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New Jersey (State of)

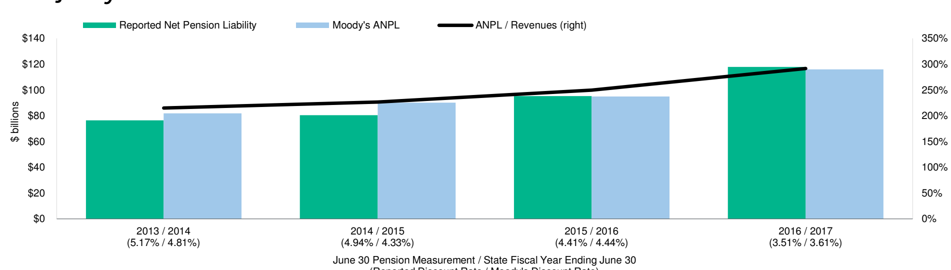
State's Severe Pension Underfunding Continues to Grow

On April 6, the state of New Jersey (A3 stable) published its remaining pension accounting results for the year ended June 30, 2016. Based on the data, Moody's adjusted net pension liability (ANPL) reached $116 billion, a 22% increase from the prior year. Despite its annually increasing contributions, New Jersey's unfunded pension obligations continue to grow faster than its revenues, a credit negative.

The state's June 2016 pension results will appear on its 2017 balance sheet, underscoring the substantial ANPL growth that many states and local governments will show in their fiscal 2017 financial reporting. Pension measurements by New Jersey and many other governments have a 12-month lag for accounting purposes.

Three key factors led to the large increase in New Jersey's ANPL. First, the Citigroup Pension Liability Index (CPLI) fell by 83 basis points, to 3.61%. The CPLI is the market-based discount rate used in our liability adjustments. Second, the state's pension funds experienced poor investment performance, with money-weighted returns of -1.15%, well below the state's assumed return of 7.65%. Third, the state's contributions to its pension plans, while on a path of incremental improvement, fell far below plan funding needs. We project that New Jersey's $116 billion ANPL will amount to 292% of its fiscal 2017 own-source revenues, up from 215% in 2014 (see Exhibit 1).

Exhibit 1
New Jersey's Unfunded Pension Liabilities Continue to Grow Relative to the State's Revenues



Note: Revenues assumed to grow by 4.5% in 2017 from 2016 levels.
Source: State of New Jersey Department of the Treasury; Moody's Investors Service

As of June 2016, all five of New Jersey's active pension funds projected insolvency under governmental accounting rules, with depletion dates ranging from 2022 to 2050. The state's two largest pension funds, the Teachers' Pension and Annuity Fund (TPAF) and the Public Employees' Retirement System (PERS), projected asset depletion by 2029 and 2034, respectively. When government pension plans project asset depletion, the reported discount rate for accounting purposes must reflect a blend of the assumed rate of return on investments and a municipal bond rate.

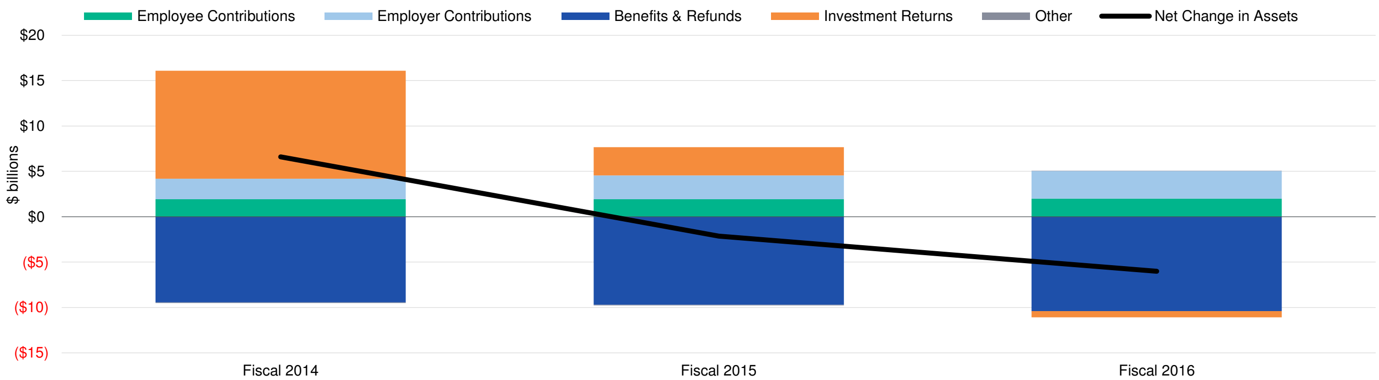
The discount rate applied under Moody's adjustments exceeded the state's reported discount rate under governmental pension accounting as of June 2015 and 2016. As of June 2016, New Jersey's liability-weighted discount rate fell to 3.51% on a reported basis, while we applied a discount rate of 3.61% under our adjustments. June 2016 market-based discount rates currently appear to represent a cyclical low. ANPLs measured as of June 2017, and impacting most governments 2018 financial reporting, will likely be based on higher discount rates than the prior year.

Continued growth in New Jersey's pension balance sheet burden signals rising long-term obligations, while the severe underfunded position of its pension plans and the state's weak contribution levels also drive an annual cash flow challenge. Driven by benefit payment outflows far in excess of contributions, pension assets declined by over $8 billion in aggregate in 2015 and 2016 after rising by nearly $7 billion in 2014 (see Exhibit 2). The state plans to annually increase its contributions in one-tenth increments compared to its actuarial payment requirement, but its ability to grow pension assets will also heavily depend on investment performance.

Exhibit 2

Poor Investment Returns in 2015 and 2016 Exacerbated the Cash Flow Challenge Faced by New Jersey's Pension Funds

Sources of changes in New Jersey's pension assets over the past three years



Reflects all of New Jersey's pension plans, including the local portions of PERS and PFRS.
Source: State of New Jersey Department of the Treasury

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