



OFFICE OF THE STATE COMPTROLLER

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New York State's Cash Flow Crunch

November 2009

Summary

New York State has already been forced to take extraordinary measures to meet its existing obligations in State Fiscal Year (SFY) 2009-10. The decline in revenue associated with the most severe recession since the Great Depression and the State's continuing failure to address its worsening structural budget imbalance have combined to create a severe cash flow crunch.

To date, these measures include extending the legal duration of temporary loans to the General Fund from the State's Short Term Investment Pool (STIP) and delaying or rescheduling payments. Even with these measures, however, current revenue trends indicate that without timely legislative action, the State's General Fund may incur a cash flow deficit of up to \$1.4 billion in December 2009 if all payments are made as currently planned. In other words, bills due and owed by the State may exceed available revenues in the General Fund.

The State has a limited number of options to deal with this shortfall, absent legislative action on a deficit reduction plan (DRP). All these options would have negative fiscal ramifications for the State. Such actions may include further payment delays, which may be disruptive to local governments, school districts, and service providers, or additional sweeps from dedicated funds and reserves, which provide one-time revenue and do nothing to address the State's structural imbalance.

A particularly harmful option would be short-term borrowing, because it would only postpone the time when the underlying problems must be addressed (and may require legislative action). This option also sends the negative message that the State is unwilling to address its financial issues. Any evidence that the State does not take these matters seriously risks a negative impact on the State's credit rating, which could translate into a loss of confidence by investors and increased borrowing costs for the State.

The current cash flow crisis is a symptom of the failure on the part of the State to address its fundamental budget problem. While payment delays and temporary loans may allow the State to manage its cash through the year, these are only temporary solutions which do nothing to resolve the State's underlying structural imbalance between revenue and spending. Furthermore, any borrowing, whether short-term or long-term, to address the State's deficit would further increase the State's debt burden, already among the highest in the nation. New York State can no longer afford delays or inadequate solutions. The

Executive and the Legislature must act now to address the current budget deficit, and must develop a long-term, realistic plan to correct its chronic structural budget imbalance.

Projected December Cash Shortfalls

The month of December has several significant payments that are either currently scheduled or have historically been made within the month. Payments include a School Property Tax Relief Program (STAR) payment of \$2.5 billion, a \$1.6 billion school aid payment and \$461 million for the Aid and Incentives to Municipalities program (AIM). In addition, this year December has five Wednesdays, which is the day on which weekly Medicaid cycle payments, which average between \$400 million and \$500 million, are typically made.

While a number of large disbursements are planned throughout the month of December, the month also marks the end of a quarter and is usually a significant tax revenue month. However, the State typically does not see any significant quarterly tax revenue until approximately the 18th. This means that the fund balances through the first two weeks in December may be particularly tight.

The Division of the Budget (DOB) projects that the All Governmental Fund balances will total only \$36 million (prior to any DRP actions) at the end of December. Based on current revenue trends through October 31, 2009 and planned spending, the Office of the State Comptroller estimates a *negative* balance which may approach \$3.0 million. The General Fund is projected to be more than \$1.0 billion in the negative by DOB, but the Office of the State Comptroller estimates this deficit could approach \$1.4 billion if revenue trends continue and all payments currently planned for December are made.

Projected Closing Balances

December 2009

(In millions of dollars)

	General Fund	All Governmental Funds
Division of the Budget	(1,088)	36
Office of the State Comptroller	(1,354)	(3)

In short, the State's cash flow crunch will become increasingly critical in December.

Cash Flow Through the Remainder of the Fiscal Year

The Office of the State Comptroller projects that All Governmental Funds tax collections through the end of the current fiscal year will be \$1.0 billion lower than the current projections by DOB. Actual results through October 31 indicate that All Governmental

Funds tax collections were already \$85.3 million below the projections in DOB's Mid-Year Financial Plan, which was updated on October 30.

Furthermore, the Office of the State Comptroller projects that All Governmental Funds spending will be \$390 million higher than the forecast contained in the Executive's Mid-Year Update to the Financial Plan, thus putting additional pressure on cash flow. Any payment delays made in December will only create additional cash flow pressure throughout the remainder of the fiscal year.

The State is reserving money to make the debt service payments scheduled for November and December. DOB plans to reserve money in January 2010 for payments due in the final quarter of the current fiscal year. Money to pay debt service on bonds secured by dedicated receipts, including Personal Income Tax bonds, continues to be set aside as required by law and bond covenants.

Cash Management Options

To date, DOB has actively managed the flow of spending to accommodate lower-than-anticipated revenue collections. However, many of these options will cease to exist as the fiscal year progresses. According to the Executive, the proposed DRP is intended not only to address the year-end projected deficit of \$3.2 billion, but also to alleviate some of the potential cash flow shortfall projected for December.

