

RatingsDirect®

Buffalo, New York; General Obligation; School State Program

Primary Credit Analyst:

Lindsay Wilhelm, New York (1) 212-438-2301; lindsay.wilhelm@standardandpoors.com

Secondary Contact:

Linda Yip, New York (1) 212-438-2036; linda.yip@standardandpoors.com

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US\$24.504 mil GO bnds due 04/01/2022		
Long Term Rating	A+/Stable	New
Buffalo GO		
Long Term Rating	A+/Stable	Upgraded

Rationale

Standard & Poor's Ratings Services has raised its long-term and underlying rating on Buffalo, N.Y.'s general obligation (GO) bonds outstanding one notch to 'A+' from 'A'. The upgrade is based on our local GO criteria released Sept. 12, 2013.

At the same time, Standard & Poor's assigned its 'A+' long-term rating to Buffalo's series 2014 general improvement GO bonds. The outlook on all ratings is stable.

The city's faith and credit GO pledge secures the 2013 bonds. Debt service on the bonds is payable from a capital debt service reserve fund, held by a trustee, and funded by a first set-aside of property tax collections. We understand that officials plan to use bond proceeds to redeem bond anticipation notes (BANs) outstanding and provide new money for capital projects. Concurrent with the bonds, the city also plans to issue \$8.7 million in BANs.

The 'A+' rating reflects our view of Buffalo's:

- Adequate economy in western New York supported by education and medical institutions that are experiencing significant investment through state-sponsored initiatives;
- Adequate budgetary flexibility, with very strong reserves, offset by what we consider limited revenue and expenditure flexibility;
- Weak budgetary performance in fiscal 2013 after adjusting for nonrecurring revenues and expenditures;
- Very strong liquidity, with strong access to external liquidity;
- Very strong management conditions, with strong financial management policies and practices and oversight provided by the Buffalo Fiscal Stability Authority (BFSA), which is currently in an advisory mode;
- Very weak debt and contingent liability profile when pension and other postemployment benefits (OPEB) are considered.

Adequate local economy

Buffalo is in Erie County, in western New York on Lake Erie. Historically a manufacturing-based economy, the city has recently embarked on a structural shift to the medical and education sectors. The population has fallen approximately 25% since 1990 to an estimated 257,377. Projected per capita effective buying income is 67.3% of the national average. Property values have shown stability, and continue to increase modestly. Market value per capita is what we consider very low, however, at \$26,152. Erie County's unemployment rate averaged 8.3% in 2012, similar to the

national rate.

A number of development projects centering on health care and high-tech manufacturing are currently in progress, however, and could add to the city's employment, tax base, and income levels in the long term. The Buffalo-Niagara Medical Campus is undergoing significant investment and anchoring much of the development. The site is adjacent to downtown and is already home to Buffalo General Hospital, the University at Buffalo's Clinical and Translational Research Center, the Roswell Park Cancer Institute, and the Hauptman-Woodward Medical Research Institute. The campus currently has 12,000 employees and is expected to grow to 17,000 by 2016. Current investments include the Kaleida Women and Children's Hospital (\$250 million); the State University of New York (SUNY) Buffalo Medical School expansion (\$375 million); and the Albany Molecular Research Facility (\$100 million). In addition, the state has pledged to invest more than \$1 billion in the Buffalo Regional Innovation Cluster, with \$225 million dedicated to the Buffalo High-Tech Manufacturing Innovation Hub at River Bend, which is a \$1.7 billion total investment, including \$1.5 billion in private funding from the clean energy companies Soraa and Silveo. The investment is expected to create 850 jobs. IBM also recently announced plans to add 500 jobs at a state-owned computer technology information center. We believe that these facilities, coupled with the presence of higher education, including SUNY Buffalo and other local universities, add stability to the local economy.

Adequate budgetary flexibility

We consider Buffalo's budgetary flexibility adequate, with very strong reserve levels offset by what we consider its limited revenue-raising flexibility. At the close of fiscal 2013, the city's available general fund reserves, including funds committed for economic stabilization, totaled \$130 million, representing 29% of adjusted general fund expenditures. Buffalo benefited from a significant surplus of \$52 million in fiscal 2013, due, in large part, to several nonrecurring revenues. The city's adopted fiscal 2014 budget appropriated \$12 million of reserves. While the city has experienced positive revenue and expenditure variances during the year, officials expect to draw down approximately \$14.5 million after adding additional items to the fiscal 2014 budget. We estimate that even with the drawdown, the city would still maintain available reserves at more than 20% of expenditures.

