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Erie County, New York; General Obligation

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Long Term Rating	AA-/Stable	Upgraded
Erie Cnty GO (BAM)		
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded
Erie Cnty GO		
Unenhanced Rating	AA-(SPUR)/Stable	Upgraded

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services raised its long-term rating on Erie County, N.Y.'s general obligation (GO) bonds three notches to 'AA-' from 'A-' based on its local GO criteria published Sept. 12, 2013. The outlook is stable.

The upgrade further reflects the county's consistently strong budgetary performance, even during the recession, that has allowed it to build up and maintain reserves to levels we consider strong.

The county's faith and credit GO pledge secures the bonds, including the statutory authorization to levy ad valorem taxes on all real property within the county, subject to applicable statutory limitations.

The county's 'AA-' GO rating reflects our view of the following credit factors:

- An adequate local economy that has experienced substantial investment with the City of Buffalo serving as the county seat and primary economic driver;
- Strong budgetary flexibility that has remained consistent over time;
- Adequate budgetary performance projected for fiscal 2014 (Dec. 31);
- Very strong liquidity, with strong access to external liquidity, albeit with a recurring need for cash flow borrowing;
- Strong management, with good financial policies and practices in place; and
- A strong debt and contingent liability profile, with limited exposure to fixed costs associated with pension and other postemployment benefit libation (OPEB) liabilities.

Adequate economy

Erie County, with a 2013 estimated population of 916,395, encompasses more than 1,000 square miles in western New York, including Buffalo, the second-most-populous city in the state, as well as the county seat. With its position on Lake Erie and the St. Lawrence Seaway, the county used to be a manufacturing hub, particularly for steel. As such, the economy was hit hard over the past several decades with the manufacturing decline. However, in January 2012, the governor announced a $1 billion, multiyear incentive package for Buffalo targeted at large investments in growth industries. The county has also benefited from more than $100 million in grant funding awarded to the Western New York Regional Economic Development Council for workforce, infrastructure, and commercial development. We believe the county has continued to experience the ancillary benefits from this investment, which has led a number of firms to invest within the county including, but not limited to: Canadian Manufacturer Welded Tube, FedEx, and General Motors Co.. As a result, the county's recent population decline has stabilization, with the population averaging 1.2% year-over-year growth from 2011-2013. The education and health care sectors remain stable employment drivers within the county, leading to a favorable 7.4% unemployment rate for 2013, and a preliminary figure of 6.3% for July 2014.

Management expects Erie County to continue to experience modest 2% assessed value growth in the medium term. Property values have remained stable or have increased slightly in the past five years. The county's market value totaled $48 billion in 2014, which is in line with the 2% increases management has forecast in its long-term financial plan. Corresponding market value per capita is $52,404 and projected per capita effective buying income levels are approximately 95% of the national average.

Adequate budgetary performance

In our opinion, Erie County has maintained a consistent budgetary performance. Fiscal 2013 closed with slight surplus operations in the general fund and a total governmental funds deficit of 0.7% of expenditures after adjustments. Adjustments include accounting for transfers in of sales tax proceeds from the Erie County Fiscal Stability Authority (ECFSA) as general fund revenue ($409 million), and recurring transfers out from the general fund to other governmental funds as expenditures ($99.6 million). Officials attribute the general fund performance to fringe benefit savings driven by aggressive vacancy control for open positions, a $1 million favorable variance in hotel occupancy tax revenue, and other departmental savings. Sales tax revenue is the county's largest general fund revenue source, at 53% (including transfers from the ECFSA fund, after payment of debt service), followed by state and federal aid (24%) and real property taxes (17%).

Erie County's adopted fiscal 2014 budget totaled $1.4 billion and it appropriated $5.4 million of the fund balance, which is in line with the 2013 adopted budget. Through July 2014, management is showing a $5.9 million positive variance, including the replenishment of appropriated fund balances; however, officials expect this variance to decrease slightly through the final five months of 2014 due to timing issues and the recognition of expenditures. Overall, management expects to regenerate the budget fund balance appropriation and close the year with a $2 million general fund surplus.

