New Issue: Moody's upgrades Metropolitan Transportation Authority's (NY) Transportation Revenue Bond rating to A1 from A2

Global Credit Research - 10 Jul 2015

$21.7 billion of long-term debt affected; outlook is stable

METROPOLITAN TRANSPORTATION AUTHORITY, NY
Mass Transit
NY

Moody's Rating

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<td>Transportation Revenue Refunding Bonds, Series 2015C</td>
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<td>Sale Amount</td>
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<td>Expected Sale Date</td>
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Moody's Outlook  STA

NEW YORK, July 10, 2015 -- Moody's Investors Service has upgraded to A1 from A2 the rating on New York Metropolitan Transportation Authority's (MTA) outstanding Transportation Revenue Bonds (TRB) and assigned an A1 rating to the $478 million Series 2015C refunding bonds. The Series 2015C bonds may be issued in multiple subseries, to be determined at the time of sale. The subseries may be fixed rate, mandatory tender bonds, and or floating rate tender bonds. The MTA plans to sell the bonds during the week of July 20th. The rating outlook is stable.

SUMMARY RATING RATIONALE

The upgrade to the A1 rating primarily reflects trends of improvement over recent years in the MTA's operating environment, including strong service area economic growth and strengthened financial condition of supporting governments New York State (Aa1) and New York City (Aa2). The upgrade also reflects MTA's growing ridership, recent history of stable financial performance, strong budget management, governance, and planning, and incorporates the Transportation Revenue Bonds' (TRB) bondholder protections provided by the gross pledge of a highly diversified revenue stream. The A1 rating also acknowledges the system's high fixed costs for debt service and retirement benefits, substantial proposed capital program with a large component that is yet-to-be funded, and the financial and operational challenges posed by the presence of strong collective bargaining units and the age and size of the transportation infrastructure.

OUTLOOK

The outlook for the TRB rating is stable, reflecting Moody's expectation that the MTA and its supporting governments will take actions, as they have in the past, to continue to balance the system's fiscal operations and capital program while maintaining adequate infrastructure quality and reasonable leverage ratios.

WHAT COULD MAKE THE RATING GO UP

- Sustained improvements in liquidity and debt service coverage by net revenues
- Sustained reduction in fixed costs and reduction in labor-related financial and operating constraints
- Substantially reduced current and projected leverage position
- Significant reduction in capital funding requirement, reflected in improved asset condition and reduced borrowing
needs

WHAT COULD MAKE THE RATING GO DOWN

- Evidence of declining support from New York State or New York City
- Sustained reduction in net revenue coverage or failure to structurally balance future budgets
- Reduced liquidity as reflected in a decline in days cash on hand
- Greater than expected rise in leverage position, including debt, pensions and OPEB
- Significant increase in capital needs and/or evidence of deteriorating asset condition

STRENGTHS

- Vast transit system that is highly essential to the largest metro economy in the U.S.
- High farebox recovery ratio, additionally supported by diversified mix of dedicated taxes, tolls revenues, and governmental subsidies
- Strong budget management and governance supports stable finances and resiliency during operating and budgetary challenges
- Strong operating environment demonstrated in high level of dedicated taxes, favorable history of fare increases, and financially sound supporting governments

CHALLENGES

- Very high fixed costs for debt and labor related expenses exacerbated by financial and operational challenges related to strong collective bargaining units
- High debt position
- Sizeable capital program for reinvestment and expansion has substantial funding gap
- Multi-level government involvement in the MTA's financial and capital planning creates complex political environment and adds to management challenges

RECENT DEVELOPMENTS

Through May, fiscal 2015 net operating results have been favorable compared to budget. Net positive variances in key revenues and expenditures amount to approximately $262 million (2% of budget). Fares have been higher than budgeted for the past several months but remain 1% below budget year-to-date due to low winter ridership and the February Metro North collision. Slightly unfavorable dedicated taxes ($16 million, or 1% below budget) were more than offset by strong real estate transaction taxes ($212 million, or 41% above budget). Spending has been 1.7% ($69 million) below budget through March, despite overtime costs being 17% ($42 million) higher than budget. The MTA operates on a January 1-December 31 fiscal year.

DETAILED RATING RATIONALE

SIZE AND MARKET POSITION: STRONG DEMAND FOR MTA'S LARGE SYSTEM, ESSENTIAL SERVICES

The MTA has a very strong market position as the largest combined transit and commuter network in North America, providing an essential service to 15.1 million people in the New York metropolitan region. The service area includes the vast, diverse economic region encompassing all five boroughs of New York City, Long Island, southeastern New York State, and southern Connecticut. MTA operations are performed through nine different agencies, including NYC Transit, Long Island Rail Road (LIRR), Metro North Railroad (MNR), and the Triborough Bridge and Tunnel Authority (TBTA) (senior lien rated Aa3).

