MOODY'S INVESTORS SERVICE

CREDIT OPINION
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New Issue

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# City of Newark, NJ

## New Issue - Moody's Assigns Baa3 und/A3 enh. to Newark's (NJ) $25M GO Bonds; Outlook Remains Negative

### Summary Rating Rationale

Moody's Investors Service has assigned a Baa3 underlying rating and A3 MQBA enhanced rating to the City of Newark, NJ's $25 million Qualified General Obligation Open Space Bonds, Series 2016 (Riverfront Park). Moody's maintains a Baa3 rating on $490.1 million of general obligation unlimited tax debt, a Ba1 rating on $39 million of general obligation limited tax debt, and an A3 enhanced rating on its Municipal Qualified Bonds. All three rated securities carry negative outlooks.

The Baa3 general obligation unlimited tax rating reflects the city's weak financial position, which improved to a positive Current Fund balance in 2015 (unaudited), and reliance on tax anticipation notes for operations. It also reflects the city's long history of aggressive budgeting, low wealth indicators and high debt burden. The rating further incorporates Newark's large and growing tax base with a large daytime employment base and numerous redevelopment projects underway.

The Ba1 rating on the city's general obligation limited tax debt reflects the city's underlying credit quality and a property tax levy limitation of 2% over the prior year's levy for the bonds. The A3 enhanced rating reflects the enhancement provided by the Municipal Qualified Bonds Act state aid intercept program and is notched once off the state's rating (A2 negative).

### Credit Strengths

» Large and diverse economic base with significant institutional presence

» Projected tax base growth given numerous private redevelopment projects

» Proximity to New York City (Aa2 stable)

» Strong state oversight

» Modest growth in population since 2000

### Credit Challenges

» Large deferred charges

» Reliance on deferred charges

» Reliance on cash flow borrowing for operations

» Low wealth levels

## Rating Outlook

The negative outlook reflects uncertainties surrounding the maintenance of improved financial flexibility demonstrated in unaudited fiscal 2015 (December 31) results. Future rating reviews will consider 2015 audited financial information, the timely adoption of the 2016 budget and 2016 operating results.

The outlook for the MQBA enhancement program is negative reflecting the state's negative outlook.

## Factors that Could Lead to an Upgrade

» Elimination of the city's structural gap by aligning recurring revenues with recurring expenditures

» Timely budget adoption

» Material improvement in monthly cash position net of TAN proceeds

» Sustained reserve and cash balance improvements on balance sheet

» Reduced deferred charges

» Successful economic development that results in prudently managed recurring revenues

## Factors that Could Lead to a Downgrade

» Weakened financial position

» Continued late budget adoption

» Increase in cash flow borrowing

» Increased debt burden

## Key Indicators

Exhibit 1

| Newark (City of) NJ | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|
| Economy/Tax Base | | | | | |
| Total Full Value ($000) | $ 18,689,497 | $ 16,000,750 | $ 15,900,454 | $ 14,660,573 | $ 13,899,665 |
| Full Value Per Capita | $ 67,437 | $ 57,652 | $ 57,252 | $ 52,459 | $ 49,539 |
| Median Family Income (% of US Median) | 66.2% | 63.6% | 60.2% | 59.1% | 57.9% |
| Finances | | | | | |
| Operating Revenue ($000) | $ 690,832 | $ 610,694 | $ 584,794 | $ 589,407 | $ 610,252 |
| Fund Balance as a % of Revenues | 11.1% | 8.7% | 7.2% | 2.4% | -1.2% |
| Cash Balance as a % of Revenues | 8.7% | 10.2% | 16.9% | 2.6% | -0.2% |
| Debt/Pensions | | | | | |
| Net Direct Debt ($000) | $ 465,465 | $ 659,196 | $ 565,010 | $ 528,336 | $ 510,337 |
| Net Direct Debt / Operating Revenues (x) | 0.7x | 1.1x | 1.0x | 0.9x | 0.8x |
| Net Direct Debt / Full Value (%) | 2.5% | 4.1% | 3.6% | 3.6% | 3.7% |
| Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x) | N/A | N/A | 1.8x | 2.1x | 2.2x |
| Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%) | N/A | N/A | 6.6% | 8.3% | 9.8% |

*Source: Moody's Investors Service and Newark Audited Financial Statements*

## Recent Developments

Since our last report, the city's financial and economic position is largely unchanged. No new financial information has been released and, apart from the effects of this issuance, the bulk of this report is unchanged from the last.

