FitchRatings

# FITCH RATES BUFFALO, NY'S LTGOS 'A+'; OUTLOOK STABLE

Fitch Ratings-New York-01 April 2013: Fitch Ratings assigns an 'A+' rating to the following city of Buffalo, New York (the city) obligations:

--$7,560,000 refunding (serial) bonds - 2013.

Proceeds will be used to refund the refunding serial bonds - 2004-A for present value savings. The bonds are scheduled for negotiated sale the week of April 9.

In addition, Fitch affirms approximately $92.4 million of the city's outstanding limited tax general obligation (LTGO) bonds and $131.9 million of the city's outstanding unlimited general obligation (ULTGO) bonds at 'A+'.

The Rating Outlook is Stable.

SECURITY

The current issue and the series 2011E, F, G, and the 2012A, B, C and D bonds are general obligations of the city for which it has pledged its full faith and credit, subject to the 2011 state statute limiting property tax increases to the lesser of 2% or an inflation factor (the tax cap law). This limit can be overridden by a 60% majority vote of the city common council. The city has pledged its full faith and credit and unlimited taxing power for debt service on outstanding GO bonds issued prior to these bonds. No exemption is made under the tax cap law for debt service on outstanding GO debt; however, the constitutionality of this provision has not been tested.

The bonds are further secured by a semi-annual segregation and deposit with the trustee of first available property taxes to pay all debt service for the subsequent six months. The bonds also benefit from a New York state intercept, which requires the state comptroller to withhold subsequent state aid payments in the event of a default by the city.

KEY RATING DRIVERS

SOUND FISCAL FOUNDATION: The Buffalo Fiscal Stability Authority (BFSA) a state-imposed oversight entity in place since 2003, helped the city restore a sound fiscal foundation, resulting in much improved reserve levels.

SWITCH FROM HARD TO SOFT CONTROL: BFSA recently transitioned from a control period to an advisory period, reflecting fundamental financial improvement. Fitch expects the city to maintain the financial discipline previously required by BFSA.

FUND BALANCE DRAWS: The city is budgeting for a notable decline in fund balance for the third year in a row, due to increased salary and pension costs. The city's four-year forecast projects large draws ending in fiscal 2014. Maintenance of adequate reserves could be a challenge in the out years.

ECONOMIC GROWTH DESPITE DOWNTURN: The economic base is diverse and continues to experience commercial and residential development despite the continued economic downturn.

BELOW AVERAGE SOCIOECONOMIC INDICATORS: Socioeconomic indicators are weak with below average income levels, high individual poverty rates, and high unemployment rates.

ELEVATED UNFUNDED OPEB LIABILITY: An elevated burden of unfunded other post-employment benefit (OPEB) liabilities is notable.

NO RATING DISTINCTION FOR LT DEBT: The bonds are rated on parity with outstanding debt as the city may exceed the property tax cap in any one year with 60% approval of the common council.

RATING SENSITIVITIES

RESTORATION OF STRUCTURAL BALANCE: The rating is sensitive to the city's ability to reduce its reliance upon use of budgeted reserves for operations in fiscal 2014 and beyond.

CREDIT PROFILE

Buffalo is located in upstate New York near the Canadian border and is the second largest city in the state. The city benefits from cross-border tourism, and retains a fairly large manufacturing presence. Population has experienced chronic declines over the past few decades, including an 11% loss in the past decade, and now stands at about 260,000 residents.

ECONOMIC GROWTH DESPITE DOWNTURN

The city has a deep and diverse economic base that benefits from its proximity to Canada with consistent tax base growth for the past five years. Notable economic anchors include Buffalo-Niagara Medical Campus (BNMC), Erie County Medical Center Corporation, Kaleida Health, and the State University of Buffalo. In particular, BNMC, which employs roughly 12,000 people, has over $500 million in new projects planned and is expected to add 4,000 new employees in the near future.

Numerous other economic development projects are in various stages, including a casino and other downtown and waterfront projects which, if successful, should further enhance employment opportunities. The city has also recently seen spending growth by residents of nearby Canadian provinces.

BELOW AVERAGE SOCIOECONOMIC PROFILE

Socioeconomic indicators are below average with per capita income levels at 63% and 72% of the state and national levels, respectively. Poverty rates are more than double the statewide average, and the city's unemployment rate has been persistently above the state and national averages over the past decade.

While the regional economy has experienced some service sector employment growth, the increase has not been sufficient to counter declines in the manufacturing sector, resulting in overall employment declines.

The most recent monthly unemployment figure (not seasonally adjusted) for December 2012 was 10.3%, an increase over the 10.1% recorded a year prior. The increase is mainly attributable to an increase in the labor force over the past year, as the employment figure has remained relatively stable. The 10.3% for December 2012 remains well above the state rate of 8.2% and the U.S. rate of 7.6% for the same period.

