Agenda

1. New General Obligation Methodology
2. US Credit Outlook
3. New Jersey Credit Outlook
4. Maintaining Credit Quality and Preparing for a Credit Review
5. Q & A
New General Obligation Methodology
General Obligation Bonds – Rated Universe

- GO is the most commonly used security by local governments in the US
- We rate approximately 8,300 local government GO credits
- Strong sector due to the potency of the ad valorem taxing power, amortizing debt structures, and overall stable institutional frameworks
- Current ratings range from Aaa to Caa3
  - Sector median is Aa3, only 2% rated Baa1 or below

Source: Moody's
# New GO Methodology

## Change in Weightings:

<table>
<thead>
<tr>
<th>Factor 1</th>
<th>Factor 2</th>
<th>Factor 3</th>
<th>Factor 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economy/Tax Base</td>
<td>Finances</td>
<td>Management</td>
<td>Debt/Pensions</td>
</tr>
<tr>
<td>30%</td>
<td>30%</td>
<td>20%</td>
<td>20%</td>
</tr>
</tbody>
</table>

- Was 40% | Unchanged | Unchanged | Was 10% |

- Factor 1 weighting lowered to reduce the influence of tax base size
- Factor 4 weighting increased to include a specific quantitative measure for pensions
New GO Scorecard - Factors, Subfactors and Weights

<table>
<thead>
<tr>
<th>Factors &amp; Sub-Factors</th>
<th>Weights</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Factor 1: Economy/Tax Base</strong></td>
<td>30%</td>
</tr>
<tr>
<td>Full Value (market value of taxable property)</td>
<td>10%</td>
</tr>
<tr>
<td>Full Value per Capita</td>
<td>10%</td>
</tr>
<tr>
<td>Median Family Income</td>
<td>10%</td>
</tr>
<tr>
<td><strong>Factor 2: Finances</strong></td>
<td>30%</td>
</tr>
<tr>
<td>Fund Balance as % of Operating Revenue</td>
<td>10%</td>
</tr>
<tr>
<td>5-Year Dollar Change in Fund Balance as % of Revenues</td>
<td>5%</td>
</tr>
<tr>
<td>Cash Balance as % of Revenues</td>
<td>10%</td>
</tr>
<tr>
<td>5-Year Dollar Change in Cash Balance as % of Revenues</td>
<td>5%</td>
</tr>
<tr>
<td><strong>Factor 3: Management</strong></td>
<td>20%</td>
</tr>
<tr>
<td>Institutional Framework</td>
<td>10%</td>
</tr>
<tr>
<td>Operating History: 5-Year Average of Operating Revenues / Operating Expenditures</td>
<td>10%</td>
</tr>
<tr>
<td><strong>Factor 4: Debt/Pensions</strong></td>
<td>20%</td>
</tr>
<tr>
<td>Net Direct Debt / Full Value</td>
<td>5%</td>
</tr>
<tr>
<td>Net Direct Debt / Operating Revenue</td>
<td>5%</td>
</tr>
<tr>
<td>3-Year Average of Moody’s Adjusted Net Pension Liability / Full Value</td>
<td>5%</td>
</tr>
<tr>
<td>3-Year Average of Moody’s Adjusted Net Pension Liability / Operating Revenues</td>
<td>5%</td>
</tr>
</tbody>
</table>
## GO Scorecard - Notching Factors

