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Fitch: Pennsylvania Has Capacity to Address Fiscal Challenges.

Fitch Ratings-New York-24 July 2017: Although Pennsylvania faces a sizable budget gap, the commonwealth's 'AA-' Issuer Default Rating (IDR) and Stable Outlook incorporates Fitch Ratings' expectation that the commonwealth will utilize the significant budgetary flexibility available to most states to respond to its various fiscal pressures adequately.

The commonwealth enacted a spending plan for fiscal 2018, but has yet to enact a revenue package to provide full funding. Pennsylvania also must address a sizable revenue shortfall from fiscal 2017. Legislative leadership and the governor remain engaged in ongoing budget negotiations. Fitch anticipates updating the commonwealth's IDR and related ratings following evaluation of an enacted revenue package.

Pennsylvania ended its last fiscal year on June 30 with a roughly \$1.5 billion general fund revenue shortfall and has enacted a fiscal 2018 spending plan with a reported \$700 to \$800 million gap with revenues available under current law. Given the enactment of a general fund appropriations bill for fiscal 2018 (HB 218), Fitch anticipates further budget balancing will rely on revenue measures. General fund appropriations of nearly \$32 billion include notable savings in recurring expenditures (\$2 billion according to the governor's office), as well as increases in key policy areas such as K-12 education.

Legislative leadership and the governor have indicated their intent to address the estimated combined budget gap of approximately \$2.2 billion (across fiscal years 2017 and 2018) in one set of measures. All parties are reportedly considering a wide range of revenue solutions from one-time sources such as leveraging tobacco settlement revenues or fund sweeps, to recurring sources with varying levels of reliability and certainty. In evaluating a final revenue package, Fitch will assess whether proposed measures include reasonable estimates of anticipated revenues, and whether those revenues are sufficiently sustainable over the long term to address Pennsylvania's ongoing structural budget gap.

Contact:

Eric Kim
Director
+1-212-908-0241
Fitch Ratings, Inc.
33 Whitehall Street
New York, NY 10004

Laura Porter
Managing Director
+1-212-908-0575

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email:

elizabeth.fogerty@fitchratings.com.

Additional information is available on www.fitchratings.com

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