## Detailed Rating Considerations

### Economy and Tax Base: Growing Tax Base with Weak Socioeconomic Profile, but Significant Institutional and Corporate Presence

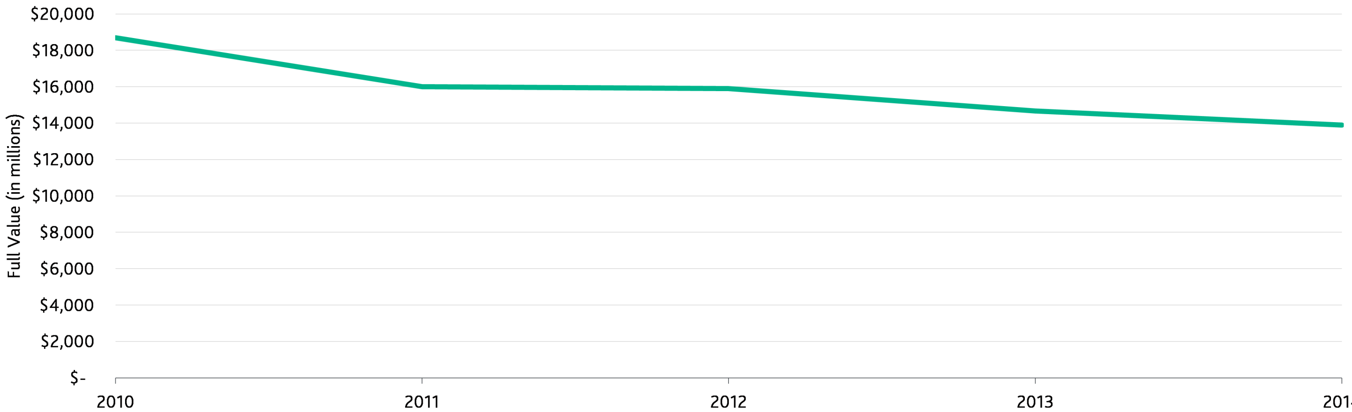
Newark's large $13.3 billion tax base is expected to grow over the near term with corporate, residential and university development projects. Despite challenges from a very weak socioeconomic profile and unemployment rates consistently above the state and nation, Newark will benefit from its favorable location across the Hudson River from New York City. Full valuation has continued declined and reductions in property values have reduced total equalized values by more than 25% since 2008. Nearly 50% of the city's tax base is tax exempt. More than $11 billion of nontaxable property value is associated with Newark Liberty International Airport, Port Newark, six colleges and universities, several hospitals, and cultural and sports facilities including the Prudential Center Arena, as well as government facilities for the federal government, the State of New Jersey (A2 negative), and Essex County (Aa2 positive). Although these entities do not pay property taxes, some pay PILOT revenues to the city and all lend a considerable amount of economic stability to Newark. The city's robust corporate presence includes, Prudential Financial Inc. (Baa1 stable), Blue Cross/Blue Shield and Panasonic Corporation (Baa1 positive).

The city's daytime population almost doubles to 500,000, reflecting an inflow of workers, students and those passing through the various transportation hubs including major highways (Route 280 and the New Jersey Turnpike) and Amtrak and PATH commuter rails. This inflow allows for the city to generate revenues from nonresidents through payroll, hotel and parking taxes, which is particularly important given that the residential population includes a significant presence of economically-disadvantaged residents, over a quarter of whom live below the poverty level. Equalized value per capita is a low $47,562 as of 2016 and the U.S. Census Bureau estimates median family income to be 57.9% of the US and 43.1% of the state as of 2014. Unemployment of 7.7% in April 2016 is above state (4.9%) and national rates (4.7%).

