THE BOND BUYER

New Jersey readies coronavirus emergency bond sale

By

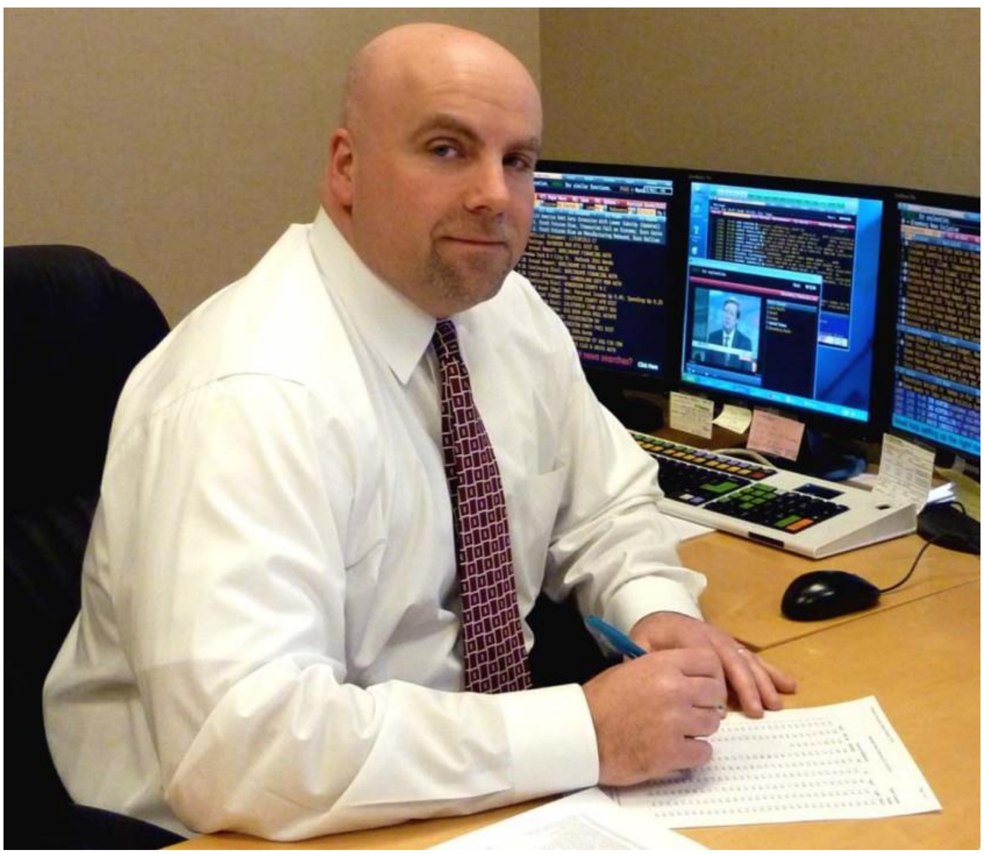
Andrew Coen

Published

November 13, 2020, 12:52 p.m. EST

New Jersey heads into the market next week to sell $4.3 billion of general obligation bonds on Nov. 18 to offset revenue the losses caused by the COVID-19 pandemic.

The deal will test the state's low bond ratings — punctuated by another downgrade ahead of the deal — against the market's continuing demand for paper.



"Spreads could widen initially on the deal because of its size but given the lack of yield available in the market our guess is the bonds will eventually tighten," says Michael Pietronico, CEO of Miller Tabak Asset Management.

The Nov. 18 negotiated offering is comprised of $2.15 billion of Series A tax-exempt COVID-19 GO emergency bonds and $2.15 billion of Series B COVID-19 taxable GO emergency bonds dedicated to local school district expenses. The state designates Series B as social bonds.

Ahead of the deal, S&P Global Ratings downgraded New Jersey GOs to BBB-plus from A-minus on Nov. 6 citing structural deficit challenges resulting from COVID-19-induced revenue losses expected to persist for the next couple budget cycles. S&P revised the state's credit outlook to stable from negative at the lower rating.

"I don't think the New Jersey GO bond offering is going to suffer any yield penalty at all," said J.R. Rieger, owner of Rieger Report LLC. "The demand for bonds seems to be looking the other way and bond funds will hold their nose and suck the bonds in."

Moody's Investors Service and Fitch Ratings both affirmed New Jersey at A3 and A-minus, respectively, with negative outlooks. Kroll Bond Rating Agency affirmed New Jersey bonds at A with a stable outlook.

