DEBTWIRE

# New Jersey liabilities continue to grow unabated; market shrugs, for now

Maria Amante - February 18, 2015

New Jersey's latest debt report, which shows that the state's non-bonded obligations, including pension and other postemployment benefit (OPEB) liabilities, exceeded bonded obligations is "worrisome," said **Neil Klein**, senior managing director and principal at **Carret Asset Management**.

Unfortunately for the Garden State, it's no surprise, either, **Klein** said.

The state's total debt jumped to USD 84.86bn in FY14, from USD 79.66bn in FY13, a difference of USD 5.2bn, or 6.53%. This news puts additional pressure on the state, **Klein** said. Market participants want to see the state making reductions to pension commitments, but New Jersey is demonstrating the very opposite by allowing these liabilities to grow, **Klein** said.

The biggest cause of New Jersey's debt growth was its non-bonded obligations, which includes the pension obligations and other postemployment benefits (OPEBs). Non-bonded obligations now equal more than half of the state's total debt, or USD 43bn. New Jersey's non-bonded obligations increased USD 4.82bn, or 12.56%, between FY13 and FY14.

Governor Chris Christie addressed the growing pension obligation in his State of the State address last month and promised reform in that speech.

With any luck, the governor will address the necessary reforms needed in his FY16 budget proposal, to be revealed on 24 February, said Marc Pfeiffer, assistant director and research fellow at the Edward J Bloustein School of Planning and Public Policy at Rutgers University.

The state's debt growth is "absolutely" in part a result of failing to make the full pension contributions, said Marcy Block, senior director at Fitch Ratings.

The growing debt burden highlights the necessity of the state addressing the pension problem, Pfeiffer said. Failure to match the pension obligations results in additional liabilities in lost interest, he said.

"New Jersey needs to address its overall fiscal situation in order to sustain investor confidence," Pfeiffer said.

New Jersey's bonded obligations only increased USD 138.3m between years, and non-bonded obligations now exceed the state's USD 35.11bn in bonded obligations.

Although the market and ratings agencies are watching the trend, the market hasn't reflected negativity since the debt report was released Friday, **Klein** said. Trading has remained relatively flat on New Jersey paper even amid negative headlines and downgrades over the past year, he said.

"Bond investors, at some point down the road, may demand higher yield on New Jersey debt. It's a nationwide phenomenon – the demand side of the market has been so strong over the past few years that even medium-sized or moderate bad news doesn't necessarily result in spread widening or yields going higher. Demand is outstripping supply by such a large margin that strong demand has found a way to mute negative headlines," **Klein** said.

The governor first enacted pension reform in 2010, which included a ramp-up plan to get the state to the full USD 3.7bn annual required contribution (ARC) by 2018. From 2011 to 2018, the state was scheduled to increase the pension contribution by one-seventh until it reached the full USD 3.7bn.

When FY14 revenues fell short by nearly USD 1bn, Christie reduced the FY14 and FY15 planned pension contributions by USD 2.4bn. In FY14, Christie contributed just USD 696m of the planned USD 1.5bn, or 46% of the scheduled amount, and said in FY15, the state would only pay USD 681m of the USD 2.25bn pension contribution, or 30.2% of the planned contribution.

Christie created the New Jersey Pension and Health Benefit Study Commission in 2014, which released a report in September adding up the pension and OPEB liabilities; the pension system has a 54% funded level while OPEBs have a 0% funded level, according to the report.

"Despite real reforms that reduced aspects of our long-term debt, post-retirement pension and health benefits continue to be unsustainable. Substantial reform in this area is necessary so that our debt can be made more affordable," said a New Jersey Department of Treasury spokesperson said.

New Jersey is rated A1/negative by Moody's Investors Service and A by Standard & Poor's and Fitch Ratings, but Fitch has the state on negative outlook.

A USD 85.1m 5% Series 2010 general obligation refunding bond due 2019 last traded in round lots at 116.139 to yield 1.37% on 12 February.

Bondholders include Van Eck's Short Municipal Index ETF Fund Holdings, according to a report dated 13 February.

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