Summary:
Morris County, New Jersey; General Obligation

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Rationale

S&P Global Ratings assigned its 'AAA' rating, and stable outlook, to Morris County, N.J.'s series 2017 general obligation (GO) bonds, consisting of general improvement, park bonds, and county college bonds. At the same time, S&P Global Ratings affirmed its 'AAA' rating, and stable outlook, on the county's GO debt outstanding.

Securing Morris' GO bonds is a full faith and credit pledge consisting of ad valorem taxes levied on all taxable property in the county without limitation as to rate or amount. We understand bond proceeds will fund county projects.

Morris' GO bonds are eligible to be rated above the sovereign because we believe the county can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions" (published Nov. 19, 2013, on RatingsDirect), Morris has a predominately locally derived revenue source, with almost two-thirds of current fund revenue from property taxes. The county also has independent taxing authority and independent treasury management from the federal government.

The rating reflects our opinion of the following factors:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Strong management, with good financial policies and practices under our Financial Management Assessment methodology;
- Strong budgetary performance, with balanced operating results in the current fund in fiscal 2016;
- Very strong budgetary flexibility, with an available fund balance in fiscal 2016 of 14.7% of operating expenditures, and the flexibility to raise additional revenues despite statewide tax caps;
- Very strong liquidity, with total government available cash at 25.3% of current fund expenditures and 2.3x governmental debt service, and access to external liquidity we consider strong;
- Adequate debt and contingent liability position, with debt service carrying charges at 11.1% of expenditures and net
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direct debt that is 126.7% of current fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 88.7% of debt scheduled to be retired in 10 years, but a large pension and other postemployment benefit (OPEB) obligation; and

- Strong institutional framework score.

Very strong economy
We consider the county's economy very strong. Morris County, with an estimated population of 501,318, is located in the New York-Newark-Jersey City MSA, which we consider to be broad and diverse. The county has a projected per capita effective buying income of 170% of the national level and per capita market value of $184,599. Overall, the county's market value grew by 1.7% over the past year to $92.5 billion in 2016. The county unemployment rate was 3.9% in 2016.

Located in the center of northern New Jersey about 25 miles from New York City, Morris is an affluent suburban area benefiting from its access to the greater New York City and Northern New Jersey metropolitan area. Residents have access to New Jersey Transit rail transportation into New York City, as well as many highways that provide easy access to the region. The county has an airport and several large industrial and pharmaceutical firms are headquartered in the county, and many are still choosing Morris, including Allergan Plc recently.

The tax base is primarily composed of residential (76.5% of assessed value [AV]), commercial (14.9%), and industrial (3.5%) properties. AV has increased slightly in the past three fiscal years. Some notable projects contributing to this growth include new luxury apartment complexes in Morristown, an age 55-plus mixed residential project in Florham Park; and a boutique hotel. Despite the presence of large pharmaceutical and industrial firms, the 10 leading taxpayers account for 2% of AV, which we consider very diverse.

Strong management
We view the county's management as strong, with good financial policies and practices under our Financial Management Assessment methodology, indicating financial practices exist in most areas, but that governance officials might not formalize or monitor all of them regularly.

Management reviews historical trends and considers forward-looking projections when arriving at revenue and expenditure assumptions in addition to using conservative revenue assumptions in its budgets. It monitors budget-to-actual results closely and posts monthly budget reports on the county website. Amendments, while infrequent, can occur through emergency appropriations and transfers, as permitted under statute. The county has a formal six-year capital improvement plan with all sources identified; it updates the plan annually. In addition, Morris maintains formalized, five-year financial projections that the governing body reviews and updates annually. These projections are integrated into the budget planning process and can take into account different financial scenarios and the impact on the budget. The county's formal cash management policy governs investments, which officials report monthly.

Morris is formalizing its debt management and reserve policies and expects to adopt them in June. Currently, an informal target governs reserves, with the county aiming to maintain at least 10% of budgeted revenues in reserve for cash flow purposes. In addition, Morris maintains an informal goal of keeping debt service at about or below 15% of the budget, in addition to maintaining rapid payback of principal of 12 years or less.
Strong budgetary performance
Morris County's budgetary performance is strong in our opinion. The county had balanced operating results in the current fund of 0.1% of expenditures in fiscal 2016. Current fund operating results of the county have been stable over the past three years, with a result of 0.0% in 2015 and 1.3% in 2014.

Morris has a history of conservative budgeting and balanced financial operations. Before fiscal 2015, the county had generated current fund surpluses in the previous four fiscal years. In fiscal 2015, it drew down reserves by $7.3 million primarily due to the use of $7.0 million relating to the settlement of litigation associated with the developer of solar projects constructed in the past few years. Excluding this one-time expense, the county's operations were balanced.

Morris achieved a small surplus in fiscal 2016, regenerating the $23.9 million of reserves it appropriated in the budget. Officials attribute the surplus to significant amounts of miscellaneous revenues not anticipated which management conservatively leaves off in its budget revenue assumptions; and a sizable lapse from prior-year reserves for unexpended 2015 appropriations. Property taxes, the main revenue source, generated about 62% of current fund revenue in fiscal 2016. The underlying municipalities guarantee the county 100% of property tax collections, providing additional stability.