Economic development is an important component of the city's recovery plan and well underway with numerous projects under construction or in the pipeline. Nearly $1 billion has been invested in the city between 2011 and 2013 with another $2 billion expected over the following three to five years. A majority of the projects will result in tax revenues as opposed to payment-in-lieu-of-taxes (PILOT), indicative of increased interest in Newark without the city needing to offer tax abatement incentives. The projects include nearly 1,500 housing units recently constructed, 500 under construction and 2,500 in the pipeline. There are two more hotels expected to open by 2017, in addition to the Courtyard by Marriott and Hotel Indigo, which opened in 2012 and 2014, respectively. Two grocery stores have joined the city; ShopRite opened in 2015 and Whole Foods will open in 2016. Additionally, office space is under construction by Cablevision and a pharmaceutical research and development company, Biotrial. The city also benefits from an important entertainment component with Prudential Arena and New Jersey Performing Arts Center.

Exhibit 2

**Recent Equalized Valuation Declines Expected to Stabilize**




*Source: Moody's Investors Service*

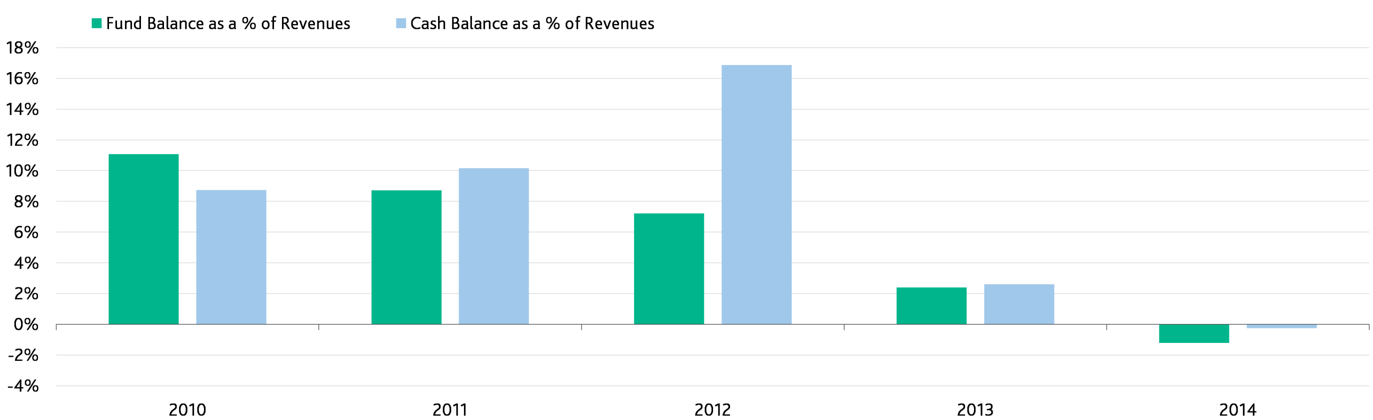
## Financial Operations and Reserves: Negative Fund Balance and Reliance on Cash Flow Borrowing

The city's financial position improved in 2015 (December 31) based on unaudited financial statements after weakening significantly over the prior two years. The large Moody's adjusted deficit in 2014 of -$51 million or -8.3% of revenues was nearly eliminated in 2015. Unaudited results posted an adjusted fund balance of $36.7 million, or 5.4% of revenues, refecting a healthier balance sheet with increased reserves. Moody's adjustments add back appropriation reserves and certain receivables that would have been included under GAAP, but are excluded from NJ Statutory Accounting methods. The 2015 reported surplus of $30 million was driven by conservative budgeting, improved tax collection procedures and expenditure savings.

