

RatingsDirect®

Summary:

Montclair, New Jersey; General Obligation; Non-School State Programs; School State Program

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Table Of Contents

Rating Action

Stable Outlook

Credit Opinion

Related Research

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Credit Profile

US\$6.0 mil gen imp bnds ser 2021A due 10/15/2031

<i>Long Term Rating</i>	AAA/Stable	New
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US\$4.0 mil sch bnds ser 2021B due 10/15/2031

<i>Long Term Rating</i>	AAA/Stable	New
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<i>Underlying Rating for Credit Program</i>	AAA/Stable	New
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Rating Action

S&P Global Ratings assigned its 'AAA' rating to Montclair Township, N.J.'s series 2021A general obligation (GO) improvement bonds and series 2021B GO school bonds. At the same time, we affirmed our 'AAA' rating on the township's existing GO bonds. The outlook is stable.

The township's full-faith-and-credit pledge secures the bonds. The New Jersey School Bond Reserve Act Program also provides additional security on certain school bond maturities.

We understand proceeds from the series 2021A bonds will be used to finance various capital improvements, while proceeds from the series 2021B bonds will be used to finance various school-related capital needs.

Montclair Township's GO bonds are eligible to be rated above the sovereign because we believe the township can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions" (published Nov. 19, 2013, on RatingsDirect), the township has a predominately locally derived revenue source, with 76% of governmental activity revenue derived from local sources with independent taxing authority and independent treasury management from the federal government.

Credit overview

The township continues to see robust economic growth, with demand for residential housing remaining strong thanks to its favorable location in proximity to New York City and a range of public transport options available. Strong management quickly implemented additional cost-saving measures to offset reductions in more economically sensitive revenues as a result of the pandemic, limiting budgetary pressure in the near term. In the longer term, rising pension and other postemployment benefit (OPEB) costs remain a concern. That said, we believe the township's historically conservative budgeting practices, remaining taxing flexibility, growing reserves, and commitment to reducing debt levels within a specific time frame will help to mitigate these concerns. As a result, we do not expect to change the rating over the near term.

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

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA), but a high county unemployment rate exceeding 10%;
- Strong management, with good financial policies and practices under our Financial Management Assessment (FMA) methodology;
- Adequate budgetary performance, with operating results that we expect could improve in the near term relative to fiscal 2020, which closed with a slight drawdown in the current fund in fiscal 2020;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2020 of 18% of operating expenditures;
- Very strong liquidity, with total government available cash at 60.3% of current fund expenditures and 5.1x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability profile, with debt service carrying charges at 11.9% of expenditures and net direct debt that is 87.0% of general fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 90.5% of debt scheduled to be retired in 10 years, but a large pension and OPEB obligation; and
- Strong institutional framework score.

Environmental, social, and governance factors

We have analyzed Montclair's environmental factors, along with social and governance risks relative to the economy, financial management, budgetary performance, and budgetary flexibility, as well as the county's debt and liability profile, and have determined all are in line with, or better than, our view of the sector standard.

The township continues to address cyber-security issues.

Furthermore, we view positively the township's efforts to become a more sustainable community and maintain strong governance by setting up a finance committee and adopting guiding principles including fiscal and operational goals.

Stable Outlook

Continued strong conservative budgetary oversight guided by several formal and well-embedded fiscal policies with very strong reserves, coupled with a robust area economy with very strong economic indicators, underpin the rating. Therefore, we do not expect to lower the rating over the near term.

Downward scenario

Although unlikely, in our opinion, if the township were to face fiscal pressures, either operational, capital related, or pension contribution related, and reserves were used to bridge the imbalances to levels no longer commensurate with those of peers and without a timely plan to restore them, we could lower the rating.

Credit Opinion

Very strong economy

We consider Montclair's economy very strong. The township, with a population of 37,985 over six square miles, is in Northern New Jersey's Essex County in the New York-Newark-Jersey City MSA, which we consider to be broad and

diverse. It has a projected per capita effective buying income of 211% of the national level and per capita market value of \$211,675. Overall, market value grew by 2.0% over the past year to \$8.0 billion in 2020. The county unemployment rate was 11.7% in 2020, which we consider high and a negative credit factor.

