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County of Erie

MARK C. POLONCARZ
COMPTROLLER

September 20, 2011

Erie County Legislature
92 Franklin Street
Buffalo, New York 14202

Re: Request ECFSA to Conduct 2011 RAN Borrowing

Dear Honorable Members:

Please be advised on Friday, September 16, 2011, my office was informed by Moody's Investors Service ("Moody's") that it will not issue a MIG 1 "best quality" rating upgrade to Erie County ("County") for the 2011 Revenue Anticipation Note ("RAN"). Rather, Moody's elected to issue a MIG 2 rating to the County for short-term obligations. As you know, the County's ability to close the upcoming RAN transaction at less cost than ECFSA was contingent upon the County securing the required MIG 1 rating followed by M&T Securities, Inc.'s ("M&T") ability to honor its rates and charges proposed in early August 2011. Therefore, I have asked the Erie County Fiscal Stability Authority ("ECFSA" or "Control Board") to conduct the County's short-term borrowing through their underwriter Roosevelt & Cross.

I was cautiously optimistic that the County would receive Moody's MIG 1 rating for the RAN sale upon receiving positive initial feedback from Moody's analyst at the conclusion of my presentation on September 8. Unlike the county executive, who did not participate on the conference call (Budget Director Gregory Gach did participate), I did not reach out to local media to proclaim that there would be "no problem" in obtaining the MIG 1 rating. As Comptroller I know you must never "count your chickens before they hatch" when dealing with the rating agencies. Ultimately Moody's credit rating committee decided to issue the MIG 2 rating for short-term obligations and further affirmed the County's A2 long term obligation rating with a stable outlook. Enclosed is Moody's full rating report for your review.

Although I'm disappointed that the County will not conduct this short-term borrowing on its own, I reiterate that my goal is to ensure County taxpayers get the best deal possible regardless of whether the County or the ECFSA issues this year's RAN.

I appreciate the Legislature's prudent decision to judiciously delay approval of the Declaration of Need. If immediate approval had been granted as requested, such action would have undermined the Comptroller's Office's efforts to issue a Request for Proposals ("RFP") and determine whether the County could complete the transaction at the lowest cost to the taxpayers.

By creating a competitive open bid process, we were able to leverage a better offer from ECFSA's underwriter, Roosevelt & Cross, than ECFSA originally offered us. As you may recall, upon learning of M&T's response to our RFP, the Control Board revisited the matter with its underwriter, which in turn submitted a second, more competitive bid that essentially matched M&T's proposed rate and charges. <u>Distinguishing between Roosevelt & Cross's initial and second offers, I was able to save the taxpayers approximately $150,000 in interest costs</u>. Since the County was positioned this way, the taxpayers won regardless of the outcome.

The Declaration of Need has been approved by the Legislature, so I now request ECFSA, working with its underwriter Roosevelt & Cross, to secure and place the County's $84 million RAN. I look forward to working collaboratively with ECFSA and ensure the successful close of this transaction by early October.

If you have any questions, please contact me at 858-8400.

Sincerely yours,

Mark C. Poloncarz, Esq.
Erie County Comptroller

MCP/nr
Encl.

cc: Hon. Christopher Collins, Erie County Executive (with encl.)
Erie County Fiscal Stability Authority (with encl.)
Gregory Gach, Director of Budget and Management (with encl.)

MOODY'S
INVESTORS SERVICE

New Issue: MOODY'S ASSIGNS MIG 2 RATING TO ERIE COUNTY'S (NY) $84 MILLION REVENUE ANTICIPATION NOTES - 2011A

Global Credit Research - 16 Sep 2011

AFFIRMS A2 RATING AND STABLE OUTLOOK AFFECTING $516.7 MILLION OF OUTSTANDING LONG TERM G.O. DEBT

County
NY

Moody's Rating

ISSUE	RATING
Revenue Anticipation Notes - 2011A	MIG 2
Sale Amount $84,000,000	
Expected Sale Date 09/29/11	
Rating Description Revenue Anticipation Notes	

Opinion

NEW YORK, Sep 16, 2011 -- Moody's Investors Service has assigned a MIG 2 rating to Erie County's (NY) $84 million Revenue Anticipation Notes - 2011A (RAN). Concurrently, Moody's has affirmed the county's A2 long term general obligation rating with a stable outlook, affecting $516.7 million of outstanding rated debt.