<table>
<thead>
<tr>
<th>Description</th>
<th>Direction</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Economy/Tax Base</strong></td>
<td></td>
</tr>
<tr>
<td>Institutional presence</td>
<td>up</td>
</tr>
<tr>
<td>Regional economic center</td>
<td>up</td>
</tr>
<tr>
<td>Economic concentration</td>
<td>down</td>
</tr>
<tr>
<td>Outsized unemployment or poverty levels</td>
<td>down</td>
</tr>
<tr>
<td>Other analyst adjustment to Economy/Tax Base factor (specify)</td>
<td>up/down</td>
</tr>
<tr>
<td><strong>Finances</strong></td>
<td></td>
</tr>
<tr>
<td>Outsized contingent liability risk</td>
<td>down</td>
</tr>
<tr>
<td>Unusually volatile revenue structure</td>
<td>down</td>
</tr>
<tr>
<td>Other analyst adjustment to Finances factor (specify)</td>
<td>up/down</td>
</tr>
<tr>
<td><strong>Management</strong></td>
<td></td>
</tr>
<tr>
<td>State oversight or support</td>
<td>up/down</td>
</tr>
<tr>
<td>Unusually strong or weak budgetary management and planning</td>
<td>up/down</td>
</tr>
<tr>
<td>Other analyst adjustment to Management factor (specify)</td>
<td>up/down</td>
</tr>
<tr>
<td><strong>Debt/Pensions</strong></td>
<td></td>
</tr>
<tr>
<td>Unusually strong or weak security features</td>
<td>up/down</td>
</tr>
<tr>
<td>Unusual risk posed by debt/pension structure</td>
<td>down</td>
</tr>
<tr>
<td>History of missed debt service payments</td>
<td>down</td>
</tr>
<tr>
<td>Other analyst adjustment to Debt/Pensions factor (specify)</td>
<td>up/down</td>
</tr>
<tr>
<td><strong>Other</strong></td>
<td></td>
</tr>
<tr>
<td>Credit event/trend not yet reflected in existing data sets</td>
<td>up/down</td>
</tr>
</tbody>
</table>
US Local Government Credit Outlook
2014 US Local Government Outlook Revised to Stable

» Economic growth, financial strength, and overall credit profiles are stabilizing
» Most Local Governments have figured out how to adjust to the new economic reality
» Outlook contemplates slower growth and weaker recovery out of recession
» Credit terrain not getting worse, but not returning to pre-2008 levels any time soon
» Credit risks are more visible and predictable
» Pockets of pressure still dot the landscape. Some New Jersey cities remain pressured.

Key drivers of our stable outlook, and factors to watch in the future:
» The housing market has stabilized in most of the country
» Property taxes have stabilized since downturn
» State funding arrangements have mostly stabilized
» Local governments are controlling costs, though pension burdens are a drag for many
» Reserve fund balances have stayed healthy
» The stable outlook applies to most of the sector, but pockets of credit pressure remain
US Local Government Ratings Mostly Held Steady Throughout the Downturn

Percentage of Total Ratings
- Same: 80.1%
- Downgraded: 13.7%
- Upgraded: 6.2%

Top and Bottom 10 States by Downgrade %
- Nevada (22)
- Idaho (32)
- Michigan (349)
- Rhode Island (33)
- Indiana (21)
- Florida (59)
- New Hampshire (49)
- California (460)
- Mississippi (44)
- Oregon (102)

Source: Moody’s Investors Service
## Pockets of Pressure Remain

### Stressed Sectors

<table>
<thead>
<tr>
<th>State</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Hampshire</td>
<td>Subsidies for nursing homes will pressure financial performance of counties.</td>
</tr>
<tr>
<td>New Jersey</td>
<td>Along with a lagging economic recovery, reduced fund balances and limits on revenue increases will weigh on cities and counties.</td>
</tr>
<tr>
<td>New York</td>
<td>Both cities and counties are facing rising pension and healthcare costs.</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>While coping with declining state aid, many issuers are also coping with strained tax bases and rising costs.</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>Cities continue to deal with weak revenue and economic growth and large pension liabilities.</td>
</tr>
<tr>
<td>Florida</td>
<td>Still recovering from the downturn, tax levels are still suppressed and many issuers still need to achieve structural balance.</td>
</tr>
<tr>
<td>Kentucky</td>
<td>Schools are strained by lease issues.</td>
</tr>
<tr>
<td>Illinois</td>
<td>Pension pressures weigh on cities, while delayed state aid is worrisome for school districts.</td>
</tr>
<tr>
<td>Indiana</td>
<td>State aid is being held flat and raising property taxes has become more difficult.</td>
</tr>
<tr>
<td>Michigan</td>
<td>Cities are coping with shrinking tax base and revenues. Schools face lower enrollment and lower state aid.</td>
</tr>
<tr>
<td>California</td>
<td>Significant revenue raising constraints and pension liabilities are above average due to generous benefits.</td>
</tr>
<tr>
<td>Nevada</td>
<td>Not yet recovered from the downturn, tax levels have not rebounded and budgets are still cut.</td>
</tr>
</tbody>
</table>