Ridership on MTA's subways, buses, and commuter railroads increased 1.4% in 2014 to 2.7 billion rides annually. Ridership was fairly resilient through the recession, declining only 2.9%, and has grown 5% over the past five years, to a level 2% higher than its pre-recession peak. MTA projects that combined ridership will average 1% annual growth through 2018.
MTA's high utilization rate (annual ridership divided by service area population) reflects the essentiality of the transit provider to the service area. Despite systematic fare increases, utilization continues to climb, and reached 171 annual rides per person in 2014, up from 160 in 2002. Utilization of the transit system alone is the highest in the country at 301, and is similar to global peers.

New York City's economy is notably large, with real GDP in 2013 larger than all but four US states. The city's labor market has recovered remarkably well. Private sector employment as of April 2015 was 11.7% greater than the pre-recession peak, compared to the national job market that is only 3.0% above its pre-recession peak. The city's unemployment rate has decreased in recent months, to 6.5% in April compared to the US rate of 5.4%.

Fiscal 2014 TRB debt service coverage increased to 9.5x, on a gross basis, from 9.0x the prior year. The improvement was driven primarily by growth in transit and commuter fares, as well as real estate transaction taxes. MTA's February financial plan reflects a 2014 decrease in coverage by net revenues to 1.14x from 1.25x in 2013, which is in-line with the mid-year forecast of 1.16x and well-above the 2010 level of 1.04x. The decline was due primarily to increased operating expenses from the labor agreements and overtime. MTA's adopted fiscal 2015 budget results in net coverage declining to 1.07x.

The fiscal 2014 ending budgetary balance of $158 million was slightly higher than expected, but the fiscal 2015 projected cash balance has been revised downward, to $47 million from $64 million, a level notably lower than the $314 million cash balance in fiscal 2013. The revision reflects various technical adjustments to operating subsidies and the three week delayed implementation of the fare increase.

FLEXIBILITY CONSTRAINED BY HIGH LABOR-RELATED FIXED COSTS

MTA's financial flexibility is constrained by high fixed costs, a substantial capital plan, and strong collective bargaining units that routinely introduce financial and operating risks at the end of multi-year contract periods. Lengthy union negotiations typically continue well into the new contract term, leaving a short period of predictable labor costs and a high frequency of budget uncertainty. The most recent round of labor agreements, settled in 2014, increased MTA's costs $1.5 billion through fiscal 2018 (or 2% of the budget in each year).

Although the new agreements will be balanced within the MTA's existing budget, the growing labor costs further restrict financial flexibility and ability to maximize funding for capital projects. Labor-related expenses, which are more difficult to contain or cut without impacting service, will comprise approximately 60% of the MTA's fiscal 2015 consolidated operations. These levels are consistent with other large transit systems in the U.S. whose labor-related costs range from 60% to 73% of expenses.

Other budgetary risks include continued reliance on unidentified cost savings to balance the budget, optimistic overtime cost projections, and the pressures of funding and managing a substantial capital program (see below).

MTA's budgetary flexibility is enhanced by sophisticated operating and capital planning, a statutory requirement to maintain a balanced budget, conservative debt service assumptions and a recent history of using budget surpluses to reduce long-term liabilities and lower future costs.

Liquidity

The MTA has sufficient liquidity to support its portfolio of variable rate demand bonds and avoid short-term borrowing for cash flow needs. Consolidated days cash on hand decreased to 117 in 2014 (based on the most recent audit) from 126 days in 2013, but remain above the recent low of 65 days in 2011. While MTA's liquidity levels are low compared to other large enterprises, they are consistent with transit systems that are typically constrained by relationships with parent subsidizing governments and collective bargaining units. Days cash on hand includes MTA's $350 million revolving line of credit from Royal Bank of Canada that can be used for operating expenses.

