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New Jersey's muni bond credit story deserves a second look

New Jersey's reputation in the municipal bond market has not kept pace with current fundamentals. Six years of full pension funding, billions in debt paydown and stronger reserves have reshaped the state's credit profile. For investors weighing New Jersey paper against outdated assumptions, the numbers tell a more constructive story.

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Six years of full pension funding turned downgrades into three upgrades.

Ratings have climbed on real fiscal progress

New Jersey's GO bonds are rated Aa3 by Moody's and A+ by S&P and Fitch, with stable outlooks across all three. That standing reflects six straight years of full pension contributions, nearly $4 billion of debt defeasance since fiscal year (FY) 2022 and reserves well above pre-pandemic levels despite recent drawdowns. Six years ago, S&P downgraded the state to BBB+ after its nearly 25 years without a full pension contribution. The reversal is stark.

Long-term challenges remain: pension and retiree health care liabilities rank among the nation's largest and the budget still isn't fully balanced. But revenue growth is outpacing expenditure growth.

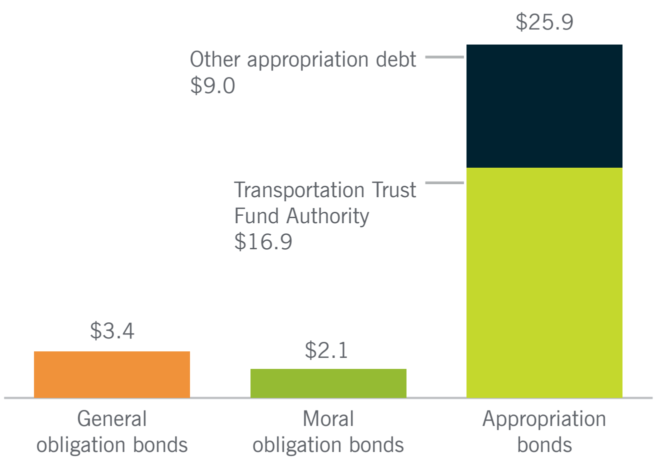
New Jersey remains a major bond issuer

New Jersey remains a significant municipal issuer despite moderating state-related supply. In 2025 the state ranked 12th nationally for total municipal issuance at roughly $10.3 billion, per *The Bond Buyer*. Supply has tightened as the state uses its Debt Defeasance and Prevention Fund to pay down debt and fund capital projects pay-as-you-go, cutting borrowing needs.

New Jersey's long-term debt falls into three categories: general obligation, appropriation-backed and moral obligation (Figure 1).

Figure 1: Appropriation debt dominates New Jersey's borrowing

New Jersey debt ($ billions)



Data source: New Jersey Transportation Trust Fund Authority, 30 Jun 2025.

General obligation (GO) debt is authorized by individual bond acts and backed by the state's full faith and credit. Bond acts generally require voter approval and are capped by the state constitution at less than 1% of annual appropriations. GO debt continues to be paid even without an enacted budget, protecting bondholders during a shutdown. If tax revenues fall short, the state must levy a property tax to cover debt service.

Appropriation-backed debt is issued by state authorities and supported by leases and contracts under which the state pays debt service subject to annual legislative approval. The legislature has no legal obligation to appropriate — though it has never failed to do so. This risk typically leaves these bonds rated one to two notches below the state's GO rating. Most state-related borrowing falls here, including debt from the Economic Development Authority, State Building Authority and Educational Facilities Authority. Transportation Trust Fund Authority bonds are also a sizeable component: special obligations payable from motor fuels taxes but ultimately secured by the state's appropriation pledge.

Moral obligation debt carries a debt service reserve fund; if that reserve falls short, the state has certified it will appropriate the deficiency. The legislature isn't legally bound to do so, but the structure has historically added support. Moral obligation bonds are typically rated two to three notches below the state's GO rating.

A wealthy, well-connected economy anchors growth

New Jersey's economy is larger, wealthier and more dynamic than its reputation suggests. The state ranks 10th nationally by GDP and 11th by population, with about 9.5 million residents.

