MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns A1 and stable outlook to the City of Buffalo's (NY) $7.6 million G.O. bonds and a MIG1 rating to $17.8 million in Bond Anticipation Notes, Series 2013

Global Credit Research - 01 Apr 2013

Affirms A1 general obligation rating on outstanding debt

BUFFALO (CITY OF) NY
Cities (including Towns, Villages and Townships)
NY

Moody's Rating

ISSUE		RATING
Refunding (Serial) Bonds, 2013 (Federally Taxable)		A1
Sale Amount	$7,560,000	
Expected Sale Date	04/08/13	
Rating Description	General Obligation	
Bond Anticipation Notes, 2013		MIG 1
Sale Amount	$17,800,000	
Expected Sale Date	04/08/13	
Rating Description	Note: Bond Anticipation	

Moody's Outlook STA

Opinion

NEW YORK, April 01, 2013 --

Moody's Investors Service has assigned an A1 rating with a stable outlook to the City of Buffalo's (NY) $7.6 million Refunding (Serial) Bonds - 2013 (Federally taxable) and a MIG 1 rating on $17.8 million Bond Anticipation Notes - 2013. The bonds and bans are general obligations of the city as limited by the Property Tax Cap Act (Chapter 97 (Part A) of the Laws of the State of New York, 2011. Concurrently, Moody's affirms the A1 rating with a stable outlook on all rated debt secured by the city's general obligation pledge. Proceeds of the bonds will refund the city's Refunding Serial Bonds - 2004-A (Federally Taxable) with an estimated net present value savings of 7.4% and no extension of maturity. The Bond Anticipation Notes (BANs) will provide original financing for various capital improvements around the city the largest of which is for infrastructure improvements.

SUMMARY RATINGS RATIONALE

The A1 rating reflects the city's overall solid reserves and liquidity despite current declines and structurally imbalanced budgets in the multi-year plan. The rating also factors: (1) challenges posed by the city's below average demographic profile; (2) a high debt burden that is expected to gradually moderate; (3) the challenges posed by open employee contracts (4) the oversight of city operations by the Buffalo Fiscal Stability Authority (BFSA, sales tax and state aid secured bonds rated Aa1), which has approved the city's four-year financial plan; (5) the city's improved revenue raising flexibility given modest growth in assessed valuation and improved taxing margin; and (6) additional bondholder security provided by the city's legally required and trustee-held bi-annual set-aside of debt service payments from first property taxes collected.

The stable outlook reflects Moody's belief that the city's liquidity and reserve position will remain adequate, evidenced by elimination of the need for seasonal cash flow borrowing in the last five fiscal years. The currently healthy cash position is expected to provide satisfactory cushion against near-term fund balance and liquidity declines.

Effective January 1, 2012, all local governments in New York State are subject to a property tax cap which limits levy increases to 2% or the rate of inflation, whichever is lower. While school district debt has been exempted from the cap, debt has not been exempted for all other local governments. Moody's believes that the risks associated with the property tax cap remain unchanged and we do not foresee making a rating distinction between debt not subject to the cap. For more information regarding the property tax cap please reference the Special Comment "New York Local Governments' Debt Under New Property Tax Cap to Be Rated the Same as Unlimited Tax General Obligation Debt " released May 14, 2012.

STRENGTHS:

-State oversight board provides third-party supervision of city's finances

-Conservative budget and strong management have led to solid reserve position and liquidity

-Direct pay of first-in property tax money to the trustee for payment of debt service

CHALLENGES:

-Uncertainty around outstanding union contracts and pending litigation

-State aid cuts could put significant pressure on city's finances

-BFSA has moved to an advisory role

DETAILED CREDIT DISCUSSION

LACK OF SHORT-TERM DEMONSTRATED MARKET ACCESS OFFSET BY OVERALL CREDIT PROFILE

The city is a frequent debt issuer with a strong history of favorable market access however it has not issued notes on its own in the past five years. On three long-term bond issuances from 2012 the city had four, five and six competitive bids. Offsetting the lack of short-term note issuance is the city's overall credit profile, including oversight of city finances by BFSA and ample liquidity. Given the city's overall credit profile Moody's expects that the city will be able to refinance the notes at maturity on April 30, 2014.

