Bond Case Briefs

Municipal Finance Law Since 1971

Fitch Ratings: N.J. Exec Budget; A More Restrained Proposal With Projected On-Track Fiscal 2019

Fitch Ratings-New York-13 March 2019: The New Jersey governor's executive budget for fiscal 2020 largely continues current fiscal initiatives, including the gradual pension contribution ramp up, apart from a proposal to raise the top income tax rate on taxpayers earning between $1 million and $5 million. Updates to current fiscal 2019 are included in the executive budget and point to an anticipated budgetary surplus despite reported revenue weakness year-to-date through January. Differing from the governor's inaugural budget proposal for fiscal 2019, the millionaires' tax is the lone substantial tax policy item. Instead, this year's proposal is more notable for its focus on expenditure savings to create space for other spending initiatives. The recommended consistency in state fiscal policies supports the Stable Outlook on New Jersey's 'A' Issuer Default Rating (IDR), says Fitch Ratings.

The proposed $38.6 billion operating funds budget includes modest $651 million (1.7%) overall net growth from fiscal 2019 as compared to 6% estimated growth in fiscal 2019, which ends on June 30. The budget proposal counts on a significant $798 million in employee health benefit savings and $475 million in recoverable Medicaid funds, that together with proposed revenue initiatives will fund higher appropriations for pensions ($546 million), PreK-12 education ($282 million), debt service ($173 million), and contract settlements ($159 million), along with an increased ($100 million) general fund appropriation for New Jersey Transit (NJT) that includes replacing prior transfers from the New Jersey Turnpike and NJT capital funds.

Fitch believes the employee health care savings goals are attainable as $333 million reportedly have already been secured and the balance appears achievable based on historical results and announced agreements with collective bargaining units. The state recently reached a tentative contract agreement with its 32,000 member Communications Workers of America unit that provides 2% annual wage increases through fiscal 2023 in exchange for $70 million in annual health care savings.

The largest appropriation increase is the additional pension contribution (84% of net proposed budget growth), raising the contribution to almost $3.8 billion. The payment represents 70% of the actuarially determined contribution (ADC) and continues the state on the path of a gradual 1/10th annual phase-in to the full ADC for pensions in fiscal 2023. Pending full contributions in fiscal 2023, Fitch would expect further deterioration in the funded condition of the plans, even if all plan assumptions are met. The $3.8 billion pension contribution accounts for 10% of the operating budget and includes a $2.7 billion appropriation from the general fund and just over $1 billion from the state lottery.

The state's well above average long-term liability burden and pension contribution ramp-up are reflected in Fitch's 'A' IDR on the state. Beyond the governor's proposal, the state recently received responses from a request for qualifications to pursue additional state asset deposits to the pensions. The state's underfunded commitments to retired state employees and teachers have weighed on the state's rating and remain a negative rating factor absent further policy action.

REVENUE INITIATIVES

As noted above, the only significant revenue initiative in the governor's proposal is the increase of the 10.75% personal income tax (PIT) rate to taxpayers earning more than a $1 million, from the current $5 million threshold (projected to generate $447 million). In addition, the budget assumes revenue from legalization and taxation of adult use cannabis for $60 million over six months partly offset by an increase in appropriations for start-up costs; an increased fee on opioids distributors and manufacturers; and an assessment on corporations that employ 50 or more people that are on Medicaid. Estimated revenue from these initiatives totals approximately $550 million. Should the measures fail to be approved; other revenue solutions or expenditure reductions will need to be identified to balance the fiscal 2020 budget.

Including the new revenue, the state forecasts just over $1 billion (2.9%) in growth from expected revenue in fiscal 2019. The forecast incorporates an $800 million reduction in the fiscal 2019 revenue base from one-time revenue measures included in the current-year budget and projects steady growth in the state's economy through the remainder of calendar 2019, with some slowing in 2020, for estimated 3.5% natural growth in the revenue base. The state's forecast is premised on continued growth in personal income, gross state product, and nonfarm employment through the forecast period. Fitch believes these forecasts to be reasonable based on recent quarterly experience and expects that future economic growth will remain below that of the nation.

Revenue in excess of budget growth and required appropriations for open space acquisition is applied to bolstering the state's ending budgetary fund balance to almost $1.2 billion (3% of appropriations). While Fitch believes the fund balance would remain slim in relation to the state's historical economic and revenue cyclicality, the planned addition is a positive step.

APRIL REVENUE UPTICK EXPECTED TO BALANCE FISCAL 2019 OPERATIONS

Updates to fiscal 2019 financial operations are included in the executive budget and point to an anticipated budgetary surplus despite reported revenue weakness year-to-date through January. Revenues from the personal income tax (PIT) and sales tax were reduced, while corporation business taxes (CBT) were boosted. Significant one-time receipts include $282 million from the state's tax amnesty program, $200 million in deemed repatriated dividends, and $200 million in CBT receipts. Total estimated revenue of $37.7 billion is a $328 million increase (0.9%) from the enacted budget, for 4.5% revenue growth (inclusive of tax policy actions and one-time receipts) from fiscal 2018.

The cut to the PIT forecast incorporates the effects of changes to federal tax law in 2017 (Tax Cut and Jobs Act; TCJA) that resulted in a significantly larger proportion of taxpayers prepaying estimated taxes on income earned in 2017 (fiscal 2018.) While the state anticipated some change to taxpayer behavior in fiscal 2019, the state reports the 72% of taxpayers that remitted estimated PIT payments by Dec. 31, 2017 plunged to 19% in Dec. 31, 2018, as the TCJA's $10,000 deduction cap on state and local tax payments removed the incentive to prepay PIT. This sharply reduced fiscal 2019 PIT collections through January (down 6% year over year.) While downgrading the PIT forecast, the state believes the balance of PIT revenue expected in fiscal 2019 will be collected by April as state economic conditions and employment remain stable.

Additional updates to the state's fiscal 2019 budget include $382 million in appropriation lapses and $629 million in increased appropriations. In combination with a higher beginning fund balance of $990 million, the state estimates an ending fund balance of just over $1 billion (2.9% of appropriations). Should the state's April revenue collections fall short of expectations, the balance is available to apply to solving the gap in addition to the governor's ability to unilaterally forestall appropriations.

Contact:

Marcy Block
Senior Director
+1-212-908-0239
Fitch Ratings, Inc.
300 West 57th Street
New York, NY 10019

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

Media Relations: Sandro Scenga, New York, Tel: +1 212 908 0278, Email: sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com