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Ratings

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Summary:

Clifton, New Jersey; General Obligation; Note

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Credit Profile		
US$32.438 mil BANs ser 2019 dtd 09/19/2019 due 09/30/2020		
Short Term Rating	SP-1+	New
Clifton BANs ser 2019 dtd 09/19/2019 due 09/30/2020		
Short Term Rating	SP-1+	Affirmed

Rationale

S&P Global Ratings assigned its 'SP-1+' short-term rating to Clifton, N.J.'s series 2019 general improvement and sewer utility bond anticipation notes (BANs). At the same time, we affirmed our 'AA-' long-term rating on the city's existing general obligation (GO) debt. The outlook is positive.

The city's location and participation in the broad and diverse New York City-Northern New Jersey metropolitan area and its recent economic re-development and stable financial position lend stability to the rating. The city's historically strong budgetary flexibility has also been factored into the rating. However, recent tax appeals and the potential for additional appeals if the city were to be required to undergo another property revaluation coupled with above-average fixed costs, which include pension and other postemployment benefit (OPEB), remain a concern. The maintenance of, at least, strong reserves and continuance adherence to fiscal policies remain an integral component to the rating.

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.

Note proceeds will refund existing BANs maturing Oct. 2, 2019, as well as finance various city and sewer capital needs.

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 methodology;
- Adequate budgetary performance, with operating results that we expect could improve in the near term relative to fiscal 2018, which closed with a slight operating deficit in the current fund in fiscal 2018;
- Strong budgetary flexibility, with an available fund balance in fiscal 2018 of 9.9% of operating expenditures;
- Very strong liquidity, with total government available cash at 31.8% of current fund expenditures and 4.3x governmental debt service, and access to external liquidity we consider strong;

- Weak debt and contingent liability position, with debt service carrying charges at 7.4% of expenditures and net direct debt that is 64.3% of general fund revenue, and a large pension and 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 85,620, is located in Passaic County in the New York-Newark-Jersey City, N.Y.-N.J.-Pa. MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 95.4% of the national level and per capita market value of $116,317. Overall, the city's market value grew by 3.3% over the past year to $10.0 billion in 2018. The county unemployment rate was 5.1% in 2018.

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%). 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. However, in fiscal years 2018 and 2019, assessed values have increased modestly; reflective of the ongoing re-development. 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. Assessed value is estimated at $5.32 billion for fiscal 2019. 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 with modest growth in the near term. In addition, the city may be required to perform a property revaluation in the near term.

Strong management

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

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.

Adequate budgetary performance

Clifton's budgetary performance is adequate in our opinion. The city had slight deficit operating results in the general fund of negative 1.2% of expenditures in fiscal 2018. Our assessment accounts for the fact that we expect budgetary results could improve from 2018 results in the near term.

Following two years of surpluses, the city closed fiscal 2018 with a $1.36 million drawdown. The drawdown is the result of the city's decision to use a portion of reserves for tax stabilization purposes, following a year where revenues exceeded budget, primarily from an increase in delinquent tax collections (following the federal state and local taxes deductions; aka SALT), and investment earnings. Property taxes accounted for 71% of fiscal 2018 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 over 98% annually over the past five years.

Management reports fiscal 2019 is trending on target with budget. Certain revenues, primarily construction code fees, are expected to come in over budget while others may be slightly below budget. Expenditures are currently tracking in line with budget. Reserves are expected to remain in line with fiscal 2018. Management has no plans to draw down on them. In addition, revenues received from recently agreed on PILOT payments coming from the former Hoffman-LaRoche property (once construction is complete) should help to maintain, at least, adequate budgetary performance in subsequent years.

We believe that management's ability to manage rising fixed costs, while maintaining or increasing reserves, will play a role in maintaining the city's stable 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 2018 of 9.9% of operating expenditures, or $10.9 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. Again in fiscal 2018, the city used a portion of reserves for tax stabilization purposes, which modestly reduced available reserve levels. However, with no plans to further significantly draw on reserves and an anticipated breakeven year for fiscal 2019, 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 31.8% of general fund expenditures and 4.3x governmental debt service in 2018. 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.

We understand the city maintains one privately placed GO issuance, with a current balance of $2.145 million, held by a local bank. Proceeds were used to refund the city's existing series 2006 GO bonds. There are no acceleration provisions and the bonds will mature Aug. 1, 2026. However, we do not believe this poses a material risk to the city's liquidity position.

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 7.4% of general fund expenditures, and net direct debt is 64.3% of general fund revenue. Overall net debt is low at 2.2% of market value, which is in our view a positive credit factor. 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.

Although the city's six-year (2019-2024) capital improvement plan includes projects totaling $76.7 million, future bond issuance amounts have not yet been determined.

Clifton's combined required pension and actual OPEB contributions totaled 13.9% of general fund expenditures in 2018. Of that amount, 8.9% represented required contributions to pension obligations, and 5.0% represented OPEB payments. The city made its full annual required pension contribution in 2018. The funded ratio of the largest pension plan is 57.9%.

While the city is currently managing pension costs and paying its full required portion of the actuarially determined contribution in 2018, we believe the city has limited ability to control future growth of contributions and, with regard to OPEB obligation, has no mechanism for prefunding its share of the liabilities.

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 reported plan fiduciary net position as a percentage of the total pension liability was 57.91% for PFRS and 40.45% for PERS as of July 1, 2018. While funding policies somewhat mitigate the risks for local governments of escalating contributions due to low plan funded ratios, the city could face escalating pension costs should the state not follow its current schedule of increasing pension contributions. For more details and information on these risks, see our report "New Jersey Pension Funding: State Actions Reverberate At The Local Level," published Dec. 12, 2018.

In fiscal 2018, the city made its portion of the actuarially determined contribution (ADC) of $8.0 million for PFRS and $1.9 million for 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.

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, 2018, is $216.5 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.

Strong institutional framework

The institutional framework score 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 one-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 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

Ratings Detail (As Of September 12, 2019)		
Clifton BANs		
Short Term Rating	SP-1+	Affirmed
Clifton GO		
Long Term Rating	AA-/Positive	Affirmed
Clifton GO		
Unenhanced Rating	AA-(SPUR)/Positive	Affirmed

Many issues are enhanced by bond insurance.