

State of the state: New Jersey

Authored by

Christopher Meteyer, CFA
Senior Analyst and Sector Team
Lead, Municipals
Invesco Fixed Income

Stephanie Larosiliere
Senior Client Portfolio Manager
Head of Municipal Business Strategy
& Development

Overview

New Jersey has continued to gain momentum with the state's second full pension contribution in a row, as well as anticipated third consecutive year in 2024.

The direction New Jersey's credit ratings will take depends on the state's ability to address its persistent underlying structural budget gap without the need to rely on deficit financing bonds or one-time stimulus programs over the longer term.

Invesco is positive on the Southern Jersey Transportation Authority (SJTA). SJTA has a sound security package, the ability to access financial markets, and an experienced leadership team.

State overview

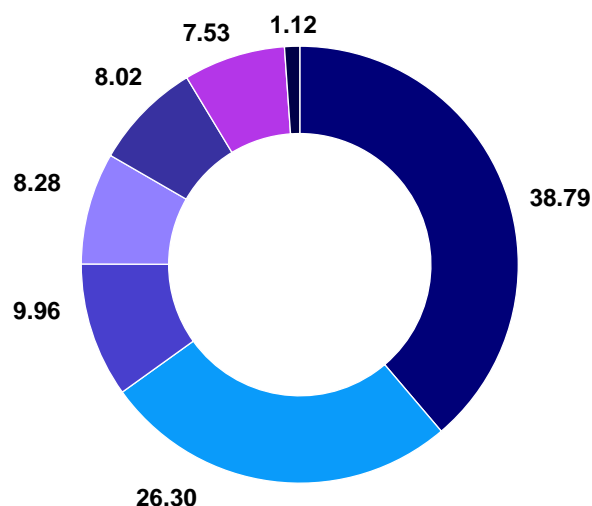
New Jersey continues to demonstrate near-term strength following the COVID-19 pandemic. The improvement in credit quality has further earned the state rating upgrades by all three public agencies earlier in 2023. This positive momentum has largely been the result of high levels of federal stimulus beginning in 2020 along with an economy that has rebounded exceptionally well post-pandemic. Combined with levels of inflation that have not been observed since the 1980s, sales tax receipts have been an important source of increased tax revenue for the budgeted 2024 fiscal year, which is anticipated to reach over \$14 billion. The state's undesignated fund balance has also risen as a result. Historically before the onset of COVID-19, New Jersey's fund balance as a percent of annual appropriations was low compared to other states at below 6%. For the upcoming fiscal year, that figure is projected to stand at nearly 19%, a level that significantly enhances the state's financial flexibility.¹ New Jersey has used this opportunity to prioritize the overall fiscal health of its accounts and reserves, particularly as it relates to addressing the state's large liability burden. As part of that effort, 2024 will represent New Jersey's third consecutive year of making its full actuarial contribution to the state's pension plans as a notable achievement. New Jersey also benefits from a large economy with high wealth levels, as illustrated by an average personal income that is 120% of the national average.² Its proximity to the New York City metro area further provides for access to a diverse set of employment opportunities, with a cost of living that is lower than residing in Manhattan itself. For these reasons, the Invesco Municipal Bond team believes debt issued by the state of New Jersey has continued to offer opportunity for municipal investors.

Despite the recent progress made, New Jersey does face longer-term challenges given its exposure to debt and retirement liabilities that are among the largest in the country. In addition, the bulk of federal stimulus money has come to an end, and as a result these challenges have the potential to become more pronounced as the state looks to sustain balanced operations and adequate reserves. The state's credit trajectory will hinge on its demonstrated ability to achieve a balanced budget solely with tax collections and other recurring revenues, while ensuring policies are in place to sustain its debt management program moving forward. Absent these controls and policy measures, New Jersey could face the politically unpopular decision to either cut appropriations or incur additional deficit financing. Either outcome would be a negative for the credit, especially following a period where the governor has expanded the budget to cover increased levels of educational spending and pension contributions. Additionally, New Jersey's already high tax rates restrict the state's ability to further increase revenues absent a continued rebound in post-pandemic economic activity. Ultimately, the direction of future credit ratings will largely depend on New Jersey's ability to address these fiscal concerns in a timely and sustainable fashion.

