Bond Case Briefs

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Fitch: New York State PIT Bonds Unlikely to be Affected by Proposed State Tax Changes.

Fitch Ratings-New York-27 February 2018: Fitch Ratings expects that Governor Cuomo's proposed changes to New York State's personal income tax (PIT) are unlikely to affect the credit quality of the state's PIT revenue bonds, the state's largest source of bond financing for capital projects.

Fitch currently rates New York State's PIT revenue bonds 'AA+'/Stable, on par with the state's Issuer Default Rating (IDR) based on bond provisions that link them to the general credit quality of the state. As a result, any rating impact from the tax law changes would be to the state's 'AA+' IDR. Assuming that any enacted state tax code changes succeed in their goal of leaving state revenue collections near current baseline expectations, the changes would have little impact on the state's revenue growth prospects or overall credit quality.

The proposed changes, which were released as part of the 30-day amendments to the fiscal 2019 executive budget, are intended to mitigate the expected negative impact on New York State taxpayers of the federal Tax Cut and Jobs Act (TCJA), passed in December 2017. Among multiple provisions, the state legislation would decouple the state tax code from the federal code to preserve individual and business filers' state deductions and prevent a state revenue windfall in the absence of offsetting changes in state law. This windfall is estimated by the state's comptroller to total a net $1.1 billion.

Additionally, the legislation would establish an optional, phased-in payroll tax (the employer compensation expense tax, or ECET) on taxable income over $40,000 for employers that choose to participate, which would be accompanied by an offsetting tax credit for their employees' wages. The ECET would be intended to leave unchanged both individual filers' take home pay and state tax revenues, while taking advantage of the continued federal deductibility of payroll taxes paid by businesses. The legislation also would establish two charitable public funds to receive taxpayer donations on behalf of state education and healthcare-related services, with such donations offset by a partial tax credit on individual filers' New York State taxable income.

The legislation appears to be crafted to address any potential negative impact on PIT bondholders. It would raise the set aside of estimated available PIT receipts to 50%, from 25%, and supplement the pledge with 50% of future ECET receipts. Combined PIT and ECET tax receipts are intended to match collections under the existing PIT, and the higher set aside is also intended to address the potential impact of charitable contributions on PIT receipts.

New York State has $34.8 billion in outstanding PIT revenue bonds as of January 2018, issued by five state agencies. Although PIT bonds benefit from the dedication of a portion of the state's largest tax revenue source, Fitch limits the credit quality of the PIT bonds to the state's 'AA+' IDR because an appropriation is required for debt service. The PIT bonds are rated on par with the state's IDR, rather than one notch below as is standard for appropriation-supported debt, because the incentive for appropriation is significantly enhanced by requirements under the bond indenture that trap pledged receipts in the revenue bond tax fund (RBTF) in the event of non-appropriation. The bond documents also require the state comptroller to transfer resources to the RBTF from the general fund without appropriation if pledged receipts are insufficient.

Beyond the implications of the proposal on New York State's PIT bonds, Fitch cautions that implementing tax law changes to a major state revenue source like the PIT always carries the risk of unforeseen consequences. With the exception of the decoupling provisions, the governor's proposal seeks to leave total state revenues largely unchanged. Other provisions, such as the optional nature of the ECET and its three-year phase-in, are intended to minimize disruptions to employers, such as those with multiyear labor contracts.

Nonetheless, other important unknowns must be considered by the legislature, such as how any change would affect cross-border commuters, whether the changes would extend to the local PIT levied by New York City and Yonkers, and how any changes to New York City's PIT would affect the future tax secured bonds issued by the New York City Transitional Finance Authority (TFA). The TFA's future tax secured bonds are payable from revenues derived from city PIT and sales and use taxes, as authorized by New York State, and are rated 'AAA'/Stable by Fitch. Fitch will monitor the legislature's actions on the governor's proposal and any other tax law changes that emerge over the coming months.

Outside of the tax proposal, the governor's executive budget for fiscal 2019 (which begins on April 1) hews closely to the state's policy direction in recent years. Consistent with the recent experience of many states, revenues in New York State are forecast to rise, albeit at a slower pace than in recent prior forecasts. State actions to absorb slower revenue growth and the resulting forecast budget gaps have included holding budgeted state operating funds spending growth at no higher than 2% annually, curbing Medicaid spending growth at the current 3.2% statutory growth cap, and making targeted fund and timing shifts. As with last year's budget, the executive budget proposes a mechanism to adjust state spending in the event that federal budget cuts exceed $850 million for either state Medicaid or other program areas.

New York State's 'AA+' IDR reflects its considerable economic resources, solid economic performance and growth prospects, strong ability to control its budget and responsive budget management. Due to budget management improvements in the last decade, the state is in a materially improved position to address future economic and revenue cyclicality relative to past experience, in Fitch's view. Liabilities and related carrying costs are just below the median for states and remain a manageable burden on resources.

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