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Ratings

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Summary:

Clifton, New Jersey; General Obligation; Note

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Table Of Contents

Rationale

Outlook

Related Research

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Credit Profile		
US$17.988 mil BANs ser 2018 due 10/02/2019		
Short Term Rating	SP-1+	New
US$11.893 mil GO bnds ser 2018 due 08/01/2038		
Long Term Rating	AA-/Positive	New
Clifton GO		
Long Term Rating	AA-/Positive	Outlook Revised
Clifton GO		
Unenhanced Rating	AA-(SPUR)/Positive	Outlook Revised

Many issues are enhanced by bond insurance.

Rationale

S&P Global Ratings has revised its outlook to positive from stable and affirmed its 'AA-' long-term rating on Clifton, N.J.'s existing general obligation (GO) bonds . At the same time, S&P Global Ratings assigned its 'AA-' long-term rating and positive outlook to the city's series 2018 GO bonds. In addition, S&P Global Ratings assigned its 'SP-1+' short-term rating to the city's series 2018 bond anticipation notes (BANs).

The outlook revision reflects our opinion that there is a one-in-three chance that we could raise the rating during our two-year outlook horizon. We base the outlook change primarily on the city's improved financial policies and practices, as well as on recent positive economic momentum stemming from a number of economic projects that we believe could help improve city revenues.

The short-term rating reflects our criteria for evaluating and rating BANs. In our view, Clifton maintains a very strong capacity to pay principal and interest when the BANs come due. The city maintains what we view as a low market-risk profile, because it has strong legal authority to issue long-term debt to take out the BANs, and Clifton is a frequent issuer that regularly provides ongoing disclosure to market participants.

The city's full faith and GO credit pledge secures the bonds and BANs.

Bond proceeds will refund existing BANs maturing October 4, 2018. BANs proceeds will refund existing BANs that will also mature October 4, 2018.

In our opinion, the rating reflects the city's:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;

- Strong budgetary performance, with an operating surplus in the general fund in fiscal 2017;
- Strong budgetary flexibility, with an available fund balance in fiscal 2017 of 11.6% of operating expenditures;
- Very strong liquidity, with total government available cash at 39.8% of general fund expenditures and 5.2x governmental debt service, and access to external liquidity that we consider strong;
- Weak debt and contingent liability profile, with debt service carrying charges at 7.6% of expenditures and net direct debt that is 74.8% of general fund revenue, and a large pension and other postemployment benefits (OPEB) obligation and the lack of a plan to sufficiently address the obligation, but low overall net debt at less than 3% of market value; and
- Strong institutional framework score.

Strong economy

We consider Clifton's economy strong. The city, with an estimated population of 86,381, is located in Passaic County in the New York-Newark-Jersey City MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 106.0% of the national level and per capita market value of $111,623. Overall, the city's market value grew by 0.5% over the past year to $9.6 billion in 2017. The county unemployment rate was 5.7% in 2017.

Clifton is 15 miles west of New York City in Passaic County. The city is mature, primarily residential, with an ample commercial, industrial, and retail sector that account for 25% of the tax base. Despite its mature nature, the city continues to experience development and redevelopment. Given its location and excellent access, residents find employment throughout the broader northern New Jersey and New York City employment bases. Wealth and income levels are slightly above national levels while county unemployment is above that of the nation.

In June 2012, Hoffman-La Roche--the city's leading taxpayer and one of the area's leading employers--announced the closing of its research and development site that straddles both the township of Nutley (75%) and Clifton (25%). About 1,000 employees lost their jobs when operations ceased in December 2013,. The company had long provided stability to the area. Since the closure, the property has been purchased and is being developed into a 116-acre biotech office site. Hackensack Meridian Health and Seton Hall University have opened a new, four#?year school of medicine at the site (primarily in Nutley). However, Quest Diagnostics is planning to build 250,000 square feet of labs and offices plus a parking garage in the city's portion of the site. A payment-in-lieu-of-taxes (PILOT) agreement was recently signed, and will provide the city with an additional $800,000 of revenues annually. The site continues to be marketed for future development.