Fiscal update: Revenues

As shown in Figure 1, New Jersey revenues are heavily dependent on gross income and sales taxes, followed by the corporate business tax. Combined, these three income streams account for 75% of budgeted revenues.¹

Figure 1: Fiscal Year 2024 Budgeted Revenues (%)

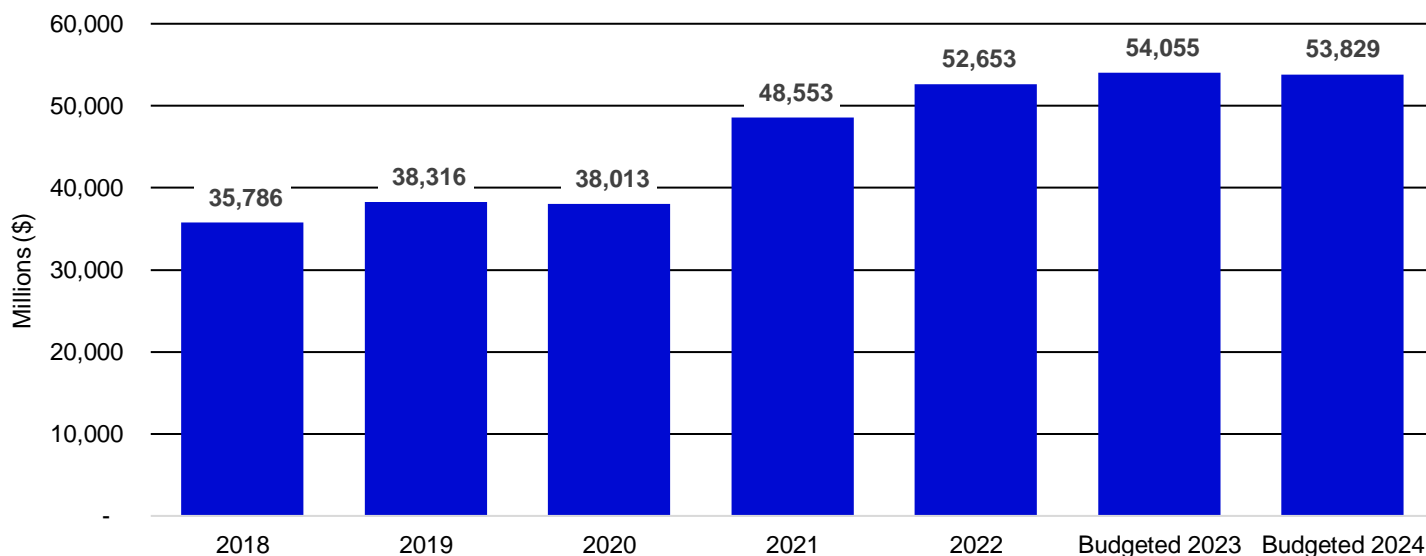


Gross Income Tax	38.79
Sales and Use Tax	26.30
Corporation Business Tax	9.96
Miscellaneous Tax and Fees	8.28
Other Major Taxes	8.02
Pass-Through Business Alternative Income Tax	7.53
Casino Taxes and Fees	1.12

Source: New Jersey Transportation Trust Fund Authority, Official Statement – Series 2023 A, dated November 8, 2023. Total may not equal 100% due to rounding. The general fund is the major operating fund of the state. It receives all state income not earmarked for a particular program or activity and not specified by law to be deposited in another fund.

