FitchRatings

RATING ACTION COMMENTARY

Fitch Upgrades New Jersey IDR to 'A+', Rates $1.1B NJEDA School Fac. Rfdg. Bonds 'A'; Outlook Stable

Mon 10 Apr, 2023 - 5:59 PM ET

Fitch Ratings - New York - 10 Apr 2023: Fitch Ratings has assigned 'A' ratings to $1,058,800,000 in New Jersey Economic Development Authority (NJEDA) school facilities construction bonds, consisting of:

--$804,100,000 school facilities construction refunding bonds, 2023 series RRR;

--$254,700,000 school facilities construction refunding bonds, 2024 series SSS (forward delivery).

The par amounts are subject to change pending final sale. The refunding bonds are expected to be offered on April 20, 2023 by negotiated sale.

In addition, Fitch has upgraded New Jersey's Issuer Default Rating (IDR) to 'A+' from 'A', and has upgraded the following ratings which are linked to or capped by the state's IDR:

--Approximately $5 billion general obligation (GO) bonds to 'A+' from 'A';

--Approximately $413 million Garden State Preservation Trust revenue bonds to 'A+' from 'A';

--The qualified bond program and school bond credit enhancement program (Chapter 72) ratings to 'A' from 'A-';

--Approximately $27.1 billion in appropriation obligations issued by state authorities and linked to the state's IDR (as detailed at the end of this release) to 'A' from 'A-'.

The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
New Jersey, State of (NJ) [General Government]	LT IDR	A+ Rating Outlook Stable	Upgrade	A Rating Outlook Positive
New Jersey Qualified Bond Program (NJ) /State Aid Intercept Rating/1 LT	LT	A Rating Outlook Stable	Upgrade	A- Rating Outlook Positive
New Jersey School Bond Credit Enhancement Program (NJ) /State School Bond Program Rating/1 LT	LT	A Rating Outlook Stable	Upgrade	A- Rating Outlook Positive
New Jersey, State of (NJ) /Garden State Trust Revenues/1 LT	LT	A+ Rating Outlook Stable	Upgrade	A Rating Outlook Positive

New Jersey, State of (NJ) /General Obligation - Unlimited Tax/1 LT	LT	A+ Rating Outlook Stable	Upgrade	A Rating Outlook Positive
New Jersey, State of (NJ) /State Appropriation/1 LT	LT	A Rating Outlook Stable	Upgrade	A- Rating Outlook Positive
New Jersey, State of (NJ) /Transportation Trust Fund Revenues/1 LT	LT	A Rating Outlook Stable	Upgrade	A- Rating Outlook Positive

VIEW ADDITIONAL RATING DETAILS

SECURITY

The bonds are special, limited obligations of the NJEDA. The source of funds for the authority's debt service payments is annual payments from the state of New Jersey under a contract between the NJEDA and the state treasurer, subject to annual legislative appropriation.

ANALYTICAL CONCLUSION

State Appropriation: The 'A' rating for the NJEDA school facilities construction bonds, one notch below New Jersey's 'A+' Issuer Default Rating (IDR), is based on the state's pledge to make annual payments equal to debt service, subject to annual legislative appropriation. The Stable Outlook reflects the Outlook on the state's IDR.

The upgrade of the IDR to 'A+'/Stable from 'A'/Positive reflects Fitch's view that New Jersey has effectively used the fiscal momentum of recent years to accelerate progress on its long-term fiscal and liability challenges. Solid economic performance matched by robust revenue growth have helped New Jersey to shrink its liabilities. Despite recent improvements, high liabilities and elevated carrying costs are likely to remain a longer-term constraint on its budget choices. Although the durability of recent fiscal improvements remains untested, New Jersey's credit quality will continue to benefit from inherent strengths including its very high wealth and the broad budget management prerogatives common to states.

Economic Resource Base

New Jersey benefits from a broad, diverse economy, high wealth indices and its geographic position in the heart of the dynamic northeast corridor. The economic base includes significant presence in key industries such as trade, transportation and utilities, financial activities, and professional and business services.

KEY RATING DRIVERS

Revenue Framework: 'aa'

New Jersey's revenue system is very diverse and sensitive to economic trends. Underlying growth prospects are slow, approximating Fitch's long-term expectations for the national rate of inflation over time. The state has no legal limitations on its ability to raise revenues through base broadenings, rate increases, or the assessment of new taxes or fees.

