STANDARD & POOR'S RATINGS SERVICES

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Summary:

Buffalo, New York; General Obligation; School State Program

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Credit Profile		
US$7.56 mil rfdg ser bnds ser 2013 due 02/01/2025		
Long Term Rating	A/Stable	New
Buffalo GO		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
Long Term Rating	A/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services has assigned its 'A' rating to Buffalo, N.Y.'s series 2013 general obligation (GO) taxable refunding bonds. At the same time, Standard & Poor's affirmed its 'A' rating on the city's GO debt outstanding. The outlook is stable.

The rating reflects our view of Buffalo's:

- Relationship with Buffalo Fiscal Stability Authority (BFSA), which recently transitioned into an advisory mode and has contributed to structurally sound operations and strong financial management practices;
- Strong financial position, built up through positive operations, albeit with several drawdowns realized or expected between 2011-2014; and
- Continuing economic development, which could add to the city's revenue and employment base.

We believe offsetting credit factors include:

- Low wealth and income measures, as well as a declining population and above-average unemployment rates;
- Limited revenue raising flexibility based on Buffalo's reliance on state aid and the recently enacted property tax cap; and
- Contingent liabilities related to unsettled labor contracts, in some cases dating back to 2004 -- although the city and school district are both accruing offsetting funds.

Furthermore, Buffalo maintains a manageable overall net debt burden, in our opinion, although other postemployment benefits (OPEB) could pose a significant future challenge if not addressed.

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 refund the taxable series 2004A GO bonds outstanding for interest-rate savings over the bonds' life, with no maturity extensions.

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 -- only two of Buffalo's eight, and four 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. The city will be required to respond publicly to the board's recommendations.

Through aggressive expenditure controls and favorable state aid funding, Buffalo's financial risk profile has improved significantly since 2003. Following eight years of positive operating results through fiscal 2010 (year ended June 30), the city has accumulated what we view as a very strong reserve position. General fund equity increased to $143 million in fiscal 2010 (34% of expenditures) from just $18 million in fiscal 2002 (6%). The improved financial operations have resulted in a sizable increase in liquidity and cash, eliminating the need for cash flow borrowing since 2008.

Beginning in fiscal 2011, officials planned for draws on fund balance for tax stabilization purposes, and have established a commitment to a flat tax rate through fiscal 2014. Correspondingly, reserves declined by $12.8 million and $16.3 million in fiscal years 2011 and 2012, respectively. Despite the draws, Buffalo's financial position remains very strong, in our opinion, with a fiscal 2012 year-end total fund balance of $113.6 million, or 27% of expenditures. Of this, $77.7 million (18%) was considered available, and $12.2 million (3%) unassigned. Included in available reserves is an economic stabilization fund of $35.7 million in which the city charter requires them to maintain at least 30 days expenditures. Officials have also indicated that they informally plan to maintain at least $100 million in total general fund reserves.

With three months remaining in fiscal 2013, management reports that sales tax revenues are coming in ahead of budget (the budget assumed a 3% year-over-year increase) and expenditures are under budget due to primarily to personnel cost savings from maintaining position vacancies. As a result, officials are not expecting to use the full $11.5 million of reserves appropriated in the adopted budget, even after setting aside unbudgeted funds in an accrued liability account for contract settlements. The city is beginning work on its fiscal 2014 budget, which is the final year subject to the city-declared tax freeze. Officials are expecting a 2% expenditure increase; a fund balance appropriation of approximately $4 million; and the use of about $8 million of non-recurring state aid and incentives for municipalities funds held by BFSA. While we believe that Buffalo's taxing freeze has benefited its constitutional taxing margin (currently at 32%), which is a credit positive in our view, the ongoing use of reserves and one-time revenues for recurring expenditures could pose significant challenges to future budgets. Officials note that the city's ongoing economic development projects, several of which are not receiving tax breaks or payment in lieu of tax arrangements, should add to both the property and sales tax bases over the next several years, and that after the tax freeze expires, they will likely consider an increase to the tax levy. Buffalo has also undertaken a comprehensive facility assessment with the goal of consolidating underused facilities and evaluating cost of maintenance and energy efficiency opportunities to close gaps in its four-year plan. In our view, other medium-term budgetary risks include uncertainty over unsettled labor contracts, dating back to 2004 in some cases, pending the results of ongoing litigation and arbitration. We understand that the city and school district have both set aside and continue to accrue funds for potential settlements and have been successful thus far in the litigation. However, the amount and probability of the accumulated liability are uncertain, and the potential for attaining certainty over future contracts is limited as a result.