As the economy continues to recover post-pandemic, so too does the state's financial health. However, revenue growth in the state does show signs of slowing. This trend is not necessarily unexpected given the rapid growth over the past three years, though does leave the state with fewer resources to fund additional spending while building reserves. Sales tax based on the Executive's 2024 certified year-end estimate, for example, shows only a 1.7% anticipated growth over the prior year, while gross income tax collections bode slightly better at 3.5% growth according to the New Jersey Office of Legislative Services.³ In addition, the 2.5% surcharge on the state's corporate business tax is set to expire at the end of calendar-year 2023 that, when fully phased out, is anticipated to reduce annual revenues by nearly \$1 billion. This loss of revenue will pressure the state's the ability to maintain a structurally balanced budget.⁴

Figure 2: Historical and Estimated Revenues: 2018 - 2024

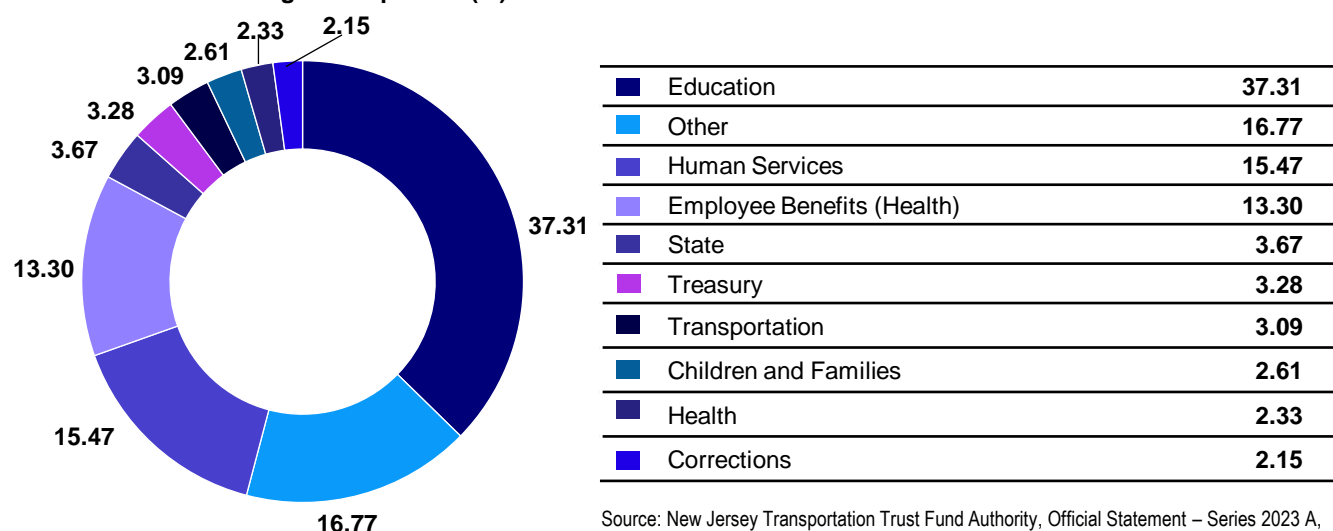


Source: New Jersey Transportation Trust Fund Authority, Official Statement – Series 2023 A, dated November 8, 2023.

Fiscal update: Expenses

After several years of notable expansions to New Jersey's budget, fiscal 2024 is expected to be the first in many that budgeted appropriations contract, expected in the amount of \$1.4 billion compared to the prior year. In part, however, the previous fiscal 2023 budget included a one-time adjusted appropriation of \$2.4 billion to the New Jersey's Debt Defeasance and Prevention Fund. Absent that funding, projected 2024 appropriations would increase by \$934 million.¹ This annual spending continues to flow to several areas, but primarily to education which remains the largest component of the proposed budget and that is reported to have a 5-year compound annual growth rate of 7.6%.⁵ Total spending for education is expected to top \$19.8 billion, or approximately 37% of total 2024 budgeted appropriations. Other expense drivers that are significant include employee benefits and human services, the ramp-up of which is the result of New Jersey's increased pension contributions in recent years.

