S&P Global Ratings

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Summary:

South Orange Village Township, New Jersey; General Obligation; Note

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Credit Profile		
US$10.285 mil BANs ser 2021 due 07/01/2022		
Short Term Rating	SP-1+	New
US$5.44 mil GO rfdg bnds ser 2021 due 11/01/2029		
Long Term Rating	AA-/Positive	New
South Orange Vill BANs		
Short Term Rating	SP-1+	Affirmed
South Orange Vill BANs ser 2021 due 07/01/2022		
Short Term Rating	SP-1+	Affirmed
South Orange Vill GO bnds		
Long Term Rating	AA-/Positive	Affirmed

Rating Action

S&P Global Ratings has revised its outlook to positive from stable on South Orange Village Township, N.J.'s general obligation (GO) rating. We have assigned our 'AA-' long term rating to the township's 2021 $5.4 million GO refunding bonds. We have affirmed our 'AA-' long term rating on the township's existing GO debt. Finally, we have assigned our 'SP-1+' short term rating to the township's $10.2 million in bond anticipation notes (BANs).

The full-faith-and-credit GO pledge and agreement to levy ad valorem property taxes, without limitation as to rate or amount, secure the bonds and BANs.

The short-term rating reflects our opinion of the township's general creditworthiness and market-risk profile, which we consider low. The low market-risk profile reflects our view of the township's strong legal authority to issue long-term debt to take out the BANs and its ongoing disclosure to market participants. Officials intend to use BAN proceeds to refund a portion of BANs outstanding and series 2021 bond proceeds to refund certain maturities for budgetary savings.

Credit overview

The positive outlook reflects that we believe there is at least a one-in-three chance we could further raise the rating during the next two years if the township continues to produce positive results, leading to growth in available reserves. The outlook revision is further supported by the township's strong operating performance in 2020 despite the pressure imposed by the COVID-19 pandemic. Furthermore, the township is anticipating meeting its fund balance target for the first time since its introduction two years.

During the past few fiscal years, management's emphasis on building reserves through conservative budgeting has increased its flexibility to withstand potential adverse operating conditions. Through the cuts and changes in its 2020 budget, South Orange maintains strong performance. Furthermore, moving forward, we anticipate additional tax base growth as several residential projects are ongoing, which should provide additional tax base growth over the outlook period.

For more information on COVID-19's effect on U.S. public finance, see "State, Local Government, School District, And Charter School Sector Views Revised Back To Stable," published March 24, 2021, and "Economic Outlook U.S. Q2 2021: Let The Good Times Roll," published March 24, 2021, both on RatingsDirect.

The rating also reflects our view of:

- Strong economy, with access to a broad and diverse metropolitan statistical area (MSA), yet 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 2019, which closed with operating draws in the current fund in fiscal 2019;
- Strong budgetary flexibility, with an available fund balance that we expect will improve in the near term from its fiscal 2019 level of 6.0% of operating expenditures;
- Very strong liquidity, with total government available cash at 19.0% of current fund expenditures and 135.4% of current fund debt service, and access to external liquidity we consider strong;
- Weak debt and contingent liability profile, with debt service carrying charges at 14.1% of expenditures and net direct debt that is 151.8% of total governmental fund revenue, and a large pension obligation, but rapid amortization, with 76.1% of debt scheduled to be retired in 10 years; and
- Strong institutional framework score.

Environmental, social, and governance (ESG) factors

We have analyzed the township's social factors and, absent the public health and safety concerns related to COVID-19 that led to high unemployment and might continue to pressure budgetary performance, we believe the township's social risks are consistent with those of the sector. Furthermore, although we view the state's governance of its pension plans and lack of mechanism to prefund other post-employment benefits (OPEB) as a weakness for New Jersey local governments, these issues affect all New Jersey local governments similarly. We view the township's environmental risks to be in line with the sector.

Positive Outlook

Upside scenario

If the township continues to maintain strong budgetary performance, resulting in sustained higher fund balances levels, while balancing a growing fixed cost burden, we could raise the rating within the outlook period.

Return to stable scenario

If reserve growth stalls or reserves fall relative to expenditures, or if the township faces competing budget priorities such as funding retirement costs versus maintaining balanced operations, we could revise the outlook back to stable.

Credit Opinion

Strong economy

We consider South Orange's economy to be strong. The township, with an estimated population of 16,751, is located in Essex County in the New York-Newark-Jersey City, NY-NJ-PA MSA, which we consider to be broad and diverse. The village has a projected per capita effective buying income of 158% of the national level and per capita market value of $186,363. Overall, the village's market value was stable over the past year at $3.1 billion in 2021. The county unemployment rate was 11.7% in 2020, which we consider high and a negative credit factor.

The 2.9-square-mile, primarily residential township is 20 miles from New York City. Seton Hall University is within the township's borders. The township has access to the greater New York City MSA through the Garden State Parkway and New Jersey Transit rail and bus stations. Ongoing redevelopment includes several residential mixed-use developments. South Orange is also looking to improve its streetscaping in its downtown area, among other capital projects that should improve overall quality of life within the township. Management and residents have collaborated on the township's master plan--the first was in 1978--which should address a variety of concerns, and provide additional structure surrounding future residential and commercial developments.

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.

We have revised our view of management policies and procedures, as the township met its fund balance policy for the first time since its inception in 2019. Management performs a trend analysis when budgeting, looking back at least five years at revenue and expenses. Management provides monthly reports on budget-to-actual results to a finance committee with ad hoc wider reports to the township board. South Orange also performs and maintains a three-year, long-term financial surplus projection it updates yearly. The township also has a rolling six-year capital plan with funding sources identified, which it updates yearly. In addition, the village has a formal cash-management plan with monthly reports to the finance committee.

