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CREDIT OPINION
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Morris (County of) NJ

Update to credit analysis

Summary

Morris County, NJ (Aaa stable) benefits from its favorable location as a wealthy outer suburb of New York City (Aa1 negative). The county has a history of strong governance with healthy reserves and a modest debt burden. The county is exposed to an underperforming solar project; however, county management has designed and implemented a detailed plan to address the issue which, in any case, is on far too small a scale to materially threaten the county's financial health.

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 Morris County. 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 Morris County changes, we will update our opinion at that time.

Credit strengths

» Substantial tax base and diverse economy

» Strong resident wealth and income

» Additional financial flexibility provided by reserves outside the Current Fund

» Conservative financial management practices

Credit challenges

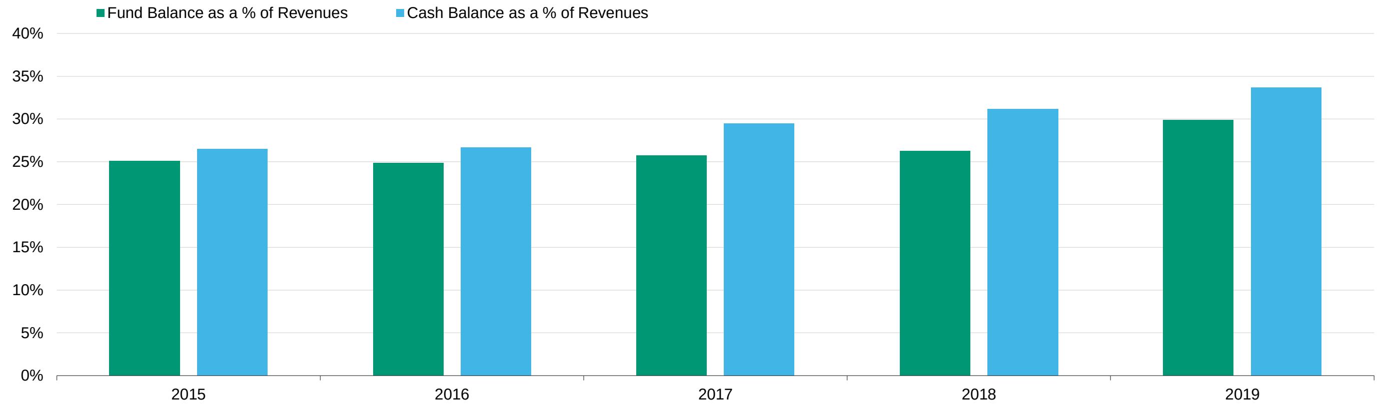
» Notable, yet manageable, enterprise risk from solar energy projects

Rating outlook

The stable outlook reflects our expectation that the county's financial position will remain strong over the near term and that the county will continue to benefit from its substantial and diverse tax base and above-average resident wealth and income profile.

Exhibit 1

Morris County's finances remain strong and stable



Fund balance figures reflect Moody's adjustments

Sources: Morris County audited financial statements & Moody's Investors Service

Factors that could lead to an upgrade

» Not applicable

Factors that could lead to a downgrade

» Unanticipated tax base decline

» Weakening of reserves and liquidity

Key indicators

Exhibit 2

Morris (County of) NJ	2015	2016	2017	2018	2019
Economy/Tax Base					
Total Full Value ($000)	$90,344,036	$91,373,880	$92,859,188	$94,391,546	$95,720,788
Population	499,509	498,423	499,693	494,228	491,845
Full Value Per Capita	$180,866	$183,326	$185,832	$190,988	$194,616
Median Family Income (% of US Median)	182.0%	182.2%	183.6%	183.8%	183.8%
Finances					
Operating Revenue ($000)	$338,254	$362,995	$349,094	$342,814	$344,505
Fund Balance ($000)	$84,887	$90,265	$89,825	$89,998	$102,958
Cash Balance ($000)	$89,648	$96,852	$102,868	$106,919	$115,981
Fund Balance as a % of Revenues	25.1%	24.9%	25.7%	26.3%	29.9%
Cash Balance as a % of Revenues	26.5%	26.7%	29.5%	31.2%	33.7%
Debt/Pensions					
Net Direct Debt ($000)	$327,729	$316,883	$310,887	$339,012	$334,852
3-Year Average of Moody's ANPL ($000)	$417,901	$455,190	$489,127	$514,556	$486,507
Net Direct Debt / Full Value (%)	0.4%	0.3%	0.3%	0.4%	0.3%
Net Direct Debt / Operating Revenues (x)	1.0x	0.9x	0.9x	1.0x	1.0x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	0.5%	0.5%	0.5%	0.5%	0.5%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	1.2x	1.3x	1.4x	1.5x	1.4x

Fund balance figures reflect Moody's adjustments

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

Profile

Morris County is located in northern New Jersey (A3 negative) about 25 miles west of New York City. It is one of the wealthiest counties in the country.