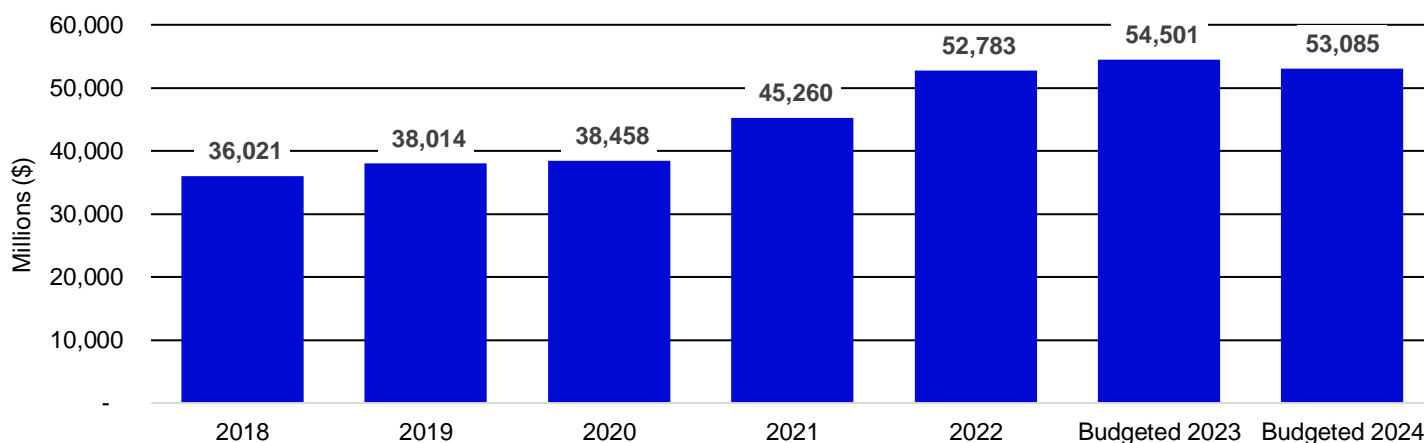
Figure 3: Fiscal Year 2023 Budgeted Expenses (%)



Source: New Jersey Transportation Trust Fund Authority, Official Statement – Series 2023 A, dated November 8, 2023. Total may not equal 100% due to rounding.

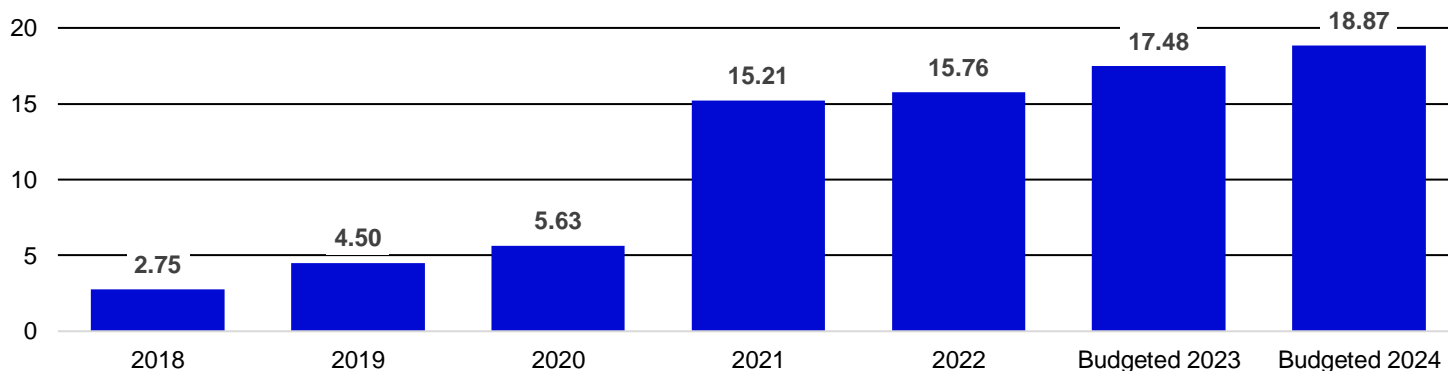
While the potential for slower future revenue growth is something that New Jersey will need to manage in the coming years, the state's fund balance remains resilient. In prior budgets, the state estimated that by 2024 it would need to begin consuming annual amounts from its fund balance and other reserves to cover appropriations; however, that need has not yet materialized. Instead, the budgeted fiscal year 2024 anticipates a very strong \$10.0 billion undesignated fund balance.¹ It should be noted that this level is nearly 6-times the balance that was previously observed pre-pandemic in 2019. At some point we expect these record reserve levels to moderate to an extent, but in the meantime this relative outperformance has offered the state an adequate cushion in near-term liquidity.

