S&P Global Ratings

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Summary:

Clifton, New Jersey; General Obligation; Note

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Credit Profile		
US$38.334 mil BANs ser 2020 dtd 09/30/2020 due 09/29/2021		
Short Term Rating	SP-1+	New

Rating Action

S&P Global Ratings assigned its 'SP-1+' short-term rating to Clifton, N.J.'s series 2020 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 stable.

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 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. 1, 2020, as well as temporarily finance various city and sewer capital needs.

Credit overview

The rating benefits from Clifton's location and participation in the broad and diverse New York City-Northern New Jersey metropolitan area and its recent economic redevelopment. Following a planned draw on reserves in fiscal 2018, unaudited results for 2019 show a return to surplus results in line with historically strong performance. The strong reserve position allows the city to weather any adverse revenue shocks resulting from the pandemic and recessionary pressures in the near term. In the longer term, above-average fixed costs, which include pension and other postemployment benefits (OPEB), remain a risk. The maintenance of at least strong reserves and continuance adherence to fiscal policies remain an integral component to the rating.

Although we note significant uncertainty around the effects of recessionary pressures on revenues and future economic growth, Clifton's generally stable revenue mix, with the predominant revenue stream of property taxes accounting for 71% of current fund revenues, which have historically collected upward of 98% during the fiscal year payable, lends stability to the rating. That said, given that there is still much uncertainty regarding the potential effects of COVID-19 and the ensuing recession on the city's finances, we will continue to monitor for any material adverse effects throughout the outlook period.

The rating reflects our opinion of 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;
- Adequate budgetary performance, reflecting expectations for improved fiscal 2019 results following a planned draw on fund balance in fiscal 2019 but also accounting for potential budgetary risks in fiscal years 2020 and 2021 resulting from the pandemic and recessionary pressures;
- 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 profile, with debt service carrying charges at 7.4% of expenditures and net direct debt that is 60.5% 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.

Environmental, social, and governance factors

We evaluated the city's environmental, social, and governance (ESG) factors relative to its economy, financial measures, management, and debt and long-term liability profile. We acknowledge, absent the implications of COVID-19 that could pressure some revenue sources, that we consider the city's social risks in line with those of the sector. We also view its governance risks and environmental risks as generally in line with the sector standard.

Stable Outlook

Downside scenario

We could lower the rating if Clifton encounters fiscal stresses stemming from an increased level of tax appeals or inability to manage rising fixed costs, including pension and OPEB costs, and it uses reserves to bridge any imbalance.

Upside scenario

Conversely, we could raise the rating if economic indicators improve to levels comparable with those of higher-rated peers and the city's finances benefit from development projects, leading to sustained surpluses and higher reserves.

Credit Opinion

Strong economy

We consider Clifton's economy strong. The city, with an estimated population of 86,393, is located in Passaic County in the New York-Newark-Jersey City, N.Y.-N.J.-Pa. MSA, which we consider broad and diverse. The city has projected per capita effective buying income of 99.7% of the national level and per capita market value of $120,842. Overall, the city's market value grew by 4.8% over the past year to $10.4 billion in 2019.

Clifton is 15 miles west of New York City in Passaic County. The city is mature, primarily residential, with ample commercial, industrial, and retail sectors that account for 25% of the tax base. Despite the city's mature nature, development and redevelopment are ongoing. Given its location and excellent access, residents find employment throughout the broader northern New Jersey and New York City employment bases. The county unemployment rate jumped following the pandemic's onset and was 17.8% in July 2020. That said, Clifton's unemployment rate has historically trended somewhat below county levels. In addition, S&P Global Economics now expects a somewhat shallower recession in 2020 followed by a modest recovery in 2021 (for more information, please see "The U.S. Economy Reboots, With Obstacles Ahead," published Sept. 24, 2020, on RatingsDirect).

The former site of Hoffman-LaRoche's research and development center, which straddles the township of Nutley and Clifton, 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). In addition, Quest Diagnostics broke ground in 2019 on a 250,000-square-foot construction of labs and offices plus a parking garage in the city's portion of the site. Clifton signed a payment-in-lieu-of-taxes (PILOT) agreement with the company that will provide it with an additional $800,000 of revenues annually. The site continues to be marketed for future development.

Following a drop in assessed values (AV) in fiscal 2017, primarily due to the ongoing redevelopment of the former Hoffman-LaRoche site, AV has increased steadily. Because the city is mostly built out, tax base growth has come mostly through redevelopments of existing properties. We understand a larger transit-oriented development could be forthcoming on the former Black Prince Distillery site near the city's train station. The city would likely enter into a PILOT agreement for this development as well. While Clifton is not subject to any material tax appeals, we understand its planning board is facing a $10 million lawsuit after denying an application for a hotel development. We understand risks to the city's financial situation are contained, as the city carries insurance for these events.

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.

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 conduct 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. Clifton also maintains its own cash management plan, which mirrors state requirements. However, no regular reporting is provided to the board, as almost all investments are 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 being used in subsequent years' budgets. If reserves fall below 4% or reserve appropriations exceed 50%, as they do in 2020, the city must make every effort to restore reserves to formal levels by the next budget year.