Erie County's fiscal 2014-2017 operations plan, approved by the ECFSA, shows the use of reserves in 2015, 2016, and 2017. In addition, the county is also projecting budget gaps for 2015-2017; however, these gaps do decline year-over-year. We understand that the assumptions built into this forecast take into account additional costs that were realized in fiscal 2013, as well as 2014. Thus, management believes that these gaps will decline further in the revised forecast expected in October 2014. The forecast also assumes 2%-3% sales tax growth. Through July 2014, the county's year-to-date sales tax growth was 3.24%. In our recent economic conditions forecast (July 8, 2014), we believe retail sales projections are showing signs of improvement with 1.64% growth in 2014, higher than our 1.4% projection in April 2014, and 2.11% growth expected for 2015. Given that sales tax is the county's leading revenue source, we believe management's ability to budget accordingly will have an impact on the county's overall budgetary performance.

We believe several factors are contributing to reduced expenditure pressures for the county including the state's phased-in assumption of Medicaid cost increases and federal payments under the Affordable Care Act, reduced pension contributions, and new contract agreements requiring employees to pay a portion of their health insurance, as well as the elimination of retiree health insurance for all new employees. In our opinion, the changes to the county's health insurance under the new contracts will provide a significant reduction to Erie County's other postemployment benefit (OPEB) obligation liability, as well as the fixed costs associated with the benefits in future. For these reasons, we believe the county will be able to maintain adequate-to-strong performance over the next two years.

Strong budgetary flexibility

In the past three fiscal years, Erie County has maintained a strong available reserve position. We consider the county's budgetary flexibility strong, with available reserves of $109.9 million, or 8.8% of expenditures at fiscal year-end 2013. The county has maintained available balances above 8% of expenditures since 2009, consistent with its reserve policy, which states that unassigned reserves must remain above 5% of expenditures. Erie County's adopted 2014 general fund budget appropriates approximately $5.4 million of the fund balance. We understand that officials do not expect to use the full fund balance appropriation and project that the county could even add to reserves at year-end.

Strong liquidity

Available liquidity at fiscal year-end 2013 represented 8.2% of expenditures and 1.39x debt service, although this amount is bolstered by a $109.4 million revenue anticipation note (RAN) issued in August of 2013 and repaid in July of 2014. We also believe that Erie County has strong access to external liquidity as it historically issues GO bonds, bond anticipation notes (BANs), and RANs. The county has historically issued cash flow RANs in the fall of each year to provide interim liquidity while it awaits federal and state social service revenue and sales tax reimbursements. In fiscal 2014, management indicates the ECFSA, on behalf of the county, will issue $110 million in RANs, which it will pay back in the summer of 2015. We understand that management hopes to reduce its cash flow borrowing in the future, as it continues to improve its available reserve position. However, at this time, we believe the county maintains high refinancing risk over the next 24 months as $110 million of its $555 million direct debt outstanding is in the form of notes, equivalent to 20% of total direct debt.

Strong management

We consider the county's management conditions strong based on our financial management assessment (FMA) assessment of "good." An FMA of good reflects our view that practices exist in most areas, although not all may be formalized or regularly monitored by governance officials. Erie County has a formal charter-mandated fund balance policy in place of requiring the maintenance of at least 5% of the preceding year's expenditures in all funds and that only the portion in excess of that 5% may be used as a revenue source. When formulating the budget, the county administration uses multiyear trends to help forecast revenues and expenses for the following year and engages in a multi-week iterative process with department heads in which budget requests are examined. In addition, management regularly monitors the budget's performance and every month a budget monitoring report is issued to the County Legislature. If budget targets are not being met, the county administration always has the ability to employ vacancy control as a measure to reduce or limit expense if budget variances materialize midyear; vacancy control consists of not filling open positions at present, thereby leading to savings within the department. County officials also maintain a five-year capital plan that is updated annually with funding sources identified. In addition, Management maintains a four-year financial plan that it updates twice annually and presents to the ECFSA. At this time, the county follows state guidelines for its debt management.