Figure 4: Historical and Estimated Expenses: 2018 - 2024



Source: New Jersey Transportation Trust Fund Authority, Official Statement – Series 2023 A, dated November 8, 2023.

Figure 5: Budgetary Fund Balance as a % of Expenses: 2018 - 2024



Source: New Jersey Transportation Trust Fund Authority, Official Statement – Series 2022 CC, dated November 8, 2023.

New Jersey pension funding

New Jersey's retirement obligations remain a significant hurdle and account for a far greater portion of the state's long-term liabilities than its outstanding bonds. According to Moody's investor service, the pension liability alone represents about half of the state's total long-term liabilities, increasing to over 80% when including post-employment benefit costs (OPEB).⁵ Funding ratios remain low but improved year-over-year at approximately 45% for state and local employees,⁴ noting that New Jersey has made progress in addressing this liability in the form of contributing its full annual pension payment in fiscal 2022, 2023, and anticipated for a third consecutive year in 2024. These payments represent the first full contributions to the plans in 25 years. The state's ability and willingness to sustain this practice of full funding will be a credit risk to monitor moving forward, especially amid rising costs and slowing revenue growth. The plans' assets also remain vulnerable to swings in market performance as has been experienced in both positive and negative directions over the past three years.

Figure 6: New Jersey Pension Funding: 2017 - 2023

	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Valuation Date	July 1, 2016	July 1, 2017	July 1, 2018	July 1, 2019	July 1, 2020	July 1, 2021	July 1, 2022
Assets	75,348	79,313	81,433	82,293	79,867	98,110	90,005
Liabilities	243,591	221,601	209,560	207,123	208,173	195,927	200,139
UAAL	(168,243)	(142,289)	(128,127)	(124,830)	(128,307)	(97,817)	(110,084)
% Funded	30.93%	35.79%	38.86%	39.73%	38.37%	50.07%	45.00%

Source: New Jersey Transportation Trust Fund Authority, Official Statement – Series 2023 A, dated November 8, 2023.

Economic update

A major factor supporting New Jersey is the state's significant wealth characteristics, as reflected in the state's per capita personal income (PCPI) that is 120% of national levels.² This level, which is among the highest in the nation, is supported by the state's proximity to the New York City metro area as a major employment center. While New Jersey's tax structure is high, especially for earners making above \$1 million per year, housing remains more affordable than comparable New York City options.

Figure 7: Per Capita Personal Income: 2016 - 2022

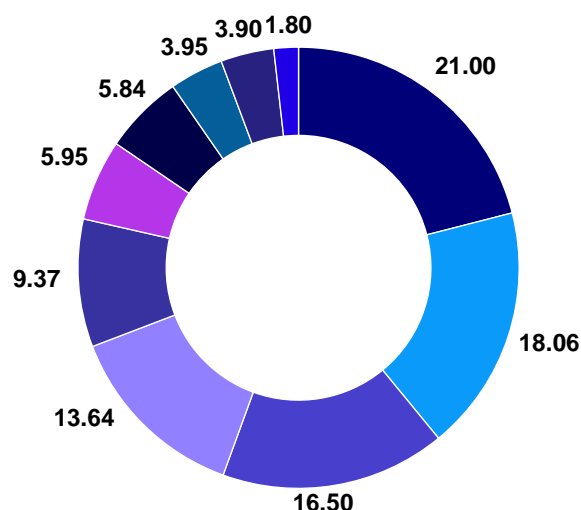
	2016	2017	2018	2019	2020	2021	2022
NJ Per Capita Personal Income	62,213	64,410	67,142	69,626	73,460	74,805	78,700
US Per Capita Personal Income	49,812	51,811	54,098	56,047	59,510	63,444	65,423
NJ/US Per Capita Personal Income	125%	124%	124%	124%	123%	118%	120%

Source: Bureau of Economic Analysis, as of December 31, 2022. Latest data available.

