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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 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)

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