

RatingsDirect®

Summary:

Emerson Borough, New Jersey; General Obligation

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US\$6.82 mil gen imp bnds ser 2020 dtd 08/20/2020 due 08/15/2032

Long Term Rating AA+/Stable New

Emerson Boro gen imp bnds

Long Term Rating AA+/Stable Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to Emerson Borough, N.J.'s \$6.82 million series 2020 general improvement general obligation (GO) bonds. At the same time, S&P Global Ratings affirmed its 'AA+' rating on the borough's existing GO debt. The outlook is stable.

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

Proceeds from this issue will be used to currently refund the borough's bond anticipation notes maturing on Aug. 21, 2020; the remaining \$1.7 million will be used to finance various capital needs.

Credit overview

Emerson is a mature, affluent, predominantly residential community, with good access to the Northern New Jersey and New York City employment centers. Our rating reflects our view of the borough's stable economy and predominantly property tax-funded operating budget, along with its conservative budgeting practices, including maintaining reserves at over 20% of expenditures over the past three years.

As with most local governments, COVID-19 and the related recession could modestly pressure Emerson's budget during the next one-two years. In-line with our view of ongoing economic contraction, we expect revenue will likely lag historical performance. (For further information, see "U.S. Real-Time Economic Data Suggests Hopeful Signs Of A Recovery Could Be Short-Lived," published July 16, 2020, on RatingsDirect.) However, we do not expect the pandemic and recession to affect the borough's ability to maintain, what we consider, balanced finances during the longer term, as management recently adopted a formal reserve policy calling for a minimum of 10% of expenditures. Management has identified budgetary adjustments for fiscal 2020 to offset lower-than-expected revenue in a few major line items and potentially higher COVID-19-related expenditures. We do not expect to change the rating during the next few years. While our outlook is generally for two years, we see some risk due to COVID-19 and the related recession during the next six-12 months.

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

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);

- Adequate management, with standard financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with an operating surplus in the current fund in fiscal 2019;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2019 of 27% of operating expenditures;
- Very strong liquidity, with total government available cash at 39.5% of current fund expenditures and 3.6x governmental debt service, and access to external liquidity we consider strong;
- Strong debt and contingent liability profile, with debt service carrying charges at 11.1% of expenditures and net direct debt that is 73.2% of general fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 80.9% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Environmental, social, and governance (ESG) factors

The rating incorporates our view regarding health and safety risks posed by COVID-19. Absent COVID-19, we consider the borough's social risks to be in-line with sector standards. We have analyzed the borough's environmental and governance risks relative to its economy, management, financial measures, and debt and liability profile and determined all are in-line with our view of the sector standard.

Stable Outlook

Downside scenario

In our opinion, if budgetary performance were to deteriorate significantly, leading to diminished reserves, due to the recession or over the longer term due to rising fixed costs, including pension and other postemployment benefits (OPEB) contributions, we could lower the rating.

Upside scenario

Conversely, if Emerson were to experience and sustain higher economic metrics and maintain its trend of positive budgetary performance and reserves, while mitigating long-term liabilities, and if management were to continue to adhere to its recently adopted formal policies and practices, we could raise the rating.

Very strong economy

We consider Emerson's economy very strong. The borough, with an estimated population of 7,596, is located in Bergen County in the New York-Newark-Jersey City MSA, which we consider to be broad and diverse. The borough has a projected per capita effective buying income of 134% of the national level and per capita market value of \$175,798. Overall, the borough's market value grew by 1.8% over the past year to \$1.3 billion in 2019. The county unemployment rate was 2.9% in 2019. While we believe unemployment will rise in the near term as a result of the recession, we do not believe it will negatively affect the rating.

Emerson encompasses 2.5 square miles about 14 miles northwest of New York City. The borough is mature and predominantly residential. Given its proximity to New York City and ease of transportation via major roadways and rail (NJ Transit), residents find employment throughout the Northern New Jersey and New York City employment bases. Therefore, wealth and income levels are above the nation while county unemployment has historically been

below the national level. Although we expect unemployment to rise in the near term as a result of the COVID-19 pandemic and ensuing recession, we do not believe it will have a significant impact on the local economy.

Although mature, the borough will experience modest economic development over the near term, as a 147-unit apartment building has approved near the train station. However, construction has not yet begun. With a payment in lieu of taxes in place for this project (30 years), the tax base is expected to remain relatively consistent over the near term. Although Emerson has outstanding tax appeals, they are modest in nature and fully covered through the borough's reserve for appeals.

Adequate management

We view the borough's management as adequate, with standard financial policies and practices under our FMA methodology, indicating the finance department maintains adequate policies in some but not all key areas.

Highlights include the use of historical trend analysis for budget preparation, coupled with monthly monitoring and reporting of budget to actuals. The borough recently implemented a six-year, long-term financial plan, which incorporates the budget year and looks five years out. The plan includes assumptions for revenues (with the exception of miscellaneous revenues) and expenditures. Management said that it plans to update this plan annually. Emerson also recently adopted a formal reserve policy, which allows the borough to use up to 50% of fund balance in the preceding budget and maintain current fund balance reserves at a minimum of 10% of expenditures. The borough does not maintain a formal debt policy of its own. Emerson maintains a three-year capital improvement plan, as required by the state. Although it identifies capital projects, the plan does not identify the funding sources for all years. Emerson follows state guidelines for investments, monitoring and reporting performance monthly. Lastly, Emerson maintains cyber-security insurance through the state's joining insurance fund. In our opinion, if the borough were to continue to adhere to its recently adopted formal policies, creating a healthy track record, the management score could improve over time.