Labor and unemployment

New Jersey's employment base is generally diverse, with no sector representing greater than 21% of the whole. Leisure and hospitality, a sector that was particularly vulnerable to pandemic-related job losses, has now effectively fully recovered and represents 9.4% of employment as of September 2023. This level illustrates a rebound from a low of 5.1% reported in June 2020. Unemployment remains significantly lower than at the height of the pandemic, however for the last six months has been on an increasing trend. As of September, the unemployment rate stood at 4.4%.⁶

Figure 8: New Jersey Employment by Industry



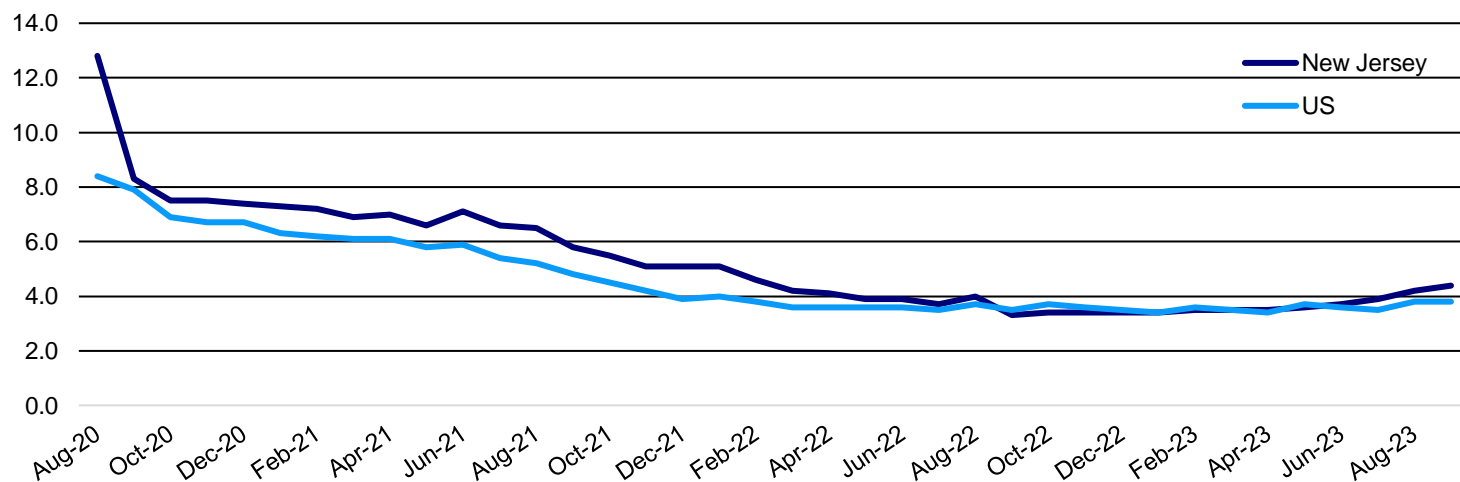
Trade, Transportation, Utilities	21.00
Education and Health Services	18.06
Professional and Business Services	16.50
Federal, State, Local Government	13.64
Leisure and Hospitality	9.37
Financial Activities	5.95
Manufacturing, State	5.84
Lodging, Mining & Construction	3.95
Other Services	3.90
Information	1.80

Source: Bureau of Labor Statistics as of September 30, 2023. Total may not equal 100% due to rounding.

The overall economic recovery following the onset of the COVID-19 pandemic has been stronger than anticipated. Unemployment has continued to fall and has now once again reached pre-pandemic levels. This positive momentum has been supported by an improving job market and a strong demand for workers. Easing pandemic restrictions has also allowed for a return to in-office work for many businesses, as well as domestic and international travel. Risks moving forward surround the potential for heightened inflation and restrictive Fed policy over a prolonged period, which could exacerbate the need for corporations to reduce employment as the demand for goods and services begins to fade, at least temporarily.

