

## **FITCH UPGRADES CITY OF BUFFALO, NY'S IDR AND GO TO 'AA-'; OUTLOOK STABLE**

Fitch Ratings-New York-14 November 2016: Fitch Ratings has upgraded the following City of Buffalo, NY ratings to 'AA-' from 'A+':

- \$81 million unlimited tax general obligation (GO) bonds;
- \$151 million limited tax GO bonds;
- Issuer Default Rating (IDR).

The Rating Outlook is Stable

### **SECURITY**

The outstanding 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.

### **KEY RATING DRIVERS**

The upgrade to 'AA-' of the IDR and GO rating reflects the application of Fitch's U.S. Tax-Supported

Rating Criteria, published April 18, 2016. The city's history of modest revenue growth is expected to benefit from ongoing economic development activities spurred by both state and private investment. The long-term liability burden is low compared to the city's personal income; however, carrying costs for pension, debt service and other post-employment benefits (OPEB) are elevated and account for more than 25% of governmental expenditures. The city's operating performance has been sound and reflects management's conservative budgeting practices and proactive fiscal management.

### **Economic Resource Base**

The city of Buffalo is the second largest city in New York and serves as the county seat of Erie County. The city is located on the western border of upstate New York on the shores of Lake Erie near the Canadian border; Buffalo benefits from cross-border tourism and also retains a fairly large manufacturing presence. The city's economic profile is characterized by its comparatively low income and high poverty, as well as a slowly declining population. The estimated 2015 population of 258,071 has experienced a modest drop since the 2010 Census.

### **Revenue Framework: 'aa' factor assessment**

The city has independent legal ability to raise property tax revenues given that the legislature can override the tax levy cap with a 60% majority. Fitch expects revenue growth to remain slow in the near term based on historical trends, although ongoing investments are expected to boost revenue trends over time.

### **Expenditure Framework: 'a' factor assessment**

Fitch expects the natural pace of expenditure growth to be marginally above revenue growth absent policy action. Expenditure flexibility is adequate despite the city's significant cost cutting measures in prior years, given the capacity to consolidate government functions. Carrying costs for debt service pension and other post-employment benefits (OPEB) accounted for one quarter of governmental expenditures in fiscal 2015.

#### Long-Term Liability Burden: 'aaa' factor assessment

The long-term liability burden is low compared to the city's resource base. Debt and pension liabilities account for approximately 6% of personal income

#### Operating Performance: 'aa' factor assessment

The city has solid financial resilience due to its healthy available general fund reserves and strong gap closing ability to offset the potential effects of a moderate economic downturn.

#### RATING SENSITIVITIES

Ability to Weather Downturns: The city's ability to maintain satisfactory budgetary resiliency through a downturn given its relatively limited spending flexibility will be critical to maintaining the rating. The city has been the recipient of significant state development aid, which is expected to have a positive impact on the city's future revenue growth prospects.

#### CREDIT PROFILE

The city's economy is anchored by Buffalo-Niagara Medical Campus (BNMC), Erie County Medical Center Corporation, Kaleida Health, and the State University at Buffalo. BNMC is a consortium of education and research institutions which employs approximately 12,000 people and currently has several new projects under construction including a bioresearch facility and the expansion of Kaleida Health's Women and Children's hospital. These healthcare projects are expected to add roughly 5,000 new employees in the near future. Another notable development is the investment in advanced manufacturing and the production of solar panels by the company Solar City, which is expected to add 3,000 permanent jobs. Fitch believes these projects, in conjunction with the state's multiyear commitment to the region to provide \$1 billion of economic development incentives, is likely to reverse, or at least stem, the trend in job losses.

#### Revenue Framework

Buffalo derives its general fund revenue primarily from intergovernmental revenue including state aid, the city's portion of sales tax revenue, and payments from the Seneca Nation's tribal agreement and mortgage taxes (combined accounted for almost 60% of budgeted revenue in fiscal 2015). Property taxes accounted for approximately 30% of revenues.

Revenue growth over the past 10 years through 2014 has been below the rate of inflation. Although growth in local revenues has been slow, taxable assessed values (AV) were very stable throughout the last economic recession. Fitch believes that the city's growth in local revenues will continue to trend below the rate of inflation in the near term; however, the ongoing economic development and accompanying AV expansion could improve the city's revenue growth prospects.