The adopted fiscal 2017 budget includes a tax levy increase of 3.43%. The increase includes exceptions to the property tax for allowable debt service, health care costs, and pension increases, demonstrating Morris' willingness to align revenues with expenditures to maintain structural balance. While the budget includes a fund balance appropriation of $25.3 million, in line with that of previous years, officials report they are expecting to replenish these funds and at least break-even, pending the timing of the transition of the Morris View Healthcare Center. The county is turning the facility over to a private operator that will lease the county-owned facility. Morris expects to incur some costs during this transition and could see a slight use of reserves for these one-time costs. However, given the county's history of maintaining structurally balanced operations, we expect performance to remain strong.

Very strong budgetary flexibility
Morris County's budgetary flexibility is very strong, in our view, with an available fund balance in fiscal 2016 of 14.7% of operating expenditures, or $53.3 million. In addition, the county has the flexibility to raise additional revenues despite statewide tax caps, which we view as a positive credit factor.

Morris has a history of maintaining strong-to-very strong available current fund balances. In fiscal 2015, management used about $7.0 million of reserves in connection with the settlement of litigation associated with its solar renewable energy program. Despite this, current fund reserves remained above 15% of expenditures at fiscal year-end. The fiscal 2016 surplus increased available reserves to $53.3 million, down slightly as a percentage of 2016 expenditures.

In addition to the county's uncommitted reserves, officials noted they have dedicated reserves for accumulated absences, storm recovery (snow removal), and other purposes, which they would turn to first to meet qualifying costs above budgeted amounts. Including these additional reserves of $12.7 million brings total noncapital reserves to about 18% of 2016 current fund expenditures.

Morris expects adoption of a comprehensive fund balance policy that will govern decisions about minimum reserve levels, permitted uses of reserves, and recovery plans for when drawdowns are required. As such, we expect reserves
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will remain strong despite the use of fund balance appropriations in the budget because we expect the county will continue to appropriate no more than they anticipate regenerating during the year.

Morris can raise its tax levy by 2% annually, not including allowable exceptions, which officials have been willing to use to maintain balanced operations. In addition, the county has about $10.8 million of banked levy capacity available for the 2018 budget, which provides it additional flexibility to raise revenues. However, given the rolling nature of the levy bank cap and reductions to banked cap seen recently year-over-year, should we no longer view banked cap amounts as providing sufficient additional financial flexibility, our view of the county's flexibility could weaken.

Very strong liquidity
In our opinion, Morris County's liquidity is very strong, with total government available cash at 25.3% of current fund expenditures and 2.3x governmental debt service in 2016. In our view, the county has strong access to external liquidity if necessary.

Morris does not invest aggressively and is not exposed to variable-rate or privately placed debt. Current holdings are largely in bank deposits. The county maintains what we view as strong access to external liquidity, with long-term GO bond issuances within the past 15 years. Management indicates it does not expect to materially draw down total cash, so we expect liquidity to remain very strong.

Adequate debt and contingent liability profile
In our view, Morris County's debt and contingent liability profile is adequate. Total governmental fund debt service is 11.1% of current fund expenditures, and net direct debt is 126.7% of current fund revenue. Overall net debt is low at 1.0% of market value, and approximately 88.7% of the direct debt is scheduled to be repaid within 10 years, which are in our view positive credit factors.

Morris actively manages its capital needs and anticipates issuing $20 million-$30 million a year in debt, depending on market conditions. We have factored this into our analysis and do not anticipate any material changes to the county's debt profile. Morris also maintains capital reserves of nearly $10 million that could be used to offset project costs. As well, the county guarantees debt issued through the Morris County Improvement Authority, which we have included in our analysis.

The county is considering facility upgrades to the Morris County Courthouse, which dates back to 1827. Potential project costs and how they could affect our view of the county's debt profile are unknown.

In our opinion, a credit weakness is Morris's large pension and OPEB obligation. Morris' combined required pension and actual OPEB contributions totaled 8.6% of current fund expenditures in 2016. Of that amount, 3.9% represented required contributions to pension obligations, and 4.7% represented OPEB payments. The county made its full annual required pension contribution in 2016. The funded ratio of the largest pension plan is 31.2%.

Morris participates in two 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 Governmental Accounting Standards Board Statement No. 67) equal to 48.55% for PFRS and 31.20% for PERS, as of June 30, 2016. Given the changes to the administered plans' discount rate and weak market returns, we
expect that the county's pension costs will continue to increase as a result.

Morris also offers postretirement healthcare benefits to certain eligible employees, which it funds on a pay-as-you-go basis. No mechanism allows for prefunding this liability, limiting the county's ability to plan for these costs. As such, the unfunded actuarial accrued liability as of Dec. 31, 2016 was $1.2 billion. However, Morris has successfully negotiated to eliminate these benefits for new employees in some of its labor contracts. As such, it expects these liabilities to decline in the future.

The county includes projections for pension and OPEB costs in its financial forecasts, taking actions in current budgets that will allow it to maintain structural balance in the future. Morris has been willing to use levy cap exemptions for increasing pension costs. Given the county's history of managing these costs and proactive financial forecasting, we expect officials to maintain balanced operations despite the rising costs associated with these liabilities.

**Strong institutional framework**
The institutional framework score for New Jersey counties is strong.

**Outlook**
The stable outlook reflects S&P Global Ratings' opinion of Morris' very strong and diverse economy and ability to withstand economic downturns while continuing to significantly increase property tax base growth and keep unemployment low. The outlook also reflects our assessment of the county's history of strong-to-very strong budget performance, budget flexibility, and liquidity. As such, we do not expect to lower the rating within the outlook's two-year period. However, if budgetary pressures from sources such as rising pension and OPEB costs were to cause performance deterioration and draws on reserves, we could lower the rating.

**Related Research**
- 2016 Update Of Institutional Framework For U.S. Local Governments
- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.