SUMMARY RATING RATIONALE

The MIG 2 rating reflects the county's narrow cash flow coverage projections for repayment at note maturity balanced against satisfactory credit fundamentals that have improved over recent years. The current borrowing is in anticipation of revenue from sales tax and state and federal aid in fiscal 2012. The credit quality of the notes benefits from the satisfactory timing of set-asides for note repayment. Both the notes and the outstanding bonds are secured by the county's unlimited property tax pledge.

The rating affirmation balances the ongoing trend of financial stabilization and improving fund balance and liquidity position, that still remain narrow, against the county's exposure to economically sensitive sales tax revenues, as well as additional financial vulnerability related to open labor contracts and potential future financial obligations to the Erie County Medical Center Corporation (ECMCC). The rating also factors the county's substantial $46.8 billion tax base which has experienced significant diversification in recent years; and a manageable debt position. Additionally, the rating reflects the ongoing oversight of the Erie County Fiscal Stability Authority (ECFSA, Aa2 Issuer Rating), which reverted to advisory status from control status on June 2, 2009, and it's approval of the county's four year financial plan (2011 through 2014) on June 13,2011. Future rating reviews will factor management's ability to continue to demonstrate structurally balanced operations and increase reserves relative to revenues.

The stable outlook reflects Moody's belief that management's conservative budgeting approach and proactive monitoring of budget performance will continue to incrementally improve and further stabilize the county's financial position given consecutive years of structurally balanced operations (2006 through 2010) with favorable results projected for 2011 (year ends December 31st) based on year-to-date performance.

Effective January 1, 2012, all local governments in New York State will be 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 will continue to treat all general obligation debt issued in New York as an unlimited tax pledge through the end of the year. We continue to research what the impact of the new property tax cap will be on debt issued by nonschool districts after it goes into effect next year. For more information regarding the property tax cap please reference the Special Comment "New York State's Property Tax Cap will Further Pressure Local Government Finances; School District's Most Impacted" released July 5, 2011.

STRENGTHS

-Large and diverse tax base

-Strong budget management

CHALLENGES

-Limited liquidity position

-Narrow reserves provide little cushion to economically sensitive revenues

DETAILED CREDIT DISCUSSION

NARROW RAN COVERAGE DESPITE AVAILABILITY OF ALTERNATIVE LIQUIDITY

The county typically relies on one annual RAN borrowing, driven by uneven monthly expenditure disbursements throughout the year. The county's cash flow borrowing has fluctuated over the last several years as the county's financial position has begun to recover following its fiscal crisis in 2004 and state aid revenue experiencing delays. Fiscal 2011 is the first year since at least 2008 that the county has sold a RAN that was not structured as a mirror to an ECFSA issued Bond Anticipation Note. In order to obtain favorable market access and pricing, EFCSA has used a Bond Anticipation Note (BAN) secured by sales tax and used the proceeds to purchase the mirror county revenue anticipation note.

Over the last two years, the county borrowed $65 million in 2009 and 2010. Following fiscal 2009 which improved the county's liquidity position, the county has intended to only borrow one note of $45 million but delayed state aid required a second note of $20 million. The county has increased this year's borrowing to $84 million driven by state and federal aid declines and additional set asides associated with the county's debt issued through the Erie County Fiscal Authority. County management intends to maintain this current level of borrowing for the foreseeable future. Despite the increase in borrowing, Moody's considers the county's level of cash flow borrowing to be manageable given the county's conservative projections of sales tax and state aid, however, a significant decline in the region's economic outlook resulting in a considerable decline in sales tax or state aid delays could place potential pressure on the county's ability to repay the note.

The General Fund cash balance fluctuates throughout the year but experiences its lowest point in July, one month after note repayment which leaves limited flexibility to accommodate mid-year cash fluctuations as the county leads up to note repayment. This risk is partially offset by the five set aside payments the county makes from February to June, however, the final set aside is on the date of the final maturity(15.5% of the total note). The county's sewer fund provides some additional flexibility as the county could likely access it for a short period of time to ensure timely note repayment. At note repayment in fiscal 2010, cash provided a satisfactory 2.8 times coverage of the $65 million note which matured June 30, 2011, the coverage is calculated based solely on the final set aside payment. However, June ending cash balance, after final payment, is a slim $22.6 million or 1.6% of total fiscal 2010 receipts. This narrow month end cash balance would be unable to offset a moderate fluctuation in sales tax or a delay in state aid. When factoring in the county's sewer fund, which had $32.1 million amount of cash on hand at maturity and is available for General Fund operations, the county had a coverage level of 3.8 times.The fiscal 2011 note coverage was much stronger as the county repaid the $20 million in April (5.4 times) and the $45 million note in June (5.4 times). Similar to fiscal 2010, June month end cash balance $40.8 million (2.8% of projected year-end receipts) would provide little cushion for budgetary fluctuations driven by the economy or state, both outside of management's control. The fiscal 2011 year-end cash balance is projected to decline from a stronger, but still narrow, $27 million 2010 year-end cash balance (2% of 2010 receipts) to a minimal $5.4 million (0.37% of fiscal 2011 projected total receipts). Management reports this decline is partially attributed to additional set aside payments to ECFSA related to new debt issued on the county's behalf.