Detailed credit considerations

Economy and Tax Base: Substantial tax base with high wealth and strong corporate presence

The county's large and diverse $96.6 billion tax base will remain stable given its advantageous location in northern New Jersey about 25 miles from New York City, its highly skilled and well-educated labor force and the potential for additional tax base growth. The tax base has increased in each of the last 5 years, growing at a compound annual rate of 1.3%. The county is among the wealthiest in the state and nation, with a median family income equal to 138.6% and 183.8% of the state and national levels respectively. Equalized full value per capita is strong at $196,420.

As of March 2020, the county's unemployment rate was 3%, lower than the 3.9% state and 4.5% national levels. This figure has, of course, materially worsened due to the pandemic. The county's assessed value is 1.2% vacant land, 76.7% residential, 14.7% commercial, 3.4% industrial, and 3% apartments. There is, of course, a very substantial amount of public park land and numerous non-profit entities which do not show up on the tax rolls.

The county also has a significant retail and corporate presence, including many Fortune 500 companies. The largest taxpayers include major pharmaceutical, retail, and financial firms and there is no material concentration in the tax base.

To date, the economic fallout from the pandemic has been comparatively modest and development is continuing, albeit at a slowed rate. The coronavirus is driving an unprecedented economic slowdown. We currently forecast US GDP to decline significantly during 2020 with a gradual recovery commencing toward the end of the year. Local governments with the highest exposure to the tourism, healthcare, retail, oil and gas and international trade sectors could suffer particularly severe impacts.

Financial Operations and Reserves: Stable financial position supported by conservative fiscal management

The county's financial position should remain strong in the medium term as management continues to budget conservatively. In 2019, current fund balance increased fractionally to $53.5 million (15.5% of revenues) from $53.4 million (15.6% of revenues) in 2018. The 2019 fund balance is in line with the 5-year average of $53.2 million representing 15.3% of revenues. 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 county's Moody's-adjusted Current Fund Balance increased sharply to $103 million (29.9%) from $90 million (26.3%). The adjusted fund balance is well above the five year average of $91.6 million (26.4%).

The county's revenue streams are highly dependable with property taxes representing 70.6% of 2019 revenues. These revenues are guaranteed to be paid in full by the county's underlying municipalities.

While many local governments have seen seriously deleterious financial impacts thanks to the pandemic, Morris County appears to be weathering the storm more smoothly than most. Thanks to both a history of conservative budgeting and the foresight to implement a COVID-19 Strategic Planning Advisory Planning Committee, comprised of elected and management officials, Morris County is still anticipating positive variances compared to budget for many of its non-tax revenue streams. Additionally this COVID-19 Strategic Planning Advisory Committee has benchmarked, with the approval of the governing body, revised future annual anticipated bonding limits relative to the anticipated results of the pandemic.

The fiscal year is not yet half way over and negative variances may still occur, but the county is well positioned to adjust to any financial headwinds which may arise. The county, unfortunately, just missed the cutoff for receiving direct CARES Act funds from the federal government, however, direct costs related to the pandemic have been modest and the county is actively seeking reimbursement from various state and federal programs.

The county's fixed costs consisting of pension, OPEB, and debt service expenses come to just under $82.9 million representing 24.1% of revenues. This is slightly above-average for the nation but typical for New Jersey.

LIQUIDITY

In fiscal 2019, the county had a current fund net cash position of approximately $116 million, representing a strong 33.7% of revenues. The county's financial position is bolstered by significant cash ($109 million) held in trust funds outside of the Current Fund, as well as $69 million in the capital fund, which could be borrowed upon in a liquidity crunch. The majority of these funds are restricted for specific purposes and would need to be repaid.

Debt and Pensions: Minimal direct debt; modest enterprise risk related to guaranteed solar energy bonds

The county's debt will remain modest in the near to medium term as the county intends to issue only small amounts of debt. The county's net direct debt is very low at approximately 0.4% of equalized value.

DEBT STRUCTURE

All of the county's bonds are fixed rate and the county has no variable rate exposure. The county guarantees approximately $144.9 million of Morris County Improvement Authority (MCIA) issued debt which is included in the 0.4% figure cited above. Approximately 40% of the guaranteed MCIA debt was issued to finance two solar panel projects for a number of participating municipalities and school districts. Both projects have faced significant financial and legal challenges.

The project developer for Solar 1, Tioga Union, filed an assignment for the benefit of creditors in April 2013, largely due to a substantial decline in the solar renewable energy credit (SREC) market. Although the project is complete and is generating revenue, the developer has been unable to make its full lease payments requiring the county to step in and honor its guarantee by making up the missing debt service. The second project, Solar 2, was stalled due to disputes between the developer and contractor. A settlement was reached in March 2015 with the contractor and developer bringing an end to several years of legal challenges.