Expenditure Framework: 'a'

Natural growth in expenditures over time is expected to be above revenue growth, driven by program spending demands. The state maintains the wide latitude to reduce spending common to most U.S. states and has repeatedly done so in response to forecast revenue shortfalls. The carrying cost for long-term liabilities is well above the U.S. state median driven by high debt and the cumulative effects of past pension contribution practices. Having now achieved full actuarial pension contributions, carrying cost growth is likely to slow going forward, and further easing is taking place with recent debt defeasance.

Long-Term Liability Burden: 'aa'

The long-term liability burden is elevated and well above that of most U.S. states, reflecting considerable outstanding debt and large net pension liabilities. The burden has been declining, both due to directing excess resources to reduce new borrowing and improved pension contribution practices, but future capital needs and continued pension demands will likely leave this ratio comparatively high. Other post-employment benefit liabilities are also significant.

Operating Performance: 'a'

Gap-closing capacity has strengthened significantly in recent years, with ending balances well above historical experience. Despite improvement, operating performance would likely be more challenged in a downturn compared to other states given somewhat constrained expenditure flexibility. Reduced reliance on nonrecurring actions and the building of higher operating balances have further strengthened budget management.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Maintaining strengthened fiscal resilience at or near current levels through near-term economic uncertainty, and prioritizing building more sustainable fiscal reserves over time;

--Accelerating economic gains that over time lead to revenue growth consistently in excess of Fitch's long-term expectations for national inflation;

--Continued focus on addressing high liabilities, including further reducing outstanding borrowing and making further progress lowering the burden of other employee and retiree benefit costs.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Evidence that New Jersey's ability to support high carrying costs within its budgetary framework, including making full actuarial pension contributions, is straining its operating performance;

--Significantly increased reliance on non-structural budget solutions or difficulty absorbing the budgetary effect of expiring federal pandemic assistance;

--A significant weakening of the state's economic trajectory that leads to revenue growth consistently below long-term expectations for national inflation.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sectorspecific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

CURRENT DEVELOPMENTS

New Jersey Economic Update

New Jersey's labor market situation has improved dramatically since the pandemic began three years ago. At the start of the pandemic, non-farm payroll declined more in New Jersey than nationally (down 17% from February 2020 to April 2020 in New Jersey, versus a 14% decline nationally). Since then a strong recovery has taken root, with 113% of jobs regained through February 2023, just under the 114% national level, but above the 92% and 101% levels in neighboring New York State and Pennsylvania, respectively.

The official state monthly unemployment rate of 3.5% in February 2023 is under the national 3.6% rate for that month. Fitch also considers the employment to population ratio (EPOP) when evaluating the health of labor markets, with New Jersey's suggesting a solid recovery. New Jersey's EPOP of 62.3% in February was above both the 60.2% national level in that month and the 61.7% rate reported in February 2020, just before the pandemic.

New Jersey Budgetary Update

Similar to many states, New Jersey's finances since the pandemic struck have been remarkably resilient relative to earlier forecasts, supported by a rapid economic rebound, federal economic stimulus and pandemic aid, state balancing actions and tax collections well beyond earlier forecasts. New Jersey had been making slow but steady progress in addressing multiple fiscal and liability challenges before the pandemic, but the surge in revenues during the pandemic recovery has enabled it to accelerate improvements, particularly lowering its long-term liability burden and building a budgetary cushion.

Fiscal 2022 actual revenue reached nearly $52.7 billion, 8.4% higher than fiscal 2021 and 24.5% higher than the forecast certified at the start of the year. The budget included a $6.9 billion contribution to pensions, consisting of the full $6.4 billion full actuarial determined contribution (ADC), plus an excess contribution of $505 million to accelerate funding progress; this marked the first full actuarial contribution after 25 years of contribution shortfalls. The payment included $5.8 billion in budgetary resources and another $1.1 billion from monthly net lottery proceeds under the 2017 Lottery Enterprise Contribution Act (LECA), which redirects lottery net revenues to pensions. The state also set aside excess fiscal 2021 resources for debt defeasance (detailed below). Fiscal 2022 ended with a balance of $8.3 billion (nearly 16% of revenues), above the $6.9 billion ending balance in fiscal 2021 and well in excess of ending balances over the decade preceding the pandemic.

