New Jersey Debt Rating Outlook Revised To Positive From Stable On Improved Pension Funding

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NEW YORK (S&P Global Ratings) Aug. 3, 2021--S&P Global Ratings revised the outlook to positive from stable on various long-term and underlying debt ratings for the State of New Jersey. At the same time, S&P Global Ratings affirmed its 'BBB+' rating on the state's general obligation (GO) bonds and 'BBB' rating on various other bonds secured by annual appropriations from the state. S&P Global Ratings also affirmed its 'BBB' rating on New Jersey bonds secured by appropriations for a human services provider, and its 'BB+' rating on South Jersey Port Corp.'s state moral obligation debt.

In addition, we revised the outlook to positive from stable and affirmed the 'BBB' rating on New Jersey Economic Development Authority's first-lien motor vehicle surcharge revenue bonds rated under our "Priority-Lien Tax Revenue Debt" criteria (published Oct. 22, 2018), which factor in both the strength and stability of the pledged revenues, as well as the general creditworthiness of the linked obligor, in this case the State of New Jersey (GO rating). The priority-lien rating on these bonds is limited by the state's general creditworthiness and appropriation risk.

"The outlook revision reflects our view that the decisions made by the state on how to spend surplus revenues in fiscal years 2021 and 2022 could position New Jersey to materially improve its long-term liability profile," said S&P Global Ratings credit analyst Tiffany Tribbitt. Specifically, efforts to improve pension funding could result in maintenance of a combined funded ratio of more than 40%, which we consider supportive of a higher rating.

Our 'BBB+' GO rating on New Jersey reflects what we consider the following weaknesses:

- A large structural operating deficit, which we calculate at 9.5% of appropriations in fiscal 2022;
- A large unfunded pension liability, a low pension funded ratio, and a history of substantially underfunding the state retirement systems' annual actuarially determined contribution (ADC), which, in our view, has created significant structural imbalance and puts pressure on future budgets;
- Large OPEB obligations; and
- High debt burden.

These weaknesses are offset, in our opinion, by the following GO credit strengths:

- Per capita income equal to 126% of the nation, among the highest of the 50 states;
- A diverse economic base of 8.9 million people showing, until now, recent growth at levels that have lagged the national rate;
- Budgeted reserves equal to a good 5.1% of appropriations; and

- New Jersey's efforts to reduce its debt burden and unfunded pension obligations.

New Jersey's overall score under our state rating criteria is '2.6', reflecting an indicative credit score of 'A', which can be further adjusted based on scoring overrides. As of the most recent June 30, 2020, GASB reporting, the state's combined pension funded ratio was 38.4%, triggering our one-notch adjustment for pensions with funded levels below 40%. We have made an additional one-notch override adjustment for weak structural budget performance, leading to a 'BBB+' indicative rating under our state criteria methodology.

We view New Jersey's social and governance risks as somewhat elevated due to court mandates regarding school funding in low-income districts and historical pension contribution underfunding. The state provides cybersecurity support for its local governments and school districts through the New Jersey Cybersecurity and Communication Integration Cell, which we view as a sign of good governance and risk mitigation. We view environmental risks as elevated given New Jersey's long coastal exposure and elevated levels of air pollution, in part due to emissions from other states, although the state actively works to mitigate these risks through agency planning and partnering with local governments.

Should the state make sustainable progress in improving its GASB pension funded ratio above 40%, without increasing its structural deficit and or experiencing deterioration in any other credit factors, we could raise the rating during our two-year outlook horizon.

If the state is unable to continue to fund the ADC and its structural deficit persists, because of such factors as little or no revenue growth due to a weakening of the economy, pension underperformance, or political unwillingness to make necessary adjustments, we could revise the outlook to stable.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020