Despite this heightened enterprise risk, we believe that the potential liability to the county is modest and manageable. The maximum annual debt service of $5 million on all outstanding solar-related debt is not a material amount relative to the budget. The county budgets sufficient funds to cover any potential shortfalls and has articulated its intention to make any guaranteed debt service payments necessary. In addition, the county reports that Solar 2 is now complete and running well.

The county has developed a detailed plan to address the deficiencies of Solar 1 which it believes will put matters on a more stable footing.

DEBT-RELATED DERIVATIVES

The county is not party to any interest rate swaps or other derivative agreements.

PENSIONS AND OPEB

Morris County's unfunded pension and retiree health care (OPEB) liabilities are significantly larger than its direct debt and, though manageable at this time, represent a potential future credit challenge.

On a reported basis the county has an average defined-benefit pension burden, based on Moody's-estimated share of a cost-sharing plans administered by the state. The reported pension burden is based on an assumed annual return of 5.95% on pension assets over the life of the plan. Moody's adjusted net pension liability (ANPL) for the county, under our methodology for adjusting reported pension data and based on a more conservative assumed return on pension assets of 4.14%, is $486.1 million, representing an above-average 1.4x 2018 Current Fund revenues.

The county's 2019 contribution to the retirement system totaled $16.3 million for the combined Police and Firemen's Retirement System (PFRS) and Public Employees' Retirement System (PERS). Required annual contributions will increase if the system is unable to achieve the assumed return on pension assets. The state-sponsored boards which control the pension funds have historically set contribution rates at a level slightly below the amount required for the plans to tread water.[1] The tread water gap is based on annual return on pension assets at the assumed rate.

The county pays OPEB costs on a pay as you go basis. The county's 2019 OPEB contribution totaled $24.8 million, representing 7.2% of county revenue. From 2015 through 2019, OPEB expense increased at a compound annual rate of approximately 12.5%. As of fiscal 2019 the county's adjusted net OPEB liability (adjusted in much the same way as pensions) totaled $938 million. Because it is not setting aside funds to cover OPEB expense as they accrue, the county's annual OPEB cost and net OPEB liability will likely continue to increase as the number of retirees grows and they age.

The county's fixed costs, consisting of debt service, pensions and OPEB, totaled $82.9 million in 2019, representing 24% of revenue. Increased pension and OPEB costs could contribute to higher fixed costs in the future.

ESG considerations

Physical environmental risk associated with climate change represents a limited credit risk for the county over the next several years that could become more significant over time. Of the physical environmental risks that Moody's affiliate Four Twenty Seven evaluates, the county's most significant exposures are to water stress and extreme hurricanes. Careful state and regional water supply planning and water infrastructure investment mitigates exposure to water stress. Exposure to hurricanes is mitigated by federal support for recovery from natural disasters.

Environmental considerations are of limited importance to Morris County's credit quality. The county has high exposure to water stress and hurricanes as well as medium exposure to extreme rainfall and sea level rise. These risks are mitigated offset by the county's extremely healthy finances and favorable location.

Apart from the ongoing pandemic, social considerations are only relevant to the extent mentioned above in the economy section. The county is wealthy and poverty is low. 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 Morris County. 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 Morris County changes, we will update our opinion at that time.

Management has a history and formal policy of budgeting conservatively and maintaining a healthy level of fund balance. Moody's expects the county's economic tax base and finances to remain stable going forward.

New Jersey Counties 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 overriden 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 Rating 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 3

Morris (County of) NJ

Scorecard Factors and Subfactors	Measure	Score
Economy/Tax Base (30%) [1]		
Tax Base Size: Full Value (in 000s)	$96,608,183	Aaa
Full Value Per Capita	$196,420	Aaa
Median Family Income (% of US Median)	183.8%	Aaa
Finances (30%)		
Fund Balance as a % of Revenues	29.9%	Aa
5-Year Dollar Change in Fund Balance as % of Revenues	4.0%	A
Cash Balance as a % of Revenues	33.7%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	4.5%	A
Notching Factors:[2]		
Other Analyst Adjustment to Finances Factor: Additional liquidity in trust fund		Up
Management (20%)		
Institutional Framework	Aa	Aa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures	1.0x	A
Notching Factors:[2]		
Unusually Strong or Weak Budgetary Management and Planning		Up
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	0.4%	Aaa
Net Direct Debt / Operating Revenues (x)	1.1x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	0.5%	Aaa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	1.4x	A
	Scorecard-Indicated Outcome	Aaa
	Assigned Rating	Aaa

[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: Morris County audited financial statements, US Census Bureau, Moody's Investors Service

Endnotes

1 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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