

## CREDIT OPINION

21 April 2020



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# Bayonne (City of) NJ

## Update to credit analysis

### Summary

Despite a high debt burden and ongoing reliance on one time revenues, the [City of Bayonne](#) (A3) is well-positioned for the near and medium term. The city benefits from a favorable location near [New York City](#) (Aa1 negative) and is undergoing a very considerable amount of redevelopment. The city recently took steps to bolster reserves, which should buy time for the new development to come online and start generating revenues sufficient to bring the finances into balance.

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. We do not see any material immediate credit risks for Bayonne. However, the situation surrounding coronavirus is rapidly evolving and the longer term impact will depend on both the severity and duration of the crisis. If our view of the credit quality of Bayonne changes, we will update our opinion at that time.

### Credit strengths

- » Favorable location near New York City
- » Strong ongoing redevelopment

### Credit challenges

- » High reliance on one time revenues
- » Above-average debt burden

### Rating outlook

Outlooks are typically not assigned to local governments with this amount of debt.

### Factors that could lead to an upgrade

- » Successful transition to structural balance
- » Substantial growth in the city's tax base and resident wealth and income

### Factors that could lead to a downgrade

- » Material deterioration of the tax base and resident wealth and income
- » Continued structural imbalance leading to material decrease in reserves

## Key indicators

Exhibit 1

Bayonne (City of) NJ	2014	2015	2016	2017	2018
<b>Economy/Tax Base</b>					
Total Full Value (\$000)	\$5,043,799	\$5,280,038	\$5,433,899	\$5,862,422	\$6,350,350
Population	64,763	65,378	65,772	66,719	65,300
Full Value Per Capita	\$77,881	\$80,762	\$82,617	\$87,867	\$97,249
Median Family Income (% of US Median)	95.1%	94.6%	92.9%	94.1%	95.7%
<b>Finances</b>					
Operating Revenue (\$000)	\$144,573	\$130,767	\$160,378	\$126,754	\$155,339
Fund Balance (\$000)	\$12,444	\$9,046	\$32,276	\$20,460	\$36,505
Cash Balance (\$000)	\$18,325	\$22,098	\$43,506	\$31,607	\$44,009
Fund Balance as a % of Revenues	8.6%	6.9%	20.1%	16.1%	23.5%
Cash Balance as a % of Revenues	12.7%	16.9%	27.1%	24.9%	28.3%
<b>Debt/Pensions</b>					
Net Direct Debt (\$000)	\$264,563	\$251,552	\$239,170	\$232,979	\$221,794
3-Year Average of Moody's ANPL (\$000)	\$286,350	\$330,150	\$369,680	\$394,778	\$408,783
Net Direct Debt / Full Value (%)	5.2%	4.8%	4.4%	4.0%	3.5%
Net Direct Debt / Operating Revenues (x)	1.8x	1.9x	1.5x	1.8x	1.4x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	5.7%	6.3%	6.8%	6.7%	6.4%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	2.0x	2.5x	2.3x	3.1x	2.6x

Fund balance figures reflect Moody's adjustments

Sources: Moody's Investors Service, US Census Bureau, and Bayonne audited financial statements

## Profile

Bayonne is a city with a population of 65,000 located in northern [New Jersey](#) (A3 negative), within easy commuting distance of New York City.

## Detailed credit considerations

### Economy: Large tax base with favorable location, below-average wealth levels, and extensive growth opportunities

In the long-run, the city's tax base will continue to rebound given its access to employment opportunities in the New York City area and extensive ongoing development. Bayonne, located immediately across the Hudson River and the Kill Van Kull from New York City, is a primarily residential community with a strong commercial base. The city benefits from easy access via the Bayonne Bridge to its larger neighbor. Bayonne also has easy access to Hoboken and [Jersey City](#) (Aa3 stable) via a light rail system. Resident wealth and income in the \$7.1 billion tax base are slightly below-average, with median family income at 95.7% of the national median while equalized value per capita is \$108,814. After experiencing a number of declines following the great recession, the tax base has rebounded sharply leading to a five-year compound annual rate of increase of 7.1%. The city's unemployment rate as of February 2020 was 4.3%, in line with the state (4.2%) and national (3.8%) rates.

Even as total population has remained fairly stable, management reports the Bayonne school district is experiencing a boom in enrollment. They ascribe this to changing demographics.