HEALTHY RESERVES AND CONSERVATIVE MANAGEMENT PROVIDE BUFFER AGAINST NEAR-TERM RISKS

Moody's believes the city's financial flexibility and liquidity will remain strong given strong financial management, solid financial policies, oversight of budgets and multi-year plan despite current and projected draw down in reserves. The city's Overall Fund balance (General Fund and City School District) increased to a strong 334.8 million (28.9% of revenues) as of fiscal 2012 from $40.6 million (6% of revenues) in 2002. During this time period, the city's net cash position (combined General Fund and City School District) improved to a solid 31% of combined revenue from a narrow 5.4% in 2003. Notably, fiscal 2008 was the first year in which the city funded its Rainy Day Fund, set by city charter to equal 30 days' operating expenditures. While the reserve position has improved over the past decade the city has begun to draw down on reserves as evidenced by a two year decline in the City's General Fund balance and one year in the city's Overall Fund balance. These declines were planned as part of the city's multi-year budget plan and were approved by the state control board, the Buffalo Fiscal Stability Authority (BFSA). These declines are expected to continue for both the city and school district through the end of the forecasted period (2016). While these declines reduce the city's operating flexibility, they are expected to gradually decline and the city expects at the end of the forecast period to have structurally balanced budgets. Management expects total fund balance at the city level to be between $90-100 million with the school district maintaining reserves in the 12%-15% of operations level.

Management had originally appropriated $12 million in fund balance to balance the city's General Fund fiscal 2012 budget but ended the year with a $16 million decline. The larger than expected decline was largely due to unbudgeted fringe benefits associated with an accrual for unsettled union contracts. Absent this accural the city would have finished the year with a budgetary surplus, replenishing at least part of its fund balance appropriation, despite revenue weaknesses. The city saw across the board expenditure savings through keeping open positions vacant and managing day-to-day expenses. Revenues were mixed across the board and finished with a slight positive variance to budget. While sales tax finished positively, weaknesses in fines, state aid and charges for services finished with negative variances.

The school district had originally budgeted to use $34 million in fund balance for fiscal 2012 and ended the year with a budgetary surplus reducing the use of fund balance to $25 million. The $9 million replenishment in fund balance appropriation was due to expenditure savings as the district finished the year with a $3.3 million negative variance in revenues. Management conservatively budgeted expenditures and held open vacant positions to achieve a positive variance in expenditures. The revenue shortfall was driven by a $9 million negative variance in state aid. Sales tax for the year was over budget by $1.7 million.

The city's fiscal 2013 budget was again balanced using approximately $11.2 million in fund balance, a 5% increase in sales tax and no increase in property tax revenues. To date management anticipates finishing the year with a slight budgetary surplus and won't replenish the majority of the fund balance appropriation. The city has once again seen savings in expenditures and sales tax has been performing better than budget. This is offset with weaknesses in some revenues, particularly charges for services. The school district budgeted the use of $20 million in fund balance for the fiscal 2013 budget. While second quarter results had suggested that the district would use all of its appropriated fund balance management now projects a slight budgetary surplus to reduce the use of fund balance. Currently sales tax is performing well in excess of budget but these gains are offset by a $8 million reduction in state aid. These declines in fund balance for both the city and BOE were approved by the BFSA.

While the city remains exposed to risks associated with potential state aid cuts, open labor contracts, ongoing litigation and stagnant growth related to the weak economy, we believe that the city's current financial position and conservative fiscal management provide satisfactory cushion against these risks. For example, management has implemented a number of policies, including the Rainy Day Fund and requirement to do four-year financial forecasting. Additionally, financial flexibility to pay debt service is available for the city with approximately $2.5 million in cash available in the city's Debt Service Fund and $73 million in the BOE Debt Service Fund.

FOUR-YEAR PLAN APPROVED BY BUFFALO FISCAL STABILITY AUTHORITY; ADVISORY PERIOD ESTABLISHED

The Buffalo Fiscal Stability Authority (BFSA) was created by act of the State Legislature on July 3, 2003 to control and supervise the financial affairs of the City of Buffalo. The BFSA has been charged with the creation and implementation of a four-year recovery plan, annual budget review and revenue forecasting. On May 29, 2012, BFSA voted 6 to 1 to move to an advisory board from a control board effective July 1, 2012, the beginning of the city's fiscal 2013 budget year. Under an advisory role the board's powers are reduced to largely only financial oversight and responsibilities. BFSA can re-impose a control period if the city were to fail to adopt a balanced budget, default on its debt, or incur an operating deficit greater than 1% of any major fund of the city, among other provisions. City management notes that it will continue to implement policies and procedures that BFSA required while in the control period and it is expected that the city and BFSA will maintain a working relationship over the life of the control board. Moody's believes the BFSA has been particularly important as the city has minimal revenue raising flexibility, given its declining and relatively poor population, and expenditure reductions already realized.

