

Contact	Phone
New York	
Catie Tsao	212-553-1362
Erin Daugherty	212-553-4534
Aaron Dworkin	212-553-7294
Alexandra Lerma	212-553-4556
Jenny Maloney	212-553-1388
Edith Behr	212-553-0566
Robert Kurtter	212-553-4453

Moody's Maintains Negative Outlook on New Jersey School Districts

Property Tax Reform Is Expected to Impose Additional Financial Pressure on School Districts

Summary Opinion

Moody's believes that New Jersey school districts may experience further fiscal pressure due to a combination of fund balance restrictions and property tax limitations, despite the granting of certain exceptions. The New Jersey Tax Reform legislation signed into law by Governor Jon S. Corzine on April 3, 2007 imposes a 4% cap on property tax levy increases for all municipal governments, including county, local governments, fire districts and school districts. The impact of the tax levy limitation on school districts is especially onerous given an existing two percent cap on the undesignated portion of districts' fund balances, which has narrowed financial flexibility for a large number of districts.

An enhanced rating of Aa2 with stable outlook is currently available to all New Jersey school districts based on the school bond reserve fund established by Chapter 72 and is not expected to be affected by the Property Tax Reform legislation. The Aa2 rating reflects the program's highly liquid reserve (balance of \$103.3 million at fiscal year-end 2006) for \$8.1 billion in school-related debt currently outstanding. The reserve has not been tapped since its inception.

Moody's currently has ratings outstanding on 280 of the 616 school districts throughout the state.

Available Exceptions Expected to Mitigate the Magnitude of the Levy Limitations

While a 4% cap on levy increases is limiting, certain exclusions apply, such as debt service payments, lease payments to county improvement authorities, revenue necessary to offset reduction in state aid, and a portion of healthcare and pension obligations. An exception is also made for costs associated with increased enrollment. Further, districts may apply to the Commissioner of Education for other increases including those for special education costs over \$40,000 per pupil, increases in tuition, capital outlay increases and incremental increases in costs for opening a new school facility. The school districts are permitted to seek voter approval to exceed the tax levy increase cap, which may be passed by a majority of people voting in the 2007 school election, but must be passed by a supermajority (60%) of those voting at the April 2008 through April 2011 school elections.

The ability to seek voter approval to exceed the cap and certain exclusions available for increased debt service payments, healthcare, pension and reduction in state aid, and growth in enrollment as well as the opportunity to appeal to the Commissioner of Education for a number of other exceptions are all expected to mitigate the impact of the levy limitation. However, Moody's anticipates that the cap will provide added fiscal challenges for all districts in the near term as they adjust to the new budgetary restrictions.



Limitation of Property Tax Levy Increases Expected to Further Narrow Financial Flexibility of School Districts

The new law is expected to create new fiscal challenges on the school district sector overall. A sample study of five wealthy districts [per capita income (PCI) and median family income (MFI) medians that exceed 150% of the state medians] showed that approximately 83% of their revenues were comprised of property taxes. These five districts had an average total fund balance of 8% and unreserved, undesignated fund balance of 1.9% of revenues (allowable maximum is 2% of budget), reflecting their ability to generate surpluses despite the fund balance restriction. While these districts are more likely to pursue voter overrides than those with less wealth, the 4% cap on property tax levy increases may impact these districts' abilities to continue generating surpluses and lead to utilization of fund balance, narrowing their financial flexibility.

The sample study also showed that five districts with more modest wealth levels (PCI and MFI medians below 100% of the state medians) received approximately 50% of their revenues from property taxes. While they had a more diverse revenue stream consisting of property taxes and state aid, they also exhibited narrower reserve levels than those of wealthy districts. These districts had average total and undesignated fund balances of 3.7% and 0.3% of revenues, respectively, significantly less than 8% and 1.9% of wealthier districts, leaving them little cushion in case of any expenditure overruns and little opportunity to restore reserves if utilized.

