New Jersey (State of)

New Jersey Reports Surge in Unfunded Liabilities Under New Pension Accounting Rule

On November 24, the State of New Jersey (A1 negative) announced that its reported unfunded pension liabilities under new accounting rules more than doubled to almost $83 billion in the fiscal year ended June 30, 2014, based on preliminary valuation data. Implementation of the Governmental Accounting Standards Board’s (GASB) Statement 67 caused much of the liability growth. While the updated disclosure highlights the severity of credit stress from unfunded state pension liabilities, Moody’s calculated New Jersey’s adjusted net pension liability (ANPL) to be $77 billion as of the fiscal 2013 plan valuations, which is in line with the state’s updated pension liability information.

The state’s new disclosures, as well as our ANPL calculation, underscore the significant pension funding challenges that New Jersey faces. In particular, the state now forecasts that its two largest pension plans — the Public Employees Retirement System (PERS) and the Teachers Pension and Annuity Fund (TPAF) — could fully expend their assets as soon as 2024 and 2027, respectively, even assuming the funds meet assumed investment returns. This projection, which under new accounting rules must incorporate employer contribution assumptions that give weight to actual funding in the past five years, indicates New Jersey’s limited time to identify structural solutions to its pension liabilities. Once plan assets are depleted, the state will have to fund pension benefits directly from its operating budget, driving its annual retiree benefit expenses significantly higher. For example, benefit payments from TPAF and the state portion of PERS amounted to approximately $4.9 billion in fiscal 2013 (equivalent to about 16% of the state’s operating revenues), according to plan actuarial valuations. In comparison, combined state contributions to these plans were approximately $878 million that year.

The reported unfunded liabilities of New Jersey’s seven pension plans jumped to $82.8 billion as of June 30, 2014, valuations, from the $37.3 billion reported a year earlier. Total liabilities (before factoring in pension asset values) increased 51% to $122.8 billion. The updated valuation data, initially disclosed in a New Jersey Transportation Trust Fund Authority offering supplement, reflects the intervening year’s investment returns and liability growth, and the measurement and reporting changes from Statement 67. Statement 67 is a GASB pension accounting rule being implemented beginning with fiscal year 2014 reporting for most public pension plans.
MOODY’S INVESTORS SERVICE
U.S. PUBLIC FINANCE

GASB’s new accounting standard requires the use of lower discount rates to value liabilities for plans with projected asset depletion dates, market value rather than the actuarial value of assets, adoption of the “entry-age normal” actuarial cost method and other changes. We expect these alterations will drive some state and local governments’ reported unfunded liabilities higher, particularly those participating in cost-sharing plans, as well as those with projected asset depletion dates or significant asset smoothing. Under the new standard, actuaries must project future pension plan cash flows based on factors such as assumed investment returns, benefit payouts and contributions into plans. If at any point these projections indicate a plan will deplete its assets, the plan must discount cash flows related to accrued liabilities subsequent to this “cross-over” date using a high-grade municipal bond index rate, instead of the higher assumed return on investment rates typically used. Plans may still apply assumed investment return discount rates to accrued liability cash flows before their cross-over dates.

In New Jersey’s case, implementation of Statement 67 brings the reported liabilities closer to Moody’s ANPL, primarily because of the substantial drop in the discount rate used to calculate liabilities. The state’s reported liability as of 2013 was less than half of our ANPL (see Exhibit 1). Calculation of New Jersey’s fiscal 2014 ANPL requires data that will not be available until the full actuarial valuation is released. However, we expect our ANPL for 2014 will be higher than the state’s reported liability.

Exhibit 1
Statement 67 pushes New Jersey’s reported unfunded liability closer to Moody’s ANPL

Source: State disclosure based on preliminary valuations; Moody’s adjusted pension data.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.
Because of its history of significant pension underfunding and the low level of pension plan assets relative to required benefit payments in coming years, New Jersey’s actuarial projections show asset depletion dates that require the state to use the lower discount rate (4.29%, according to the state’s disclosure) for plans after their respective cross-over dates (see Exhibit 2).

