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Moody's: Pension Underfunding, Potential Cost Shift Could Increase Credit Risk for New Jersey's School Districts.

New York, October 19, 2015 — Potential pension reforms to fix New Jersey's (A2 negative) chronic teacher pension underfunding could lead to higher credit risk for the state's school districts and their finances, Moody's Investors Service says. A state commission is recommending reforming pensions by creating a new plan to be paid by school districts through savings realized from proposed, concurrent district and municipal health benefit reform.

The largest component of New Jersey's FY 2014 $80.5 billion unfunded pension liability is the Teacher's Pension and Annuity Fund (TPAF) at $53.8 billion, Moody's says in "New Jersey Pension Underfunding Poses Risk to School Districts." New Jersey currently pays all teacher pension and retiree health care costs.

"Since 2010, state pension contributions to TPAF have averaged only 15% of the annual required contribution (ARC), resulting in rapid liability growth. As the state has made efforts to increase its contributions, spending on pensions and other post-employment benefits have increased to 8% of the fiscal 2015 budget from 4.9% in 2010," Moody's Vice President Josellyn Yousef said.

The commission intends for the pension shift to be cost neutral for school districts through savings on benefit cuts at school districts and municipalities. However, if reforms fail or if the state decides to offload the pension burden in some other fashion, school districts can raise taxes, cut costs, borrow, or spend reserves to raise funds to cover the gap.

"Each option offers potential downsides or limitations," Yousef said. "For example, raising taxes would be simplest but the ability and willingness of taxpayers to accept a higher levy may be limited."

Further, Moody's notes a potential wildcard via an ongoing lawsuit New Jersey faces regarding outstanding pension litigation which could meaningfully worsen the pension funding position owing to a 2011 cost-of-living adjustment (COLA) freeze. If the COLA freeze is reversed, it would materially increase the pension funds' unfunded liabilities and annual contribution needs for TPAF by roughly 35%.

The report is available to Moody's subscribers here.