FitchRatings

Fitch Upgrades Monroe County, NY's GO and IDR to 'A'; Outlook Stable

Fitch Ratings-New York-27 July 2017: Fitch Ratings has upgraded the following Monroe County, NY ratings to 'A' from 'BBB+':

--$99.8 million outstanding unlimited tax general obligation (ULTGO) bonds;
--$84.5 million outstanding limited tax general obligation (LTGO) bonds;
--Long-Term Issuer Default Rating (IDR).

The Rating Outlook is Stable.

SECURITY

The bonds are general obligations of the county for which the county has pledged its full faith and credit and ad valorem tax subject to the 2011 state statute limiting property tax increases to the lesser of 2% or an inflation factor (the tax cap law). This limit can be overridden annually by a 60% vote of the county's governing body.

KEY RATING DRIVERS

The upgrade to an 'A' rating is driven by the county's low long-term liability burden and strong budgetary flexibility, despite weak operating performance characterized by minimal available general fund balance and weak cash position. The county has significant legal ability to increase revenues and satisfactory ability to cut spending.

Economic Resource Base
The county is home to Rochester and located on the southern shore of Lake Ontario in western New York. The county's 2016 population of 747,727 has remained relatively unchanged over the past decade. Wealth levels are average when compared to the state and nation.

Revenue Framework: 'aa' factor assessment
The solid revenue framework reflects Fitch's expectation that revenue growth will approximate inflation over time driven by steady taxable assessed value (AV) increases and significant legal ability to increase revenues under the New York State tax cap.

Expenditure Framework: 'a' factor assessment
The county's expenditure flexibility is adequate and carrying costs for debt service, pension and other post-employment benefits (OPEB) are modest.

Long-Term Liability Burden: 'aaa' factor assessment
The long-term liability burden is low relative to the county's economic resource base.

Operating Performance: 'bbb' factor assessment
The county's financial resilience is limited given its narrow cash position and reserves, despite a high level of budgetary flexibility and low expected revenue volatility.

RATING SENSITIVITIES

Reserve Adequacy: The rating is sensitive to the level of the county's reserves as well as its cash position. A notable decline in the already slim reserves leading to a weakened liquidity position could put negative pressure on the rating; conversely consistent improvement in reserves leading to stronger financial resilience could lead to a positive rating outcome.

CREDIT PROFILE

The county's economy has diversified from its manufacturing roots and is now home to a robust healthcare and higher education presence. The University of Rochester and its associated medical center are the county's leading employers with almost 27,000 employees. Other large employers include Xerox, Wegmans Food Market, Paychex and Lifetime Healthcare. Fitch expects the county to benefit from large state and federally funded economic development projects designed to expand job growth in the long-term, including the American Institute of Manufacturing Phototonics and the Upstate Revitalization Initiative. Unemployment rates historically have trended slightly below the state and the county reports an uptick in mortgage tax collections and home prices. The local housing market was not materially affected by the national housing market downturn and average annual growth in TAV has been approximately 2% since 2008.

Revenue Framework
The county's 2017 budgeted general fund revenues are primarily composed of property taxes and intergovernmental revenues, each accounting for almost 30% of gross general fund revenues. The county's receipt of intergovernmental revenues is largely determined by caseload trends for social services managed by the county as well as state and federal service mandates. Almost 75% of the county's sales tax collections are shared with other local governments including the City of Rochester. The county's portion of sales taxes makes up approximately 15% of general fund revenues.

Fitch expects that growth prospects for general fund revenues will be in line with inflation based on the county's history of moderate growth. A slight decline in general fund revenue in 2014 and 2015 was due to decreased state and federal aid from lower caseloads driven by improved economic opportunities within the local tax base. Locally generated revenue collections improved in 2016 and for the first half of 2017 due to steady increases in taxable assessed values (TAV) and rebounding energy prices; however, intergovernmental aid is expected to remain flat.

The county retains substantial legal ability to raise revenues, despite a New York State law limiting annual property tax revenue increases to the lesser of CPI or 2%. The limit may be overridden by a supermajority of the local governing body. The county has held the tax rate at 8.99 mills since 2008.