General fund revenues consist primarily of state aid (46%), local revenues (36%), and intergovernmental revenue (primarily the county sales tax; 16%). State general purpose aid and sales tax revenue are payable to BFSA for payment on city and BFSA debt, respectively, before distribution to the city. Federal aid makes up just 0.4% of the city's budget.

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 the city's management has adopted them into its operating practices.

Buffalo's overall net debt burden, including school debt net of state building aid and BFSA mirror bonds, remains low at $1,508 per capita, but moderately high at 6% of market value. Debt service carrying charges were moderate at 11% of combined governmental expenditures in fiscal 2012. However, amortization is rapid, with officials planning to retire 85% in the next 10 years.

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 $595 million, accounting for the bulk at 82%. 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 2012 year-end, the district had $221 million in total fund balance, representing a very strong 36% of expenditures. The district is expecting a third consecutive operating drawdown in fiscal 2013, of approximately $20 million. Officials are working on closing a $26 million budget gap in fiscal 2014, after a $16 million fund balance appropriation, assuming a flat property tax distribution from the city. An increase in state aid and up to five several school closures could help close the gap. Like Buffalo, the district continues to face pressure from litigation over the BFSA-imposed wage freeze.

The city contributes to the state's retirement systems on behalf of its employees. Fiscal 2012 contributions totaled $32 million, or 5% of combined (governmental and business-type activities) expenditures. Buffalo also provides other OPEB, which it finances on a pay-as-you-go basis. The city's 2012 annual required contribution (ARC) was $82 million, or 14% of combined expenditures; actual contributions represented 40% of the ARC. Its total unfunded liability was $1.6 billion as of July 1, 2010, the most recent valuation date, representing a sizable 24% of full equalized value.

Buffalo is in Erie County, in western New York on Lake Erie. Historically a manufacturing-based economy, the city has seen population decline, which it is attempting to offset through a structural shift to health care and education. The population has fallen approximately 25% since 1990 to an estimated 257,377. Income levels are low-to-adequate, with median household effective buying income (EBI) at 59% of the national average, and per capita EBI at 68%. Property values have shown stability, and continue to increase modestly. Market value per capita is what we consider low, however, at $26,611. The city's unemployment increased to an annual average of 11.1% in 2012, above both state and national rates. A number of development projects are currently in progress, however, and could add to the city's employment, tax base, and income levels in the long term. The state recently announced plans to invest more than $1 billion in the Buffalo Regional Innovation cluster, and has already made two installment payments totaling approximately $250 million. A large portion of the investment is funding the continued expansion of the Buffalo-Niagara Medical Campus, which has already added 5,000 employees, and could add up to 5,000 more in the next four years. A number of private developments are also in the works. Officials note that there are 89 projects in various stages of development within the city, with several expected to come online in 2016-2017.

Outlook

The stable outlook reflects our view of Buffalo's very strong financial position coupled with its strong management practices. As a result, we expect that officials will budget and take appropriate action to maintain the city's strong financial position, and we do not expect to raise or lower the rating during the two-year outlook horizon. In the long term, Buffalo's ability to capitalize on economic growth, restore structural balance, maintain strong finances, and reduce potential labor contract liabilities could lead to our raising the rating. However, we also believe that the city continues to face fiscal pressures, including economic vulnerability, limited revenue raising flexibility between the levy cap and reliance on state aid, and a significant OPEB liability.

Related Criteria And Research

- USPF Criteria: GO Debt, Oct. 12, 2006
- USPF Criteria: Key General Obligation Ratio Credit Ranges – Analysis Vs. Reality, April 2, 2008

Ratings Detail (As Of April 1, 2013)		
Buffalo GO State Credit Enhancement		
Long Term Rating	A/Stable	Affirmed
School Issuer Credit Rating	A/Stable	Affirmed
Buffalo GO State Credit Enhancement (AGM)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
School Issuer Credit Rating	A/Stable	Affirmed
Buffalo GO		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
Buffalo GO State Credit Enhancement		
School Issuer Credit Rating	A/Stable	Affirmed
Unenhanced Rating	A(SPUR)/Stable	Affirmed
Long Term Rating	A/Stable	Affirmed

Many issues are enhanced by bond insurance.

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