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Tax Filing Delays Will Hit Near-Term Liquidity for State Govts.

Fitch Ratings-New York-30 March 2020: Extension of tax filing deadlines and reduced economic activity brought on by the coronavirus pandemic will pressure states' short-term liquidity, although Fitch Ratings says most, and potentially all, states will absorb the deterioration without materially affecting credit quality. April personal income tax (PIT) receipts are a disproportionately large share of many states' total tax collections as final payment dates are typically aligned with the federal government's April 15 filing deadline. Importantly, tax deadline extensions do not delay receipt of withholding taxes, the bulk of PIT collections. We do not currently anticipate any states will be unable to meet operating cash demands but consider liquidity the most significant risk the pandemic presents for states and are closely monitoring developments.

Federal aid measures enacted in recent weeks, including an enhanced federal match for Medicaid, direct aid for pandemic costs, and assistance for public transit and schools, will benefit states, although the details remain fluid. Under the Coronavirus Aid, Relief and Economic Security (CARES) Act signed by President Trump on Friday, the US Treasury department will distribute $150 billion to state and local governments within 30 days, essentially on a per-capita basis. While states will receive their funding immediately, the statute intends for it to be used for coronavirus expense reimbursement rather than as a pure cash flow injection.

As of Monday morning, 38 of the 44 states that levy a PIT extended their filing or payment deadlines to as late as July 15, in line with the federal filing delay, and some have granted similar extensions for corporations. To provide additional relief, some states have extended deadlines for monthly sales and related tax payments.

April revenues for PIT states are critical to supporting liquidity and help set expectations for future collections as states prepare next fiscal year's budgets. According to data from the Federation of Tax Administrators, more than 17% of state PIT receipts for the year ended in June 2019 were received in April. Similarly, many states' prior cash flow projections showed April 2020 accounting for 11%-12% of total fiscal year tax receipts. Extensions will primarily affect estimated and final payments tied to non-wage income, such as capital gains. Withholding payments tied to wages will continue, although negatively affected by the sharp economic downturn.

We are monitoring states' liquidity management closely and expect the vast majority of states to absorb the impending liquidity squeeze with limited effect on daily operations. States have an extraordinary range of fiscal powers to manage their short-term liquidity, including tapping budgetary reserves or other internal borrowable resources, reducing (temporarily or permanently) planned spending, shifting pay-go capital spending to bonding or delaying it outright, and issuing cash flow notes.

As the crisis unfolds many states have exceptionally high liquidity buffers following the decade-long economic expansion. The National Association of State Budget Officers highlighted in December 2019 in its latest fiscal survey that the median state rainy day fund stood at 7.6% of general fund expenditures in FY 2019, a record level.

Liquidity strains are more likely in some states, particularly those at the center of the pandemic, or with lower IDRs, reflecting more limited flexibility to address the emerging economic and revenue challenges. New York (AA+/Stable), the current pandemic epicenter, has a solid reserve position. The states with the lowest IDRs, Illinois (BBB/Stable) and New Jersey (A/Stable), entered the crisis with very limited reserves, while Connecticut (A+/Stable) has seen rapid reserve growth.

We anticipate, or have already observed, offsetting cash management measures including reductions to core spending (New Jersey) and pursuit of external liquidity (Rhode Island). Fitch believes all states will continue to prioritize key items including debt service, employee payroll and retirement contributions, Medicaid spending, and coronavirus response.