FINANCIAL OPERATIONS IMPROVED DURING BFSA CONTROL PERIOD

The city experienced financial pressures early in the past decade, resulting in chronic fiscal imbalance and ultimately a strain on liquidity. Consequently, in 2003, state lawmakers created the BFSA to facilitate financial reforms within the city. From inception, the authority operated as a hard control board, and as such its powers included the ability to invalidate union contracts, impose wage and hiring freezes, and approve budgets and debt issuances.

The authority moved to an advisory role on July 1 as the city had achieved predetermined benchmarks. The hard control period can be reimposed if certain fiscal conditions are not maintained. Fitch looks favorably on management's plans to codify many of the policies required by the BFSA so that best practices remain in place regardless of the nature of the oversight board.

The city achieved operating surpluses every year from fiscal 2003 through fiscal 2010. During this period, the general fund unreserved fund balance improved from $9.7 million or 2.6% of expenditures and transfers out to over $110 million or 24.5%.

DEFICIT OPERATIONS IN FY 2011 and 2012

The city recorded a $12.8 million net operating deficit after transfers (2.8% of spending) in fiscal 2011, and a larger $16.3 million net operating deficit after transfers (3.5% of spending) in fiscal 2012. The planned fund balance draws were driven by a reduction in tax rates, a decrease in state aid, and increased salary and pension costs. Fitch notes that both deficits partially resulted from the city prudently reserving funds for the resolution of several unsettled labor contracts.

The fiscal 2012 unrestricted general fund balance (the sum of the unassigned, assigned and committed fund balance under GASB 54) declined to $77.7 million or a still adequate 16.6% of spending. The unrestricted fund balance includes the city's policy mandated rainy day fund (equal to a minimum of 30 days of total general fund expenditures or approximately $35 million). The rainy day fund may be used for certain unforeseen events with approval from various government officials.

ADDITIONAL FUND BALANCE DRAWS PROJECTED

The city's fiscal 2013 budget includes an $11.5 million fund balance draw, reducing the unrestricted fund balance to approximately 13% of expenditures. The budget includes 2% growth in sales tax revenues, a $7.4 million increase in pension payments, and an $18.7 million spin-up payment from the state. The spin-up is the acceleration of a March 2014 payment from the state to June 2013, so the city benefits from the payment in fiscal 2013 while the state is unaffected, as the payment remains within its 2014 fiscal year. State aid is expected to revert to approximately its prior level in fiscal 2014.

The city's four-year financial plan features additional fund balance appropriations, though these are much smaller beginning in fiscal year 2014. These appropriations were approved before the change in status of BFSA and should not cause BFSA to revert to its prior hard control status. Management plans to continue its policy of maintaining or reducing tax rates through fiscal year 2014, which will present a budgetary challenge. The ability of the city to meet its goals of reducing its reliance upon budgeted reserves and restore structural budgetary balance will be important credit considerations. As projected in the financial plan, unrestricted fund balance could be drawn down below $54 million or less than 11% of expenses and transfers, levels which Fitch believes could impair the city's ability to stay at its current rating level.

MODERATE DEBT & PENSION BURDENS WITH HIGH OPEB LIABILITY

The city's overall debt burden is elevated, but manageable at $1,630 per capita and 6.3% of market value. Total debt outstanding has declined consistently since fiscal 2002. Future debt needs are modest with annual issuance below the amount of debt amortized, and principal amortization is strong with 93% retired in 10 years.

Buffalo's long-term liabilities related to employee benefits are notably high. Employees participate in well-funded state-sponsored defined benefit pension plans, and the city has made all required pension payments to the state. Payments have been increasing and are expected to rise again for fiscal 2013.

As of July 2010, the city's other post-employment benefits (OPEB) liability totaled $1.6 billion or a very high 24% of market value. The city currently funds its liability on a pay-go basis. Total carrying costs for debt, pension and OPEB claimed a high 27.3% of governmental fund spending (net of capital projects).

Contact:

Primary Analyst
Arlene Bohner
Director
+1-212-908-0554
Fitch Ratings, Inc.
One State Street Plaza
New York, NY 10004

Secondary Analyst
Eric Friedman
Director
+1-212-908-9181

Committee Chairperson
Marcy Block
Senior Director
+1-212-908-0239

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available at 'www.fitchratings.com'. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, University Financial Associates, S&P/Case-Shiller Home Price Index, IHS Global Insight, Zillow.com, National Association of Realtors.

Applicable Criteria and Related Research:
--'Tax-Supported Rating Criteria' (Aug. 14, 2012);
--'U.S. Local Government Tax-Supported Rating Criteria' (Aug. 14, 2012).

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Tax-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. Local Government Tax-Supported Rating Criteria
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