Despite its proximity to New York City, Bayonne has a surprising amount of room for new development. Management reports that the city has a number of large, vacant plots of land, many of which are either under active development or being prepared for new development. These developments include new residential buildings, hotels, and other commercial properties. The largest properties are located primarily on a peninsula jutting into the upper New York Harbor, but also include various lots throughout the city. The city has been actively pushing these projects and reports a considerable number of abatement deals are being negotiated with developers.

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The response to the coronavirus pandemic has resulted in an unprecedented slowdown in economic activity across the US. The effect on local governments will vary based on the extent and duration of local disruption and could be more or less severe than the nation overall. The evolution of the crisis remains highly uncertain and the full extent of the economic costs will be unclear for some time. As matters currently stand, management is not yet in a position to estimate the economic impact, although some negative effect is certain.

### **Finances and Liquidity: Favorable reserve position with improved cash-flow timing but reliance on one-time revenues and high fixed costs**

Due to very large one-time revenues, the city's financial position should remain satisfactory in the near-to-medium despite a structurally imbalanced budget. Current Fund Balance was \$28.6 million, or 18.4% of revenues, in 2018, up from \$15 million, or 12.5% of revenues, in 2017. Moody's makes certain [adjustments](#) to New Jersey local governments' fund balances to include receivables and reserves that would be eligible to be included in fund balance under GAAP accounting but are excluded as a result of state statutory accounting regulations. The city's Moody's-adjusted Current Fund Balance increased to \$36.5 million, or 23.5% of revenues, in 2018, from \$20.5 million, or 16.9% of revenues, in 2017.

As seen in Exhibit 1 above, the fund balance has fluctuated considerably in recent years and jumped in 2016. The bulk of the remarkable balance sheet improvement was driven by what was essentially the factoring of certain monies owed to the city by the [Port Authority of New York and New Jersey](#) (Aa3 negative). In exchange for \$28 million upfront, the city sold \$40 million over 8 years due from the Port Authority. Although the city retained 7 years of Port Authority payments, this transaction cannot be repeated on a regular basis.

The city has limited financial flexibility due to a reliance on one-time revenues, primarily land sales, and high fixed costs. In 2018, the city received \$25.2 million in payments from the sale of land, \$19.1 million over budget. This figure is slightly higher than the \$16 million increase in fund balance, indicating continued structural imbalance. This is exacerbated by high fixed costs; including debt service, pensions, and other post employment benefits, total fixed costs come to \$36.9 million, an above-average 23.8% of revenues. This expenditure limitation is in addition to the 2% statutory property tax cap limiting revenue-raising flexibility. The city is relying on land sales to finance the gap in the short term and on revenue increases from the new development to achieve balance. Bayonne's ability to use these new revenues to bring its finances into balance will be a major factor in future rating reviews.

### **LIQUIDITY**

Liquidity is likely to remain satisfactory in the near to medium term, as the city's cash management has materially improved, resulting in the city not issuing Tax Anticipation notes since 2013. The city had previously issued cash flow notes regularly, including a high of \$57 million in 2010. Net cash at the end of 2018 was \$44 million or 28.3% of revenues.

Management expects a decline tax collection rates for the duration of the pandemic crisis but is not yet sure of how much of an impact there will be. They are prepared, if necessary to issue notes to cover the delay but hope to avoid it.

### **Debt and Pensions: Above-average debt and pension burden**

The city's debt burden will likely increase in the near to medium term as the city is in the early stages of planning a large debt issuance for its school district. The net direct debt burden, including the April 2020 issuance is 2.8% of equalized value. The debt burden appears above-average for New Jersey in part because it includes bonds previously issued on behalf of the school district, which is not usually the case with New Jersey municipalities. As mentioned above, this will also be the cause of the increase in debt. The city intends to purchase, on behalf of the district additional buildings. The precise figures, timing, and structure of the debt remain to be determined but the amount is likely to be considerable.

### **DEBT STRUCTURE**

All of Bayonne's long-term debt is fixed rate. The city regularly issues bond anticipation notes and bonds out according to market conditions.

### **DEBT-RELATED DERIVATIVES**

The city has no derivative exposure.

