S&P: Pennsylvania Fiscal 2021 Short-Term Spending Plan Provides Some Breathing Room Ahead Of Substantial Fiscal Challenges

HARTFORD (S&P Global Ratings) June 5, 2020–S&P Global Ratings believes the short-term general fund budget recently enacted by the Commonwealth of Pennsylvania (A+/Stable) provides some budgetary stability by addressing immediate funding demands. However, we expect the pandemic-driven recession will create a sizable budget gap for the commonwealth in fiscal 2021. Pennsylvania's budget and liquidity management will be crucial to maintaining the commonwealth's long-term credit quality.

Pennsylvania's temporary general fund spending plan for fiscal 2021 totals $25.8 billion and funds public education (including pre-kindergarten, kindergarten through grade 12, and higher education) for a full 12 months, while most other agencies are funded for the five months ending Nov. 30, 2020. The budget sustains education funding at 2019-2020 funding levels, fully funds debt service, and makes pension contributions at actuarially determined levels. Approximately $2.6 billion of federal Coronavirus Relief Fund (CRF) funding from the Coronavirus Aid Relief and Economic Security (CARES) Act is appropriated for fiscal 2021, which leaves about $1.3 billion of CRF funding available.

We believe the short-term budget provides additional time to make informed fiscal decisions. Looking ahead, we expect Pennsylvania's estimated budget gap for fiscal 2021 will be sizable. Officials have projected up to a $5 billion general fund shortfall on a combined basis for fiscal 2020 and fiscal 2021. This represents about 7.1% of combined fiscal-year expenditures, but we expect that the fiscal 2021 budget will shoulder the majority of the shortfall. The Department of Revenue reports that through May, collections were down $2.6 billion (8.2%) for fiscal 2020, of which management estimates $1.9 billion is attributed to delayed tax filing deadlines and $700 million reflects reduced economic activity. Officials expect the commonwealth's revenue forecasting for fiscal 2021 will be updated before a long-term budget is needed at the end of November. However, the timing of a revenue forecast update is unknown.

It's unclear how Pennsylvania intends to solve the projected budget gap. But management reports it's considering various options. Heading into the downturn, Pennsylvania's rainy-day reserves were a low $342 million or 1.0% of budgeted appropriations. In our view, the commonwealth's history of prolonged budget impasses, limited willingness to raise taxes, and the budget's relatively minor level of discretionary spending could also limit options for solving the gap. For example, in 2018, the commonwealth helped solve a $2.2 billion budget shortfall (7% of general fund expenditures) by issuing $1.5 billion of deficit bonds backed by tobacco master settlement payments.

We believe active management of Pennsylvania's liquidity will remain a key credit factor because officials anticipate the commonwealth's liquidity needs will substantially increase in fiscal 2021–assuming declining revenues due to the pandemic and level expenditures. Management is currently holding internal discussions regarding options for obtaining additional liquidity, including internal and external sources. Pennsylvania has not borrowed externally since fiscal 2011 when it issued tax anticipation notes to mitigate cash flow imbalances. As of May, there was no balance outstanding against the state's current $2.0 billion line of credit with the treasury's short-term investment pool.

The extent of Pennsylvania's budgetary challenges will depend on the severity and duration of the pandemic's effects on the economy. S&P Global Economics forecasts a 5.3% contraction in the U.S. economy this year (see "An Already Historic U.S. Downturn Now Looks Even Worse," published April 16, 2020, on RatingsDirect). Officials report that economy activity has begun to resume with the vast majority of Pennsylvania's counties expected to be involved in some phase of reopening by June 5, 2020. We incorporate the commonwealth's history of acrimonious budget negotiations, chronic structural imbalance, and stressed liquidity position into our 'A+' rating on Pennsylvania and expect these credit factors to persist as the commonwealth faces new budgetary hurdles in an uncertain economic environment.

This report does not constitute a rating action.

S&P Global Ratings, part of S&P Global Inc. (NYSE: SPGI), is the world's leading provider of independent credit risk research. We publish more than a million credit ratings on debt issued by sovereign, municipal, corporate and financial sector entities. With over 1,400 credit analysts in 26 countries, and more than 150 years' experience of assessing credit risk, we offer a unique combination of global coverage and local insight. Our research and opinions about relative credit risk provide market participants with information that helps to support the growth of transparent, liquid debt markets worldwide.