

RatingsDirect®

Summary:

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:

Lisa R Schroer, Charlottesville (1) 434-220-0892; lisa.schroer@standardandpoors.com

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Summary:

Buffalo, New York; General Obligation; School State Program

Credit Profile

US\$30.078 mil Gen Imp Serial Bnds ser 2015 due 04/01/2026

<i>Long Term Rating</i>	A+/Stable	New
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Buffalo GO

<i>Long Term Rating</i>	A+/Stable	Affirmed
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Rationale

Standard & Poor's Ratings Services has assigned its 'A+' long-term rating, with a stable outlook to Buffalo, N.Y.'s series 2015 general obligation (GO) general improvement serial bonds. At the same time, Standard & Poor's affirmed its 'A+' rating, and stable outlook, on the city's GO bonds outstanding.

The city's faith and credit GO pledge secures the bonds, including the statutory authorization to levy ad valorem taxes on all real property within the city, subject to applicable statutory limitations. 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. The outstanding city GO bonds issued for Buffalo City School District are further secured by the New York State Aid Intercept program, pursuant to Section 99-b of the state finance law.

We understand that officials plan to use series 2015 bond proceeds to redeem a portion of the city's outstanding bond anticipation notes and to provide new money for capital projects.

The 'A+' GO 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 2014 and projected for fiscal 2015 as the city continues its tax stabilization measures;
- 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;
- Weak debt and contingent liability profile characterized by high pension and other postemployment benefit (OPEB) fixed costs; and
- Strong Institutional Framework.

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 257,280. Projected per capita effective buying income is 72.3% 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 \$26,839. Erie County's unemployment rate averaged 7.4% in 2013, similar to the national rate.

A number of development projects in the city, spurred by the Buffalo Niagara Medical Campus and the state's commitment of the "Buffalo Billion" continue apace and could lead to employment, tax base, and income growth 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 a Coventus medical office facility (\$100 million). The state's pledge of \$1 billion for the Buffalo Regional Innovation Cluster centers on the High-Tech Manufacturing Innovation Hub at River Bend, which broke ground in September 2014. The city reports that SolarCity is planning to invest \$5 billion in a 1.2 million square-foot facility which would be the largest solar panel manufacturing facility in the western hemisphere and create 3,000 new 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 view as its limited revenue and expenditure flexibility. At the close of fiscal 2014, the city's available general fund reserves, including funds committed for economic stabilization, totaled \$110.8 million, representing 23% of adjusted general fund expenditures. For fiscal 2015, officials are projecting a drawdown in line with the adopted budget, despite increasing the use of fund balance in the revised budget. Even with an expected drawdown of approximately \$27 million, we expect available fund balance to remain very strong. We understand that the city is unlikely to raise its property tax levy in fiscal 2016 and will likely appropriate fund balance in the budget once again.

We believe that Buffalo's very strong fund balance 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 2014), 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. Buffalo is currently at 76% of its constitutional taxing margin, which has benefited from its recent tax stabilization measures. In addition, given the city's backlog of unsettled union contracts, we believe that its ability to cut expenditures in the interim is somewhat limited.

Weak budgetary performance

We consider Buffalo's financial performance weak driven, in large part, by its commitment to tax stabilization, which has resulted in the city's appropriating fund balance for recurring operations. Audited results for fiscal 2014 show a general fund operating deficit of \$19.4 million, representing negative 4% of adjusted general fund expenditures, and a total governmental funds deficit of \$35.8 million, or negative 6.3% of total governmental expenditures after adjusting for bond-funded capital expenditures and transfers to and from utility funds. The city's fiscal 2015 adopted budget included provisions for labor settlements and appropriated \$27.5 million of fund balance, mostly for recurring expenditures. Despite Buffalo increasing the appropriation in the revised budget, we understand that the drawdown will likely be similar to what was originally budgeted. For fiscal 2016, we understand that the city could see some potential savings on healthcare costs by switching to self-insurance and will see some relief on pension costs, but will likely maintain the existing tax rate and require the use of fund balance once again. We therefore expect budgetary performance to remain weak in the next two years.

Buffalo's current four-year financial plan, approved by BFSA on June 18, 2014, projects increased deficits from the previous plan, including a deficit of \$27 million in fiscal 2015, \$25 million in fiscal 2016, \$10 million in fiscal 2017, and \$5 million in 2018. The plan assumes expenditure growth of less than 1.5% each year — including flat education aid — property tax levy growth of 2% and sales tax growth of between 2.5% and 3% based on new developments in the city's downtown. In our opinion, the city's financial position could be pressured if these gaps are not mitigated.

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 67% of expenditures and 7.6x debt service in fiscal 2014. 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. Although most of its collective bargaining agreements have been expired for several years, the city has set aside funds for settlement and maintains the capacity to bond for retroactive judgments. Given the city's very strong cash position, we would not expect a retroactive payment to have a significantly detrimental impact on Buffalo's liquidity position.

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.

Weak debt and contingent liability profile

Buffalo's net direct debt burden represents 33% of total governmental revenue. Debt service carrying charges were 8.8% of adjusted total governmental expenditures in fiscal 2014. The city plans to issue between \$20 million and \$25 million of additional debt in the next two years to fund its capital improvement program, which is less than planned amortization. We estimate that 80% of the city's direct debt will retire in 10 years. Overall net debt is 3.6% 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 15.6% of total governmental expenditures in fiscal 2014. However, the city continues to make its full pension contributions and has not chosen to amortize its pension contributions as allowed by the state. The state does not currently permit municipalities to accumulate assets against unfunded OPEB liabilities. Given the magnitude of the city's \$1.6 billion liability, we believe that it is somewhat limited in its ability to reduce its exposure.

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").

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, significant deterioration in the city's reserve position, to levels less than those we consider strong, could lead to our lowering the rating barring a concrete plan to re-balance operations given the city's limited revenue-raising flexibility and unsettled collective bargaining agreements.

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

Ratings Detail (As Of April 1, 2015)		
Buffalo sch serial bnds		
<i>Long Term Rating</i>	A+/Stable	Affirmed
<i>Underlying Rating for Credit Program</i>	A+/Stable	Affirmed
Buffalo sch serial bnds ser 2011D due 04/01/2012-2026		
<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Affirmed
<i>Underlying Rating for Credit Program</i>	A+/Stable	Affirmed
Buffalo GO State Credit Enhancement		
<i>Long Term Rating</i>	A+/Stable	Affirmed
<i>Underlying Rating for Credit Program</i>	A+/Stable	Affirmed
Buffalo GO State Credit Enhancement (AGM)		
<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Affirmed
<i>Underlying Rating for Credit Program</i>	A+/Stable	Affirmed
Buffalo GO (BAM)		
<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Affirmed

Ratings Detail (As Of April 1, 2015) (cont.)

Buffalo GO

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

<i>Underlying Rating for Credit Program</i>	A+/Stable	Affirmed
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<i>Unenhanced Rating</i>	A+(SPUR)/Stable	Affirmed
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<i>Long Term Rating</i>	A+/Stable	Affirmed
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Many issues are enhanced by bond insurance.

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