## PENSIONS AND OPEB

Bayonne has an above-average defined-benefit pension burden, based on Moody's-estimated share of a cost-sharing plans administered by the state. Moody's adjusted net pension liability (ANPL) for the city, under our methodology for adjusting reported pension data, is \$379.1 million which is an above-average 2.44 times Current Fund revenues (the reported liability, based on a more aggressive discount rate, is a more modest \$213.4 million). The city's 2018 contribution to the combined Police and Firemen's Retirement System (PFRS) and Public Employees' Retirement System (PERS) was \$14 million. Moody's ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities.

The state-sponsored boards which control the pension funds have historically set contribution rates at a level insufficient to allow the plans to tread water.<sup>1</sup> This is exacerbated by the very aggressive assumptions underpinning the actuarial analysis

Failure by the pension system to realize its assumed return on assets and rising OPEB expense as the number of retirees increases and they age could both result in higher fixed costs in the future.

## ESG Considerations

Although environmental risks are of considerable consequence for Bayonne, they are offset by its very favorable location. According to data from Moody's affiliate Four Twenty Seven, the city has medium exposure to heat stress and high exposure to water stress and sea level rise. The borough has high exposure to hurricanes. This is hardly surprising as Bayonne is a peninsula dividing Newark Bay from the New York Upper Bay. Favorably, multiple levels of government, including the Army Corps of Engineers, are perennially working on projects related to the harbors, rivers, and other bodies of water in the New York region.

Social risks are material to extent MFI and unemployment are discussed in the economy section. We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. We do not see any material immediate credit risks for Bayonne. However, the situation surrounding coronavirus is rapidly evolving and the longer term impact will depend on both the severity and duration of the crisis. If our view of the credit quality of Bayonne changes, we will update our opinion at that time.

City management has taken strong steps to improve Bayonne's finances. Notable recent progress include weaning the city off cash flow notes and reducing the structural imbalance.

New Jersey Cities have an Institutional Framework score of Aa, which is high compared to the nation. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. The sector's major revenue sources are subject to a cap which can be overridden with voter approval only. However, the cap of 2% still allows for moderate revenue-raising ability and excludes debt service, pensions, and certain health care costs. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Across the sector, fixed and mandated costs are generally greater than 25% of expenditures. Unpredictable expenditure fluctuations tend to be minor, under 5% annually. The State has public sector unions, which can limit the ability to cut expenditures.

## Rating methodology and scorecard factors

The US Local Government General Obligation Debt methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching factors dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

## Exhibit 2

## Bayonne (City of) NJ

Rating Factors	Measure	Score
Economy/Tax Base (30%) <sup>[1]</sup>		
Tax Base Size: Full Value (in 000s)	\$7,105,526	Aa
Full Value Per Capita	\$108,814	Aa
Median Family Income (% of US Median)	95.7%	Aa
Finances (30%)		
Fund Balance as a % of Revenues	23.5%	Aa
5-Year Dollar Change in Fund Balance as % of Revenues	10.1%	Aa
Cash Balance as a % of Revenues	28.3%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	8.7%	A
Notching Factors: <sup>[2]</sup>		
Unusually volatile revenue structure		Down
Management (20%)		
Institutional Framework	Aa	Aa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	1.0x	A
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	2.8%	A
Net Direct Debt / Operating Revenues (x)	1.3x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	5.8%	Baa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	2.6x	A
	Scorecard-Indicated Outcome	A2
	Assigned Rating	A3

[1] Economy measures are based on data from the most recent year available.

[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology.

[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs publication.

Fund balance figures reflect Moody's adjustments

Sources: Moody's Investors Service, US Census Bureau, and Bayonne audited financial statements

## Endnotes

- Our "tread water" indicator measures the annual government contribution required to prevent reported net pension liabilities from growing, given the entity's actuarial assumptions. An annual government contribution that treads water equals the sum of employer service cost and interest on the reported net pension liability at the start of the fiscal year. A pension plan that receives an employer contribution equal to the tread water indicator will end the year with an unchanged net pension liability relative to the beginning of the year if all plan assumptions hold. Net liabilities may decrease or increase in a given year due to factors other than the contribution amount, such as investment performance that exceeds or falls short of a plan's assumed rate of return. Still, higher contributions will always reduce unfunded liabilities faster, or will allow unfunded liabilities to grow more slowly than lower contributions.

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