Fiscal 2023 Continues with Solid, but Slowing, Revenue Performance

The state maintained a cautious approach in the fiscal 2023 enacted budget, assuming a slower pace of economic growth. Total revenue was forecast at $50.4 billion, 3% below then-estimated fiscal 2022 revenue, reflecting the expectation that collections would revert to longer-term trends as the economy slowed. Although net sales taxes was projected rise 1.4% yoy, gross income tax (GIT), pass-through business alternative income tax (PTBAIT), and corporation business tax (CBT) would decline 2.9%, 11.5% and 7.3%, respectively.

Actual experience has far exceeded initial state expectations, with the state now assuming a revenue slowdown emerging later in the fiscal year. The revised fiscal 2023 revenue forecast in the executive budget for fiscal 2024, released in February, anticipates total revenue of almost $54.1 billion, 7.3% above the amount certified at the start of the fiscal year and 2.7% ahead of prior year actuals. The revised forecast assumes that net sales taxes and CBT rise 4.4% and 1.1% yoy, respectively, while GIT and PTBAIT decline 1.6% and 0.5%, respectively.

Actual collections suggest slowing receipts; with the treasurer reporting that cash collections for major revenues in February 2023 were $170 million (5.6%) below February 2022. Nonetheless, year-to-date collections through February 2023 are $607 million (2.3%) higher than the same period in fiscal 2022.

Fiscal 2023 appropriations, including changes proposed with the governor's recent executive budget, stand at $54.5 billion, about 3.3% above fiscal 2022 appropriations. The budget included a full $6.8 billion actuarial pension contribution (from both budgeted resources and state lottery receipts under LECA), the second consecutive year of full actuarial contributions. It also funded more than $2 billion for property tax relief through the state's ANCHOR program and $9.9 billion for K-12 school formula aid, a $650 million increase. The state now estimates that the fiscal 2023 ending balance will stand at $9.5 billion (18% of estimated revenues); this level is well above the enacted budget forecast at $6.8 billion (13.5% of then-forecast revenues).

Fiscal 2024 Anticipates Revenue Slowdown

The governor's executive budget for fiscal 2024 forecasts a slowdown in revenue while continuing recent actions to address the state's fiscal challenges. Forecast revenues fall to $53.8 billion (-0.4%) from fiscal 2023, reflecting both the slowing economic outlook and tax policy changes. The latter includes allowing the Dec. 31, 2023 expiration of the 2.5% CBT surtax. The surtax was first imposed in tax year 2018 and extended in fiscal 2020 in response to the pandemic. The planned sunset will contribute to a fiscal 2024 CBT decline of $421 million (-7.3%) from fiscal 2023, with the CBT totaling just under $5.4 billion. GIT, PTBAIT and net sales tax rise only 2.3%, 2.2% and 1.1%, respectively.

Fiscal 2024 executive budget appropriations stand at $53.1 billion, 2.6% below estimated fiscal 2023 appropriations. The spending plan includes a third year of full actuarial pension contributions totaling $7.1 billion, consisting of nearly $6 billion in state funds and about $1.1 billion in LECA contributions. It also continues funding $2 billion for property tax relief through the ANCHOR program and funds almost $10.8 billion for K-12 school formula aid, an $830 million increase. At fiscal 2024 year-end, the ending balance is forecast at $10 billion (almost 19% of forecast revenue).

State Directs Excess Resources to Debt Reduction

In the last two enacted budgets and the executive proposal for fiscal 2024, New Jersey has directed substantial excess resources to accelerating debt reduction. As part of the fiscal 2022 budget, the state deposited $3.7 billion in excess fiscal 2021 resources in a new debt defeasance and prevention fund (DDPF), with $2.5 billion to retire outstanding GO and appropriation debt and $1.2 billion for pay-go capital. The fiscal 2023 budget deposited another $5.2 billion to the DDPF from the fiscal 2022 ending balance, with allocations of $1.9 billion for school capital, $814 million for New Jersey Transit (NJT) and $230 million for transportation and the remainder for defeasing outstanding debt or funding other capital.

The state estimates that in its first two years, DDPF deposits have been used to defease $3.5 billion in outstanding debt and eliminate $4.7 billion in future annual debt service payments through fiscal 2042, with almost $2 billion in funds still unallocated. The fiscal 2024 executive budget proposes a supplemental $2.35 billion deposit from fiscal 2023 excess resources, which would leave the fund's unallocated balance at $4.3 billion.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

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APPLICABLE CRITERIA

U.S. Public Finance Tax-Supported Rating Criteria (pub. 04 May 2021) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

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Dodd-Frank Rating Information Disclosure Form

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