The city's four-year plan (fiscal years 2013 through 2016) was approved by the BFSA on May 8, 2012. Moody's considers the development of a multi-year plan and the oversight provided by BFSA to be key credit strengths for the city. The current plan assumes annual budget growth of 4.4% in fiscal 2013 primarily driven by increasing benefit costs, specifically pension contribution increases. Budget growth in fiscal 2014 through 2016 is expected to be minimal ranging from 0.06% to 0.8%. While benefit expenses are expected to increase by 15% in fiscal 2013, management is budgeting 2% growth in each of the following years given that pension costs are beginning to level out at these higher levels. The plan budgets for sales tax growth of 5% in the current year with 3% growth in the out years. This growth assumption reflects healthy sales tax increases for the city and county due to increased cross-border traffic from Canada. The plan also assumes that the city will use $3.7 million in state AIM money currently held by BFSA to balance the current budget and that the following two years will use $8.5 million and $2.5 million respectively. The plan assumes no increases in state aid for fiscal 2013 and 2014 and then a 2% increase in the following two years. The plan is also balanced with the use of reserves, including $11.5 million in fiscal 2013 but declining to $3.8 million in fiscal 2014.

The BFSA-approved four-year plan for the Board of Education projects the annual use of $15.9 million in fund balance and growing out-year gaps of $25.7 million, $30.7 million, and $56.2 million in fiscal years 2014 through 2016. This would result in a cumulative $45 million use of the district's unassigned fund balance and leave it with little financial flexibility. Management expects to close these gaps through a combination of school closures, staff reductions, and other cost-saving initiatives.

The city's financial future isn't without risks, however. The city currently has ten expired collective bargaining contracts outstanding, some of which date back almost a decade. While management continues to negotiate a new contract with each of the units the overall financial impact to the city is unknown at this time. In addition, the Seneca Nation, which runs a casino in the City of Buffalo and has agreed to share revenues from the casino, has not upheld its end of the agreement over the past two years, withholding more than $14 million from the city. Management has indicated that this had little financial impact on the city. Future rating action will consider the city's ability to implement the multi-year plan and make adjustments as necessary to maintain sufficient financial flexibility.

TAX BASE CHALLENGED BY LOW WEALTH LEVELS AND HIGH POPULATION LOSSES, UNEMPLOYMENT AND POVERTY; MEDICAL INDUSTRY AND REGIONAL COUNCIL EXPECTED TO DRIVE GROWTH

Moody's expects the city's $6.5 billion tax base will remain challenged by continued population declines, high unemployment and poverty levels, and income levels that are well below state medians. According to U.S. Census figures, the city's 2010 population was 261,310, down 10.7% from 2000, a continuation of the trend that began in 1950 when the city's population peaked at 580,132. Despite the population losses, unemployment has consistently remained above the state and national averages, and was 11.2% in January 2013 as compared to 9.4% and 8.5% for the state and nation, respectively. While the city remains exposed to potential future automotive industry reductions, growth in the health care sector is expected to drive the economy in the near to medium term. See Moody's issuer comment dated February 3, 2012 for more information on the transformation of the city's tax base towards the health care sector. Additionally, the governor of New York recently challenged the area's Regional Council to develop a viable plan to create thousands of jobs and spur significant new investment into the region. The fiscal 2013 state budget included approximately $100 million for the first phase of economic development which could reach a total of $1 billion from the state and federal funds over multiple years. In addition, the city has significant economic development along the waterfront and inner harbor. Recently the Buffalo Sabres' HARBORcenter Development, LLC won a bid to build a new hockey-themed complex along the inner harbor. The project is estimated at $172 million and is expected to include a new hotel, retail, restaurants and two ice rinks. The project will generate 1,500 new construction jobs and 350 new full-time jobs upon opening. Additionally, management expects that, upon completion, the new complex will generate $4.1 million in new revenue for the city. Additionally, development is currently underway on two projects totaling $45 million which will bring retail, office space, a hotel and a museum. Construction has resumed on the Buffalo Creek Casino, a temporary casino has been operating since 2007. The casino will have 800 slot machines with 15 table games and will include a Buffalo-themed restaurant. Unfortunately it will not include a hotel. According to Moody's Economy.com (January 2013) Buffalo's recovery took a step back in 2012 as manufacturing layoffs and weaker service growth led to a loss in jobs over the course of the year. The report notes that the slow recovery will continue throughout 2013, until it recoups all jobs lost during the recession, which isn't expected to occur until 2015.

