



RATING ACTION COMMENTARY

Fitch Rates NYC Transitional Fin Auth \$1.3B Fiscal 2023 Ser D Bonds 'AAA'; Outlook Stable

Fri 21 Oct, 2022 - 5:44 PM ET

Fitch Ratings - New York - 21 Oct 2022: Fitch Ratings has assigned a 'AAA' rating to the following New York City Transitional Finance Authority (TFA) future tax secured (FTS) subordinate bonds fiscal 2023 series D:

--Approximately \$950,000,000 subseries D-1 (tax-exempt);

--Approximately \$210,440,000 subseries D-2 (taxable); and

--Approximately \$139,560,000 subseries D-3 (taxable).

The subseries D-1 bonds will be sold through negotiated sale the week of October 24, and the subseries D-2 and D-3 bonds will be offered through competitive sale on Oct. 26. Proceeds will be used to finance general city capital expenditures.

In addition, Fitch has affirmed the outstanding TFA senior lien, subordinate lien and recovery subordinate lien FTS bonds at 'AAA'. The affirmation includes the outstanding fiscal 1999 subseries A-1 Future Tax Secured Bonds, which are being converted from senior variable rate demand bonds to subordinate fixed rate bonds on November 3

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 (SUT) (collectively, the pledged revenues) imposed by New York City, as authorized by the state of New York. Payment of the PIT and SUT revenue to the TFA is not subject to city or state appropriation.

SUT 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 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 pledged revenues 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 pledged 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. Debt service on variable-rate bonds is assumed at the maximum rate for purposes of the ABT.

ANALYTICAL CONCLUSION

The 'AAA' ratings on the senior and subordinate FTS revenue bonds reflect solid long-term growth prospects for pledged revenues and the bonds' highly resilient structure. Fitch anticipates the bond structure can withstand changes in economic cycles and maintain solid debt service coverage (DSC). Fitch's analysis indicates resilience would be strong even if New York City fully leveraged the pledged revenues up to their legally permitted amount, but issuance will likely fall well below that level as excess revenues flow to the city for general operations. A very strong legal structure insulates bondholders from the operating risk of New York City (Issuer Default Rating [IDR] AA-/Positive).

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 SUT revenues are key credit strengths. Payment of the PIT and SUT revenue to the TFA is not subject to city or state appropriation. Statutory covenants prohibit action that would impair bondholders.

Robust Resilience: Fitch does not make a rating distinction between the senior and subordinate liens due to the high coverage levels and strong legal and practical protections against overleveraging. Fitch anticipates the security provided for both liens will remain highly resilient through the current economic environment and future downturns.

Solid Growth Prospects: 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. Fitch believes longer-term growth of pledged revenues may slow from historical levels but remain solid at levels between inflation and U.S. GDP following recovery from the effects of the pandemic.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Not applicable as the bonds are rated at Fitch's highest rating category.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A decline in pledged revenues that is more severe and prolonged than anticipated, combined with a significant increase in leverage beyond Fitch's expectation.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

CURRENT DEVELOPMENTS

Performance of unaudited actuals for SUT and audited PIT revenues reached record levels for fiscal 2022 improving overall current and projected debt service coverage. Unaudited pledged revenues increased by about 17% in fiscal 2022, with PIT revenue growth of 11%

and SUT revenue growth of 31%. Pledged revenues improved by 2.7% in fiscal 2021 following a modest decline of 0.7% in fiscal 2020.

Fiscal 2022 PIT revenues benefitted from federal stimulus and strong performance of financial services companies. These revenues are projected by the city to decline moderately by 8% in fiscal 2023 from the high of fiscal 2022 but remain close to or above fiscal 2021 levels through fiscal 2026. Fiscal 2022 SUT revenues increased at a more moderate pace through fiscal 2026 as the city's recovery continues and workers return to the office; however, the impact of inflation and recessionary pressures could temper spending as household savings accumulated during the pandemic are gradually reduced. Pro-forma debt service coverage based on expected debt issuances through fiscal 2026 is very strong at 5.57x.

Fitch considers these projections reasonable, as it expects employment and tourism will continue to show improvement and eventually recover to pre-pandemic levels. Job recovery and hotel occupancy levels continue to improve. However, uncertainty regarding persistently high inflation, a rising interest rate environment and changes in remote work practices could alter the pace of recovery for the city and impact pledged revenue performance.

ECONOMIC RESOURCE BASE

The economic profile of the city features high wealth levels; per capita personal income is approximately 138% of the U.S. However, the above-average individual poverty rate of 17.3% exceeds the national rate of 12.8% -- indicative of some income disparity and the demand for social services, but common in other large urban U.S. cities. The census population for the city for 2020 was 8.8 million, up 7.7% since 2010 (compared to 7.4% nationally).