Although primarily residential, the township maintains a healthy retail and commercial component. Given its desirable location and good transportation access via major roadways and rail, many residents find ample employment opportunities in the New York City and Northern New Jersey MSA employment bases. Despite these strengths, county unemployment spiked to 18.4% in June 2020 as a result of the pandemic. However, it has been falling, and remains in line with historical trends at slightly above state and national levels. Nonetheless, demand for residential properties remains very strong with many interested buyers from the New York City MSA. Although the township's commercial and retail sectors (restaurants and hotels) softened during the height of the pandemic, they have begun to stabilize. New development and re-development continue with additional projects in the planning stages; all adding to the tax base over time.

Montclair's tax base has seen continued growth, reaching just over \$8 billion in 2021. A mix of new residential, commercial, and mixed-use buildings as well as redevelopment of existing buildings, including the creation of a new boutique hotel, have supported tax base growth. We believe consistent property appreciation and ongoing economic development projects, coupled with no significant tax appeals, should aid in continued tax base growth.

Strong management

We view the township'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 conservative budgeting practices that look back to the prior year and ongoing monitoring of budget-to-actuals with twice monthly reports provided to the council. The township also maintains a five-year financial plan that makes various assumptions. In addition, it maintains a capital improvement plan, although financing sources are not included for all projects. Montclair does not maintain a formal investment policy of its own, but rather follows the state's guidelines. Updated reports are provided quarterly to the council. Although it has no formal debt issuance or reserve policies, the township has, by resolution, adopted a plan to reduce outstanding debt and maintain reserves at a level sufficient to prevent tax rate fluctuations.

We view positively the township's efforts to protect itself from emerging risks, such as cyber risks. Montclair has also been designated a Clean Energy Leader by the New Jersey Board of Public Utilities and a Climate Showcase Community by the U.S. EPA, validating its efforts to become a more sustainable community. Lastly, management adopted a set of guiding principles including fiscal and operational goals and set up a finance committee headed by the township's CFO in 2019. The township has recently begun to convert its existing fleet of vehicles over to hybrid or fully electric cars.

Adequate budgetary performance

Montclair's budgetary performance is adequate, in our opinion.

Despite a drawdown in fiscal 2020 and another, more modest one projected for the close of fiscal 2021, the township

has maintained conservative budgeting practices. Consecutive operating surpluses from fiscal years 2011 through 2019 have allowed significant increases to available reserves to currently very strong levels. Management has historically attributed these positive variances to conservative budgeting controls.

Montclair closed fiscal 2020 with a \$1.1 million drawdown. While the township increased unexpended appropriation reserves and continued with cost-cutting measures, miscellaneous revenues, primarily municipal court costs and parking and other fees, fell short of budget. Nonetheless, reserves remained very strong. Property taxes, a stable revenue stream, accounted for 76% of total current fund revenues. Property tax collections have remained strong, averaging over 98% over the past five years. Pandemic-related expenses were fairly minimal and mostly covered by CARES Act funding.

To date, management estimates fiscal 2021 (fiscal year-end Dec. 31) to close with a modest \$500,000 drawdown. The estimated drawdown is a result of several factors, including the increased use of fund balance of \$9.45 million (compared to \$7.95 million in fiscal 2020) for planned tax stabilization purposes, coupled with the potential of not being able to accrue payments in lieu of taxes (PILOT) payments from a hotel within the fiscal year. However, if the township is able to accrue the roughly \$2.0 payment in the fiscal year, a surplus is anticipated. Furthermore, it is waiting receipt of a total \$4.0 million in ARPA funds (\$2 million of which has already been received), none of which will be included in the fiscal 2022 budget. We understand Montclair, similar to other New Jersey municipalities, will incorporate these funds into the fiscal year 2023 and 2024 budgets and will likely use them to fund utility projects and cover lost revenues.

