New Jersey Bond Costs Swell Fivefold in Stress Sign: Muni Credit.

New Jersey's relative borrowing costs grew fivefold in its first general-obligation sale in 19 months, signaling that underfunded pensions and revenue shortfalls are rattling municipal-bond investors.

The state issued $525 million of general-obligation debt yesterday in a competitive offer won by Bank of America Merrill Lynch, which beat out seven banks. Bonds maturing in June 2025 priced to yield 2.75 percent, or about 0.5 percentage point more than benchmark munis, data compiled by Bloomberg show. In comparison, the yield spread was 0.09 percentage point for 10-year debt in the state's last long-term general-obligation sale, for $350 million in May 2013, the data show.

Investors are rendering their verdict on policy moves by Republican Governor Chris Christie, 52, who plugged a revenue shortfall in June by cutting $2.5 billion in promised pension payments for this fiscal year and last year. That maneuver, plus three straight years of overestimated revenue and a lackluster recovery from the recession, led the three biggest rating companies to downgrade the state a combined eight times under the governor, the most for a chief executive of the state.

"The spreads should have been much wider based on the deterioration of New Jersey's credit quality," Tom Metzold, co-director of munis in Boston at Eaton Vance Management, which oversees $27 billion of local debt, said in a telephone interview. He anticipates the yield gap will widen to as much as one percentage point within the next year.

Timing, Size

The state treasurer's office calculates that the yield spread rose from 0.23 percentage point in the May 2013 transaction. The increase amounts to $1.4 million a year in additional debt-service costs, and resulted in part from the different time of year and the larger size, according to Christopher Santarelli, a spokesman for Treasurer Andrew Sidamon-Eristoff.

"We would emphasize the market met our GO bonds enthusiastically today with the top eight firms bidding for the entire offering," Santarelli said in an e-mail.

Christie, in his second term, plans to announce next year whether he'll seek the nomination for president in 2016. He's in Canada through Dec. 5 to discuss energy, an issue that will be central to the Republican contest. He visited Mexico in September to press for expanded North American energy ties.

Building Classrooms

Back home, Christie has struggled with New Jersey's budget as revenue falls short of projections and pension, benefit and debt costs eat up more of annual spending.

The bonds sold yesterday include $450 million to build college classrooms and labs for science, technology, engineering and math programs. The balance is for environmental projects.

Christie campaigned for the $750 million Building Our Future Bond Act, as did Senate President Steve Sweeney, a Democrat. They've said college projects would create construction jobs and attract students, a boost for a state that trails the U.S. and its neighbors in recovering from the 18-month recession that ended in June 2009.

New Jersey's unemployment rate, at 6.6 percent in October, compared with 5.8 percent nationally, 6 percent in New York and 5.4 percent in Pennsylvania.

Casino Faith

Christie's faith in another promised revenue generator, the gambling destination Atlantic City, hasn't paid off, as four of 12 casinos stopped operations this year while a fifth, Trump Taj Mahal, plans to close this month. He has yet to identify a permanent funding source for the Transportation Trust Fund, the highway repair and construction account that will run dry next fiscal year, and hasn't said how he plans to resolve the shortfall in pensions and retiree health benefits.

New Jersey's retirement system had enough assets to cover 32.6 percent of projected liabilities as of June 30, according to a bond-offering supplement released Nov. 25. That compared with 54.2 percent a year earlier.

The lower ratio is because of new Governmental Accounting Standards Board rules that change how states must calculate underfunding. New Jersey was the first to disclose the numbers under the new requirement, Fitch Ratings said in a Nov. 25 report.

New Jersey in 2013 made 28 percent of the required pension payment, the worst among U.S. states, according to Loop Capital Markets, a bond underwriter in Chicago.

'No Signs'

Tom Kozlik, a municipal-bond analyst for Janney Montgomery Scott LLC in Philadelphia, said the funding is the biggest cause for concern that New Jersey debt will grow riskier.

"There are currently no signs that a significant amount of reform will occur to New Jersey's spending or budgeting habits," Kozlik said by e-mail after the bond sale. "Balance requires a significant amount of political will, but the longer state political actors wait, the more politically and financially difficult changes become."

New Jersey requires voter approval to issue general-obligation bonds, which are backed by the state's taxing power. The state had about $35 billion of bonds as of June 2013, including $2.4 billion of general obligations, according to its most recent debt report.

The general obligations are rated A1 by Moody's Investors Service, the fifth-highest investment grade, and A, one step lower, by Standard & Poor's and Fitch. Only Illinois has lower rankings among U.S. states.

Zia Ahmed, a spokesman for Charlotte, North Carolina-based Bank of America, didn't have a comment on the sale.

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