The fiscal 2011 note (dated September 29, 2011; matures June 29, 2012) is projected to have 2.4 times coverage at note maturity, although inclusion of non-operating reserves (sewer funds) coverage increases to a healthy 5.31 times(coverage is calculated solely only final set-aside). June month end cash balance is projected to decline to $18.2 million (1.26% of projected year-end receipts) leaving management with limited General Fund resources. Assuming similar cash balances in the sewer fund as fiscal 2011, the inclusion of these funds improves June month end cash balance to $56 million (3.9% of projected total fiscal 2012 receipts). The sewer fund year-end cash balance has declined over the last two years to $15.7 million fiscal 2010 from $29.7 million fiscal 2008.

Overall, Moody's believes the cash flow projections are relatively conservative but that the county is still working to regain their financial stability and maintain limited cash flow flexibility. The fiscal 2012 projections through June assume sales tax growth would be approximately 2.91% over fiscal 2011 projections over the same period. The county reports that fiscal 2011 sales tax is projected to exceed current estimates.

STEADY FUND BALANCE AUGMENTATION, ALTHOUGH RESERVES AND LIQUIDITY REMAIN NARROW

Moody's believes the county's financial position has stabilized given augmentation of reserves in each of the last six fiscal years (2005 through 2010), reversing the previous four years of operating losses that significantly depleted General Fund reserves to the very narrow fiscal 2004 level of $5 million or 0.6% of revenues. The $43.6 million surplus in fiscal 2009 resulted from the one-time revenue windfalls of unbudgeted Federal Medicaid Assistance Percentage (FMAP) funds. Outside of this revenue, financial results reflected a conservatively structured budget. The fiscal 2010 $23.5 million surplus was driven by largely by $44.8 million in FMAP funds that the county received during the fiscal year. Net of the $278 million of sales tax receipts passed through to underlying municipalities, ending fund balance comprised a stronger, although still narrow, 11.8% of revenues (an increase from 4.9% in fiscal 2007). Undesignated fund balance, at $66.9 million, comprised 6.3% of revenues net of the sales tax pass-through, an improvement from 3.3% in fiscal 2007. The county management has achieved surpluses in the last several years despite operating pressures throughout the budget.

The fiscal 2011 budget grew by a minimal 0.3% when compared to 2010 actual results, but included a $16.7 million appropriation of reserves from the General Fund. Year-to-date, management anticipates positive performance in sales tax will likely result in the county replenishing slightly over half ($10 million) of the original appropriation. The General Fund may decline slightly which will place additional pressure on the county's currently narrow liquidity. The budget also included a modest 1.1% increase in property tax revenue and sales tax was budgeted to increase by 3%. Current projections show the county will exceed the sales tax budget by approximately $12.9 million driven by the weakened U.S. dollar compared to the Canadian dollar and increased cross border traffic. The county may face more limited increases to the fund balance in upcoming years as state and federal aid which have helped bolster its reserve position are expected to continue to decline. Additionally, the strengthening of the U.S. dollar may put pressure on sales tax revenues. Positively, a county charter amendment approved in 2006 sets an unreserved fund balance policy minimum at 5% of the prior year's budget, demonstrating management's commitment to maintaining and improving financial flexibility.

The county guarantees approximately $100 million of debt associated with the Erie County Medical Corporation (ECMCC) and has historically provided modest financial support for its operations. ECMCC is a public benefit corporation created in 2004 and is a component unit of the county. Although the county's guarantee has not been called on to directly support debt service, anticipated declines in health care support from the federal and state governments, may place pressure on hospital operations which could impact the county's financial position.