Figure 9: New Jersey Seasonally Adjusted Unemployment Rate (%)

Monthly rates from August 2020 – September 2023



Source: Bureau of Labor Statistics, as of September 30, 2023.

New Jersey General Obligation Update

Moody's Rating: A1 / Stable as of April 6, 2023

S&P Rating: A / Stable as of April 12, 2023

Fitch Rating: A+ / Stable as of April 10, 2023

Moody's upgraded the state's general obligation rating to A1 and revised the outlook to stable on April 6, 2023. The updated outlook incorporates New Jersey's "solid economic recovery, with job gains leading the region and driving employment above the state's pre-pandemic peak. It is supported by the state's commitment to full, actuarial pension contributions through fiscal 2024 (starting July 1, 2023) and its additional allocations of funds to a program to decrease debt and cash-fund capital projects. The state remains subject to long-term liability and fixed-cost burdens much more substantial than those of most other states."⁷

S&P upgraded the state's general obligation rating to A and revised the outlook to stable on April 12, 2023. "The upgrades reflect better pension funding levels and improved structural balance, largely the result of an anticipated third consecutive year of full actuarial pension contributions in fiscal 2024," according to S&P. However, the "state's lack of consensus budgetary revenue forecasting has also sometimes led to over-optimistic revenue projections in the past."⁸

Fitch upgraded the state's general obligation rating to A+ and revised its outlook to stable on April 10, 2023. Fitch notes that "New Jersey has effectively used the fiscal momentum of recent years to accelerate progress on its long-term fiscal and liability challenges. Solid economic performance matched by robust revenue growth have helped New Jersey to shrink its liabilities. Despite recent improvement, high liabilities and elevated carrying costs are likely to remain a longer-term constraint on its budget choices. Although the durability of recent fiscal improvements remains untested, New Jersey's credit quality will continue to benefit from inherent strengths including its very high wealth and the broad budget management prerogatives common to states."⁹

Spotlight on a New Jersey Revenue Bond: South Jersey Transportation Authority

Moody's: BBB+ / Stable as of July 21, 2022

S&P: AA- / Stable as of November 17, 2022

Fitch: A+ / Stable as of July 22, 2022

South Jersey Transportation Authority (SJTA) established in 1991 and is responsible for the operation of three divisions: Atlantic City Expressway, Atlantic City International Airport, and Transportation Services. SJTA's management team has been in place for years, allowing for consistent leadership along economic cycles. The regional economy is tourism based; however, SJTA has seen positive economic development across various sectors within its six-county service area.

The Atlantic City Expressway is SJTA's largest revenue generator. The Expressway is a toll road that began operating in segments during 1964 and 1965. Today, the Expressway is 46.4 miles from Turnersville in the west to Atlantic City in the east.¹ More than 47 million vehicles traveled along the Expressway in 2022.¹⁰ The second largest revenue generator is the Atlantic City International Airport which consists of the Civil Terminal Building, parking areas, and two runways on 5,000 acres located off the Expressway 10 miles northwest of Atlantic City.¹ Transportation Services operates and manages all SJTA parking facilities and parking shuttles.

Monitoring the financial performance of credits is a primary focus for the Invesco Municipal Credit team. Having characteristics such as a sound security package to pay debt service, the ability to access financial markets, and an experienced leadership team are likely to help SJTA successfully navigate economic cycles that impact South Jersey. SJTA's revenue streams that secure bonds and the underlying credit qualities have remain adequate and continued to support a bond rating in the BBB category. Our Invesco Municipal Bond team has built a position in South Jersey Transportation Authority over a period of time by participating in multiple bond offerings.

¹ New Jersey general obligation bonds and South Jersey Transportation Authority issues comprised 3.05% and 1.86%, respectively of Invesco New Jersey Municipal Fund's (ONJAX) portfolio as of September 30, 2023. Holdings are subject to change without notice.

