RESEARCH

Hudson Yards Infrastructure Corp., New York; Appropriations

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Credit Profile

US$2 bil Hudson Yards sr rev bnds fiscal 2007 (New York City) ser A due 02/15/2047	A
Sale date: 06-DEC-2006	
OUTLOOK:	STABLE

Rationale

Standard & Poor's Ratings Services assigned its 'A' rating to Hudson Yards Infrastructure Corp. (HYIC), N.Y.'s new $2 billion senior revenue bonds, fiscal 2007 series A, reflecting the following:

- The general creditworthiness of New York City ('AA-' GO rating, stable outlook) factors into the rating, as does the city's success in managing large-scale infrastructure and development projects. While there is a direct security related to interest payments on the bonds only, the city is highly invested in the project and its commitment to interest extends until the bonds are repaid. Standard & Poor's expects that the city will have the incentive and the capacity over a 40-year time period to ensure that sufficient development occurs in the project area to provide a viable revenue stream to retire the bonds or develop an alternative financing strategy to repay the bonds.
- There is a strong level of city support for the project area and the infrastructure supporting development, as well as for the bonds.
- New York City is a major economic and employment center with a high-value real estate market that has experienced continued investment and growth over time, albeit cyclical.
- The Hudson Yards Financing District (the project area) benefits from its location adjacent to the city's strong and vibrant midtown Manhattan business district, which will likely support commercial and residential development over time. In addition to its favorable location, the lack of available development capacity in midtown should support the demand for residential and commercial construction over a 40-year time period.

Principal is payable from revenues generated from new construction and development within the project area over the next 40 years, including payments in lieu of city property taxes, other property tax revenue due to the city related to development in the project area, and other development-related revenues. Interest on the bonds is payable by the city, subject to annual appropriation. Pledged revenues will fund interest payments in the first instance to the extent they are sufficient each year. The city council has authorized bonds totaling $3 billion.

There is no legal requirement for New York City to fund the principal amount of the bonds. However, the city is using bond proceeds to fund $3 billion of infrastructure within the development district to support the project, and will be responsible for funding interest on the life of the bonds under the terms of the support and development agreement between the HYIC, the Hudson Yards Development Corp. (HYDC), and New York City. If no development occurs, the interest subsidy could total more than $6 billion or $7 billion.

The 45-block Hudson Yards Development Area extends from West 28th Street on the southern end, Seventh and Eighth avenues on the east, West 43rd Street on the north, and out to the Hudson River on the west. The redevelopment of Hudson Yards is designed to allow for the expansion of the Midtown Central Business District, as well as for the realization of the development potential of Manhattan's far west side.

Proceeds of this issue will finance the extension of the No. 7 subway line from Times Square between Seventh and Eighth avenues to a new terminal station at West 34th Street and 11th Avenue. Proceeds will also fund development of various parks, public open spaces, and street improvements. Another bond issue is expected in 2009 to complete the projects authorized by the city.

The zoning in the Hudson Yards project area was outdated and not conducive to high value development. About 70% of the property was zoned for manufacturing use, 27% for low-density commercial use, and just 3% residential.

The Hudson Yards special district zoning ordinance was adopted by the city council in January 2005 by a vote of 46 to one. The comprehensive rezoning for the project area is designed to provide for a mix of commercial and residential uses. The city also adopted a uniform tax-exempt policy that will provide for various exemptions to encourage growth in the area.

There has been widespread support and approval for major aspects of the project over time at all levels of government, including city elected officials, the state, and various government authorities. There are also complementary projects under construction that are in close proximity to the project area--the most significant of which is the joint city and state expansion and modernization of the Jacob K. Javits Convention Center currently under way. Other projects are in various stages of planning, and could ultimately have a positive effect on the project area.

The entire Hudson Yards project and financing plan is a city initiative. As such, it would be reasonable to expect that the city would have incentive to see that the project area develops to ensure an adequate flow of revenues. The successful and timely completion of the subway expansion will be critical to commercial development in the area, with completions scheduled for 2013.

The city's economic and real estate history suggests that the level of development necessary to support the bonds is not unrealistic or inconsistent with prior development/investment patterns. Since 1950, the supply of office space in Manhattan has averaged 4.3 million square feet annually. The actual level of development each year over this time period has been cyclical due to economic conditions, as well as the availability of development sites.