The 2014 operating deficit of $22 million was due to uncollected revenues as well, but primarily because of a change in the city's accounting practices. As part of state fiscal oversight, the state required the city to close its books on December 31, rather than January 15, in line NJ statute. As a result the city only collected a partial year of payroll, parking and hotel taxes. The 2013 operating cash deficit in operations of $30 million was largely driven by uncollected revenues, including $17 million of property taxes resulting from property tax appeal settlements.

Exhibit 3

**Current Fund Balance Dropped Significantly in 2013 and 2014**




*Source: Moody's Investors Service*

The 2016 introduced budget reflects an increase in recurring revenues and certain expenditure cuts. Future rating reviews will consider the city's success in adopting a budget in a timely manner and meeting operating targets. In order to reduce expenditures, management began requiring employees in 2015 to contribute to health benefit costs as mandated under the 2011 pension reform law which was never implemented under prior administrations. Employee health benefit contributions generated $6.5 million of additional recurring revenues as of fiscal 2014. Unaudited 2015 numbers show an increase to $9.8 million and the 2016 budget shows an increase to $13 million. The city is also collecting a full year of special tax revenue collections, which generated between $10 million and $14 million additional revenues in 2015 than in 2014. Beyond fiscal 2015, $41 million of additional revenues from expected projects will add to recurring revenues in the long-term.

The city's revenue sources are diverse, but still incorporate a significant amount of state aid. Revenues include property taxes (35% of total fiscal 2014 revenues), state aid (17%; CMPTRA and ETR) Port Authority NYNJ lease payment (13.7%), and special taxes (11%; payroll, parking and hotel).

#### LIQUIDITY

The city relies on cash flow financing and interfund borrowing for liquidity. The city's fiscal 2016 monthly cash balances, net of $55 million of tax anticipation notes, are expected to be negative every month after April, but November. The $55 million in notes constitutes a decrease of approximately $15 million from the amount of tax anticipation notes issued in 2015.

### Debt and Pensions: Above-Average Debt Expected to Rise

The city has an above-average debt profile with a net direct debt burden of 4.3% of full value. The city's debt burden should increase further if water and sewer enterprises do not become fully self-supporting, given plans for $300 million to $400 million in state loan borrowings for badly needed capital work to aging pipelines. Favorably, the utilities increased rates in 2015 and recorded substantial surpluses according to unaudited financials. Further rate increases have been adopted for 2016 and 2017. The city does not expect to pursue additional capital project related to claims of contaminated city water. The city also plans to issue approximately $50 million of GO debt and potentially $9 million in tax appeal refunds over the next three years.

#### DEBT STRUCTURE

All of the city's debt is fixed rate. Principal is amortized adequately with 80% of debt repaid within ten years and includes an overall declining amortization schedule.

#### DEBT-RELATED DERIVATIVES

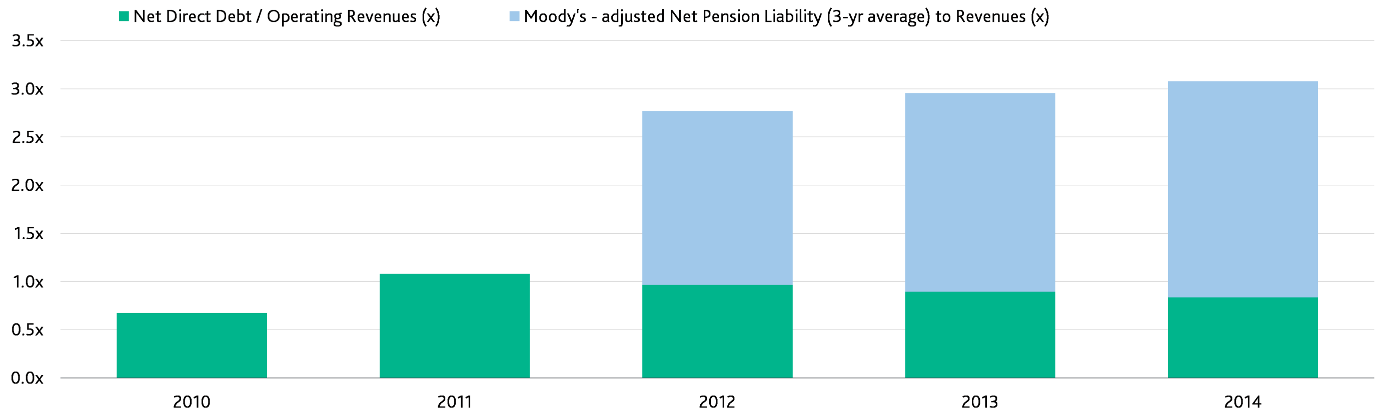
The city has no derivative exposure.

