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Fitch: Expiration of Public Safety Arbitration Cap Could Pressure New Jersey Local Finances.

Fitch Ratings-New York-20 December 2017: A New Jersey law that establishes a 2% cap on the base salary arbitration award for affected police and fire labor organizations is set to expire on Dec. 31 and could pressure N.J. local government finances, according to Fitch Ratings.

The public safety arbitration cap has been in effect since Jan. 1, 2011 (it was extended for a subsequent three-year period in 2014). The arbitration cap will likely expire on Dec. 31, at least temporarily, as the state legislature, the governor, and the governor-elect await a final report (also due on Dec. 31) of the Police and Fire Public Interest Arbitration Impact Task Force (the task force), which was charged with studying the impact of the arbitration cap on property taxes, government spending, collective negotiation agreements, personnel, and crime.

Fitch believes the arbitration cap is beneficial to local government credit quality as it helps to align revenue and spending measures and supports structural balance in the context of statutory caps on property tax growth. Property taxes, which are the dominant source of funding for local governments, are subject to a permanent 2% cap on annual growth enacted in 2010, albeit with exemptions for debt service and certain increases in pension and health care costs. Without the cap arbitration awards would remain subject to a reasonable determination of the issues, including the financial impact on the local government and taxpayers, and the ability of the local government to maintain or expand its programs or services.

However, bargaining groups may become more emboldened to pursue arbitration as opposed to voluntary settlement if the arbitration cap expires. Arbitration awards were significantly higher prior to the cap, ranging from 2.50% to 5.65% from 1993-2010, according to a report of the New Jersey Public Employment Relations Commission (PERC). Voluntary settlements, which are not subject to the arbitration cap, were also higher in years preceding the arbitration cap according to data reported by the task force in a preliminary report released in September.

The majority of Fitch-rated New Jersey local governments exhibit a high level of fundamental financial flexibility. As such we do not expect immediate degradation of credit quality if the arbitration cap is not extended. However, elimination of the arbitration cap could force local governments to reduce governmental services and/or rely on one-time resources to accommodate higher wage expenses. Furthermore, elimination of the arbitration cap could also have an impact on pension liabilities and contribution levels, as plan benefits are based on employee wages, among other factors. Over time these risk factors may weaken some of the long-term credit fundamentals that underpin Fitch's Issuer Default Ratings assigned to New Jersey local governments. Fitch will continue to monitor the situation and comment as information warrants.

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