FITCH RATES NEW JERSEY EDA'S $350MM BONDS 'A-'; OUTLOOK STABLE

Fitch Ratings-New York-14 September 2017: Fitch Ratings has assigned an 'A-' rating to $350 million of state of New Jersey Economic Development Authority (NJEDA) school facilities construction bonds, 2017 series DDD. The bonds are scheduled to be offered by negotiated sale on or about Sept. 27, 2017.

In addition, Fitch has affirmed the following ratings for New Jersey:

--Issuer Default Rating (IDR) at 'A';
--$2 billion of general obligation (GO) bonds at 'A';
--$764 million of Garden State Preservation Trust bonds at 'A';
--Approximately $32 billion of state obligations linked to the state's IDR (as detailed at the end of this release) at 'A-'.

The Rating Outlook is Stable.

SECURITY
The bonds are special, limited obligations of the NJEDA; debt service is paid under a state contract between the state treasurer and the authority subject to annual legislative appropriation.

ANALYTICAL CONCLUSION

State Appropriation: The 'A-' rating for the current NJEDA bond issue, one notch below New Jersey's 'A' IDR, reflects NJEDA's pledge to make annual payments equal to debt service on these obligations through a contract with the state treasurer, subject to annual appropriation by the state legislature.

New Jersey's 'A' IDR incorporates a history of structurally imbalanced financial operations and slim reserves, persistent underfunding of its liabilities, and an elevated long-term liability burden, as well as the state's diverse and high wealth economy that has returned to sustained growth. In the absence of additional pension reforms Fitch expects that incremental pension contribution increases will consume the bulk of natural revenue growth for the next several years and remain a significant part of the state's budget going forward. The rating also incorporates the strong control over revenues and spending inherent in a state's powers.

Fitch views the recently enacted Lottery Enterprise Contribution Act (LECA) as having a neutral impact on the state's credit standing. The 30-year, irrevocable contribution of the lottery enterprise to the state's three largest pension systems will increase reported funded ratios, but total current and forecast contributions remain below actuarial levels for at least several more years. LECA provides a monthly cash flow to the plans, which, in concert with a recent statutory change disbursing annual pension contributions on a quarterly basis, is expected to reduce cash flow pressures on the systems. It also mitigates the risk of reductions to annual funding that the systems have suffered from in the past, as the lottery revenues flow directly to the systems and are not subject to the annual budget process. LECA is structured to have a neutral budgetary impact through the first five years, commencing in fiscal 2018, followed by seven years of manageable, increasing cost to the state; this is an important consideration given the state's budget challenges.

Economic Resource Base

New Jersey benefits from a broad economy and high wealth indices. Population growth is significantly slower than the national average, but personal income remains among the highest of the states and the state economy benefits from its geographic position in the heart of the dynamic northeast corridor.

KEY RATING DRIVERS

Revenue Framework: 'aa'
The state's revenue system is highly influenced by economic trends and has only recently benefited from more robust growth following the end of the great recession. 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'
Carrying costs are well above the U.S. state average and the state has appropriated for just half of its actuarially determined contribution (ADC) to pensions in fiscal 2018. The state maintains the broad expense-cutting ability common to most U.S. states and has leveraged this attribute in response to unexpected revenue shortfalls. Given the need to fund sizable and increasing pension and other post-employment benefit (OPEB) expenditures, growth in expenditures is expected to be well above future revenue growth absent offsetting policy actions.

Long-Term Liability Burden: 'a'
The state's long-term liability burden is elevated but still in the moderate range and well above most U.S. states. This reflects its considerable outstanding debt load and large net pension liabilities (NPL). Future capital needs and continued pension demands will sustain this ratio at a high level and weigh on the state's credit.

Operating Performance: 'a'
Financial operations are characterized by sizable spending pressures, and structural budget imbalance in the form of persistently inadequate contributions for liabilities. New Jersey does not maintain a rainy day fund, limiting its operating flexibility in periods of downturns.

RATING SENSITIVITIES
Fiscal and Liability Position: The rating is sensitive to changes in the state's approach to managing its fiscal and long-term liability position. The Stable Outlook assumes a continuation of the state's current financial practices.