#### PENSIONS AND OPEB

The city participates in two defined benefit, multi-employer retirement plans administered by the state of New Jersey. The city's combined adjusted net pension liability for fiscal 2013, under Moody's methodology for adjusting reported pension data, was approximately $1.6 billion, or an above average 2.6 times operating revenues. The city's three-year average ANPL is a lower at 2.2 times revenues, but a very high 10.1% of equalized valuation. Moody's uses the adjusted net pension liability to improve comparability of reported pension liabilities. The adjustments are not intended to replace the city's reported liability information, but to improve comparability with other rated entities. We determined the city's share of liability for the state-run plans in proportion to its contributions to the plans.

Exhibit 4

**Newark Leverage High with Net Pension Liability and Debt Burden**




*Source: Moody's Investors Service*

Fiscal 2014 total fixed costs, inclusive of debt service and annual contributions to pensions, health benefits and OPEB, were about $203 million, or an above average 32% of expenditures.

### Management and Governance

The city's current mayor assumed office in July of 2014, after which he brought on a new management team. Management has begun implemented fiscal recovery strategy that successfully generated a $29.5 million surplus in 2015. Our future rating reviews will consider the maintenance of the city's improved financial position in audited 2015 results and 2016 operations.

New Jersey cities have an institutional framework score of "Aa", or strong. Expenditure costs are highly predictable given the arbitration award cap. While the property tax levy limitation somewhat constrains revenue raising ability, the risk of property tax appeals has declined as cities have become better at preventing appeals.

## Legal Security

The current issue is secured the city's general obligation unlimited tax pledge and further secured by the MQBA program.

The vast majority of the city's debt is secured by its general obligation unlimited tax pledge. The city's Lease Revenue Bonds (City of Newark Project) Series 2010 A, issued through the Essex County Improvement Authority, are secured by the city's limited general obligation pledge, subject to the state of New Jersey's 2% levy increase limitation.

## Use of Proceeds

Proceeds from the bonds will be used to fund the expansion of Newark Riverfront Park.

## Obligor Profile

Newark is the county seat for Essex County and New Jersey's most populous city.

## Methodology

The principal methodology used in the underlying rating was US Local Government General Obligation Debt published in January 2014. The principal methodology used in the enhanced rating was State Aid Intercept Programs and Financings: Pre and Post Default published in July 2013. Please see the ratings Methodologies page on www.moodys.com for a copy of these methodologies.

## Ratings

Exhibit 5

### Newark (City of) NJ

| Issue | Rating |
|---|---|
| Qualified General Obligation Open Space Bonds, Series 2016 (Riverfront Park) | Baa3 |
| Rating Type | Underlying LT |
| Sale Amount | $25,000,000 |
| Expected Sale Date | 08/24/2016 |
| Rating Description | General Obligation |
| Qualified General Obligation Open Space Bonds, Series 2016 (Riverfront Park) | A3 |
| Rating Type | Enhanced LT |
| Sale Amount | $25,000,000 |
| Expected Sale Date | 08/24/2016 |
| Rating Description | General Obligation |

*Source: Moody's Investors Service*

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