Source: Moody’s Investors Service

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**Pockets of Pressure Remain Despite General Stabilization**

- Not Pressured
- Pressured
- Not Applicable

Source: Moody’s Investors Service
New Jersey Credit Outlook
Strengths of New Jersey Local Governments

- Strong socio-economic wealth indicators, well educated workforce
- Proximity to New York and Philadelphia metropolitan areas
- Very strong state oversight
- Budgetary relief from pension and health benefit reform
- Statutory accounting creates cash-rich balance sheets – full reserves for receivables
- Unused levy cap allowance can be banked for three years
- Health benefit reform relief will continue as contribution escalates
- Constraints on interest arbitration
- Municipal debt is lower than national medians
- Limited need for cash flow borrowing
- Very active municipal bond market
New Jersey Municipal Rating Distribution

- Median rating is Aa3, the same as for the nation

Source: Moody's
Median Family Income Second Highest in the Nation

Source: BLS, Moody's Analytics, data as of 2012
Unemployment Remains Higher than Average

Source: BLS, Moody’s Analytics, as of April 2014
Unemployment Improving Relative to National Average

Source: BLS, Moody’s Analytics
Home Prices Stabilizing but Lagging National Recovery

Source: BLS, Moody's Analytics, FHFA home price index
The Highest Foreclosure Inventory in the Nation

Source: Moody’s Analytics - MBA Delinquency: All loans - % of # of loans, (%, NSA), data as of Q12014
Foreclosures Remain Stubbornly High

Source: Moody’s Analytics - MBA Delinquency: All loans - % of # of loans, (%, NSA)
NJ Fund Balances Stabilizing while US Average Improves

Stabilizing financial reserves for New Jersey cities, boroughs and towns

Source: Moody’s Investors Service, Audited Financial Statements
NJ Experiencing Lower Downgrade Ratio than the Nation

Downgrades continue to outpace upgrades

Source: Moody’s Investors Service
Recent Upgrades and Positive Outlook Changes

- 3/7/2012 Lower Township, NJ from A1 to Aa3
- 5/21/2012 Harrison Town, NJ from Ba3 to Ba2
- 5/31/2012 Collingswood Borough, NJ from Ba1 to Baa3
- 5/31/2012 Rumson School District, NJ from Aa2 to Aa1
- 9/14/2012 Mendham Borough, NJ from Aa2 to Aa1
- 10/8/2012 Little Silver School District, NJ from Aa3 to Aa2
- 3/5/2013 Harrison Town, NJ from Ba2 to Ba1
- 3/12/2013 Northwest Bergen County Utilities Auth, NJ from Aa3 to Aa2
- 5/13/2013 Paramus Borough, NJ from Aa2 to Aa1
- 11/6/2013 Municipality of Princeton, NJ from Aa1 to Aaa
- 12/5/2013 Collingswood Borough, NJ from Baa3 to Baa2
- 1/24/2014 Ridgefield Borough, NJ from A1 to Aa3
- 2/24/2014 Elizabeth City, NJ from A1 to Aa3
- 5/24/2014 Burlington County, NJ Aa2 removal of negative outlook
Maintaining Credit Quality and Preparing for a Rating Review
Understanding credit ratings

What They Are:

- Independent, objective assessments of the relative creditworthiness of debt obligations
- Shorthand symbols denoting the relative ability and willingness of debt issuers to make full and timely payment
- Opinions about future potential risks

What They Are Not:

- Ratings are not recommendations to purchase, sell, or hold particular securities
- Ratings are not predictors of non-credit-related market price movements
- Ratings are not audits, and do not guarantee the authenticity of information from issuers
- Ratings are not public policy report cards
- Ratings are not fixed; they may change over time
- Rating analysts are neither financial advisors nor investment bankers
Managing to Maintain Credit Quality

Challenges faced by local government managers in current environment

» Uncertainty surrounding economically sensitive revenues
  – Building permits, interest income

» Levy limitations

» Desire to maintain service levels

» High degree of fixed or mandated expenditures
  – Contractual salary increases, pension contributions and debt service

Higher rated entities manage these demands successfully
Managing to Maintain Credit Quality

Management’s response to economic pressures is key to maintaining credit quality

- Plans and policies to ensure financial flexibility is maintained
- Ability and willingness to make mid-year adjustments
- Use of multi-year budgets and projections
- Conservatively structured budgets
- Active monitoring of revenues
- Ongoing expenditure controls
- Limited exposure to enterprise guarantees
- Limited reliance on one time revenues
Strong Financial Policies

Example from a Virginia county

- At a minimum, Unreserved, Undesignated Fund Balance must equal 8.5% of operating expenditures.