Despite ongoing economic development, the city's tax base has seen modest declines in recent years, stemming from several commercial appeals. Just a few smaller appeals remain outstanding and are not expected to negatively affect the tax base in the next several years. In addition, the city reserves for appeals. Management estimates AV at $5.3 billion for fiscal 2018. With the majority of appeals in the past and the former Hoffman-LaRoche site purchased and under construction, we believe the tax base should remain stable and see modest growth in the near term. In addition, the city may be required to perform a property revaluation in 2020 or 2022.

Strong management

We view the city's management as strong, with good financial policies and practices under our FMA methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them on a regular basis.

Based upon receipt of updated fiscal policies, the FMA has been revised to good from standard.

Highlights include the use of historical trend analysis for budget preparation, coupled with monthly monitoring and reporting of budget to actuals. The city does not perform any long-term financial planning, but does maintain the state required six-year capital improvement plan (CIP), which is updated annually and includes both projects and funding sources. The city also maintains its own cash-management plan, which mirrors state requirements. However, no regular reporting is provided to the board, as almost all of the city's investments are currently in money-markets. There is no formal debt issuance policy. The city does maintain a formal reserve policy that requires reserves to remain, at least, 4% of budget and requires no more than 50% of reserves in subsequent years' budgets. If reserves fall below 4%, the city must make every effort to restore reserves to formal levels by the next budget year.

Strong budgetary performance

Clifton's budgetary performance is strong, in our opinion. The city had surplus operating results in the general fund of 1.9% of expenditures in fiscal 2017.

Clifton closed fiscal 2017 with its fourth operating surplus in the past five fiscal years (2013-2017) and aiding in increasing total available reserve levels. Management attributes the recent surpluses to revenues coming in over budget, primarily from court fees and interest on investments while expenditures were slightly under budget.

Property taxes accounted for 75% of fiscal 2017 current fund revenue followed by state aid at 9%. The city has managed within the state mandated levy cap allowing cap bank to expire. Clifton's collections have been sound, in our view: averaging 98.5% annually over the past five years.

To date, the city projects to close fiscal 2018 on a breakeven basis, keeping reserves in-line with fiscal 2017. If certain miscellaneous revenues, such as court fees, continue to track above budget, the city may experience a modest surplus. Additional revenues received from recently agreed on PILOT payments coming from the former Hoffman-LaRoche property (once construction is complete) should help to maintain strong budgetary performance in subsequent years.

We believe that management's ability to manage rising fixed costs, while increasing reserves, will play a role in maintaining the city strong budgetary performance. We believe budgetary performance will likely remain, at least, adequate in the near term.

Strong budgetary flexibility

Clifton's budgetary flexibility is strong, in our view, with an available fund balance in fiscal 2017 of 11.6% of operating expenditures, or $12.3 million.

Over the past three fiscal years (2015-2017), the city has steadily built up reserves to what we consider strong levels following the planned drawdown in fiscal 2015 for tax stabilization purposes. With fiscal 2018 projecting, at least, balanced operations and no plans to spend down on reserves, we believe the city's budgetary flexibility will remain strong.

Very strong liquidity

In our opinion, Clifton's liquidity is very strong, with total government available cash at 39.8% of general fund expenditures and 5.2x governmental debt service in 2017. In our view, the city has strong access to external liquidity if necessary.

We believe Clifton's regular debt issuance supports its strong access to external liquidity.

Clifton has contingent liquidity risk exposures that we consider manageable at the current rating level. The exposures come from $3.165 million of GO debt sold directly to a local bank to refund the city's existing series 2006 GO bonds. There are no acceleration provisions and the bonds will mature in 2026. However, we believe the city has sufficient liquidity to offset the risk.

Furthermore, Clifton has additional reserves outside the current fund (self-insurance and other trust fund), which have not been included in these calculations, that can be used for specific purposes. Although the state allows for what we view as permissive investments, we believe the city does not currently have aggressive investments.

It has consistently maintained very strong liquidity, and we expect our assessment of liquidity to remain unchanged during the outlook period.

Weak debt and contingent liability profile

In our view, Clifton's debt and contingent liability profile is weak. Debt service is 7.6% of general fund expenditures, and net direct debt is 74.8% of general fund revenue. Overall net debt is low at 2.2% of market value, which is in our view a credit strength.

Although the city's six-year (2018-2023) CIP includes projects totaling $29.2 million, management has no plans to issue any additional debt in the near term.