While DOB has some ability to manage some spending, many payment dates are statutorily established and require an act of the Legislature to be changed. Other disbursements may be affected by economic conditions, programmatic variances or unanticipated events. For instance, although the average payment is \$400 million to \$500 million a week, Medicaid cycle payments from All Governmental Funds can vary by hundreds of millions of dollars above or below that figure.

Revenue collections are much more difficult to control. While certain revenue collections are or can be scheduled, tax collections can be volatile. The months of June, September, December and March are significant collection months as they close the quarters with due dates for certain business taxes and estimated Personal Income Taxes. January is generally a significant month for Personal Income Tax collections, as taxes associated with end-of-year bonuses from the financial sector are usually received at that time. Other tax collections in the remaining months are generally less robust.

To date, in each month of the current fiscal year, the Office of the State Comptroller has reported that year-to-date revenue collections have been below Financial Plan projections. Through October 31, 2009, General Fund revenue collections were \$110.5 million below DOB's Mid-Year Financial Plan projections from October and \$2.1 billion below DOB's Enacted Budget projections from April.

A number of cash management options exist for the Executive if disbursements exceed revenue, but all of these would have negative consequences for the State's long-term financial outlook. The decision to delay payments or use fund balances largely rests with

the Executive. However, the issuance of intra-year notes requires the agreement of the Executive and legislative leaders, and the issuance of any notes for non-capital purposes may require legislative action. Each of these actions would worsen the State's financial outlook and add to next year's budget deficit. None of these actions are fiscally responsible, but would only continue the State's ongoing pattern of avoiding its fiscal problems.

Delayed Payments

DOB has already postponed payments in response to lower-than-anticipated revenues. For instance, the State was scheduled to pay \$704 million in October 2009 and \$861 million in November 2009 to school districts for STAR. A third payment of \$1.04 billion was scheduled for December.¹ In the Mid-Year Update to the SFY 2009-10 Financial Plan, the October and November payments were drastically reduced to \$12 million and \$53 million, respectively, and the December payment was increased to nearly \$2.5 billion, thus freeing up General Fund resources in October and November, but worsening the cash flow problem in December.²

Similarly, the State has traditionally prepaid its pension contribution, which has the benefit of lowering the cost, as the interest is discounted from the March 1 required payment date. In May, the Executive had planned to prepay what was estimated at the time to be the \$959.1 million SFY 2009-10 pension payment on September 1.³ The Executive now plans to make this payment in March 2010 in order to preserve cash temporarily in the General Fund. This measure, however, will cost the State an additional \$30 million in interest, in an effort to free up resources as tax collections continue to fail to meet expectations.⁴

Significant payments in December include \$2.5 billion for STAR, \$1.6 billion for school aid, and \$461 million for AIM, as well as five Wednesdays that typically are associated with Medicaid cycle payments (at about \$400 million to \$500 million each week on average for All Governmental Funds). Some payment dates may require legislative approval to be changed. However, local governments and service providers depend on timely payments from the State. In addition, any postponements would merely delay the State's deficit problem without addressing the underlying structural issues.

Temporary Loans From the Short Term Investment Pool

In response to the expectation that the State would face larger than normal cash flow problems in SFY 2009-10, the Enacted Budget for SFY 2009-10 included language that allows the General Fund to borrow from other funds in the State's Short Term Investment Pool (STIP) for a period not to exceed four months or until the end of the fiscal year, whichever is shorter, to meet its obligations in the event of a cash shortfall (inter-month).

¹ SFY 2009-10 Enacted Budget Financial Plan; First Quarter Update to the SFY 2009-10 Financial Plan.

² Mid-Year Update to the SFY 2009-10 Financial Plan, released on October 30, 2009.

³ Annual Information Statement, State of New York, May 15, 2009.

⁴ This payment plan is included in the Division of the Budget's Mid-Year Financial Plan Update, 2009-10 through 2012-13.

Previously, temporary loans from other funds in STIP were allowed, but had to be paid back within the same month (intra-month).

The temporary loan authorization has been in existence for some time and has been used by DOB to meet the State's General Fund obligations. Within certain months, required or scheduled payments may temporarily exceed available revenue. Intra-month temporary loans allow DOB to smooth these variances. However, the new language allowing General Fund temporary loans to cross over several months indicates a more severe cash flow problem.

While it is commonplace for temporary loans to cross months for many special revenue and capital project funds, this is not the case for the General Fund. In prior years, the State was able to balance the General Fund by month's end. In SFY 2009-10, this is no longer projected to be the case.