DEBT AND LEGAL COVENANTS: LEVERAGE POSITION WILL REMAIN HIGH DUE TO LARGE CAPITAL NEEDS

The MTA has $36.5 billion of debt (including the recently-closed RRIF loan that has not been drawn on yet) composed of several different securities. This amount does not include $253 million of state service contract bonds that are an obligation of the state. The $22.7 billion in TRBs and TRB BANs are one of four primary credits that the MTA uses to finance its capital programs.
MTA is highly leveraged with consolidated net debt to revenues of 2.37x. Despite a recent history of steady borrowing that has increased total outstanding debt to $36.5 billion from $20.3 billion in 2004, dedicated tax growth and fare increases have kept pace. Net debt to revenues was 2.64x in 2004 and peaked at 2.79x in 2009. We expect debt metrics will remain elevated and likely increase going forward given MTA’s substantial capital needs and plans to increase debt by approximately $2 billion per year through 2018.

Debt Structure

Total variable rate and puttable debt has declined to 15% ($5.352 billion) of total debt in 2015 from a high of 30% in 2004. The largest share of that ($2.4 billion) is in floating rate notes. $2.2 billion (10%) of the TRBs are variable rate and put bonds, with $1.4 billion of that in floating rate notes. MTA policy limits unhedged variable rate exposure to 25% of the portfolio.

In March 2015, MTA issued its first 40-year final maturity bond ($275 million), extending final maturity of outstanding bonds by five years to 2045. While long-maturity bonds increase interest costs and reduce future flexibility, the additional risks are offset by the relatively small amount of 40-year debt and the long-life of the financed assets.

Debt-Related Derivatives

The swap portfolio on all securities had a moderate negative market valuation of $591 million as of March 31, 2015. The MTA pays a fixed rate and receives floating rates, mostly based on LIBOR. Counterparties cannot optionally terminate swaps, but the MTA can. The MTA’s swaps are subject to involuntary termination in the event of a downgrade below investment grade of the counterparty or the MTA security associated with the swap.

Pensions and OPEB

MTA has substantial pension and OPEB obligations due to the labor-intensive nature of its enterprise. Employees are represented by over 60 unions and are participants in six single-employer and multi-employer pension plans. MTA pays 100% of the actuarial recommended contribution (ARC) every year. Moody's makes certain adjustments to reported pension data, including a common 20-year amortization period, as well as an assumed 13-year duration of plan liabilities and a market-based discount rate to value the liabilities. Based on these adjustments, MTA’s fiscal 2014 Moody’s adjusted net pension liability (ANPL) was $14.5 billion. The 3-year average ANPL was 114% of consolidated revenues.

On an as reported basis, MTA’s share of the combined unfunded liability on all six plans has increased to $8.26 billion in 2014 from $2.05 billion in 2009. The combined ARC has been more stable, growing to approximately $1.38 billion in 2014 from $1.07 billion in 2009. For the multi-employer plans, we calculate MTA’s share of the unfunded liability and ARC to match MTA’s share of the total annual contribution into the pension fund.

Like most employers, MTA pays its Other Post-Employment Benefits (OPEB) on a pay-as-you-go basis. The annual OPEB pay-go has increased to $486.5 million in 2014 from $347.6 million in 2009. In fiscal 2012 and 2013, MTA contributed a total $300 million to an OPEB trust. In addition, MTA has OPEB Reserve with a current balance of $147 million. While the amount remains very small in comparison to the $20.2 billion total liability, the use of budget surplus to pay-down long-term liabilities reflects sound budget management.

CAPITAL PROGRAM: "STATE OF GOOD REPAIR" PROJECTS INCREASE CAPITAL PLAN 32% BUT AWAIT BOARD APPROVAL

The MTA’s proposed $32 billion 2015-2019 capital plan is 32% larger than the final 2010-2014 plan (excluding Superstorm Sandy restoration and resiliency projects), reflecting the escalating demands of maintaining and improving the state of repair on an extensive infrastructure network. The projected costs of the core capital program, or general maintenance and improvement projects, has increased to $23.5 billion from $16.3 billion in the final 2010-2014 plan. Some of this increase reflects MTA’s implementation of heightened resiliency standards post-Sandy. Federal aid is expected to cover about 90% of the $10.5 billion of Tropical Storm Sandy recovery and resiliency projects that were added after the storm.

As is typical in the MTA’s capital planning process, the proposed 2015-2019 plan is not fully funded. The MTA has identified $16.9 billion of funding from federal, MTA and city resources, funding 53% of the plan and leaving a gap of $15.1 billion. Similarly, the 2010-2014 plan, when initially proposed, was 69% funded with a $9.9 billion funding gap, and funding was identified over the first two years of the plan.
The length of negotiations to identify capital funding reflect the high burden of MTA's capital costs. Capital funding will be an ongoing challenge given the persistence of large capital needs and MTA's narrowly balanced financial operations.