We believe that Buffalo's very strong reserve position is offset by its limited revenue-raising flexibility and a significant fixed cost burden: The city depends on state aid for a large share of its general fund revenue (43% in 2013), and as it is one of New York's Big Four cities with dependent school districts, we believe that the city's constitutional taxing margin (2% of the five-year average full valuation) is pressured relative to that of other cities for which the school districts have independent taxing power. The city is currently at 76% of its constitutional taxing margin, which has benefited from its recent tax stabilization measures. In addition, given Buffalo's pension, OPEB, and debt service representing 27% of expenditures, plus a backlog of unsettled union contracts for most of its largest collective bargaining units, we believe that its ability to cut expenditures is somewhat limited.

Weak budgetary performance

Despite an audited general fund surplus in fiscal 2013, we consider the city's budgetary performance weak after adjusting for significant, nonrecurring items including: a state aid payment spin-up (\$18.5 million); receipt of retroactive payments from the Seneca Nation (\$16 million); and the release of funds set aside for labor contract awards following settlement (\$32 million). After adjusting for these and other items, we estimate a general fund deficit of 2.5% of expenditures and a total governmental funds deficit of 3% of expenditures. The city's projected fiscal 2014

drawdown equates to approximately 3% of expenditures. Given the city's very strong reserve position, built up through eight straight years of positive operating results between fiscal years 2003 and 2010, officials have committed to tax stabilization through at least fiscal 2015, which has pressured Buffalo's recent structural performance. However, based on recent history, the city generally outperforms its budget.

Buffalo's current four-year financial plan, approved by BFSA on June 19, 2013, projects a deficit of \$12 million in fiscal 2014, decreasing to between \$2 million-\$6 million in the next three fiscal years. The plan assumes strict expenditure controls to offset rising pension and health benefits, and limits budgetary growth to 1% and property tax levy growth to 2%. However, given the city's continued commitment to tax stabilization in 2015, we believe that projections could weaken if tax base growth does not occur, or offsetting measures are not taken. Although we believe that the city's revenue assumptions are generally conservative, it is our opinion that budgetary risks remain, especially with respect to the limited room for budget growth and the backlog of unsettled union contracts (though we believe that the city is making progress in the settlement and arbitration process).

Very strong liquidity

Buffalo's liquidity position has improved significantly since fiscal 2002, which has eliminated the need for cash flow borrowing since fiscal 2007. Total governmental cash was 87% of expenditures and nearly 8x debt service in fiscal 2013. We believe that Buffalo has strong access to external liquidity based on its frequent GO issuance. The city does not have any tender option debt that would contribute to liquidity or refinancing risk. While most of its labor contracts have been expired for several years, the city has set aside reserves for settlement and maintains the capacity to bond for retroactive payments. Therefore, given the city's very strong cash position, we would not expect a retroactive settlement to have a significantly detrimental impact on Buffalo's liquidity.

Strong management conditions

We consider Buffalo's management practices "strong" under our Financial Management Assessment. This indicates that practices are comprehensive and sustainable. It should be noted that many of the policy enhancements were put in place after the BFSA came into the picture, and that the city's management has adopted them into its operating practices even after BFSA moved to an advisory mode.

Very weak debt and contingent liability profile

Buffalo's overall net debt burden, including BFSA and school debt (net of state building aid), represents 49% of net revenue. Debt service carrying charges were 11% of expenditures in fiscal 2013. The city plans to issue between \$15 million and \$18 million of additional debt in the next two years to fund its capital improvement program, which is less than planned amortization. We estimate that 64.6% of the city's debt will retire in 10 years. Overall net debt is 5.1% of market value.

We consider Buffalo's pension and OPEB obligations significant: the combined pension annual required contribution and OPEB pay-as-you-go payments represented 16.1% of governmental expenditures in fiscal 2013. However, the city continues to make its full pension contributions and has not chosen to amortize its pension contributions as allowed by the state.

We consider the Institutional Framework score for New York cities (other than New York City) as "strong" (see "Institutional Framework Overview: New York Local Governments," Sept. 12, 2013).

Outlook

The stable outlook reflects our view of Buffalo's very strong reserve position and the state-supported economic development underway in the city and the region. For these reasons we do not expect to change the rating during the two-year outlook horizon. Although we consider upward rating potential limited at this point, a significant deterioration in the city's reserve position, to levels less than those we consider very strong, could lead to our lowering the rating, given the city's limited revenue-raising flexibility and high fixed costs.

