of New York, including the city's statutory obligation to restore HHC's capital reserve fund if necessary; and other features of the moderate legal structure including a gross pledge of HHC's sizeable health care reimbursement revenues and a lock box mechanism that collects the revenues and uses them to pay debt service before they flow to HHC for operations.

The downgrade to Aa3 for the ECF bonds is based on the city's obligation to make lease payments in amounts sufficient to pay debt service when due, subject to appropriation, the essential nature of the school projects financed with the bonds, and the moderate legal structure that, in addition to the need for appropriation, includes the ability of ECF to initiate a mechanism to intercept appropriations of education aid from the State of New York if necessary should the city not appropriate sufficient amounts to replenish the debt service reserve fund.

The downgrade to Aa3 of the IDA special revenue bonds is based on the less essential nature of the economic development project and a moderate legal structure that reflects the city's absolute and unconditional obligation to make lease payments, subject to appropriation, regardless of the project's completion.

The downgrade of the enhanced Aa3 on the DASNY Municipal Health Facilities and Court Facilities Lease Revenue bonds and of the underlying Aa3 appropriation-backed debt issued through DASNY reflects the credit quality of the City of New York and its absolute and unconditional obligation to make rental payments to DASNY in amounts sufficient for debt service, subject only to appropriation. The rating also reflects DASNY's ability, through the comptroller of the State of New York to intercept available state appropriations of Medicaid aid to the city to ensure timely debt service payments even if they city does not appropriate.

The affirmation of the Aaa senior and Aa1 subordinate future tax secured revenue bonds ratings reflect strong debt service coverage provided by the pledge of the City of New York personal income tax and sales tax revenues, a strong legal structure that insulates TFA from potential city fiscal stress, the open subordinate lien that permits future leverage of the pledged revenues, and New York State's ability to repeal the statutes imposing the pledged revenues.

The affirmation of the VMIG 1 short-term general obligation and TFA conditional liquidity ratings reflects (i) the credit quality of the various banks acting as liquidity support providers under the standby bond purchase agreements (SBPAs); and (ii) our assessment of the likelihood of an early termination of each SBPA without a mandatory tender.

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. The economic and fiscal consequences of the coronavirus crisis is a key driver for this rating action.

RATING OUTLOOK

The negative outlook reflects ongoing uncertainty about how long the pandemic's economic consequences will impact the city's economy and budget, including the return of office workers, business and leisure travel and real estate markets. The outlook also reflects our opinion that the city cannot shift to a "back to normal" economy until a vaccine is widely available.

FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATINGS

- GO: Recovery of city economy to near pre-pandemic levels, combined with structurally-balanced budgets
- GO: Stronger reserves, at levels similar to higher-rated peers
- GO: Reduction of debt burden or further reduction in fixed costs
- DASNY, HYIC, HHC, ECF, IDA: Upgrade of the city's general obligation rating
- HYIC: Additional development well in excess of current forecasts
- HYIC: Significant growth in revenues that do not require appropriation
- DASNY municipal health facilities: Upgrade of the state's rating
- TFA subordinate lien bonds: A higher additional bonds test or other indenture provision increasing

bondholder protections against possible dilution of coverage

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATINGS

- GO: Emergence of significant liquidity strain, especially that results in the need for large cash-flow borrowing
- GO: Failure to find recurring solutions to balance the budget
- DASNY, HYIC, HHC, ECF, IDA: Downgrade of the city's general obligation rating
- HYIC: Weakened political support for the city to pay interest if it is required
- HYIC: A prolonged real estate recession that leads to material declines in assessed values in the district
- ECF: Failure by the city to appropriate funds for debt service or to restore the debt service reserve
- IDA: Failure by the city to appropriate funds for debt service
- DASNY municipal health facilities: Downgrade of the state's rating
- DASNY municipal health facilities: Failure of the intercept program's mechanics to make sufficient state aid available to pay debt service
- TFA subordinate lien bonds: Significant weakening of the pledged revenues that reduces currently high levels of coverage
- TFA subordinate lien bonds: Large additional bond issuances that materially dilute coverage

LEGAL SECURITY

The general obligation bonds are full faith and credit obligations of the city, secured by a real property tax levied without limitation as to rate or amount. All of the city's property tax is deposited into the general debt service fund, which is administered and maintained by the state comptroller.

The Hudson Yards bonds are payable 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 has pledged to cover interest, subject to annual appropriation, for the life of the bonds if the TEP revenues are insufficient. The ratings, therefore, are derived from the city's credit quality.

HHC's bonds are paid by a gross pledge of its sizeable health care reimbursement revenues and a lock box mechanism that collects the revenues and uses them to pay debt service before they flow to HHC for operations. The rating is derived from New York City's legal obligation to fund any shortfall in HHC's Capital Reserve Fund, subject to annual appropriation.

The Educational Construction Fund bonds are payable from city rental payments for the school portion of combined facilities projects in amounts equal to principal and interest on the bonds, subject to annual appropriation.

The IDA bonds are payable from monthly city rental payments equal to the sum of principal and interest coming due in the next succeeding month and any amounts owed under any credit facility. The city's obligation to make rental payments is absolute and unconditional, regardless of the project's commencement, completion, or availability for use and occupancy, subject to annual appropriation.

The DASNY Municipal Health Facilities and Court Facilities Lease Revenue bonds and underlying Aa3 appropriation-backed debt issued through DASNY are payable through a master lease between DASNY and New York City, rental payments in an amount equal to debt service on all outstanding bonds are an absolute and unconditional obligation of the city, subject only to annual appropriation. The city has covenanted in the lease to include an amount sufficient for debt service in each annual budget.

The Transitional Finance Authority's bonds are payable from pledged personal income and sales taxes collected by the New York State Department of Taxation and Finance and held by the state comptroller, who makes daily transfers to the trustee (net of refunds and the costs of collection). The trustee makes quarterly set-asides of amounts required for debt service due in the following quarter on the outstanding bonds

Additionally, future tax secured bonds issued before November 2006 have a first lien on appropriations of state building aid to the city if necessary to meet debt service requirements.

USE OF PROCEEDS

Proceeds of the new money bonds will be used to finance portions of the city's capital plan.

PROFILE

New York City, the largest city in the United States, is large and diverse, with a population of 8.3 million people and above average wealth levels: personal income per capita is 141% of the US level. The size and scope of the city's operations are broader than most local governments: in addition to the city government, New York City is five counties and the nation's largest public school system, with 1.1 million students. New York City's GDP is larger than all but four states.

METHODOLOGY

The principal methodology used in the general obligation ratings was US Local Government General Obligation Debt published in July 2020 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBM_1230443 . The principal methodology used in the long-term underlying lease ratings was Lease, Appropriation, Moral Obligation and Comparable Debt of US State and Local Governments published in July 2018 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBM_1102364 . The principal methodology used in the DASNY Municipal Health Facilities rating was State Aid Intercept Programs and Financings published in December 2017 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBM_1067422 . The principal methodology used in the long-term underlying special tax ratings was US Public Finance Special Tax Methodology published in July 2017 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBM_1077147 . The principal methodology used in the short-term enhanced ratings was Variable Rate Instruments Supported by Conditional Liquidity Facilities published in March 2017 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1057134 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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