In conjunction with this financing, Cushman and Wakefield prepared a demand and development study for the city that analyzed the city's real estate fundamentals over a 30-year time period. The development study concluded that over the forecast period, the planned infrastructure improvements can support the transformation of Hudson Yards from an industrial district to a mixed-use community with between 40.9 million-45.0 million square feet of commercial, residential, hotel, and retail space. This would represent just a portion of the projected demand of 100 million square feet of office space in Manhattan between 2006-2035.

The city's ongoing commitment to the project area will remain a major factor in the credit review process given that future development is necessary to support the bonds and there are regular risks associated with real estate development.

Outlook

The outlook is stable. While the development outcome of the project area is currently uncertain, if private construction occurs at the pace anticipated by the city, there could be upside potential for this rating over a longer term basis. If development does not occur, Standard & Poor's will continue to evaluate the city's commitment to the project area and the bonds.

Issuer: Created And Staffed By New York City

HYIC is a local development corporation established in 2004 under the not-for-profit law of New York State. HYIC was created by the city to facilitate the transformation of the Hudson Yards Financing District to a mixed-use community, expanding the Midtown central business district to include commercial, residential, hotel, and retail development to expand the amount of public open space and to contribute to the cultural and recreational life of the city. The board of HYIC consists of the New York City budget director, the deputy mayor for administration, the deputy mayor for economic development and rebuilding, the city comptroller, and the speaker of the city council. HYIC's officers and staff consist of bond finance professionals from the mayor's Office of Management and Budget and the city law department. The HYDC was created by the city in 2005 to manage the implementation of the Hudson Yards Infrastructure Project. HYDC has an experienced staff composed of planning, development, and construction professionals. HYDC's 13-member board includes a representation from a broad array of elected officials and mayoral appointees, including the city comptroller, speaker of the city council, Manhattan borough president, and the director of the Office of Management and Budget.

Pledged Revenues: Subject To Future Development

There are various revenues pledged to secure the bonds, and pledged revenues will pay interest to the extent they are sufficient. Under the terms of the interest support agreement between HYIC, HYDC, and New York City, interest on the bonds will be payable by the city each year, subject to appropriation if other development-related revenues are insufficient. Current estimates indicate that city interest support will be necessary through fiscal 2016. The expense budget submitted by the mayor to the city council will include the net amount of interest due for the fiscal year. While the amount included is a net amount, the mayor will take all actions required to seek an increase in the appropriation for interest costs due. As a practical matter, the city adjusts its budget throughout the year on a formal and established schedule, and revisions are common.

All revenues pledged to support the bonds are subject to future development. The pledged revenues to support principal are described below.

Payments in lieu of taxes

Payments in lieu of taxes (PILOT) revenues would be generated by commercial property in the area. A PILOT is a payment in lieu of ad valorem real property taxes made pursuant to PILOT agreements. The New York City Industrial Development Agency (IDA) is authorized by state statute to enter into PILOT agreements with developers of commercial property in the project area. For each agreement, there will be a PILOT mortgage. The IDA is expected to grant discounts for up to 19 years on new commercial developments in the project area pursuant to a uniform tax-exemption policy. Beginning in year 20, PILOTs will equal the full real property taxes levied by the city. The PILOTs are assigned to the HYIC pursuant to an assignment agreement. PILOT revenues may also come from the Metropolitan Transportation Authority and the Convention Center Development Corp. (a state-created entity to expand the Javits Convention Center), and these are also assigned to HYIC. These revenues would be recurring and would be the primary revenue securing the bonds. PILOTs are expected to represent more than 50% of total pledged revenues, depending on the development scenario.

Tax-equivalency payments

These payments are subject to annual appropriation by the city and represent the amount of ad valorem real property taxes collected on new development or substantial rehabilitation in the project area since Jan. 19, 2005. These payments would be generated from residential developments in the project area, hotel developments, and any commercial developments where there is no PILOT agreement (unlikely due to discount). This will be a recurring revenue source securing the bonds. The city's department of finance will prepare the necessary calculations and be responsible for record keeping. The city agrees to transfer these payments to the trustee in two equal payments throughout the fiscal year. The city agrees to include amounts due in its annual budget, and once appropriated, the payment obligation is absolute and unconditional.