We view positively the steps management has taken to protect itself from emerging risks, such as cyber risks.

Adequate budgetary performance

Clifton's budgetary performance is adequate in our opinion. Following a slight draw on the fund balance due to an operating result in the current fund of negative 1.2% of expenditures in fiscal 2018, unaudited results for fiscal 2019 indicate a return to surplus operations. Our assessment also accounts for potential near-term risks from the pandemic and recessionary pressures that have negatively affected some of Clifton's revenues.

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), 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.

Unaudited results for fiscal 2019 indicate a return to surplus results and an addition to fund balance, bringing results back in line with historical performance. The fiscal 2020 budget was adopted following the onset of the pandemic and, therefore, reflects many of the anticipated budgetary challenges. The budget also includes a somewhat larger-than-usual surplus appropriation of $7.7 million (about 59% of available current fund balance) but also a tax levy increase of 2%, the maximum allowable under New Jersey law. Management reports that property tax revenues track broadly in line with historical collection rates, notwithstanding some minor shortfalls and delays given the extended payment deadlines. Other revenues, especially court revenues, are tracking below budget. However, Clifton is generating some savings on the expense side, given that city hall is closed. On the personnel side, it also generated some savings on crossing guards and parking enforcement officers. In addition, the city received $4.9 million in Coronavirus Aid, Relief, and Economic Security Act funding from Passaic County, which covers pandemic-related expenses. Overall, we believe Clifton could make a small draw on fund balance in fiscal 2020, although reserve levels would remain in line with historically strong levels.

In the longer term, 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. That said, unaudited fiscal 2019 results show an increase to about $13.0 million or 10.4% of operating expenditures.

Notwithstanding planned drawdowns for tax stabilization purposes in fiscal years 2015 and 2018, the city has a track record of strong budgetary performance and a steady buildup of available reserves. Unaudited fiscal 2019 reserves confirm this track record, as Clifton has likely been able to add to fund balance again. Considering potential budgetary shortfalls, given the ongoing pandemic and recessionary pressures, we believe 2020 could potentially see a small draw on available reserves. That said, we believe the city will likely maintain reserves at levels we consider 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 $1.820 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 it can use 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 will be 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 60.5% of general fund revenue. Overall net debt is low at 2.0% 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 (2020-2025) CIP includes projects totaling $83.6 million, future bond issuance amounts have not yet been determined. Nevertheless, we understand the city expects to permanently finance outstanding BANs in 2021, given the drop in debt service costs in subsequent years.

Pension and other postemployment benefits

- We view pension and OPEB liabilities as a source of credit pressure for Clifton, as for most New Jersey local governments.
- While it is currently managing pension costs, we believe the city has limited ability to control future growth of these liabilities, given state restrictions and funding discipline.
- OPEBs are, by state statute, funded on a pay-as-you-go basis, which, given claims volatility as well as medical cost and demographic trends, is likely to lead to escalating costs.

Clifton participates in the following state-administered pension plans:

- Police and Firemen's Retirement System (PFRS): 57.9% funded as of June 30, 2018 with a crossover date in 2076, with a proportional share of the net pension liability (NPL) equal to $165.7 million;
- Public Employees' Retirement System (PERS): 40.5% funded as of June 30, 2018 with a crossover date in 2057, with a proportional share of the NPL equal to $87.7 million.

Although the city is handling pension and OPEB costs, its combined required pension and actual OPEB contributions are an elevated 13.9% of current fund expenditures as of 2018. Of that amount, 8.9% represented required contributions to pension obligations, and 5.0% represented OPEB payments. Although it funds 100% of its pension actuarially determined contributions (ADCs), contributions fell short of both static and minimum funding progress, in part because of poor assumptions and methodologies, but also due to the state's continued underfunding of its portion of the ADC. The plans' 30-year, level-dollar open amortization schedule will result in slow funding progress. 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). The state announced it would reduce scheduled fiscal 2020 pension contribution increases and in addition, not make up shortfalls from lottery contributions, which could result in higher required contributions for Clifton.

In fiscal 2018, the city made its portion of the 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 in 2012 the city started paying back the deferred amount with interest over 15 years.

OPEB liabilities are funded on a pay-as-you-go basis, which, given claims volatility as well as medical cost and demographic trends, could lead to escalating costs in the short term. The actuarially determined OPEB liability totals $216.5 million. New Jersey does not allow cities to establish dedicated OPEB trusts. If pension or OPEB costs escalate, we believe these expenditures could crowd out others associated with operations and create budgetary pressure over the long term.

Strong institutional framework

The institutional framework score is strong.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of September 30, 2020)		
Clifton BANs ser 2019 dtd 09/19/2019 due 09/30/2020		
Short Term Rating	SP-1+	Affirmed
Clifton BANs ser 2020 dtd 09/30/2020 due 09/29/2021		
Short Term Rating	SP-1+	Affirmed
Clifton GO		
Long Term Rating	AA-/Stable	Affirmed
Clifton GO (FGIC) (National)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		