Exhibit 2
Projected depletion dates for New Jersey pension assets range from 2021 to 2032, assuming investment return targets are met

<table>
<thead>
<tr>
<th>State Plan</th>
<th>Net Liability (Millions)</th>
<th>Projected Depletion Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Employees’ Retirement System</td>
<td>$22,327</td>
<td>6/30/24</td>
</tr>
<tr>
<td>Teachers’ Pension and Annuity Fund</td>
<td>$52,813</td>
<td>6/30/27</td>
</tr>
<tr>
<td>Police and Firemen’s Retirement System</td>
<td>$4,734</td>
<td>6/30/27</td>
</tr>
<tr>
<td>Consolidated Police and Firemen’s Pension Fund</td>
<td>$2</td>
<td>6/30/24</td>
</tr>
<tr>
<td>State Police Retirement System</td>
<td>$2,248</td>
<td>6/30/32</td>
</tr>
<tr>
<td>Judicial Retirement System</td>
<td>$654</td>
<td>6/30/21</td>
</tr>
<tr>
<td>Prison Officers Pension Fund</td>
<td>$(3)</td>
<td>*</td>
</tr>
<tr>
<td>Total</td>
<td>$82,774</td>
<td></td>
</tr>
</tbody>
</table>

* The prison officers fund was projected to have sufficient assets for all projected future benefits.

Source: State disclosure based on preliminary valuation data.

We expect New Jersey will see a greater reported liability increase from implementing the new accounting standard than will most states that have a better funding record or where employer contributions have been even loosely tied to actuarially determined funding. We do not expect most other states’ reported GASB 67 figures to move close to our states’ ANPLs, because they will generally be able to use the higher investment return figure to discount all of their liabilities under GASB’s rules.

New Jersey’s latest pension valuation results also highlight a divergence between the health of state and local shares of two plans, PERS and PFRS. Given that employer contributions for the local portions of these plans have been closer to actuarial requirements, their increases in net liability from 2013 to 2014 under the new accounting rule were less severe, at 43% for PERS and 59% for PFRS, to $10.1 billion and $10.6 billion, respectively. Depletion scenarios for the local portions of each plan are more favorable, with no depletion anticipated for PERS and a much later date (6/30/2055) for PFRS, than for the state’s portions. Our fiscal 2013 ANPLs for the local parts of these pensions are greater than the new reported figures for 2014.
Moody's Related Research

Issuer Comment:
» New Jersey's Late-Year Revenue Shortfall Will Be a Hard Fix, April 2014 (169903)

Special Comment:
» Moody’s US Public Pension Analysis Largely Unchanged By New GASB 67/68 Standards, June 2014 (171874)
MOODY'S CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS FOR RETAIL INVESTORS TO CONSIDER MOODY'S CREDIT RATINGS OR MOODY'S PUBLICATIONS IN MAKING ANY INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER.

All information contained herein is obtained by MOODY'S from sources believed to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody's Publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody's Investors Service, Inc. for appraisal and rating services rendered by it fees ranging from $1,500 to approximately $2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moodys.com under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

For Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail clients. It would be dangerous for "retail clients" to make any investment decision based on MOODY'S credit rating. If in doubt you should contact your financial or other professional adviser.

For Japan only: Moody's Japan K.K. ("MJJK") is a wholly-owned credit rating agency subsidiary of Moody's Group (Japan) K.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJJK. MSFJ is a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJJK and MSFJ are credit rating agencies registered with the Japan Rating Organization ("NRSRO").

© 2014 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND ITS RATINGS AFFILIATES ("MIS") ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND CREDIT RATINGS AND RESEARCH PUBLICATIONS PUBLISHED BY MOODY'S ("MOODY'S PUBLICATIONS") MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

AUTHORS
Tom Aaron, Timothy Blake, Ted Hampton and Marcia Van Wagner
NEW JERSEY (STATE OF) REPORTS SURGE IN UNFUNDED LIABILITIES UNDER NEW PENSION ACCOUNTING RULE