Payments in lieu of mortgage recording tax

Any commercial property securing construction or permanent financing for commercial development will be subject to a payment in lieu of mortgage recording tax (PILOMRT). This payment will be required for each PILOT payment agreement negotiated. It will be a onetime payment by commercial developers assigned by the IDA to HYIC.

District improvement fund bonus payments
These are nonrecurring payments made to HYIC in exchange for higher density developments.

Sale of Eastern Rail Yard transferable development rights
Revenues received from the sale of transferable development rights over the Eastern Rail Yard (up to $200 million).

Legal Provisions: Structured Around Future Revenue Flow

The indenture limits the principal amount of bonds to $3 billion unless city council increases the authorization. The limitation on senior bonds is $3.5 billion prior to conversion of the bonds. There is no limit on subordinate bonds. Bond proceeds are limited to project costs, including subway extension, public amenities, property acquisition, acquisition of transferable development rights, HYDC costs, issuance costs, capitalized interest, and refunding of any HYIC debt.

Conversion is key to legal documents and requirements under the indenture. When pledged revenue are sufficient to fully cover debt service, conversion will occur as outlined under the terms of the indenture. Prior to the conversion date, no debt can be issued as variable rate, capital appreciation bonds, or deferred-income bonds. No bond can mature prior to Feb. 15, 2047, and there is no scheduled amortization of bonds prior to maturity.

Flow of funds
Available revenues fund operating costs of the HYIC. Revenues then fund interest cost for the current fiscal year as well as the subsequent-year; revenues then flow into a redemption account to be used for pro rata "turbo" redemption of senior bonds. Prior to the conversion date outlined below, the flow of funds is closed.

Conversion test
Under the terms of the indentures, "conversion" occurs when net recurring revenues for each of the preceding two fiscal years equal 1.25x of reamortized maximum annual debt service (MADS) on outstanding senior bonds and 1.05X of reamortized MADS on all outstanding bonds. Amortization of bonds is calculated using level debt service. Nonrecurring, development-related revenues that are pledged to repayment cannot be used for purposes of conversion test; only PILOT and tax equivalency payment revenues may be utilized.

The conversion date is defined as the date that the city delivers notice to the trustee that it has met the above requirements. No later than June 30 of the fiscal year that the conversion date occurs, a schedule of sinking fund installments is established for all bonds issued prior to conversion until final maturity. Installments must produce substantially level or annually declining debt service on all bonds. After the conversion date, the flow of funds opens and project area revenues can be released to the city. The city may also issue additional senior or subordinate debt as long as it conforms to the coverage requirements and other conditions outlined in the indenture.

Support and development agreement
The support and development agreement is between HYIC, HYDC, and the city. This outlines the city's commitment to funding interest payments on the bonds as well as tax equivalency payments and any other PILOTS received that may not be through IDA subject to annual appropriation. The payment obligation of the city is absolute and unconditional once appropriation is made.

HYIC notifies the city each April 1 of interest requirements that need to be covered by the city. The mayor includes the amount necessary in the city's expense budget. The city will calculate tax equivalency payments annually and pay to HYIC amounts due twice a year (Aug. 1 and Feb. 1) in equal payments, also subject to annual appropriation.

Project Area: City's Substantial Actions To Develop

The Hudson Yards is a comprehensive proposal to realize the development potential of Manhattan's Far West Side. The Hudson Yards Development Area is composed of 45 blocks. The area extends from West

28th Street on the south, Seventh and Eighth avenues on the east, West 43rd Street on the north, and the Hudson River on the west. The redevelopment of Hudson Yards is designed to allow for the expansion of the Midtown Central Business District.

The city's master plan for Hudson Yards identifies critical public sector actions that would be necessary to attract private development to the area:

- Zoning for appropriate densities and uses,
- Establishment of a uniform tax-exemption policy,
- Extending subway service to the area,
- Establishing a new open space network, and
- Creating a convention corridor.

Rezoning
The zoning in the Hudson Yards Development District was outdated and not conducive to high value development; the city estimates that it was last rezoned in the 1970s. About 70% of the property was zoned for manufacturing use, 27% for low-density commercial use, and only 3% rezoning. The Hudson Yards special district zoning ordinance was adopted by the city council in January 2005 by a vote of 46 to 1. It is designed to provide for a mix of commercial and residential uses, with a major office and commercial core in the south and west of the redevelopment area, and a mix of residential and lower density commercial uses to the north and east. The new zoning for the area provides for:

- 24 million square feet of office space,
- 13,500 units of housing, and
- Two million square feet of hotel space and one million square feet of retail space.