CREDIT PROFILE

New Jersey's high wealth and economic diversity has not spared it from an unusually weak economic recovery. An initially sluggish recovery in key industries of trade, transportation and utilities; financial activities; and professional and business services began to shift to stronger performance only in 2015. Employment growth has improved relative to national averages, with gains strengthening in 2016 and year to date in 2017 and with the state finally recovering all employment lost during the recession in late 2016. Year over year employment growth recently has matched the national average, contributing to declines in the unemployment rate; however, a stagnant labor force remains a key factor. Personal income per capita in New Jersey stands at 125% of the national level, third highest among the states.

Revenue Framework
The personal income tax (PIT) provides the largest support of operations, totaling over 40% of preliminary, unaudited fiscal 2017 operating fund revenues, with sales tax revenue providing the next largest share at 28%. At 7% in fiscal 2017, the corporate business tax (CBT) is a notably smaller contributor to revenues, but its volatility makes forecasting difficult and contributes to

uneven performance. Gaming revenue is a small contributor to the state's operations yet a modest uptick in performance in 2017 incorporates escalating interest in online gaming in the state. Recent revenue forecasts have been more conservatively derived than in years past. Similar to other states, New Jersey's fiscal 2017 actual revenue collections underperformed earlier forecast targets, despite growing relative to fiscal 2016.

Within the past year, the state enacted two significant revenue adjustments. In October 2016, it enacted Chapter 57, which increased the state's petroleum products gross receipts taxes (PPGRT) in exchange for a two-year reduction to the sales tax, a phase-out of the estate tax and an increase in the earned income tax credit. A recently approved amendment to the constitution now dedicates all gas tax revenue to the transportation trust fund (TTF) for transportation capital projects. These actions are expected to substantially decrease revenue to operating funds beginning in fiscal 2018, after a temporary boost in fiscal 2017.

New Jersey's revenue growth over the 10 years through fiscal 2015 was below growth in both U.S. GDP and inflation, incorporating its very slow momentum coming out of the recession. Tax policy changes tied to the approval of a higher PPGRT in 2016 moderates overall projected revenue growth in fiscal 2018 to 2.6%, following 3% preliminary revenue growth in fiscal 2017. The fiscal 2018 forecast is premised on growth in personal income of 4% in 2017 and 4.5% in 2018. Fitch believes attaining the revenue forecast is dependent on both national and state economic conditions including the state's ability to grow its workforce.

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
As in most states, education and health and human services are New Jersey's largest operating expenditures. Education is by far the larger line item, including for higher education, as the state provides significant funding for local school districts and the public university and college system. Health and human service spending is the second largest area of spending, with Medicaid being the primary driver.

Federal action to revise Medicaid's programmatic and financial structure remains a possibility given recent federal legislative and administrative efforts. Most proposals to date include a basic restructuring of federal Medicaid funding to a capped amount. Whether a change in federal Medicaid funding has consequences for Fitch's assessment of a state's credit quality would depend on the state's fiscal response to those changes. Responses that create long-term structural deficits or increase liability burdens could negatively affect both the expenditure framework assessment and the IDR.

Pension contributions of $1.9 billion approximated 5.4% of fiscal 2017 adjusted appropriations, but were only four-tenths of the $4.7 billion actuarially-determined contribution (ADC). A contribution at the ADC would have resulted in pensions consuming 13.5% of fiscal 2017 adjusted appropriations. The state has appropriated $2.5 billion for its fiscal 2018 contribution, 50% of the ADC, consistent with its stated plan to incrementally add one-tenth each year until full funding of the ADC is reached, in fiscal 2023. Under LECA the state's payment is offset by anticipated net lottery receipts, resulting in a net $1.5 billion payment from operating funds. The state is concurrently shifting education appropriations to offset lottery enterprise receipts now flowing to the pensions. The first five years of LECA-related changes are expected to be budget neutral, followed by manageable, increasing general fund expenses over a seven-year period. Fitch views the plan as generally fiscally neutral while noting the diminishment in the state's operating flexibility as a result. For additional information on LECA, see 'Fitch Focus on Munis: Pensions - States Use Financial Engineering to Lower Contributions', published July 31, 2017 and available at www.fitchratings.com.

