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Ratings

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Summary:

Englewood, New Jersey; General Obligation

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Credit Profile		
US$14.285 mil GO bnds ser 2017 due 04/01/2031		
Long Term Rating	AA/Negative	New
Englewood GO		
Long Term Rating	AA/Negative	Affirmed

Rationale

S&P Global Ratings has revised its outlook on Englewood, N.J.'s debt to negative from stable, reflecting the weakening of the city's budgetary performance and flexibility resulting from several years of the use of reserves for tax stabilization purposes. The negative outlook reflects our opinion that there is a one-in-three chance that we could lower the rating within our two-year outlook horizon. At the same time, we assigned our 'AA' long-term rating to Englewood's general obligation (GO) bonds series 2017 and affirmed our 'AA' GO rating on the city's existing debt.

The bonds are secured by the city's full faith and GO credit pledge.

We understand proceeds from this issue will be used to permanently finance a portion of the city's existing bond anticipation notes (BANs).

In our opinion, the rating reflects the city'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;
- Weak budgetary performance, with an operating deficit in the general fund in fiscal 2015;
- Adequate budgetary flexibility, with an available fund balance that we expect will decrease in the near term from its fiscal 2015 level of 8.3% of operating expenditures;
- Very strong liquidity, with total government available cash at 15.6% of current fund expenditures and 1.6x governmental debt service, and access to external liquidity we consider strong;
- Very weak debt and contingent liability position, with debt service carrying charges at 9.9% of expenditures and net direct debt that is 133.6% of general fund revenue, and a large pension and other postemployment benefit (OPEB) obligation and the lack of a plan to sufficiently address it, but low overall net debt at less than 3% of market value; and
- Strong institutional framework score.

Very strong economy

We consider Englewood's economy very strong. The city, with an estimated population of 28,221, encompasses five square miles in Bergen County less than five miles from the George Washington Bridge. It is in the New York-Newark-Jersey City MSA, which we consider to be broad and diverse. The city has a projected per capita effective buying income of 138% of the national level and per capita market value of $170,350. Overall, market value grew by 2.3% over the past year to $4.8 billion in 2016. The county unemployment rate was 4.6% in 2015.

The city is primarily residential, yet has a healthy commercial and retail component. Given its location and ease of access to the diverse regional employment, many residents find employment in New York City and northern New Jersey which has contributed to above-average wealth and income levels and below-average county unemployment levels, when compared to the state and nation. With modest levels or economic development and re-development, the tax base has seen growth of 1.3% over the past three years to a current $4.4 billion in 2016. Given the number of development projects, which are in various stages of development and expected to come onto the tax roll in 2018 and beyond, we expect continued modest tax base growth over the next several years. Projects include a few mix-used sites.

Adequate management

We view the city'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 looking back five years for both revenues and expenditures. Budget-to-actuals are monitored monthly with reports provided every month to the board. The city does not perform any formal long-term financial planning. It does maintain a rolling five-year capital improvement plan which identifies projects but not all funding sources. The city has its own cash management plan which mirrors state guidelines and monitors investments monthly, but reports are not currently provided to the board. The city does not maintain any formal debt issuance or reserve polices, yet remains in compliance with state guidelines.

Weak budgetary performance

Englewood's budgetary performance is weak, in our opinion. The city had deficit operating results in the current fund of negative 2.7% of expenditures in fiscal 2015.

The city closed fiscal 2015 with a much larger drawdown than in the prior year of $1.6 million. Management attributes the drawdown of reserves to ongoing tax stabilization needs. This drawdown of $1.6 million, coupled with the more modest drawdown in fiscal 2014, continues to weaken reserves and place pressures on overall financial performance, in our opinion.

Although still unaudited, the city's fiscal 2016 annual financial statement, estimates another sizable drawdown of almost $1.8 million, bringing reserves to $3.2 million or roughly 5% of budget. Again, management attributes these drawdowns to tax stabilization needs, bridging the gap between maintaining services while not increasing property tax rates accordingly. We understand the city has been reluctant to raise property taxes in recent years---increasing rates by just 1.6% since 2011 (against a state levy limit of 2% plus exceptions). Property taxes accounted for almost 79% of total current fund revenues. Offsetting further reductions in reserves has been the use of one-time revenues related to the sale of city of property; spread out over several years. As a result, total available reserves have fallen. While management has indicated an informal target of maintaining reserves somewhere between $4.0 million and $5.0 million; it remains unclear as to when reserve levels will be restored.