DEBT BURDEN EXPECTED TO REMAIN WELL ABOVE AVERAGE

Moody's expects the city's overall debt burden (6.8% of the city's fiscal 2013 full valuation) will remain high, but will gradually moderate given modest tax base growth, rapid amortization of debt and management's policy of retiring more debt than is issued annually. While state school building aid reduces the city's debt burden, it remains well above average at 5.1% of full valuation. Pursuant to New York State Statute, the city has established a Debt Service Reserve Fund held by the trustee. The trustee intercepts all first in property tax revenue for payment of debt service during each collection period (July 1 and December 1). After the trustee has sufficient cash to cover debt service for the period following the collections the remainder of the property tax money is then remitted back to the city. This provides additional security for the payment of the city's debt service. The city school district maintains sizable capital needs, although, these are expected to be financed by the Erie County IDA and should not alter the debt profile. Approximately $1.4 billion has been issued under this program since 2003 ($1.1 billion currently outstanding). These separately secured, yet parity issuances are each rated Aa3/stable outlook, reflecting the city school district's obligation to make lease payments to the Erie County Industrial Development Agency (ECIDA) to pay debt service; a pre-default state aid intercept in the event of non-appropriation; a flow of funds that provides full segregation of debt service 30 days before annual principal and interest payment; and a Debt Service Reserve Fund that is funded at 50% of MADS. This debt is excluded from the city's debt statement based upon security mechanics and sources of payment from non-city funds, primarily state school building aid. All of the city's outstanding debt is fixed rate, and the city is not party to any derivative agreements.

OUTLOOK

Moody's stable outlook reflects our belief that the city's liquidity and reserve position have improved substantially, as evidenced by elimination of the need for seasonal cash flow borrowing in the last three fiscal years. The currently healthy cash position is expected to provide satisfactory cushion against risks related to the weak economy, potential state budget cuts and disbursement delays as well as liabilities related to open labor contracts and ongoing litigation. The outlook factors our expectation that management will maintain its currently strong financial position in the face of these challenges, given its demonstrated conservative fiscal management and policies.

WHAT COULD MAKE THE RATING GO UP:

- Demonstrated ability to maintain satisfactory financial flexibility and liquidity relative to peers

- Structurally balanced budgets which reduce the annual fund balance appropriation and declining reserve position

- Continued strengthening of city financial policies

- Significant increases in socio-economic profile

WHAT COULD MAKE THE RATING GO DOWN

- Continued use of reserves beyond what is currently expected

- Structurally imbalanced operating results

- Reversal of trend of increasing taxing capacity

KEY FACTS

2010 population: 261,310 (10.7% decline from 2000)

2013 full value (regular equalization rate): $6.5 billion

Full value per capita: $24,887

Direct debt burden: 5.7%

Overall debt burden: 6.8% (5.1% adjusted for state school building aid)

Principal payout (10 years): 83%

FY12 Combined Fund balance (General Fund, CSD): $334.8 million (28.9% of General Fund revenues)

FY12 Combined Operating Net Cash balance (General Fund, CSD): $622.2 million (53.7% of combined revenues)

Per capita income as % of state and US (2010 American Community Survey): 62.7% and 71% respectively

Median family income as % of state and US (2010 American Community Survey): 55.2% and 59.1% respectively

Post-sale rated parity outstanding debt: $243 million (excludes debt issued through BFSA and ECIDA)

The principal methodology used in rating the general obligation bonds was General Obligation Bonds Issued by U.S. Local Governments published in October 2009. The principal methodology used in rating the bond anticipation notes was Bond Anticipation Notes and Other Short-Term Capital Financings published in May 2007. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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