Based on the state's current statutory pension contribution ramp-up, in combination with escalating health care expenses for employees and retirees despite recent achievement of real cost savings from a redesign of certain components of the employee and retiree health care plan, the natural pace of expenditure growth is expected to be well ahead of expected revenue growth in the absence of policy action. This disparity presents a significant challenge to the state and is likely to crowd out other spending priorities.

New Jersey has demonstrated an ample ability to adjust budgeted expenditures to meet changing fiscal circumstances, albeit sometimes by deferring spending, and the governor has strong executive authority to implement any necessary reductions to balance the budget. These powers were affirmed by a state Supreme Court decision, in June 2015, affirming that financial obligations except for GO debt are subject to annual legislative appropriation unless approved by voters.

The state's above-average cost pressures are reflected in a carrying cost metric that is well ahead of most U.S. states. The metric incorporates the state's sizable debt load and pension ADC as well as considerable OPEB pay-go expenditures.

Long-Term Liability Burden

New Jersey's combined burden of debt and net pension liabilities is high for a state, at 23.2% of personal income as of fiscal 2016. Net tax-supported debt alone is also high for a U.S. state, and ongoing capital demands for school construction, environmental protection and transportation remain large. Net tax-supported debt as of June 30, 2017 equated to 7% of 2016 personal income, including a $3.2 billion GARVEE issued in November 2016.

The state administers seven pension plans, with the bulk of its own liability in three multiemployer plans covering retired employees, police and firefighters, and local teachers; the state assumes the liability for local teacher pensions. For the seven systems in aggregate, fiduciary assets cover only 35.7% of total pension liabilities as of June 30, 2017, based on the indicative GASB 67 valuation prepared in conjunction with LECA and not incorporating the impact of the scheduled contribution ramp up. Under this valuation all of the state's plans use blended discount rates for reporting and forecast asset depletion, resulting in low ratios of assets to liabilities; the employees' plan forecasts depletion in fiscal 2039, while the teachers' plan forecasts depletion in fiscal 2036. Incorporating the ramp-up of annual contributions through fiscal 2022 would eliminate projected depletion dates from all but one of the plans, according to the state's disclosure, raising the aggregate ratio of assets to liabilities to 47.3%.

Unlike the accounting valuation, the statutory funding valuation reflects the benefit of LECA on actuarial assets, elevating the estimated funded ratio for the state's share of the seven systems to 56.5% as of June 30, 2017. Even assuming the plans' assets achieve their recently lowered 7.65% investment return assumption, the statutory funded condition of the plans is expected to deteriorate from the higher level at least over the near term given the gradual phase in to full actuarial contributions. The steady deterioration of New Jersey pensions is a negative rating factor, and Fitch does not anticipate additional reforms that would substantially improve their sustainability.

The state's UAAL for OPEB stood at $67.5 billion as of fiscal 2016, equal to 12.2% of personal income. It has risen in recent years given new mortality assumptions extending life expectancies, higher prescription drug costs, and maintaining the plan as pay-go. While Fitch views OPEB as a more flexible obligation when compared to pensions, the significant escalation in this liability is a concern.

Operating Performance

New Jersey's response to cyclical downturns largely rests with its willingness to reduce expenditures given its limited financial cushion and sensitivity to increasing tax rates. The state experienced sharp revenue declines in fiscal years 2009 and 2010, responding by applying cash balances and reducing expenditures, including making no appropriation for pension contributions in fiscal years 2010 and 2011.

The state does not maintain a separate rainy day fund and views its operating fund balance as its budgetary cushion. The balance equaled an estimated 1.3% of operating appropriations at the end of fiscal 2017, although this figure is preliminary and final results could be stronger, down from 2.5% in fiscal 2015 due to revenue underperformance and changes in statute. Fitch views the balance as providing only limited operating flexibility relative to historical revenue cyclicality. The fiscal 2018 adopted budget anticipates a further reduction in the balance.

