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New Jersey Issues Rare Debt as Yield Premiums Soar to Near Highs.

Sold, at bargain prices: bonds from New Jersey, where the transportation fund is going broke, the pension system's shortfall is growing and the economy has been slow to recover from the recession.

The \$131 million deal Wednesday was the state's first sale of general-obligation debt since 2014. The securities, with stronger credit ratings than those New Jersey typically sells, were priced with a top yield of 2.36 percent for those due in 7 years, some 0.9 percentage point more than benchmark debt, after the size of the offering was cut back by about \$10 million. The state also borrowed \$98 million through the building authority at yields as high as 4.1 percent on securities that mature in 2030, almost two percentage points over top-rated debt.

"There are not too many situations out there besides Illinois that investors are getting paid right now for those risks and that potentially bumpy ride," said Paul Brennan, a senior vice president in Chicago at Nuveen Asset Management, which oversees about \$100 billion of municipal bonds.

New Jersey's 10-year bonds yield 2.82 percent, the highest after Illinois among the 20 states tracked by Bloomberg. That's almost a full percentage point more than top-rated tax-exempt debt, near the highest since the data begin in 2013. That premium, a measure of the perceived risk, is more than three times what investors demand from California, Michigan and Massachusetts.

New Jersey's mounting tab from its employee retirement plans are squeezing its finances because years of failing to set aside enough to cover promised benefits have caused the annually required contributions to soar.

The state's strains don't end there. Republican Governor Chris Christie and the Democratic-controlled legislature have yet to replenish a fund that finances transportation projects and is set to run out of money in July. A lackluster recovery from the recession has also stymied the state: It wasn't until late last year that private-sector payrolls climbed back above their 2008 peak, a benchmark the U.S. reached in early 2014.

"There is a lot of uncertainty," said Rob Amodeo, head of municipals in New York for Western Asset Management Co., which holds \$25 billion of the securities.

The state is able to benefit from interest rates that are hovering near a five-decade low, even if its yields have held above other states. Proceeds from the general-obligation sale, the first since a \$525 million deal in December 2014, refinanced higher-cost securities.

Buyers gravitated toward the bonds sold by the building authority, which had higher yields and longer maturities than the general obligations, said Joseph Perone, a spokesman for the state's Treasury Department. He said that Citigroup Inc., the lead underwriter on the offering, will "sell the remainder of the GO bonds in the market in due course."

"We were pleased with the outcome," he said in an e-mail.

The state primarily borrows through appropriation-backed bonds, with most of its debt service relying on funds that are allocated by the legislature. Those securities are rated one step lower than the state's \$2.4 billion of general obligations, which are backed by its full faith and credit and don't depend on lawmakers' approval.

Falling Behind

While Christie has put aside more for pensions than his predecessors, the retirement system is about 48.6 percent funded, the lowest ever, according to preliminary offering documents for Wednesday's sale. For the year beginning in July, his administration has proposed making a \$1.9 billion payment, about 40 percent of what actuaries say is required.

Senate President Steve Sweeney, a Democrat, is pushing legislation that would ask voters to mandate that the state pay what it owes every year, a move Christie opposes because he says it would require a massive tax increase.

The three major credit-ratings firms have downgraded New Jersey a total of nine times since Christie took office in 2010, when the impact of the recession was roiling its finances. It has a lower rating from Moody's Investors Service and Standard & Poor's than any state but Illinois.

The state's grade "will continue to fall" absent any significant change, Moody's, which ranks it A2, five steps above junk, said in a report last week. On Tuesday, S&P lowered the outlook on New Jersey to negative from stable, a sign the rating could be cut.

Investors who bought the new deal should be prepared for volatility, said Amodeo, the money manager with Western Asset. It's likely that New Jersey's yield premiums will increase over the next few months, he said.

"If you believe the current status quo remains in place, you'd want to avoid it," he said, ahead of the sale's close. "If you have a long-term view that the situation would find a remedy, it's offering good value."

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by Romy Varghese

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