Adequate budgetary performance

Emerson's budgetary performance is adequate, in our opinion. The borough had surplus operating results in the general fund of 4.5% of expenditures in fiscal 2019.

Because of the sudden rapid economic deterioration across the nation, we have applied our event risk adjustment, shifting the budgetary performance assessment to adequate from strong. This assessment incorporates heightened near-term uncertainty that exists due to the recessionary pressures related to the COVID-19 pandemic and resulting financial pressures.

The borough's financial position remains positive, having closed each fiscal year since 2012 with surpluses and increasing reserves to very strong levels. Fiscal 2019 closed with a \$549,000 operating surplus. Management attributes these surpluses to ongoing conservative budgeting practices, increases in miscellaneous revenues, lapsed appropriations, and school tax deferrals (which are permitted within state statutes). Property taxes account for 80% of total current fund revenues. Collections have been strong, averaging 99% over the past five years. Furthermore, the borough levies only what is necessary under the state-mandated levy cap and does not use any allowable waivers, with available cap bank expiring. Therefore, we believe the borough has additional flexibility, should it need it.

Midway through fiscal 2020, management reports major revenues and expenditures are tracking on target with budget. Certain revenues, such as court and construction fees, are trending below budget as a result of the pandemic, but they comprise less than 2% of budget. However, expenditure savings are likely to offset these reductions. Surplus anticipated increased somewhat in the fiscal 2020 budget to \$1.495 million, compared with \$1.040 million in fiscal 2019. Included in the surplus anticipated are some reserves for soft costs for future capital needs. Nevertheless, management believes fiscal 2020 could close with a modest drawdown or on a break-even basis.

While we believe the borough will face some near-term challenges as a result of the recession, we do not expect budgetary performance to further weaken over the near term.

Very strong budgetary flexibility

Emerson's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2019 of 27% of operating expenditures, or \$3.3 million.

With the projection for either a modest drawdown or break-even fiscal 2020, coupled with the recent adoption of a formal reserve policy, we do not expect the borough's reserve position will significantly weaken over the near term, despite potential COVID-19-related pressures. Furthermore, the borough has about \$1.29 million in banked levy capacity that it could use if necessary, providing additional flexibility.

Very strong liquidity

In our opinion, Emerson's liquidity is very strong, with total government available cash at 39.5% of general fund expenditures and 3.6x governmental debt service in 2019. In our view, the borough has strong access to external liquidity if necessary.

We believe the borough has strong access to external liquidity, having issued GO bonds and notes infrequently over the past 20 years. Emerson does not maintain any investments we deem aggressive. Furthermore, the borough does not have any material contingent liability risks because it does not maintain any privately placed bank loans. Given Emerson's projection for, at least, a break-even year in fiscal 2020, we do not expect liquidity to weaken over the near term. Conversely, if the borough significantly draws on reserves without a timely plan to restore them, it could negative affect the rating.

Strong debt and contingent liability profile

In our view, Emerson's debt and contingent liability profile is strong. Debt service is 11.1% of general fund expenditures, and net direct debt is 73.2% of general fund revenue. Overall net debt is low at 1.7% of market value, and approximately 80.9% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

Following this issuance, Emerson will have \$10.2 million of direct debt outstanding. The borough plan to propose an ordinance to the governing body for the issuance of approximately \$11 million of GO debt to finance the renovation and construction of a new municipal building. The decision to issues GO bonds or notes has not yet been finalized. Nevertheless, we do not expect Emerson's debt and liability profile to significantly weaken if the GO debt was issued over the near term.

- We view pension and OPEB liabilities as a source of credit pressure for Emerson, as with most New Jersey local

governments.

- While it is currently managing pension costs, in our opinion, the borough has limited ability to control future growth of these liabilities.
- 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.

Emerson participates in the following state-administered pension plans:

- Police and Firemen's Retirement System: 60.2% funded with a proportional share of the net pension liability equal to \$11.5 million.
- Public Employees' Retirement System: 42% funded with a proportional share of the net pension liability equal to \$10.5 million.

Emerson's combined required pension and actual OPEB contributions totaled 7.0% of general fund expenditures in 2019. Of that amount, 6.6% represented required contributions to pension obligations, and 0.4% represented OPEB payments. The borough made its full annual required pension contribution in 2019. Although it funds 100% of its actuarially determined contributions (ADCs) for pensions as billed by the State of New Jersey, contributions fell short of both static and minimum funding progress, in part because of poor assumptions and methodologies, but also as a result of 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 "New Jersey Pension Funding: State Actions Reverberate At The Local Level," published Dec. 12, 2018. The state recently announced it would reduce scheduled fiscal 2020 pension contribution increases and would not make up shortfalls from lottery contributions, which could result in higher required contributions for the borough.

Strong institutional framework

The institutional framework score for New Jersey municipalities is strong.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020
- 2019 Update Of Institutional Framework For U.S. Local Governments

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