The state Capital Program Review Board (CPRB) rejected, without prejudice, the MTA’s proposed 2015-2019 capital plan. Negotiations regarding the final size and funding sources continue. MTA has sufficient remaining authorization under the 2010-2014 capital program to continue capital projects in the near term, however a longer delay could negatively alter the timing of MTA's planned projects.

LEGAL SECURITY: BONDS SECURED BY DIVERSE REVENUE STREAM; LEGAL POVSITIONS ARE ADEQUATE WITH SOME WEAKNESS

The transportation revenue bonds (TRBs) are one of four primary credits that the MTA uses to finance its capital programs. The TRB bonds are special obligations of the MTA, payable on a gross basis from transit and commuter system revenues, certain state and local operating subsidies, dedicated taxes, and operating surpluses of the Triborough Bridge and Tunnel Authority (TBTA) after operating and maintenance requirements and debt service payments on the TBTA’s own debt (Aa3/stable senior lien). TRB financed projects must be approved by the CPRB.

The TRB rate covenant requires sum sufficient coverage by fares and subsidies of debt service and O&M. Only board approval is required to raise fares for the rate covenant. Unlike most other rated transit systems, there is no debt service reserve fund and no explicit additional bonds test for the TRBs, although the balanced budget requirement and CPRB approval provide solid leverage controls. Pledged revenues flow to a trustee held account and are set-aside monthly for debt service before being released for operations.

OPERATING ENVIRONMENT: STRONG SUPPORT FROM HIGHLY-RATED GOVERNMENTS, COMPLEX ENVIRONMENT

The MTA has a very supportive but complex operating environment. MTA has historically received strong support from its highly-rated subsidizing governments (New York State, Aa1 and New York City, Aa2), but support has been somewhat less predictable during times of state and local fiscal stress. As discussed above, the MTA provides a highly essential service for a very large metropolitan area, and therefore generates a high level of political support. In 2010, the New York State legislature authorized collection of the Payroll Mobility Tax to support MTA operations with a substantial and stable new revenue stream.

The MTA, like all transit agencies, is dependent on a significant amount of operating support from state and local appropriations and dedicated taxes. These taxes and operating subsidies comprised nearly 43% of 2014 pledged revenues. Total subsidies, dedicated taxes and transfers, have doubled over the past ten years, reaching $6.6 billion in fiscal 2014 compared to $3.3 billion in fiscal 2005. In addition, MTA receives substantial capital funding from the federal government, state and city, amounting to $7.6 billion (more than 30%) of the 2010-2014 capital program.

Although the state has reduced or shifted subsidies in years of fiscal stress, it has consistently made MTA whole when tax policy changes have negatively affected subsidies. Other shifts have been revenue neutral (a shift to capital from operating support) or short lived, such as the 2011 one-time reduction in MMTOA. The MTA’s generally supportive operating environment is also evidenced by the successful implementation of biannual fare increases, the most recent of which went into effect on March 22, 2015. The next fare increase is planned for 2017, and is projected to raise $250 million of additional revenues in the first year.

KEY STATISTICS

- 2014 Annual Ridership: 2.7 billion
- Service Area Population: 15.1 million
- Utilization (Ridership / Population): 180
- 2014 Farebox Recovery Ratio (Fares / Operating Expenditures): 52%
- 3-Yr Average Fixed Costs as a % of Operating Expenditures: 30.5%
- 2014 Net Debt / Revenues: 2.30x
- 2015 YTD Net Debt / Revenues: 2.46x
- 3-Yr Average Annual Debt Service Coverage by Net Revenues (GAAP basis): 1.28x
- 2014 Days Cash on Hand: 117

OBLIGOR PROFILE

The MTA is a public benefit corporation of New York State, created by the New York State legislature in 1965. The MTA’s governing board is appointed by the governor with advice and consent of the state Senate. The MTA is responsible for developing and implementing a unified mass transportation policy for the Metropolitan Transportation District which includes New York City and the surrounding Duchess, Nassau, Orange, Putnam, Rockland, Suffolk, and Westchester counties.

LEGAL SECURITY

The TRB bonds are special obligations of the MTA, payable on a gross basis from transit and commuter system revenues, certain state and local operating subsidies, dedicated taxes, and operating surpluses of the Triborough Bridge and Tunnel Authority (TBTA) after operating and maintenance requirements and debt service payments on the TBTA’s own debt (Aa3/stable senior lien).

USE OF PROCEEDS

Proceeds will refund outstanding TRBs with no extension of maturity.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was Global Mass Transit Enterprises Methodology published in February 2015. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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Baye Larsen
Lead Analyst
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