The Short Term Investment Pool is made up of All Governmental Funds (including the General Fund, State and federal special revenue funds, State and federal capital projects funds and debt service funds), enterprise and internal service funds used for financing goods and services between agencies and certain operations as well as fiduciary funds for which the State acts as a fiscal agent for individuals, private organizations or non-State governmental units.

These funds are invested temporarily until needed. However, a significant portion of the daily balance is restricted and is not available to be temporarily loaned to the General Fund. These restricted funds are held by the State in a fiduciary capacity—such as payroll taxes held pending payment to the taxing authorities or payroll deductions held pending payment of health insurance premiums. The STIP cash balance as of the end of October totaled \$6.8 billion, of which \$3.5 billion is restricted. Restricted, enterprise and internal service funds are *not* included in DOB's projected All Governmental Funds opening and closing balances.

STIP loans cannot solve the State's underlying budgeting problems and offer only limited relief from the cash flow crunch.

Other Cash Management Practices

In the absence of a deficit reduction plan that solves the State's cash crunch, the Executive could pursue the drawdown of available funds from various sources including public authorities, agencies and other entities. In addition, payments due to the State may be accelerated, such as recoupment of Medicaid overpayments to providers. However, the drawdown of such funds and the acceleration of payments provide only one-time benefits to the State, and ultimately make the long-term problem worse.

Reserve fund cash, including funds in the Rainy Day, Tax Stabilization and other reserves, has already been used by DOB within the fiscal year. The State utilizes those fund balances throughout the year and then repays them on the last day of the fiscal year. These reserve funds are included in DOB's \$1.4 billion General Fund balance projected for

March 31, 2010, which assumes full implementation of the Executive's proposed DRP. In the event a Tax Stabilization loan is not repaid by year-end, by law the State would be required to repay the loan in three equal installments over the next six years.

Using restricted reserves to meet unaffordable spending commitments simply exacerbates the State's structural imbalance and delays the difficult choices that need to be made to bring recurring spending in line with recurring revenue.

In the past, the State has used intra-year cash flow Tax and Revenue Anticipation Notes (TRANs) to meet its obligations. However, the Debt Reform Act of 2000 requires State debt to only be issued for capital purposes. Furthermore, the TRANs would have to mature and be repaid within the current fiscal year, which, given the magnitude of the deficit facing the State, may not be possible.

Aside from existing legal hurdles, the issuance of intra-year TRANs would be a significant and troubling action on the part of the State. The State has not issued intra-year TRANs since SFY 1993-94. In 1990, the State created the New York Local Government Assistance Corporation (LGAC) to "bond out" its Spring Borrowing—which was the practice of issuing TRANs at the beginning of each fiscal year and paying them back at the end of the fiscal year, only to borrow an essentially equivalent amount early in the subsequent fiscal year.

In order to eliminate the State's reliance on the issuance of intra-year TRANs, LGAC was authorized to issue up to \$4.7 billion of debt, not including costs of issuance and other expenses. LGAC issued the last of the bonds authorized by statute in SFY 1995-96. On March 31, 2009, approximately \$3.8 billion of LGAC debt remained outstanding. These bonds are not scheduled to be fully repaid until April 1, 2025. Now, less than 20 years after LGAC's creation to end the State's dependence on Spring Borrowing, New York should not be looking to the issuance of intra-year TRANs to address its cash flow problems.

In the past, the State has issued deficit TRANs to meet its obligations. Deficit notes are short-term obligations issued by the State in the current fiscal year to be repaid in the next fiscal year. By law, the proposed Executive Budget has to include funds to repay the debt in the succeeding fiscal year. However, the issuance of deficit TRANs would not resolve the fiscal problem but simply push it into the next fiscal year when the State is already facing a significant budget deficit, and would cause the State to incur additional costs associated with the short-term borrowing. In addition the Debt Reform Act requires State debt to only be issued for capital purposes.

In either case, short-term borrowing to address the cash flow crunch only postpones the time when the State's underlying fiscal problems are addressed. These actions also send the negative message that the State is unwilling to address its financial issues. Any evidence that the State does not take these matters seriously risks a negative impact on the State's credit rating, which could translate into a loss of confidence by investors and increased borrowing costs for the State. Furthermore, other requirements associated with these issuances may eliminate such issuances as an option.

Cash management options fall far short of the prudent, realistic, long-term response the State's current fiscal crisis demands.

Conclusion

The Comptroller strongly recommends against using cash management options that merely push the State's current deficit into the next fiscal year. Such options will add to the State's ongoing structural imbalance and postpone the difficult decisions needed to align recurring spending with recurring revenue. Similarly, borrowing to address the State's deficit would be irresponsible, incurring additional costs and adding to the State's already high debt burden. As more time goes by without meaningful effort to address the State's budget problem, the cost of inaction will grow and the consequences will be significantly more severe.

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