Sources:

1. New Jersey Transportation Trust Fund Authority, Official Statement – Series 2023 A, dated November 8, 2023.
2. Bureau of Economic Analysis, as of December 31, 2022.
3. Office of Legislative Services Revenue Snapshot, September 2023.
4. Kroll, as of May 1, 2023.
5. Moody's, as of April 12, 2023.
6. Bureau of Labor Statistics, as of September 30, 2023.
7. Moody's, as of September 6, 2023.
8. Standard & Poor's, as of April 12, 2023.
9. Fitch, as of April 10, 2023.
10. Merritt Research, as of December 31, 2022.

Invesco Municipal Bond team

The Invesco Fixed Income Municipal Bond team's investment philosophy is based on the belief that creating long-term value through comprehensive, forward-looking research is the key to providing clients with diversified portfolios that aim to maximize risk-adjusted returns.

Proprietary credit research and risk management are the foundations of our investment process, supported by a deep and experienced team of investment professionals with expertise that spans the entire municipal investment universe. We maintain an integrated, team-based investment process that combines the strength of our fundamental credit research analysts with the market knowledge and investment experience of our portfolio managers.

Our position among the top 5 municipal investment managers by assets in the US^{*} enables us to access preferred market opportunities and gain valuable market insight. Our team has established relationships with more than 120 national and regional municipal debt dealers in the US. We believe these established relationships, as well as our size, allow us to achieve fluid execution in daily transactions. Our ability to aggregate trades across multiple portfolios also enables us to obtain lower institutional pricing, which can contribute to portfolio performance.

About risk

Municipal securities are subject to the risk that legislative or economic conditions could affect an issuer's ability to make payments of principal and/or interest.

Junk bonds involve greater risk of default or price changes due to changes in the issuer's credit quality.

The values of junk bonds fluctuate more than those of high quality bonds and can decline significantly over short time periods.

All fixed income securities are subject to two types of risk: credit risk and interest rate risk. Credit risk refers to the possibility that the issuer of a security will be unable to make interest payments and/ or repay the principal on its debt. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa.

Municipal bonds are issued by state and local government agencies to finance public projects and services. They typically pay interest that is a tax in their state of issuance. Because of their tax benefits, municipal bonds usually offer lower pre-tax yields than similar taxable bonds. The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

Before investing, investors should carefully read the prospectus and/or summary prospectus and carefully consider the investment objectives, risk, charges and expenses. For this and more complete information about the funds, investors should ask their financial professional for a prospectus/summary prospectus or visit [invesco.com/fundprospectus](https://www.invesco.com/fundprospectus).

Invesco does not provide tax advice. The tax information contained herein is general and is not exhaustive by nature. It is not intended or written to be used, and it cannot be used by any taxpayer, for the purpose of avoiding tax penalties that may be imposed on the taxpayer under US federal tax laws. Federal and state tax laws are complex and constantly changing. Investors should always consult their own legal or tax advisor for information concerning their individual situation.

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions, there can be no assurance that actual results will not differ materially from expectations.

Past performance does not guarantee future results.

A credit rating is an assessment provided by a nationally recognized statistical rating organization (NRSRO) of the creditworthiness of an issuer with respect to debt obligations, including specific securities, money market instruments or other debts. Ratings are measured on a scale that generally ranges from AAA (highest) to D (lowest); ratings are subject to change without notice. NR indicates the debtor was not rated and should not be interpreted as indicating low quality. For more information on rating methodologies, please visit the following NRSRO websites: www.standardandpoors.com and select 'Understanding Ratings' under Rating Resources on the homepage; www.moodys.com and select 'Rating Methodologies' under Research and Ratings on the homepage; www.fitchratings.com and select 'Ratings Definitions' on the homepage.

The opinions expressed are those of the author, are based on current market conditions and are subject to change without notice. These opinions may differ from those of other Invesco investment professionals.

*Source: Simfund as of September 30, 2023.