New York State law requires property tax revenue increases be limited to the lesser of CPI or 2% annually, unless a supermajority of the local governing body votes for a larger increase. The ability to override the cap provides substantial legal flexibility to raise revenues. Additionally, the city has the ability to increase other fees and departmental revenue.

#### Expenditure Framework

Public safety and education are the city's largest expenditure items, accounting for approximately 30% and 16% of fiscal 2015 general fund spending, respectively.

Fitch expects expenditure growth to increase above the rate of revenues absent policy action. Like most governments, the main cost drivers are contractual salary increases and employee benefits. The city's 3,123 employees are covered by eight collective bargaining agreements. Four of its largest labor unions (including police, fire, blue collar and white collar units) recently reached agreements, providing a notable amount of certainty to near and intermediate term labor costs. The

white and blue collar union agreements included retroactive pay increase to 2011, and the average annual salary increase for all new contracts is slightly above inflation.

The Buffalo Board of Education, a component unit of the city, recently settled a long-running teacher contract dispute. The contract did not include any retroactive pay increases, but did include a 10% wage hike for 2016 to bring salaries in line with competitive rates. Salary increases in 2017 and 2018 are modest at 2%, and the city negotiated cost saving concessions including changes to health care benefits.

The city's flexibility of main expenditure items is adequate. Carrying costs for debt service pension and other post-employment benefits (OPEB) account for approximately 25% of governmental expenditures. The city's contributes 16% of its general fund appropriation to the Board of Education, which further limits its ability to reduce general fund expenditures. Despite significant cost reductions in the early 2000s due to financial stress, management retains some control over labor costs (primarily through attrition). The city has additional opportunities to consolidate government functions for savings.

#### Long-Term Liability Burden

The city's long-term liability burden (debt and retiree benefit obligations) is low and compromises approximately 6% of the city's personal income. The majority of the debt is direct GO debt issued by the city, including school district debt issued on behalf of the Board of Education. The city has modest future borrowing plans, largely to fund infrastructure maintenance for streets and cityscapes.

The city participates in two well-funded state-sponsored defined benefit pension plans; the Employees Retirement System (ERS) and Local Police and Fire Retirement System (PFRS). The city makes all required actuarial pension payments to the state. The ratio of the plans' proportionate share net position to pension liability is approximately 83% with a 7% return on assets assumption.

As of July 2014, the city's other post-employment benefits (OPEB) liability totaled \$1.4 billion or a very high at approximately 26% of personal income. The city currently funds its liability on a pay-go basis. The new labor contracts with the white and blue collar unions eliminated post-employment health care for new hires. The change produces no near-term budgetary savings but will minimize the growth in the city's long term OPEB liability.

#### Operating Performance

The city's has solid financial resilience given its ability to close budget gaps in the event of a moderate economic downturn including the legal ability to increase revenues above the state tax cap. The city has not increased the tax rate above the cap in prior years, relying instead on streamlining operations to reduce expenditures. The current available reserves provide a sound financial cushion against what would likely be moderate revenue volatility in a typical economic downturn.

The city has maintained healthy available reserves since fiscal 2008 after a period of financial pressures early in the past decade that resulted in chronic fiscal imbalance and ultimately a strain on liquidity. State lawmakers in 2003 created the Buffalo Fiscal Stability Authority (BFSA) to facilitate financial reforms and exercise significant control over the city's finances, including the ability to invalidate union contracts, impose wage and hiring freezes, and approve budgets and debt issuances. The authority moved to an advisory role in 2012 as the city had achieved predetermined benchmarks. Fitch looks favorably on management's efforts to codify many of the policies required by the BFSA so that best practices remain in place.

The city had a \$4.8 million increase in general fund balance in fiscal 2015, which increased the available general fund balance to 24% of general fund expenditures. City officials report positive preliminary results for fiscal 2016 due to expenditure savings from reductions in employee salaries, lower energy costs and health care plan changes. The current projection comfortably exceeds budget and includes an available fund balance of approximately 23% of expenditures. The fiscal 2017 budget maintains spending levels and does not include a property tax increase.

From fiscal 2008 through fiscal 2016 the city did not issue revenue anticipation notes to supplement cash flow gaps given the increase in the city's overall cash position.

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In addition to the sources of information identified in the applicable criteria specified below, this action was informed by information from Lumesis and InvestorTools.

#### Applicable Criteria

U.S. Tax-Supported Rating Criteria (pub. 18 Apr 2016)

<https://www.fitchratings.com/site/re/879478>

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