Uniform tax-exempt policy
The IDA approved an amendment to its uniform tax-exempt policy. This amendment allows for financial assistance to be available to commercial construction projects in the project area. The financial assistance is in the form of real property and sales and use tax exemptions. The New York City Council approved the assignment of these PILOT agreements to HYIC.

Mass transit access
A critical element of the redevelopment plan is the mass transit connection of Hudson Yards to the rest of Manhattan. A portion of these bonds proceeds will be used to extend the No. 7 subway line west to 11th Avenue and then south to west 34th street. Total project cost is $2 billion, with a $100 million contingency. A memorandum of understanding has been signed between the city and the Metropolitan Transportation Authority in order to facilitate the construction. Although several lawsuits have been filed by property owners in the area, the city has received favorable judgments on all litigation. This allows for property acquisition to proceed. There have been 46 below-grade easements acquired by negotiation with owners. Project completion is projected by 2013. Timely construction of the subway will play a key role in commercial development of the area and overall project revenues.

Open space network
There are currently a lack of amenities and open space. A system of new streets and parks is being designed to create a pedestrian thoroughfare. Mid-Block Boulevard and Park will run from 33rd to 39th streets between 10th and 11th avenues. Initial project costs for parks, streets, and property acquisition is $700 million. Additional private investment is anticipated.

Convention corridor and other complementary projects
The planned expansion of the Javits Center and the construction of a new 1,000-plus-room hotel will act as the cornerstone of the new convention corridor. Groundbreaking occurred in October 2006. Construction will be done at state level. No direct revenues from the convention center secure the bonds, but the project is expected to generate development momentum in the project area. Other complementary projects are planned or are in preliminary stages of planning including High Line Park, Hudson River Park, Moynihan Station, and the Madison Square Garden relocation.

Real Estate Demand: Forecasted To Be Strong

HYIC engaged the firm of Cushman and Wakefield Inc. to analyze real estate fundamentals and development of the redevelopment area over a 30-year time horizon. The development study concluded that over the forecast period, the planned infrastructure improvements can support the transformation of Hudson Yards from an industrial district to a mixed-use community with about 25 million square feet of office space, 15,000 new housing units, and 3,000 new hotel rooms. This would represent just a portion of the shortage of development sites to meet the 100 million square feet of office space demand in Manhattan forecasted between 2006 and 2035. As part of the study, 18 large sites in Hudson Yards were evaluated for potential development. Fourteen of those sites were found to be well suited for Class A office development, and four were found to be better suited for hotel sites. Four of the office development sites would require partial or total platform coverage of the rail yards to permit development. There are no plans at this time to construct a platform. The four largest sites, which surround the planned West 34th Street subway station, account for about 31% of the office space within the redevelopment area, and due to their location are expected to developed before first. While the demand analysis took into account several variables and assumptions, including economic and demographic forecasts, it is based on the assumption that the key city infrastructure projects are accomplished by 2013. Any delay or failure to complete these infrastructure improvements, particularly the subway, would likely delay office property development.

The analysis developed two scenarios over the development period. The base scenario assumed steady long-term economic growth and continual development. That scenario forecasted a total 45.0 million square feet being developed as follows:

- 25.7 million square feet of office space,
- 15.6 million square feet of residential,
- 2.3 million square feet of hotel, and
- 1.4 million square feet of retail.

The second scenario, a cyclical scenario, reflected market variability over the course of multiple business cycles, and consequently development would be slightly reduced to 40.9 million square feet. This is broken out as follows:

- 24.0 million square feet of office space,
- 13.4 million square feet of residential,
- 2.1 million square feet of hotel, and
- 1.3 million square feet of retail.

Revenues: Projected To Be Sufficient Under A Range of Economic Growth Scenarios

Under the base scenario, revenues dedicated to HYIC from new real estate development are expected to total $38.9 billion, growing from $11.1 million in 2006 to $2.2 billion in 2050. Under this scenario, PILOTs make up the majority of expected revenues, accounting for 55.5% of revenues over the time period followed by tax-equivalency payment revenues at 40.6%. PILOT revenues begin in 2012, amounting to about $14 million, reach about $500 million by 2031, and more than a billion annually from 2044-2050. Tax-equivalency payment revenues start out in 2007 at about $2.7 million, expand to more than $100 million annually by 2020, and grow continuously to 2050 where they amount to just over $1 billion.