Strong debt and contingent liability profile

We understand that, at the request of the county executive and county legislature, the ECFSA is closing on a BAN sale on behalf of Erie County. The notes, which Standard & Poor's did not rate, and which are for the county's 2014 cash flow RAN totaled $109.2 million. Factoring in this debt, the county has total direct debt of $555.2 million. Total governmental funds debt service was 7.3% of expenditures in 2013 and net direct debt represented 35.7% of total governmental fund revenue. Overall net debt represented 6.9% of market value. Amortization is rapid with more than 88% of GO debt retiring in 10 years, excluding BANs. Management indicates it will continue to issue about $30 million-$39 million in long-term bonds annually, which will be guided by the county's capital improvement program. We understand Erie County's largest capital needs include renovating or rehabilitating roads and bridges, and maintaining and improving county buildings and equipment, as well as maintaining the annual capital need associated with the county-owned Ralph Wilson Stadium. Management indicates it will issue $28.7 million in October 2014 for various capital purposes. We do not believe this issuance will have a material impact on the county's debt score.

Erie County continues to make its full annual required contribution (ARC) to the state's pension system and has not taken advantage of pension amortization. It also provides other postemployment benefits(OPEB) on a pay-as-you-go basis. As of the county's latest actuarial valuation date, Jan. 1, 2012, its unfunded liability is $838.7 million. However, in management's latest contract settlements with all bargaining unions, all employees must pay for health insurance, and retiree health care insurance for new hires will not be offered. We believe this a proactive step by management to reduce its exposure to the long-term fixed costs associated with this unfunded liability. In addition, as of the next OPEB valuation, we believe that the county's unfunded liability will be reduced as a result of these changes. The combined pension ARC and OPEB contribution represented 4.9% of expenditures in 2013.

Strong Institutional Framework

We consider the Institutional Framework for New York counties strong. See Institutional Framework score for New York, published Sept. 12, 2013, on RatingsDirect.

Outlook

The stable outlook reflects our view of Erie County's strong financial management, which has contributed to a consistent and stable financial position over time. We do, however, believe the county's financial strength is somewhat tempered by the adequate local economy. We expect the county to maintain at least an adequate budgetary performance over time, and believe management will make the necessary adjustments to offset any fluctuations in sales tax receipts throughout economic cycles. For these reasons, we do not expect to change the rating within the two-year outlook horizon. However, while not expected, a sustained period of weak performance and a deterioration in available reserves could lead us to lower the rating.

Erie County Fiscal Stability Authority

On July 12, 2005, the governor of New York State signed legislation creating the ECFSA. The ECFSA began its work in an advisory role in 2005 and provides Erie County with financial oversight while giving local leaders the ability to improve the county's fiscal condition without further state intervention. The ECFSA is included as a governmental activity in the governmentwide financial statements of Erie County's audit. On Nov. 3, 2006, the ECFSA imposed a control period on the county empowering the ECFSA to operate with its maximum authorized complement of control and oversight powers over county finances. On that date, the ECFSA also imposed a hiring freeze and contract review process. The ECFSA reverted back to an advisory status on June 2, 2009, and continues to maintain its advisory status.

The ECFSA is governed by seven directors, each appointed by the governor, including one each appointed on the recommendation of the Majority Leader of the State Senate, the Speaker of the Assembly, and the state comptroller. The governor also designates the chairperson and vice-chairperson from among the directors. Under ECFSA legislation, Erie County is required to submit a four-year financial plan to the ECFSA for approval. The ECFSA has power under the act to monitor and oversee Erie County's finances, and upon declaration of a control period as defined in the act, additional oversight authority. If the county fails to meet certain criteria including, but not limited to, incurring a major operating funds deficit of 1% or more in the aggregate results of operations of such funds of the county in its fiscal year, the ECFSA may declare and enter the aforementioned control period.

The ECFSA is also empowered to issue its bonds and notes for various county purposes. The ECFSA last issued $109.4 million in BANs in 2013, as well as $35. 8 million in sales tax-secured bonds. We understand the ECFSA is planning to issue $110 million in BANs in September 2014 (for the county's 2014 cash flow RAN, which we have included in the county's direct debt.

Related Criteria And Research

Related Criteria

- USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013
- USPF Criteria: Financial Management Assessment, June 27, 2006
- USPF Criteria: Debt Statement Analysis, Aug. 22, 2006

Related Research

- U.S. State And Local Government Credit Conditions Forecast, July 8, 2014
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013