Its position in the Washington-to-Boston corridor gives it direct access to regional and global markets, supporting a diversified employment base across technology, health care, financial services, biopharmaceuticals, advanced manufacturing and tourism.

Transportation and logistics has become a growth engine, driven by the state's highway network and its role as the primary corridor between New York City and Philadelphia. Financial services employment shows some concentration, but less than in neighboring New York.

Demographics remain a credit positive. Population grew 7.6% over the last decade, outpacing the nation and regional peers. While New York and Pennsylvania have struggled with stagnation, New Jersey has attracted residents by offering lower costs than New York City with ready access to its labor market and transportation network.

The state ranks among the most educated in the nation, supporting strong wealth and income metrics: per capita income sits at 115.5% of the national average (6th highest), and the poverty rate of 9.7% falls below the 12.5% national rate.

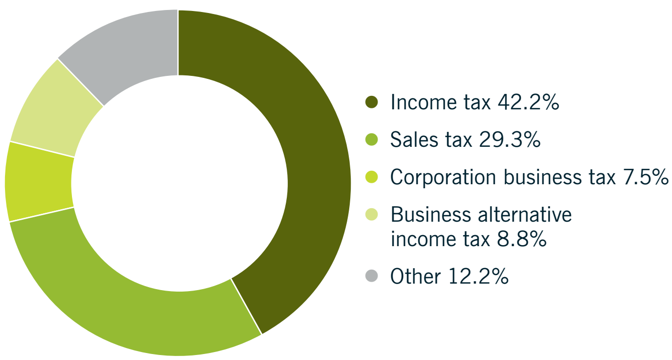
These fundamentals support the tax base, though revenues track economic and financial-market conditions — a sensitivity that shows up clearly in the state's revenue mix and recent budget performance.

Reserves remain strong as budget gaps narrow

New Jersey's revenue base leans heavily on economically sensitive taxes: personal income tax, sales tax and business-related taxes (Figure 2). This mix drives strong upside in expansions but ties the outlook closely to economic growth.

Figure 2: Income and sales taxes drive state revenue

New Jersey budgeted major revenues



Data source: State of New Jersey Budget in Brief, fiscal year 2027.

New Jersey's improved fiscal position reflects strong operating performance and reserves well above historical norms. The state entered the pandemic with reserves of just $1.7 billion, or 4% of revenues — little cushion against disruption. Federal support and strong tax collections rebuilt the balance sheet, pushing reserves to an all-time high of $10.5 billion, or 19% of revenues, by FY23.

Since then the state has drawn down reserves to manage structural imbalances, though results keep beating earlier projections. FY26 outperformed budget on stronger revenue growth, producing a smaller deficit than projected and leaving reserves at $7.3 billion, or 12.6% of revenues — still well above pre-pandemic levels.

Governor Sherrill signed the $60.7 billion FY27 budget on June 30, a 1.6% increase over the prior year. Revenue is projected to grow 2.7%, driven by modest economic growth and about $750 million in new revenue measures, including a cap on business loss write-offs and a per-employee fee on large employers with Medicaid-enrolled workers.

Expenditures are projected to grow just 1.6%, below revenue growth: a constructive shift after years of reserve drawdowns that, if sustained, should keep narrowing structural gaps. The budget projects a closing General Fund balance of $5.4 billion (9.1% of revenues).

New Jersey looks better positioned than many states on federal Medicaid changes. Medicaid is about 12% of the FY27 budget, and the state benefits from the statutory 50% floor on federal matching funds — guaranteeing no state's match rate falls below 50% — which survived the latest federal legislation.

The biggest near-term risk, in our view, is an economic slowdown that weakens income and sales tax collections.

Long-term liabilities still limit flexibility

New Jersey underfunded its actuarially required pension contributions for decades starting in 1996, compounding into one of the nation's largest unfunded pension liabilities. Structurally imbalanced budgets became routine, patched with one-time fixes like debt restructuring and pension deferrals. Ratings fell steadily from their 2010 highs, bottoming out around 2020 (Figure 3).