In our opinion, a credit weakness is Clifton's large pension and OPEB obligation, without a plan in place that we think will sufficiently address the obligation. Clifton's combined required pension and actual OPEB contributions totaled 14.8% of general fund expenditures in 2017. Of that amount, 8.6% represented required contributions to pension obligations, and 6.2% represented OPEB payments. The city made its full annual required pension contribution in 2017. The funded ratio of the largest pension plan is 54.5%.

The city participates in the cost-sharing multiple-employer Police and Firemen's Retirement System (PFRS) and Public Employees' Retirement System (PERS) pension plans. The plan fiduciary net position as a percent of the total pension liability, as defined in the Governmental Accounting Standards Board (GASB) Statement No. 67, was 54.52% for PFRS and 36.78% for PERS as of June 30, 2017. Although the plans' funded ratio(s) have slightly improved since last year, they remain significantly underfunded. This is the result of numerous years of underfunding by the state, aggressive assumptions, and weak market performance. Under current funding assumptions, PFRS is projected to be exhausted by 2057 and PERS by 2040. This projection reflects a projected asset return of 7%, the plan actuary's modified mortality projection table, and the projected unit credit (PUC) actuarial methodology. We believe use of PUC understates liabilities and could result in inadequate plan assets. In addition, unfunded liabilities are amortized over an open 30-year period, which we believe does not sufficiently pay down unfunded liabilities in a timely fashion.

Projections assume actuarial contributions are calculated in accordance with the state's plan to phase in a reduction to its funding discount rate to 7.00% from 7.50% over the next four years. This change is positive in that it lowers the system's reliance on investment returns; however, it will also result in higher contributions for local government units. In fiscal 2017, the city made its portion of the actuarially determined contribution (ADC) of $7.5 million for PFRS and $1.6 million PERS. In 2009, the state allowed local employers to fund 50% of their ADC. The city elected to defer a portion of its payment that year. The deferred amount totaled $3,531,897 and will be paid back with interest over 15 years, beginning in 2012.

Although assets and liabilities are separated between local and state employers when calculating the local government's contribution, these are cost-sharing systems as defined by GASB and, therefore, there is no legal separation. Assets are in a common pool and all employer contributions go to this common pool. Benefits are paid to plan retirees regardless of whether the corresponding employer fully paid its contribution or not. Given that the state has not fully funded its contribution requirement for more than a decade for either plan, we believe local government annual pension contributions may increase if assets allocated to the state for funding calculations are depleted. Legislation passed in 2017 transfers lottery revenue to PERS, PFRS, and the Teachers' Pension and Annuity Fund, and changes the timing of pension funding payments from end-of-year to quarterly. We believe this legislation will have a moderately positive effect in that the state should no longer be able to completely abstain from making contributions. However, paying 100% of the ADC into the plans would mitigate the risk of becoming increasingly underfunded. Furthermore, to the extent that the overall system becomes increasingly underfunded, experiences negative cash flows, or needs to revise its return assumptions downward, local governments could face increasing contributions.

The city also provides OPEB to eligible city retirees through a single employer defined benefit health care plan administered by the city.

The unfunded actuarial accrued liability for the city's OPEB as of Dec. 31, 2017, is $189.2 million. These benefits are funded on a pay-as-you-go basis with no mechanism in place that allows for prefunding, limiting the city's ability to plan for these costs. In 2017, the city contributed $6.5 million toward its OPEB obligations, which represented 27% of its annual required contribution for its OPEB costs.

Strong institutional framework

The institutional framework score for New Jersey municipalities is strong.

Outlook

The positive outlook reflects our opinion that we believe there is a one-in-three chance that we could raise the rating over our two-year outlook horizon. We base the outlook change primarily on the city's improved financial policies and practices, as well as recent positive economic momentum stemming from a number of projects that we believe could improve Clifton's revenues. To the degree economic indicators improve and the city's finances benefit from these development projects, all other factors constant, we could raise the rating. Conversely, if the city encounters fiscal stresses stemming from an increased level of tax appeals or inability to manage rising fixed costs, including pension and OPEB costs, and the city uses reserves to bridge any imbalance, we could revise the outlook back to stable.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Incorporating GASB 67 And 68: Evaluating Pension/OPEB Obligations Under Standard & Poor's U.S. Local Government GO Criteria, Sept. 2, 2015
- 2017 Update Of Institutional Framework For U.S. Local Governments