Historically, state financial operations have been characterized by aggressive forecasts of revenues, persistent underfunding of liabilities and a lack of consensus on short- and long-term solutions to support more sustainable finances. These negatives were compounded by unusually slow economic performance coming out of the great recession. More recently, Fitch believes revenue forecasts have become more conservative, aided by stronger economic growth and enabling more balanced financial performance, despite unanticipated revenue shortfalls in fiscal years 2016 and 2017. The state responded to those shortfalls by reducing expenditures and applying a portion of its slim fund balance in fiscal 2017.

Over the past year, the state has tackled a number of critical issues such as transportation infrastructure funding and pension contribution changes (LECA, discussed earlier). Fitch believes transportation funding changes will be sufficient to address currently identified road and rail safety projects, even as other needs remain unaddressed, such as funding for the state's portion of new trans-Hudson rail tunnels. Longer term, the TTFA solution came at a cost to the general fund by swapping cuts to growing tax revenue sources (sales and estate taxes) with an increase in slow-growing motor fuel taxes. Fitch estimates this creates an operating fund revenue loss approximating $8 billion over the eight year program authorization.

Current Developments

The state reports that revenues for fiscal 2017, which ended on June 30, are below earlier expectations, similar to fiscal 2016. Slow PIT and CBT collections and the reduction in sales tax rates as part of the TTFA reauthorization contributed to fiscal 2017 revenues being lowered to an estimated $33.8 billion. In response, the state lapsed appropriations and applied a portion of its slim fund balance to cure the shortfall, lowering the currently estimated ending fund balance to a modest $435 million (1.3% of appropriations).

The state's almost $34.7 billion enacted operating budget for fiscal 2018 is essentially flat to fiscal 2017 partly due to the financial impacts of LECA, as higher phased in state pension contributions are offset by expected net lottery receipts. One-time measures rise to 4% of total appropriations after declining to 1.6% in fiscal 2017; this assumes the state achieves an additional $125 million in unspecified savings for employee and health benefits and OPEB from future reforms and $200 million in new revenue from reform efforts at its division of taxation. One-time measures include $325 million in asset sales, proceeds from litigation, balance transfers and tax policy changes.
The state continues to manage periodic shortfalls in available cash through the issuance of tax and revenue anticipation notes (TRANs). The state treasurer has approved TRANs of up to $2 billion for fiscal 2018, with $900 million issued to date, largely to address the required quarterly pension payments; the state does not expect to issue the full amount.

Related Debt

Fitch has affirmed the ratings on the following credits, which are linked to the state's IDR. The Rating Outlook is Stable.

--Approximately $14 billion New Jersey Economic Development Authority annual appropriation bonds at 'A-';
--Approximately $15.6 billion New Jersey Transportation Trust Fund Authority annual appropriation bonds at 'A-';
--Approximately $482.5 million New Jersey Building Authority annual appropriation bonds at 'A-';
--Approximately $754.9 million New Jersey Educational Facilities Authority annual appropriation bonds at 'A-';
--Approximately $650 million New Jersey Health Care Facilities Financing Authority annual appropriation bonds at 'A-';
--Approximately $349 million New Jersey Sports and Exposition Authority annual appropriation bonds at 'A-';
--Approximately $559 million of state of New Jersey certificates of participation at 'A-'.

The 'A-' ratings for the state's appropriation obligations, one notch below the state's IDR, reflect the requirement of annual legislative appropriations for debt service.

The 'A' rating for the Garden State Preservation Trust revenue bonds reflects that, while annual legislative appropriation of dedicated sales tax revenue is necessary, Fitch believes the incentive for appropriation is significantly enhanced by a provision in the state's constitution that prevents dedicated funds from being used for other purposes in the event of legislative failure to make the appropriation, allowing for a rating on par with the state's IDR.

Contact:

Primary Analyst
Marcy Block
Senior Director
+1-212-908-0239
Fitch Ratings, Inc.
33 Whitehall Street
New York, NY 10004

Secondary Analyst
Douglas Offerman
Senior Director
+1-212-908-0889

Committee Chairperson
Laura Porter
Managing Director
+1-212-908-0575

Media Relations: Benjamin Rippey, New York, Tel: +1 646 582 4588, Email: benjamin.rippey@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable Criteria
U.S. Public Finance Tax-Supported Rating Criteria (pub. 31 May 2017)