Buffalo Fiscal Stability Authority

BFSA was created by the New York State legislature in 2003 and is administered by a nine-member board of directors, seven of whom the governor appoints. The statute allows the authority to issue sales tax bonds with a double-barreled state municipal aid intercept mechanism. The city has \$88 million in debt outstanding through BFSA, with final maturity in 2023.

The legislation creating the authority specifies two modes: a control period and an advisory period. Effective July 1, 2012, BFSA transitioned to an advisory mode from the control period that it had been in since 2003.

The authority's transition was based on its determination that Buffalo had met the provisions of the BFSA Act, including: achieving three sequential balanced budgets (absent financial assistance from the board); and joint certification by both the city and state comptroller that Buffalo has issued debt in the previous fiscal year and that there is a substantial likelihood of future market access. In the advisory mode, BFSA will continue to review and comment on the city's four-year financial plans; monitor compliance with the plan; and review and comment on the impact of proposed debt issuances and collective bargaining agreements -- only two of Buffalo's eight, and one of the school board's eight bargaining units are in contract, and several lawsuits related to the 2004 BFSA-imposed wage freeze, and arbitration awards are pending. Buffalo is required to respond publicly to the board's recommendations. A control period could be imposed again at any time if the city:

- Fails to submit or maintain a balanced budget and reasonable financial plan, as required by the act;
- Fails to pay principal or interest on its debt; or
- Incurs an operating deficit of 1% or more in its major operating funds during its fiscal year.

During a control period, BFSA has the power to:

- Set a limit on the maximum level of spending for any proposed city budget;
- Impose hiring or wage freezes; review and approve any proposed collective bargaining agreement Buffalo enters;
- Participate in the binding arbitration process; review and approve contracts, including debt issuance;
- Perform audits and management reviews of city operations or any related organization (including the school district); and
- Take any action necessary to implement the financial plan.

Effective July 1, 2012, the BFSA transitioned to an advisory period from a control period after determining that Buffalo had met all of the necessary provisions of the BFSA Act. The authority had been in a control period since its inception

in 2003. In the advisory mode, BFSA will continue to review and comment on the city's four-year financial plans; monitor compliance with the plan; and review and comment on the impact of proposed debt issuances and collective bargaining agreements

Buffalo City School District

The city issues debt on behalf of the Buffalo City School District. The district is a legally separate component entity of the city, maintaining independent accounts and managing its own appropriations. The Buffalo City Council must approve the district's budget and levy and collect real property taxes and issue debt on its behalf. The city provides about 10% of the district's general fund revenue, with state aid, at \$634 million, accounting for the bulk at 84%. Combined district debt, issued through Buffalo, the Municipal Bond Agency, and the Joint School Construction Board, totals \$1.4 billion. The New York state aid intercept program also secures the school district debt, and state building aid offsets almost all of the debt. At fiscal 2013 year-end, the district had \$201 million in total fund balance, representing 30% of expenditures, which we consider very strong. The district is expecting a fourth consecutive operating drawdown in fiscal 2014, of approximately \$25 million. Like Buffalo, the district continues to face pressure from litigation over the BFSA-imposed wage freeze.

Buffalo City School District also submits a four-year plan, which shows gaps (before the use of reserves) of \$31 million in fiscal 2014, \$39 million in 2015, \$46 million in 2015, and \$49 million in 2016 prior to gap-closing measures. The district had \$208 million of fund balance at the end of fiscal 2013. Gap-closing measures include building closures, attrition, staff reductions, and cost-saving initiatives.

Related Criteria And Research

Related Criteria

- USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013
- USPF Criteria: State Credit Enhancement Programs, Nov. 13, 2008

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Institutional Framework Overview: New York Local Governments, Sept. 12, 2013

Ratings Detail (As Of March 6, 2014)		
Buffalo GO State Credit Enhancement		
<i>Long Term Rating</i>	A+ / Stable	Upgraded
<i>School Issuer Credit Rating</i>	A+ / Stable	Upgraded
Buffalo GO State Credit Enhancement (AGM)		
<i>Unenhanced Rating</i>	A+(SPUR) / Stable	Upgraded
<i>School Issuer Credit Rating</i>	A+ / Stable	Upgraded
Buffalo GO (BAM)		
<i>Unenhanced Rating</i>	A+(SPUR) / Stable	Upgraded
Buffalo GO		

Ratings Detail (As Of March 6, 2014) (cont.)

<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Upgraded
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Buffalo GO State Credit Enhancement

<i>School Issuer Credit Rating</i>	A+/Stable	Upgraded
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<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Upgraded
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<i>Long Term Rating</i>	A+/Stable	Upgraded
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Many issues are enhanced by bond insurance.

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