Figure 3: A decade of downgrades has reversed since 2021

New Jersey GO bond rating history

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Moody's	Aa2	Aa3	Aa3	Aa3	A1	A2	A2	A3	A3	A3	A3	A3	A2	A1	A1	Aa3	Aa3
S&P	AA	AA-	AA-	AA-	A	A	A-	A-	A-	A-	BBB+	BBB+	A-	A	A	A+	A+
Fitch	AA	AA-	AA-	AA-	A	A	A	A	A	A	A-	A-	A	A+	A+	A+	A+

Data source: Moody's Ratings, S&P Global Ratings, Fitch Ratings; New Jersey Treasury, 2010-2025.

The trajectory turned in FY22, when the state resumed full pension contributions for the first time in roughly 25 years — discipline sustained through both favorable and challenging budget cycles, and continued in Governor Sherrill's FY27 budget for a sixth straight year. The state also paid down nearly $4 billion of debt between FY22 and FY26, lowering fixed costs and freeing room for higher pension contributions.

Long-term liabilities remain a central constraint. Pension and retiree health care obligations rank among the nation's largest, and fixed costs stay exceptionally high relative to peers. The state's aggregate pension funded ratio (GASB 67) climbed from 30.93% in FY16 to 53.4% in FY25 — real progress, but still well below full funding. No statute requires full pension contributions, so discipline rests on political will rather than institutional structure. Sustaining the trajectory depends on continued discipline ahead.

The state's rating history tells the story: ratings as high as Aa2/AA/AA in 2010 declined steadily through the 2010s before all three agencies upgraded the state two to three notches since 2021. Few states have seen a 15-year arc this dramatic.

Local credit quality varies by issuer

How much does the state's credit quality matter locally? It varies by issuer. Above-average wealth, strong access to regional jobs and solid reserves broadly support credit quality across municipalities, counties and school districts.

State-aid reliance varies among cities and counties. Issuers with heavier exposure face downstream pressure when state revenues soften or policy shifts. Most local governments, though, rely primarily on property taxes — a steady stream that limits dependence on state finances. The state's 2% property tax cap can constrain flexibility, but it exempts debt service, certain pension and health care cost growth, emergencies and new tax base growth.

Reserves are also healthy: S&P reports median available reserves above 22% of general fund revenues for municipalities and 17% for counties, both favorable against national peers. The state backs this with formal oversight tools — including transitional aid and stabilization mechanisms — for governments under acute stress.

School districts lean more heavily on the state, though reliance varies. K-12 education is the largest expenditure in New Jersey's budget, and FY27 includes a record $12.4 billion in school funding — a supportive baseline for most districts. The state also covers teacher pension and retiree health costs in full, keeping district fixed costs low; shifting those costs to schools is a risk but would likely be politically unpalatable.

Some districts have faced fiscal stress, but the pressure stays concentrated rather than widespread. The main driver: 2018's S-2 legislation, which phased out supplemental "adjustment aid" over seven years, with pandemic-era federal aid masking the impact until those dollars expired. FY26 likely marks the trough, and FY27 caps annual state-aid reductions at 3% — pointing to a more stable outlook for most districts. Governor Sherrill has also launched outreach on a broader funding-formula overhaul, though changes remain years away.

For districts under acute stress, the state's Qualified Bond Act adds protection: it lets the state intercept aid and direct it to bondholders, reducing default risk. New Jersey locals span a wide rating distribution, from highly rated issuers to a handful of challenged names — underscoring why bottom-up credit analysis matters here.

New Jersey enters 2027 on stronger footing

New Jersey enters federal policy uncertainty and funding-cut headwinds far stronger than five years ago. Reserves sit well above historical norms, the state has sustained years of full pension funding and FY27 revenue growth should outpace spending growth.

Long-term liabilities remain a real constraint, and any lapse in pension discipline could undo recent progress. Still, state leaders' commitment has held firm. For investors, New Jersey is a high-quality credit on an improving trajectory — one that has outpaced its reputation among some market participants.

For more information, please visit nuveen.com.

Endnotes

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