While budgetary performance has moderated to adequate, we believe this to be temporary. In our opinion, the planned use of reserves for fiscal 2021 will likely be offset by continued conservative budgeting, and the receipt of PILOT payments and ARPA funds in subsequent years, returning the township's budgetary performance to strong over the near term.

Very strong budgetary flexibility

Montclair's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2020 of 18% of operating expenditures, or \$15.8 million.

Montclair's available fund balance has consistently improved since fiscal 2010, reaching what we consider very strong levels in fiscal 2018. Despite the drawdown in fiscal 2020 as certain economically sensitive revenues did not meet budget, and another more modest planned drawdown for fiscal 2021, we do not expect the township's budgetary flexibility to weaken over the near term. In fact, the full receipt of ARPA money could boost reserves over time.

Very strong liquidity

In our opinion, Montclair's liquidity is very strong, with total government available cash at 60.3% of general fund expenditures and 5.1x governmental debt service in 2020. In our view, the township has strong access to external liquidity if necessary.

We believe the township's strong access to external liquidity is supported by its frequent debt issuances, including GO bonds and bond anticipation notes (BANs). Management has confirmed it has no contingent liquidity risks from financial instruments with payment provisions that change on the occurrence of certain events. Though the state

allows for what we view as permissive investments, we believe the township does not currently have aggressive ones, with the majority in demand deposits and the New Jersey Cash Management Plan. Township liquidity, which includes water, sewer, and parking fund operating cash, has consistently been very strong and we expect that it will likely be maintained over the near term.

Adequate debt and contingent liability profile

In our view, Montclair's debt and contingent liability profile is adequate. Debt service is 11.9% of general fund expenditures, and net direct debt is 87.0% of general fund revenue. Overall net debt is low at 2.1% of market value, and approximately 90.5% of the direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

In line with management's goals, Montclair has reduced its debt burden significantly over the past ten fiscal years. Total gross debt fell from over \$220 million in fiscal 2011 to about \$165 million in fiscal 2020. Given the township's relatively limited future borrowing plans, we expect the debt burden will remain relatively stable.

In our opinion, a credit weakness is Montclair's large pension and OPEB obligation.

Pension and other postemployment benefits:

- We view pension and OPEB liabilities as a source of credit pressure for Montclair, as with most New Jersey local governments.
- While it is currently managing pension costs, we believe the township 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.

Montclair participates in the following state-administered pension plans:

- Police and Firemen's Retirement System: 58.8% funded with a crossover date in 2076, with a proportional share of the net pension liability (NPL) equal to \$117.3 million.
- Public Employees' Retirement System: 42.9% funded with a crossover date in 2057, with a proportional share of the NPL equal to \$67.4 million.

Although the township is handling pension and OPEB costs, its combined required pension and actual OPEB contributions have increased to 10.6% of current fund expenditures in 2020. Of that amount, 10.0% represented required contributions to pension obligations, and 0.6% 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 year 2020 pension contribution increases and in addition, not make up shortfalls from lottery contributions, which could result in higher required contributions for Montclair.

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 \$40.97 million. New Jersey does not allow townships 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. In 2020, the township contributed \$539,000 toward its OPEB obligations.

Strong institutional framework

The institutional framework score for New Jersey municipalities 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 October 12, 2021)

Montclair Twp sch bnds ser 2018B due 04/01/2028		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
<i>Underlying Rating for Credit Program</i>	AAA/Stable	Affirmed
Montclair Twp GO		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Montclair Twp GO		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
<i>Underlying Rating for Credit Program</i>	AAA/Stable	Affirmed
Montclair Twp GO		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
Montclair Twp GO		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
<i>Underlying Rating for Credit Program</i>	AAA/Stable	Affirmed
Montclair Twp GO rfdg bnds ser 2017A, B due 03/01/2031		
<i>Long Term Rating</i>	AAA/Stable	Affirmed
<i>Underlying Rating for Credit Program</i>	AAA/Stable	Affirmed

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