Bloomberg BRIEF
Municipal Market
Thursday
Jan. 14, 2016
www.bloombergbriefs.com

New Jersey Turnpike Debt Acts as Route Around State's Fiscal Jam

- Authority sells bonds backed by tolls from critical highway
- Debt an alternative for state investors seeking tax breaks

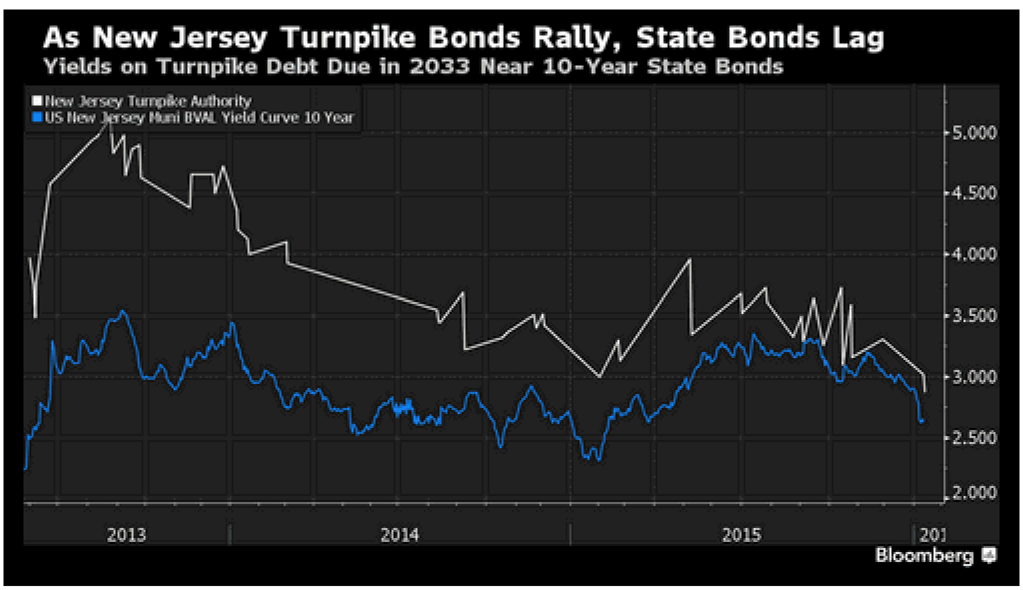
By Romy Varghese

(Bloomberg) -- Few things are more symbolic of New Jersey than its highways –- and for the state's municipal-bond investors, few are more attractive.

Investors avoiding the New Jersey government's bonds because of its mounting fiscal challenges find value in securities from the turnpike authority, which is selling $149 million of them Thursday. The debt is backed by tolls that aren't affected by the state's financial outlook, which is a draw to residents looking for tax-free income.

The authority runs its largest tolled highways: the Garden State Parkway and the New Jersey Turnpike, part of the Interstate 95 corridor that links the northeastern states with the Mid Atlantic. That stream of cash has kept its credit rating from Moody's Investors Service steady for more than a decade, even downgrades to New Jersey have left it the second-lowest ranked U.S. state.

"There is demand from investors looking to avoid state-backed names or reduce their exposure. The turnpike is a really solid alternative," said Paul Brennan, a portfolio manager in Chicago at Nuveen Asset Management, which oversees about $100 billion of munis. "It's such a crucial stretch of highway.''



The appeal has led to lower yields for turnpike bonds compared to that of other New Jersey agencies. A turnpike security due Jan. 2033 traded Wednesday at an average yield of 1.44 percentage point above benchmark municipal debt. That gap for an economic development authority bond due Sept. 2026 was more than 0.7 percentage points higher Wednesday despite the shorter maturity, according to data compiled by Bloomberg.

Neil Klein, Senior Managing Director at Carret Asset Management, said he's avoiding debt that relies on funds that have to be appropriated by the legislature, such as the economic development authority bonds. He's interested in buying the new turnpike bonds because he considers them among the best in the state.

"It's a simpler credit," said Klein, who helps oversees $750 million of munis from New York. "We can see the revenues coming in. We can see how the state and how the turnpike authority spend those revenues.''

Investors have pushed borrowing costs higher for New Jersey, which has been downgraded nine times since 2010 as pension obligations swell. Only Illinois pays more, according to data on 20 states tracked by Bloomberg.

The authority isn't immune to the state's fiscal challenges. Under an agreement that expires in June, the turnpike since 2012 has provided $1.47 billion for New Jersey's transportation fund after paying off bondholders first, bond documents show. With that deal lapsing, there's a risk that lawmakers may seek to draw more from the road operator to help close any shortfalls in the budget when the new year begins in July.

"The deepening fiscal challenges for the state increase the likelihood and magnitude of assistance" the turnpike may have to provide in the future, Moody's said in a report.

The New York-based ratings company has a positive outlook on its A3 rating, seventh-highest, suggesting an increase is more likely. Standard & Poor's grades the securities two steps higher at A+. The new securities will retire existing bonds to save about $28 million, said Donna Manuelli, the authority's chief financial officer.

The turnpike is so important that raising tolls 40 percent in 2008 and 53 percent in 2012 barely dented traffic, said Jeff Kovala, senior analyst at Columbia Threadneedle Investments, which manages about $30 billion in local debt.

"When there's a large increase and you don't see that drop-off, it speaks to the fact that it's a very needed and essential roadway," he said.

The authority is on track to either meet or exceed its estimates on toll collections for the fourth consecutive year, said Manuelli, the CFO.

“We’re just very stable and predictable. It’s not like we need a 10 percent growth rate one year or two years to meet our projections,” she said. “We just need to chug along at our normal historical growth rate. That’s something investors should take confidence in.’’

Related ticker:
STONJ1 US (State of New Jersey)

To contact the reporter on this story:
Romy Varghese in Philadelphia at rvarghese8@bloomberg.net
To contact the editors responsible for this story:
Dave Liedtka at dliedtka@bloomberg.net
William Selway