The fiscal 2017 has not yet been presented, but we understand a sizable property tax rate increase is to be included of approximately 7%. The increase is within the levy cap and includes the use of a portion of available cap bank. The 2017 budget is estimated to be a 1.59% increase over the prior year and we see a reduction in fund balance used (as there is less available). We understand management's expectation is that among reduced capital needs, a reduction in fund balance used, growth in the tax base, and a property tax rate increase, the city's financial position can begin to stabilize and it can begin to rebuild reserves.

It is our opinion that the budgetary performance score will likely remain weak for the near term as the city works toward structural balance. If management can, at least, close fiscal 2017 on a break-even basis, the budgetary score may improve to adequate. Conversely, if the city can't restore structural balance, this could have a negative effect on the rating.

Adequate budgetary flexibility

Englewood's budgetary flexibility is adequate, in our view, with an available fund balance that we expect could decrease in the near term from its fiscal 2015 level of 8.3% of operating expenditures, or $5.0 million.

Over the past three fiscal years, the city has seen total available reserves decline from 12% of expenditures in 2013 to 8.3% in 2015 as a result of the use of reserves for tax stabilization. Although still unaudited, fiscal 2016 is projecting to close with another drawdown in reserves--for the same purpose, bringing reserves to an estimated $3.2 million or roughly 5% of expenditures. As a result, the city's budgetary flexibility score falls to adequate. While Englewood has an informal target of maintaining reserves between $4.0 million and $5.0 million of expenditures and plans to rebuild reserves over time, it is unclear as to when these levels will be restored. Management believes that a sizable property tax rate increase in the soon-to-be-proposed 2017 budget, along with other items, should aid in the restoration process. However, we believe the budgetary flexibility score will likely remain adequate over the near term.

Very strong liquidity

In our opinion, Englewood's liquidity is very strong, with total government available cash at 15.6% of general fund expenditures and 1.6x governmental debt service in 2015. In our view, the city has strong access to external liquidity if necessary.

We believe the city has strong access to external liquidity as it has issued GO debt over the past 20 years. Management has confirmed it has no contingent liquidity risks from financial instruments with payment provisions that change on the occurrence of certain events. In addition, the borough does not have any investments we consider aggressive as most are currently in cash or CDs.

Very weak debt and contingent liability profile

In our view, Englewood's debt and contingent liability profile is very weak. Debt service is 9.9% of general fund expenditures, and net direct debt is 133.6% of general fund revenue. Overall net debt is low at 2.5% of market value, which is, in our view, a positive credit factor.

We understand the city plans to issue $5.0 million of notes in the summer of 2017 to finance various capital needs; which is roughly half of what has typically been issued in prior years. Management has indicated that it will likely issue a total of $20 million over the next four years (fiscal years 2018-2021) for ongoing capital projects. We also understand that the city plans to issue GO bonds in 2019, refinancing another portion of existing BANs to smooth out debt service payments in the future.

In our opinion, a credit weakness is Englewood's large pension and OPEB obligation, without a plan in place that we think will sufficiently address it. Englewood's combined required pension and actual OPEB contributions totaled 10.0% of general fund expenditures in 2015. Of that amount, 8.2% represented required contributions to pension obligations, and 1.8% represented OPEB payments. The city made its full annual required pension contribution in 2015. The funded ratio of the largest pension plan is 52.8%.

The city participates in the cost-sharing multiple-employer pension plans, the Police and Firemen's Retirement System (PFRS) and the Public Employees' Retirement System (PERS). S&P Global Ratings considers both PFRS and PERS funded below an adequate level, with the plan fiduciary net position as a percentage of the total pension liability, as defined in GASB Statement No. 68, equal to 52.8% for PFRS and 38.2% for PERS as of June 30, 2015. OPEBs are funded on a pay-as-you-go basis. Pension and OPEB costs could continue to increase, and there are currently no means for the city to reserve against future costs.

Strong institutional framework

The institutional framework score for New Jersey municipalities is strong.

Outlook

The negative outlook reflects our opinion that there is a one-in-three chance that we could lower the rating within our two-year outlook horizon. The outlook reflects the city's weakened financial position based on the declines in the budgetary performance and flexibility scores to weak and adequate, respectively. The debt and liability score has also weakened, reflecting rising pension and OPEB contribution costs. However, the very strong area economy continues to lend stability to the rating. In our opinion, if the city continues to draw down on reserves for any purpose and lacks a credible and timely plan to restore structural balance and reserves, the rating may be lowered. Conversely, if the city is able to restore structural balance and reserves, in a timely manner, the outlook may be to stable.