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The MTA Is Selling Green Bonds This Week. Investors Should Prepare for More Borrowing.

New York's Metropolitan Transportation Authority is planning to sell tax-exempt green bonds backed by the agency's transportation revenues. Analysts at Fitch have downgraded that debt, citing the risk that the country's largest transit system could borrow a lot more in the future as the pandemic has sharply reduced ridership.

The MTA said it would sell $257.5 million of bonds this week to pay down bonds that mature in mid-November. The bonds are backed by a lien on revenues from the commuter and transit system, along with some of the surplus from the city's bridges and tunnels, state-and-local-government operating subsidies, and revenue from other miscellaneous taxes and fees. They will also be green bonds with certification from the Climate Bonds Initiative, thanks to their use financing mass transit.

The offering comes as revenues have slumped for New York's subways, buses, and commuter rail, however, as pandemic-wary commuters avoid public transit. On Oct. 23, for example, subway ridership was down nearly 70% from last year, bus ridership was down more than 50%, Long Island Railroad ridership was down 71%, and Metro-North ridership was down 76%. Bridge and tunnel use was down 12% from last year.

In a recent investor presentation, the MTA reiterated past estimates that put its budget shortfall at $3.2 billion for this year and $5.8 billion for 2021 in the absence of federal funding. MTA Chairman and CEO Patrick Foye has requested $12 billion in federal grants for the next two years to cover the deficits—but it isn't clear how quickly the MTA will be able to obtain aid from Congress, or how much aid it will end up receiving.

Until the outlook becomes clearer, officials estimate they can reduce this year's deficit by $1.1 billion by cutting spending and tapping other sources of cash within the agency, such as retirement-benefit reserves.

Beyond those steps, board members have proposed tapping the full $2.9 billion of cash available from the Federal Reserve's Municipal Liquidity Facility, though the MTA has only a little more than a month to file a Notice of Interest to meet the Fed's current requirements. The MTA has already tapped the Fed facility once, borrowing $450 million in August.

New York state has given the MTA permission to borrow to cover up to $10 billion in deficits through 2022. But ratings-firm Fitch says that increases the MTA's reliance on capital markets, along with its "sensitivity to the timing and strength of an eventual revenue recovery that is highly dependent on public health and economic conditions and mass transit ridership behaviors."

For now, the pandemic-related revenue crunch has prompted Fitch to downgrade all of the MTA's outstanding transportation revenue bonds by two notches, to A- from A+.

The firm's analysts estimate that the transit authority is burning $300 million of cash per week, and have a "Negative Outlook" for the debt, meaning that future downgrades are more likely than upgrades.

On the bright side, the MTA has about $5.2 billion of liquidity on hand, with about $2 billion of that in cash, according to Patrick Luby, analyst with CreditSights.

What's more, the market's pricing of the MTA's bonds does seem to reflect the risks created by the pandemic—meaning that while the MTA will likely need to pay high interest rates to borrow, the bond yields may be too high for risk-tolerant investors to resist.

The spread between the MTA's bonds and AAA-rated benchmark muni yields closed around 338 basis points (or about 3.4 percentage points) on Friday, Luby wrote in a recent note. That is up from a spread around one-tenth that size—33 basis points—at the start of this year. In its investor presentation, the transit authority cited "strong legal provisions [enacted] to ensure timely payment" of those interest costs, such as a New York state law that prevents the MTA or its affiliates from voluntarily filing for bankruptcy to reorganize its debt.

The bonds are expected to price on Thursday, according to Fitch.

Barron's

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