The county also has the ability to significantly increase revenues by billing for services to localities, referred to as chargebacks. Beginning in 2008, the county began charge backs for various services including community college and snow removal costs which generated over $40 million in general fund revenue in fiscal 2016. The county also has control over how much hotel tax revenue is allocated and distributed to local governments. In 2017, the county appropriated 86% of the $9.1 million in projected hotel tax collections for distribution.

Expenditure Framework

The majority of the county's general fund expenditures fund health and welfare (45% of budget) and public safety services (20%). State mandated costs for social services and economic assistance comprise a significant amount of the county budget.

Fitch expects that expenditure growth will remain in line with to moderately above revenue growth based on modest labor cost growth, the state cap on growth in Medicaid costs and other initiatives including enhanced federal medical assistance reimbursements. Negotiated salary increases in recent labor contracts have been below the rate of inflation. The most recent police contract was settled through interest arbitration with a modest salary increase in exchange for employee contributions for health insurance and no retroactive payments. There are currently two labor contracts being negotiated.

Fitch believes that expenditure flexibility is adequate although mandated service costs account for more than 70% of the budget. The county's ability to control costs includes hiring freezes, contract reductions, delaying cash funded capital projects and reducing non-mandated programs.

Carrying costs for pension, OPEB and debt service account for a low 9% of general fund expenditures. Pension costs are expected to remain low even though the county has participated in the state pension stabilization plan since 2010 which allowed local governments to amortize for 10 years a portion of annual pension expenses.

Long-Term Liability Burden

The long-term liability burden accounts for a low 6% of personal income. The majority of the long-term liability relates to overlapping debt. The county's tax-supported borrowing plans are a modest $200 million, based on the 2018 - 2023 capital improvement plans.

The county participates in the state's defined benefit retirement systems. The county had elected to amortize the maximum allowable annual pension contribution from fiscal 2010 through 2016 under the state pension stabilization program. The ratio of combined pension assets to liabilities is 81% at a 6% rate of return. The unfunded actuarial accrued liability for other post-employment benefits (OPEB) is $1 billion, or 3% of personal income.

Operating Performance

The county's unrestricted reserve position has historically been very slim, which limits the county's ability to withstand a moderate economic downturn. The county has the legal ability to increase revenues and some capacity to make expenditure reductions; however, Fitch believes the current financial position leaves the county vulnerable to financial stress in the event of a recessionary revenue decline.

The county's $1.18 billion budget is managed at close to break-even levels with the general fund reserve position relative to spending fluctuating between a 1% deficit and a 2% balance since 1993.

The county's unrestricted general fund balance was narrow at 1.4% of general fund expenditures in fiscal 2016. The county has had operating surpluses each year from 2014 to 2016, driven by active cost management of payroll and contractual services and declining health and social service caseloads due to improvements in local employment.

The 2017 adopted budget holds operating expenditures relatively flat over the 2016 budget. Revenue assumptions included in the 2016 and 2017 adopted budgets were conservative, including relatively flat sales tax projections in response to slow growth in 2014 and 2015. Despite depressed fuel prices, 2016 sales tax collections exceeded budgeted estimates by approximately 3% and first half 2017 collections are up 3.5% over the first half of 2016. The 2017 budget assumes a 2.7% increase in property taxes based on growth in TAV. The county has held the property tax rate flat since 2008 and management expects to continue to do so. Mortgage tax collections in 2017 are projected to be up by over 20% from 2015 levels.

Based on year-to-date results, the county anticipates ending 2017 with a modest general fund surplus due in part to positive revenue collections. The county's multi-year budget forecast projects a general fund deficit at the current service levels; however management has been successful in bridging the gap in recent years.

The government-wide cash position is low at only 49 days of operations. The county is reliant on cash flow borrowing due to the timing of receipt of state and federal fund. The 2016 par amount was $70 million or 20% of general fund state and federal aid receipts, a decline from $75 million in 2015.

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Applicable Criteria
U.S. Public Finance Tax-Supported Rating Criteria (pub. 31 May 2017)

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