Bank of America is lead underwriter for the transaction. Acacia Financial Group is financial advisor. Chiesa Shahinian & Giantomasi PC and M. Jeremy Ostow are bond counsel.

The state is hitting the market amid rising COVID-19 infections with 296,000 cases and more than 16,000 deaths as of Nov. 11.

After being slammed in the early months of the pandemic along with neighboring New York City, New Jersey enjoyed a relatively calm summer before new case numbers began rising sharply in October, according to the state's data.

Gov. Phil Murphy ordered restaurants to close at 10 p.m. this week in an effort to curb spread of the virus.

Dan Berger, senior market strategist at Refinitiv's Municipal Market Data, said in general New Jersey GOs are thinly traded with the bonds maturing in 2042 last trading at Sept. 23 at 75 basis points above the MMD triple-A scale. He said there might be a penalty on the new GOs due to the downgrade, but strong demand from high-yield investors may limit the cost.

"The market levels will be tested by this deal and it is a lot for the market to digest," said Berger, noting that only Illinois trades at higher spreads than New Jersey for state GOs. "There are people who will take advantage of this who are yield buyers."

Berger noted that New Jersey appropriation bonds, which are rated one notch lower than the GOs and comprise around 90% of the state's outstanding debt, have traded at higher spreads recently. An approximately $2 million block of bonds issued for the New Jersey Economic Development Authority maturing in 2033 traded at 186 bp above the triple-A benchmark last week. A block of $15 million in NJEDA bonds maturing in 2024 also traded on Sept. 29 at a 200 bp spread.

Michael Pietronico, CEO of Miller Tabak Asset Management, expects strong investor reception to the New Jersey deal despite the S&P downgrade.

"Spreads could widen initially on the deal because of its size but given the lack of yield available in the market our guess is the bonds will eventually tighten and perform in line with Moody's rating as opposed to S&P," Pietronico said.

The state last sold GOs in January with two competitive deals totaling $325 million marking its first GO issuance since December 2016. The long-range bonds from the deal maturing in 2042 priced at spreads at 28 bps compared to 120.6 on 2037 maturities in the 2016 deal.

Howard Cure, director of municipal bond research at Evercore Wealth Management, said he does not foresee much of a spread penalty because New Jersey GOs trade much tighter to the AAA scale than the state's appropriation debt. The state has $33.4 billion of outstanding debt with only $1.6 billion comprised of GOs.

Cure also stressed that New Jersey will benefit from floating such a large issue at a time when there is little supply in the market just before the Thanksgiving holiday.

"The low supply should also help tighten spreads," Cure said. "They are going to be the dominant issuer next week."

The deal arrives four months after Murphy signed the New Jersey COVID-19 Emergency Bond Act authorizing the debt to combat revenue losses resulting from the virus. The state's current 6.625% sales tax and local property taxes collected by municipalities will be increased if general budget revenues are insufficient to meet debt service requirements, according to the bill.

The bonds will be sold in 12-year maturities.

State Treasurer Elizabeth Maher Muoio previously forecast in August that 2021 fiscal year revenues would be $5.6 billion less than February's projections issued before Murphy unveiled his initial budget proposal before COVID-19 cases began to mount.

Murphy signed a shortened nine-month $32.7 billion state budget in late September that relies on $4.5 billion of proceeds from new borrowing to offset revenue losses. The spending plan also hinges on $700 million of new revenues from tax increases including a long-sought millionaire's tax that raises the marginal rate on annual income above $1 million to 10.75% from 8.97%.

On Nov. 6, the state treasury revised the state revenue outlook upward by $398 million from the projection certified in the state budget. As a result, the emergency bond authorization was decreased by the same amount.

New Jersey had previously explored utilizing Federal Reserve's Municipal Liquidity Facility with short-term debt for part of the deal before BofA advised it to sell long-term bonds instead due to market conditions.

The state treasury department's press office did not immediately respond for comment on the upcoming bond sale.

Muoio said in a Nov. 6 statement after the S&P downgrade that the bonding approach is part of a multi-pronged strategy to confront an "unprecedented" financial crisis resulting from the virus.

"From the outset, we have taken a balanced, fiscally responsible approach that involved carefully targeted spending reductions, a measured approach to borrowing, and new tax initiatives — all of which were designed to avoid harming those who have already been disproportionately hurt by the pandemic," she said. "Our goal was to avoid the type of draconian cuts made during the Great Recession, which stymied our economic recovery and led to New Jersey being one of the last states to emerge from the recession."

Andrew Coen