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MEMORANDUM
ERIE COUNTY
COMPTROLLER'S OFFICE

To: Honorable Members of the Erie County Legislature

From: David J. Shenk, Erie County Comptroller DJS

Re: Correction to Comptroller David J. Shenk's letter to County Executive Mark C. Poloncarz regarding 2012 Capital Borrowing (duplicative costs of issuance)

Date: May 24, 2012

Please note a correction to my attached correspondence to Erie County Executive Mark C. Poloncarz regarding the upcoming 2012 Capital Borrowing.

On Page 2, section titled **Review of Debt Service Analyses for $24.2 Million Capital Borrowing**, the amount for the duplicative costs of issuance for the mirror bond transaction is <u>not</u> "approximately $150,000." Rather, considering ECFSA's bond counsel's and financial advisor's charges for the 2011 Bond Series B (i.e., new capital money at $18.7 million), the total was approximately $46,500. Therefore, proportionally adjusting the estimated (duplicative) cost of issuance figures to the $24.2 million capital borrowing (~$60,200), this section's first and second paragraphs should read:

"My office has reviewed two sets of debt service analyses, including the Erie County Fiscal Stability Authority's ("ECFSA" or "the Authority") recent debt service analysis, and recognize that ECFSA's total debt service over the 13-year life of the borrowing (maturity of 2025) is approximately $920,000 less than Erie County's total debt service over the same period. By removing approximately **$60,200** in duplicative costs of issuance for the mirror bond transaction, the difference in total debt service between ECFSA and the County is reduced to only about **$859,800**.

Considering the comparison of carrying each entity's debt service on an annual basis, the average savings of having the ECFSA conduct the borrowing is only about **$66,140 per year** (i.e., $859,800/13 years = $66,138)."

COUNTY OF ERIE

DAVID J. SHENK
COMPTROLLER

May 23, 2012

Hon. Mark C. Poloncarz
Erie County Executive
95 Franklin Street, 16th Floor
Buffalo, NY 14202

Re: 2012 Capital Borrowing

Dear County Executive Poloncarz:

My office has completed its review of financing scenarios regarding the upcoming borrowing for Erie County's 2012 capital projects as specified in the approved 2012 Consolidated Bond Resolution.

Below is my office's set of findings regarding the 2012 capital borrowing. I preface the findings and analysis by noting that I recommend that Erie County ("the County") conduct the borrowing and issue approximately $24.2 million of general obligation ("GO") bonds relating to the 2012 capital projects.

Background

The estimated maximum cost for the County's 2012 capital budget, comprised of 23 projects, is approximately $36.7 million, of which approximately $21.2 million is authorized to be bonded. In addition, the County Legislature approved a bond resolution in December 2011 committing to borrow and appropriate $3 million for the Buffalo Zoological Gardens' Arctic Edge polar bears habitat exhibit. As such, this $3 million will be part of this year's capital borrowing package thereby bringing the total borrowing for 2012 capital projects to approximately $24.2 million.

After the 2012 Consolidated Bond Resolution was passed by the County Legislature in late March, in early April the Department of Public Works and the Department of Parks, Recreation and Forestry requested – and I approved – cash advancing for 18 projects amounting to approximately $9.9 million staggered over six months beginning this month (reference the attached document titled 2012 Capital Budget $10 million Cash Advance – April 2012).

In mid-April I approved the requested set of cash advances because our projected cash flow shows the County can accommodate the set of cash advances; however, my office's current projected cumulative cash flow balance at July month-end ($17.2 million) shows that we should close on the borrowing and receive the bond proceeds by late July 2012.

Review of Debt Service Analyses for $24.2 Million Capital Borrowing

My office has reviewed two sets of debt service analyses, including the Erie County Fiscal Stability Authority's ("ECFSA" or "the Authority") recent debt service analysis, and recognize that ECFSA's total debt service over the 13-year life of the borrowing (maturity of 2025) is approximately $920,000 less than Erie County's total debt service over the same period. By removing approximately $150,000 in duplicative costs of issuance for the mirror bond transaction, then the difference in total debt service between ECFSA and the County is reduced to only about $768,000.

Considering the comparison of carrying each entity's debt service on an annual basis, the average savings of having the ECFSA conduct the borrowing is only about $59,000 (i.e., $768,000/13 years = $59,077) per year.

Given prevailing low borrowing interest rates for the County (even at its overall lower A credit rating), the County could aggressively reduce the life of the bonds to 11 years (maturity in 2023). Shortening the maturity from 2025 to 2023 would compress the overall difference between the maturities by more than $150,000. I recognize that whether you agree to reduce the maturity is a policy decision that would be principally driven by the Division of Budget and Management's Four Year Financial Plan forecast on annual debt service costs.

Review of Debt Service Analyses with $24.2 Million Capital Borrowing ("New Money") and Re-Funding of Three County Bond Series (2003B, 2004C and 2005A Bonds)

In ECFSA's debt service analysis submission, the Authority's underwriter and financial advisor advances the possibility of completing the 2012 capital borrowing as "new money" and re-funding three series of bonds, amounting to $29.2 million, which will supposedly save the County $1.5 million (or approximately $2.4 million between the new money and re-funding).

A cursory review indicates that it might be cost-effective for the County to have ECFSA re-fund the three bond series along with borrowing the new money for the 2012 capital projects. However, upon detailed review, it would not be cost-effective or prudent for the County to have ECFSA complete the new money borrowing and re-funding of the three bonds.