While the township does not have a formal debt policy, there is an informal target. Management's goal is to not authorize more debt than it retires annually. Recently, the township adopted a reserve policy that targets maintaining a fund balance equal to one month of previous year budgeted operating expenditures. The township is meeting this target based on the unaudited 2020 fund balance.

Adequate budgetary performance

South Orange's budgetary performance is adequate in our opinion. The township had operating draw of 1.6% of expenditures in the current fund. Our assessment accounts for the fact that we expect budgetary results could improve from 2019 results in the near term.

Property taxes generate almost 63% of current fund revenue, with miscellaneous items accounting for the remainder. Officials report property tax collections remain strong, with no uptick in delinquencies related to recessionary pressure. The township did not fully regenerate the surplus it utilized as part of its 2019 budget. Management attributes surplus use to a tax-relief mechanism for residents. In addition, the township completed several capital projects during fiscal 2019 that increased expenses.

The fiscal 2020, $36.9 million budget includes an appropriated fund balance surplus of $1.5 million and reductions for several miscellaneous revenue streams because management anticipated decreases in recreational and court fees and fees and permits. To offset expected lost revenue, officials froze raises at 2% and cut back on capital projects. Based on the township's 2020 annual financial statement (AFS), 2020 year-end results outpaced 2019 results. The township was able to regenerate and add to fund balance through its budgetary savings measures it put in place during the year, in addition to some support via its share ($417,000) of Coronavirus Aid, Relief, & Economic Security Act funding from the county. Tax collections remained strong.

The 2021 budget has been introduced at $38.7 million, which is 4.7% higher than the previous year, as the township reintroduces programing and other expenses that were eliminated in the 2020 budget. We note that as part of the budget, the township utilized a three-year rolling average for its miscellaneous revenues, which provides conservative estimates for those revenues. The county has allocated roughly $1.5 million in American Rescue Plan funds to the township. Currently management is working on a spending plan. Moving forward, we anticipate the township should be able to maintain strong performance as looks to continue to grow its reserve position.

Strong budgetary flexibility

South Orange's budgetary flexibility is strong, in our view, with an available fund balance that we expect could improve in the near term from its fiscal 2019 level of 6.0% of operating expenditures, or $2.2 million.

Reserves were utilized in 2019, as part of management's tax relief mechanism for residents. Based on the unaudited numbers in the AFS, fund balance is expected to grow to $3.5 million, or roughly 9.5% of expenditures. With this growth in fund balance, our view of South Orange's budgetary flexibility improves to a level we consider strong. In the introduced 2021 budget, officials, utilize $1.8 million in fund balance, which is higher than the previous year, but officials anticipate being able to regenerate, if not add to fund balance at year end. Future improvement in the township's rating will be due in part to increase and sustained levels of reserves we consider strong. We recognize the township has an additional $1.48 million of taxing flexibility, which it might use in future budgets.

Very strong liquidity

In our opinion, South Orange's liquidity is very strong, with total government available cash at 19.0% of current fund expenditures and 135.4% of current fund debt service in 2019. In our view, the village has strong access to external liquidity if necessary.

In our view, South Orange's strong external liquidity reflects its issuance of GO bonds and bond anticipation notes (BANs) during the past 20 years. The village does not have any contingent-liquidity risks from financial instruments with payment provisions that change upon certain events. The majority of investments are largely in bank deposits and certificates of deposit, which we do not consider aggressive. During the outlook period, our expectation is for liquidity to remain very strong.

Weak debt and contingent liability profile

In our view, South Orange's debt and contingent liability profile is weak. Total governmental fund debt service is 14.1% of total governmental fund expenditures, and net direct debt is 151.8% of total governmental fund revenue. Approximately 76.1% of the direct debt is scheduled to be repaid within 10 years, which is in our view a positive credit factor.

We have not included any amortization of the township's BANs. Outside of the BANs, debt amortizes fully by 2034. Outside of permanently financing BANs, officials currently plan to authorize $3.0 to $3.5 million in GO debt and roughly $500,000 in utility capital debt annually, offset by simultaneously amortized debt.

Pension highlights:

- We view pensions as a source of credit pressure for South Orange Village Township, as they are 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.
- South Orange's pension contributions totaled 8.7% of total governmental fund expenditures in 2019.

At Dec. 31, 2019, the township participates in:

- New Jersey Police & Firemen's Retirement System, which is 60.2% funded with a crossover date in fiscal 2062, with a $29.6 million proportional share of the net pension liability; and
- New Jersey Public Employees' Retirement System, which is 42% funded with a crossover date in fiscal 2046, with a $35.4 million proportional share of the net pension liability.

We consider the township not offering OPEB to employees or having outstanding liabilities positive factors.

Although South Orange funds 100% of its actuarially determined contributions, contributions fell short of static-funding and minimum-funding-progress metrics due partially to poor assumptions and methodologies but also to the state's continued underfunding of its portion of actuarially determined contributions. In our opinion, the plans' 30-year, level-dollar open amortization will result in slow-funding progress. In our view, an assumed long-term rate of return of 7.5% for both plans could lead to contribution volatility. (For more details and information on these risks, see "New Jersey Pension Funding: State Actions Reverberate At The Local Level," published Dec. 12, 2018.)

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