While some districts may be more dependent on property taxes as a revenue source, the sample study showed that there was no significant difference in the rate of average annual property tax increases since fiscal 2000 between the two groups, with an annual average levy increase of 9.34% for wealthy districts and 9.24% for more modest districts. These approximate increases of 9.3% include certain items such as increases in debt service, pension obligations, healthcare and special education costs, which are not included in the 4% cap. Therefore, the historic average of 9.3% property tax levy increase is not exactly comparable to the 4% limitation imposed by the Property Tax Reform Act. However, the Corzine administration anticipates seeing a total increase of 7%, including exemptions, which is still below the current trends displayed by the sample districts.

Increased Fiscal Oversight and Accountability for School Districts

Governor Corzine also approved the bill A-5/S-4, which calls for increased fiscal oversight and accountability of school districts. The bill stipulates that, as a condition of receiving state aid, a district shall examine cost-saving options for insurance policies, energy costs, maximize participation in the federal grant programs and refinance all outstanding debt if the district can achieve a net present value savings of 3%. The bill also requires that the districts make available a plain language budget summary to the public and submit supporting documents for superintendents, assistant superintendents and business administrators whose salaries exceed \$75,000.

A Commission to Study Possibility of Municipal Consolidation

Approved bill A-15/S-12 creates a commission to study and recommend a municipal consolidation plan to increase efficiency through local government shared services. The commission shall make its recommendations to the Governor within two years following the effective date of the act. The commission's study may result in a consolidation plan for a number of districts if it deems that doing so will help to achieve improved operating efficiency and lessened tax burden.

Conclusion

Moody's believes that the four percent cap on property tax increases for school districts limits the ability to raise revenues to meet increasing expenditures and, together with existing fund balance restrictions, will present challenges to school districts to balance their budgets going forward. Moody's will continue to monitor the impact of the property tax levy limitation to determine its full impact on the New Jersey school district sector.

Related Research

Special Comments:

[Negative Outlook Assigned To The New Jersey School District Sector; Aa2 And Stable Outlook Affirmed On Chapter 72 Reserve, August 2004 \(88269\)](#)

[Moody's Affirms Aa2 Rating on Chapter 72 Bonds Despite Expectation of Significant Legislative Change, June 2003 \(77869\)](#)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

To order reprints of this report (100 copies minimum), please call 1.212.553.1658.
Report Number: 102807

Author

Catie Tsao

Editor

Edith Behr

Senior Production Associate

Yelena Ponirovskaya

© Copyright 2007, Moody's Investors Service, Inc. and/or its licensors and affiliates including Moody's Assurance Company, Inc. (together, "MOODY'S"). All rights reserved. **ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY COPYRIGHT LAW AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.** All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, such information is provided "as is" without warranty of any kind and MOODY'S, in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any such information. Under no circumstances shall MOODY'S have any liability to any person or entity for (a) any loss or damage in whole or in part caused by, resulting from, or relating to, any error (negligent or otherwise) or other circumstance or contingency within or outside the control of MOODY'S or any of its directors, officers, employees or agents in connection with the procurement, collection, compilation, interpretation, communication, publication or delivery of any such information, or (b) any direct, indirect, special, consequential, compensatory or incidental damages whatsoever (including without limitation, lost profits), even if MOODY'S is advised in advance of the possibility of such damages, resulting from the use of or inability to use, any such information. The credit ratings and financial reporting analysis observations, if any, constituting part of the information contained herein are, and must be construed solely as, statements of opinion and not statements of fact or recommendations to purchase, sell or hold any securities. **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.** Each rating or other opinion must be weighed solely as one factor in any investment decision made by or on behalf of any user of the information contained herein, and each such user must accordingly make its own study and evaluation of each security and of each issuer and guarantor of, and each provider of credit support for, each security that it may consider purchasing, holding or selling.

MOODY'S 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 have, prior to assignment of any rating, agreed to pay to MOODY'S for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,400,000. Moody's Corporation (MCO) and its wholly-owned credit rating agency subsidiary, Moody's Investors Service (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 on Moody's website at www.moodys.com under the heading "Shareholder Relations — Corporate Governance — Director and Shareholder Affiliation Policy."