The reason it would not be financially sound is that the County – or ECFSA on the County's behalf – would borrow $34.4 million to pay off the current $29.2 million required to retire the bonds, the call provision (i.e., pre-payment penalty) and any interest due. In effect, the County would endure a net payout of $5.2 million to pay off the existing bonds and there would be negative arbitrage: the County would consent to borrowing money at a higher rate (approximately 1.7%) and earn interest at a lower rate.

If the County elects to issue a re-funding of bonds, the highest level of savings can be achieved through an ECFSA issuance; however, the negative arbitrage would be so significant in each scenario that it would offset a large portion of the savings.

With interest rates projected to remain at historically low levels through 2014, the County can and should wait to re-fund the bonds as the call date approaches, which will significantly reduce the negative arbitrage in the escrow and ultimately improve the debt service savings.

Justification and Considerations for the County Conducting the Borrowing for the 2012 Capital Projects

I recognize that the ECFSA offers a lower cost of capital to the County on a stand-alone basis. Since ECFSA has a higher credit rating (AA), the Authority is able to obtain lower interest rates than the County. The amount of the interest rate differential changes on a daily basis, and currently the interest rate spreads between credit ratings are narrow as there is a shortage of supply of new issues in the marketplace. Therefore, investors are willing to purchase bonds at lower interest rates.

The ECFSA's borrowings trigger a mirror bond issue by the County for like amounts and terms. These mirror bonds result in additional issuance costs for the Authority's bond counsel and fiscal advisors which reduce the savings derived from the ECFSA's superior rating.

Overall it is important for the County to re-establish itself in the bond markets after nearly 5.5 years of not selling bonds to the public under its own authority. Given current market conditions, the County's relatively small amount to be borrowed for capital projects, and its pace of retiring debt over the next several years, this is an excellent opportunity for the County to re-enter the market place.

There are several other factors to consider:

- The County is set to borrow "only" $24.2 million for its 2012 capital projects which is substantially less than recent prior years ($51.8 million in 2008, $50 million in 2009, $42 million in 2010 and $27 million in 2011).

- At the beginning of 2012, the County's GO debt was approximately $417 million which is a reduction of approximately $32 million from about $449 million at fiscal year-end 2010. Going forward, from 2012-2017, the County is projecting to retire $40 to $45 million in GO debt each year.

- The City of Buffalo ("City") has been permitted by the Buffalo Fiscal Stability Authority to borrow under its own authority even during a control period and the City was recently upgraded to a credit rating of A1. The City's rating is currently a notch above Erie County, in large part due to the City being able to borrow on its own. In April 2012, the City was able to borrow money at less than 3%, which is the lowest interest rate it has ever received. Citing the City's upgrade and successful bond sale, there is clear reason to believe that the County can and will accomplish same.

- The County has an opportunity to soon approach the rating agencies with the County's own borrowing and receive an upgrade in the County's rating. A higher rating for the County will narrow the gap in borrowing interest between the County and the ECFSA and further result in a smaller difference in overall cost of the issue.

- The County has evolved to a strong financial position over the past seven years, including weathering the Great Recession:

    - Posted operating surpluses every year 2005-2011
    - Unassigned fund balance is projected to be $83.6 million as of 12/31/11
    - Total fund balance projected to be $116.3 million as of 12/31/11
    - Collected more than 97% of its property taxes in each fiscal year's first year and nearly 100% within three years of the base fiscal year
    - Sales tax is growing again: 4.5% increase in actual FY 2011 compared to actual FY 2010 and is budgeted to increase 2.5% in 2012

In summary, after consulting with the County's financial advisors, I conclude that given the aforementioned factors and in consideration of the benefit to the County to re-enter the credit markets, this is the opportunity for the County to conduct its own capital borrowing for the first time since 2006.

If you have any questions regarding this correspondence, please contact me at 858-8404.

Sincerely,

David J. Shenk

David J. Shenk
Erie County Comptroller

DJS/nr
Enclosure

Cc: Robert W. Keating, Director, Budget and Management
✓ Erie County Legislature
Erie County Fiscal Stability Authority

2012 Capital Budget $10 million Cash Advance - April 2012 (modified 4/20/12)

Accommodate Cash Advances for DPW and Parks

Dept./Div.	Item No.	Bond Description	Cash Advance
Bldg.	1	Rehab. of Ralph Wilson Stadium	$1,700,000
"	2	Buffalo Niagara Convention Center	$500,000
"	3	Countywide Code & Envir. Compliance	$400,000
"	4	Countywide Highway Facility Improv.	$300,000
"	5	Countywide Roof Replacement	$100,000
"	6	Countywide Mech. Elec. & Plumbing	$250,000
Parks	7	Countywide Parks Improvements	$600,000
"	8	Akron Falls Service Rd. Bridge	$750,000
Bldg.	9	EC Morgue & Toxicology Bldg.	$150,000
"	10	Public Safety Campus Redundant AC	$200,000
Hwy.	11	Preservation of Roads Const.	$2,000,000
"	12	Large Vehicle Replacement	$900,000
"	13	Dam Safety & Preservation -Const.	$150,000
"	14	Dam Safety & Preservation - Design	$600,000
"	15	Lake Ave. Bridge Reconstruction	$220,000
"	16	Preservation of Bridge, Culvert's	$608,432
Parks	17	Roads, Pathways & Parking Lot Repair	$250,000
"	18	Shelter, Building & Comfort Station Replacement	$250,000
			$9,928,432

Cash Flow

	May	June	July	Aug.	Sept.	Oct.
All Projects (in $1,000's)	$2,206	$2,206	$2,206	$1,103	$1,103	$1,104