Under the cyclical scenario outlined above, revenues dedicated to HYIC from new real estate development are expected to fall below the base scenario total by about $4.5 billion, and grow from $11.1 million in 2006 to $2.0 billion in 2050. Like the base scenario, under this scenario PILOTs make up the majority of expected revenues, accounting for 50.0% of revenues over the time period followed by tax-equivalency payment revenues at 41%. PILOT revenues also begin in 2012 amounting to about $6 million, reach about $500 million by 2033, and more than $1 billion annually from 2047-2050. Tax-equivalency payment revenues start out in 2007 at about $2.7 million, expand to over $100 million annually by 2022, and grow continuously through 2050, when they will generate $887.5 million annually.

Under the more conservative scenario, New York City is expected to pay a portion of the interest payments required on the bonds through 2016. It is anticipated at that time that sufficient HYIC revenues will be available to pay interest only on the bonds through about 2022 and begin reducing principal in 2023. Conversion is projected to occur in 2027, when a fixed maturity schedule on the bonds will be formulated. At that point, HYIC revenues will provide at least 1.25x coverage of debt service.

Under this scenario there would be about 15.3 million of the 27.4 million square feet of commercial space developed, including 13.5 million square feet of office space, which would require the development of between eight to 10 buildings. About 91% of residential space would also have to be developed by 2027 for this to occur.

Economy: City Has Seen Strong Performance

Population trends in New York City through 2000 were very strong, with growth recorded in each of the city's five boroughs. U.S. Census Bureau figures for 2000 showed population exceeding eight million--an increase of 9.4% over 1990 levels. This growth was much more robust than in other metropolitan areas in the state and region. The city's well-above-average income levels remain a credit strength, with 2004 personal income about 22% above the national level. After a period of decline due to the recession, personal income growth has accelerated and is expected to average 5% annually in 2006-2010.

New York City continues its role as a major global center for finance, commerce, tourism, and retail activity, and is the largest employment center in the country. The city's economy is centered on service producing employment sectors, which account for 78% of total employment compared with the U.S. average of 67% for this sector. The city's employment mix is diverse within the service sector, with education and health services accounting for 18.7% of employment; trade, transportation, and utilities accounting for 15.2%; professional and business services 15.3%; and financial activities 12.3%. On the earnings side, the city is less diverse, with the financial sector accounting for nearly one-third of total earnings. This concentration has always contributed to some level of revenue volatility related to industry performance, and has been a factor in the city's credit rating over time.

The city's tax base is diverse and has experienced steady growth. The residential market has been strong, with steady appreciation of property values. The city's assessed value base for fiscal 2007 is projected to be $116.5 billion, which is a 23.2% increase over 2003. The fiscal 2007 full valuation is estimated at $621 billion, which represents a strong 84% increase over fiscal 2001. Manhattan is a vital part of the city's economic structure. On a market value basis, it represents 33.4% of city's total tax base. The city's tax base is diverse. Utility properties represent 9.9% of the base, while the 10 leading nonutility properties in the city represent about 2% of the total assessed value base. Commercial vacancy rates have steadily declined since the 2001 recession, and were 9.4% in 2005; they are forecasted to decline again in 2006 to 7.7%, well below the 12% recorded in 2004. Vacancy rates are forecasted to decline steadily through 2010 to 6.9%. Rental rates have also increased, and growth is expected to average 4.1% through 2010.

New York City recorded employment declines in 2001-2003, with a total decline of 5.1% from the peak employment reached in 2000. Employment growth resumed in 2004 and 2005 with 0.5% and 1.4% growth recorded, respectively. Healthy growth of 1.5% is forecasted for 2006, but employment gains are expected to level off and grow at a slower pace of 0.6% in 2007 and 0.7% in 2008 based on the city's current economic assumptions. Job gains were strong throughout the service sector. Unemployment rates peaked at 8.4% in 2003 compared with the low of 5.7% recorded in 2000. The most recent report by New York State Department of Labor indicates that the city's unemployment rate declined to o 4.1% in October 2006, its lowest level on record. Gross city product increased by 3.7% in 2005, which was higher than originally expected; growth of 2.3% is forecasted in 2006.

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