FOUR-YEAR FINANCIAL PLAN APPROVED BY ECFSA

The New York State legislature created ECFSA in July 2005 with a broad range of financial control and oversight powers, including the power to issue bonds and notes on behalf of the county, supported by the state comptroller's intercept of Erie County sales tax revenues and state Aid and Incentives for Municipalities (AIM) aid to the county. The authority's oversight and control powers vary depending on its status as either an advisory or control board. Upon its creation, the authority acted as an advisory board, with the power to review county operations and management, including auditing county financial plans. In addition, in an advisory period, ECFSA has authority to comment on the county's budget, debt issuances and collective bargaining agreements. On November 3, 2006, the ECFSA imposed a control period following its rejection of the county's fiscal 2007 budget and financial plan for fiscal years 2007 through 2010. During a control period, the Authority is empowered to set expenditure caps for any proposed budget, to impose a wage or hiring freeze, and to approve or disapprove contracts, borrowings, settlements in excess of $50,000, and financial plans of the county. On June 2, 2009, the board reverted to advisory status and approved the county's four year financial plan covering 2009 through 2012. With reversion to advisory status, the county no longer is required to obtain ECFSA approval on contracts, filling vacant positions or borrowing requests.

The county's current four-year plan (2011-2014) intends to appropriate $3 million from the General Fund in fiscal 2012 and produce modest surpluses in 2013 and 2014. The four-year plan includes annual 3% increases in sales tax and 2% annual growth in the county's tax base. Although these are relatively modest growth assumptions, continual weakening in the national economy may make these assumption difficult to achieve. As a result, Moody's believes that the county will be challenged to significantly grow reserves relative to budget.

SUBSTANTIAL TAX BASE EXPECTED TO REMAIN RELATIVELY STABLE

Following declines in the manufacturing sector in the 1980s, the county, with a taxable full valuation of $46.8 billion, has seen population declines in each of the last four decades. Population loss continues to pose a threat to economic stability, although significant proportions of these losses stem from the City of Buffalo (G.O. rated Baa2/positive outlook), which represents roughly one-third of the county's population, while suburban areas continue to show population growth. Overall, the county's population declined 3.2% during the 2000s an increase from the modest decline of 1.9% during the 1990s, but slower than the 4.6% and 8.8% rates of decline in the prior two decades. Total population as of the 2010 census is 919,000. In recent years, the economy has become more diversified, with growth in the financial, health and service sectors replacing lost manufacturing jobs.

The county's tax base has continued to experience modest growth over the last several years despite the economic downturn. Over the past five years, full valuation has grown at a moderate average rate of 4.2% annually, including approximately 6% growth from 2006 through 2007 and slower, albeit notably still positive growth of 3.8% in 2009, 4% in 2010 and 1.4% in 2011, despite many New York municipalities experiencing tax base declines over the last several years. County income and wealth levels remain in line with upstate norms, and officials report that the county is not significantly impacted by the housing market downturn as sales volume remains strong and home prices have improved in 2011. The presence of significant government employment provides some long-term employment stability, however, this sector may experience additional layoffs in the near-term; nevertheless, the county's unemployment rate, at 7.7% in June 2011, below the state (8%) and national (9.3%) levels for the same period.

DEBT BURDEN REMAINS MANAGEABLE

Given current debt levels and moderate borrowing plans, Moody's expects the county's debt position to remain manageable. Overall debt burden is above average at 5.7% of full valuation, but is driven by significant overlapping obligations that account for three quarters of total debt. The direct debt burden, at 1.1% of full valuation, is also above Moody's median for New York counties (0.7%) and for counties nationwide (0.5%). The debt position is expected to remain manageable given management's plan to issue approximately $50 million annually, in line with annual principal retirement. The county has refund a significant portion of their debt through ECFSA which has issued bonds on their behalf that are secured solely by sales tax. Principal amortization (78% repaid within ten years), debt service comprised a moderate 4.7% of fiscal 2010 operating expenditures. The county has no variable rate debt and is not party to any derivative agreements.

WHAT COULD MAKE THE RATING GO UP:

-Improvement of reserve in line with budgetary growth

-Enhanced liquidity position

WHAT COULD MAKE THE RATING GO DOWN:

-Decline in the county's financial position

-Significant tax base weakening

KEY STATISTICS:

2010 Population: 919,00 (-3.2 since 2000)

2011 Full Valuation: $46.8 billion

2011 Full value per capita: $50,879

Median Family Income as % of state: 96%

Per Capita Income as % of state: 87%

Direct debt burden: 1.1% (includes debt guaranteed on behalf of ECMCC)

Overall Debt burden: 5.7%

Unemployment (June 2011): 7.3%

FY2010 General Fund balance: $125 million (9.4% of revenues; 11.8% net of sales tax pass-through)

FY2010 Undesignated General Fund balance: $66.9 million (5% of revenues; 6.3% net of sales tax pass-through)

G.O. debt outstanding: $517 million

The principal methodology used in this rating was Short-Term Cash Flow Notes published in May 2007. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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