- If at the end of any Fiscal Year the County’s Unreserved, Undesignated Fund Balance is less than 8.5% of operating expenditures, the County Board shall take action, aided by an economic plan developed by the County Administrator, to restore the Fund to the acceptable level, within two years.

- The County Board also established a target Unreserved, Undesignated Fund Balance as a percentage of operating expenditures of at least 10%, above which the County can use the following ways:
  - Leave in the General Fund for subsequent year’s fund balance;
  - Appropriation for one-time expenditures that would not increase recurring operating costs;
  - Establish a legitimate reservation of fund balance;
  - Appropriation for start-up expenditures of new programs undertaken at mid-year; or,
  - Designation to establish a Discretionary Stabilization Fund to address temporary cash flow shortages.
Checklist of Materials to Provide

Factor 1 – Economic Strength
» 5 to 10 years of assessed values and equalized values
» Top ten taxpayers and employers
» Annual tax levy, millage rate and collection data
» List of material new development projects
» Census data & Unemployment data

Factor 2 – Financial Position
» 3 to 5 years of audited financial statements
» Current fiscal year budget detail (including multi-year budget projections)

Factor 3 – Debt Position and Pension Liability
» Summary of outstanding debt (short and long-term, security pledge, bonds and loans)
» Copy of current Capital Improvement Plan
» Copy of pension actuarial valuation report

Factor 4 – Management and Governance
» Copy of formal financial, debt and other policies
» Recent management turnover
» Schedule of budget adoption and release of audited financials
» Details on health insurance plans
» Current status of labor contracts
Discussion Topics to Anticipate

Factor 1 – Economic Strength
» Contributing factors to property value trends
» Economic development trends – specify major development projects with projected equalized value
» What makes your tax base unique?

Factor 2 – Financial Position
» Contributing factors to the overall financial position in recent years
» Specific operating results for most current audited fiscal year
» Financial health of General Fund and other primary funds, including enterprise funds
» Legal authority to raise revenues
» Budget process and budget pressures
» Trend of fixed costs
» Trend of primary revenues and expenditures
Discussion Topics to Anticipate… Continued

Factor 3 – Debt Position and Pension Liability
» Plans for new debt over the next 2 to 3 years
» Overview of Capital Improvement Plan – what type of projects? Funding sources?
» Annual debt service costs and projected trend
» Annual pension and OPEB costs and projected trend
» Long-term pension and OPEB unfunded liabilities

Factor 4 – Management and Governance
» How closely does your municipality comply with formal policies?
» Long-term goals for maintaining financial health
» Trend in health insurance costs, benefits and type of plan
» Overview of labor relations and current contract details
» Plans to address long term unfunded pension and OPEB liabilities
Ongoing Surveillance and Transparency

**Annual rating review by the rating agency:**

- Annual rating review requirement
- Ratings are reviewed after the release of an annual audit
- Annual monitoring could involve one of several levels of review

**Annual disclosure by the issuer/municipality:**

- Timely release of audit reports
- Timely release of continuing disclosure requirements

**Goal of transparency:**

- The rating analyst should clearly explain the rationale behind rating outcome
- Understand the strengths and challenges within the rating factors
- Understand what could move the rating up or down
Practical Reminders

» Moody’s ratings reflect relative credit risk
» Levy changes are not, by themselves, credit negative or positive
» Urban, suburban and rural tax bases all have strengths and challenges
» Debt/Pensions make up 10%/10% of our GO rating under normal circumstances
» Tax base growth is credit positive; economic development is one component
» Forecasting and projections are valuable to the market
» Disclose alternate sources of liquidity