Estimated census figures for 2021 show a 3.8% drop from 2020 levels to 8,467,513. The city is the most populous city in the United States and its population is larger than the combined populations of Los Angeles and Chicago, the next two most populous cities in the nation.

The city's tourism sector is an important driver, with a reported record of nearly 67 million visitors in 2019. The city had experienced reduced activity due to the pandemic; however, activity has rebounded, as evidenced by improved levels of hotel occupancy. Hotel occupancy in the city was 88.5% as of week ending Oct. 15, 2022 compared to the 2019 level of 94.9% for the similar period as reported by the city, up significantly from a year ago.

Revenue per available room (RevPAR) for week ending October 15 is exceeding pre-pandemic levels at \$353 versus \$316. Fitch expects New York City to resume its role as the leading American city for both domestic and international tourism as recovery continues.

DEDICATED TAX CREDIT PROFILE

As a true sale structure, TFA's rating is limited to six notches above New York City's IDR of 'AA-/Positive.

Strong Legal Framework Protects Bond Repayment

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 SUT revenues are imposed by the city and collected by the state. Revenues from the PIT and the SUT, 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 SUT, but Fitch believes the risk of this is negligible given the city's dependence on residual revenues for its operations.

Solid Pledged Revenue Growth Prospects

Total pledged revenues grew at a CAGR of approximately 5% over the 10 fiscal years through 2021 and fiscal 2022 SUT and PIT revenues exceed fiscal 2021 levels. Fitch believes the city continues to have sound economic growth prospects. Given the sensitivity of both PIT and SUT revenues to economic activity, Fitch expects revenue growth over time to exceed Fitch's expectations for long-term rates of inflation but be below GDP growth, consistent with a 'aa' revenue growth assessment.

PIT revenues totaled approximately 70% and 66% of fiscal 2021 and fiscal 2022 pledged revenues, respectively, and are expected to provide most of the growth and volatility in

pledged revenues, at least in the near term, due to the recent growth in employment levels offset partially by the potential changes in residency and commuting patterns due to the prevalence of remote work, variability of employee compensation related to financial services activities, and the ongoing effects of the 2017 federal tax law changes on taxpayer behavior.

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 April 2020 to Dec. 31, 2023. The city'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. Such reduction in the rate would also have a significant negative effect 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 SUT revenues.

Sensitivity and Resilience of Pledged Revenues through Economic Declines

DSC on all FTS bonds from fiscal 2021 pledged revenue was 7.0x. 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.

The Fitch Analytical Stress Test model generates a 4.4% decline in pledged revenue under the -1% U.S. GDP moderate recession scenario. The largest actual cumulative decline in historical revenues was a sizable 17.9% drop between fiscal years 2001 and 2003. A slightly smaller decline occurred in fiscal 2009 amid the financial crisis. 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 2021 pledged revenues could decline 78% and still cover pro forma annual debt service of \$4.7 billion in fiscal 2026, which incorporates issuance of approximately \$18.2 billion of FTS bonds (after issuance of the fiscal 2023 series D bonds) for general city capital purposes during the remainder of fiscal 2023 through fiscal 2026. This is equal to approximately 15x the moderate scenario output and 4x the largest historical decline. Fitch believes issuance to the ABT is highly

unlikely given the city's debt issuance plans for pledged revenues and its reliance on residual revenue for its operations.

Fitch assumes the city would delay future borrowing plans if pledged revenues fell significantly short of management's expectations to preserve sufficient residual revenues to fund operating expenses.

Pledged PIT revenues are deposited into the collection account daily, with a monthly amount retained in the debt service fund equal to one-half of the debt service payable in the three-month period. Revenues are retained for debt service until debt service is fully funded for the following three-month period.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

RATING ACTIONS

ENTITY / DEBT ⇅	RATING ⇅	PRIOR ⇅
New York City Transitional Finance Authority (NY)		
New York City Transitional Finance Authority (NY) /NYC TFA Future Tax Secured - Subordinated/1 LT	LT AAA Rating Outlook Stable Affirmed	AAA Rating Outlook Stable

New York City Transitional Finance Authority (NY) /NYC TFA Future Tax Secured/1 LT	LT	AAA Rating Outlook Stable	AAA Rating Outlook Stable
	Affirmed		

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APPLICABLE CRITERIA

[U.S. Public Finance Tax-Supported Rating Criteria \(pub. 04 May 2021\) \(including rating assumption sensitivity\)](#)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

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