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S&P Bulletin: New Jersey's $9.9 Bil. Borrowing Plan Could Pressure Its Credit

NEW YORK (S&P Global Ratings) July 16, 2020–S&P Global Ratings said today that the credit impact of the recent agreement between the governor and legislative leaders of New Jersey (A-/Negative) to borrow up to $9.9 billion for budgetary relief will depend upon the amount of actual borrowing and its long-term implication for the state's ongoing structural deficit. The agreement would allow for general obligation (GO) borrowing through fiscal 2021. The state has not yet directed any new borrowing to take place, and the current three-month budget ending Sept. 30 does not call for new cash flow or deficit borrowing, although it defers a substantial amount of expenses that would normally be paid in September 2020 into October 2020. The amount of borrowing in fiscal 2021 will depend on what is included in the state's fiscal 2021 budget, expected to be enacted in September. However, by authorizing up to $2.7 billion of GO budgetary relief borrowing between now and Sept. 30, the new agreement makes it increasingly likely, in our view, that new legislative action will lead to a borrowing of near that amount, either to avoid budget cuts, or to eliminate the need for the September cash deferrals–particularly cash deferrals to schools. The currently enacted three-month budget anticipates $2.2 billion of cash deferrals from September into October, close to the amount of borrowing that would be authorized. An additional $7.2 billion of borrowing for budgetary relief would be authorized for the state's nine-month fiscal year ending June 30, 2021. A borrowing of that size would amount to about 27% of the state's earlier projection of $26.2 billion of budgetary operating revenue for the 12 months ending June 30, 2021, which we would view as a large structural deficit, if it were fully issued long-term for budgetary relief. Over the last several years, the state has typically arranged for up to $2 billion of cash flow notes due within its fiscal year. The governor is expected to release his fiscal 2021 budget proposal in August, which will outline specific borrowing proposals. We believe that until July revenue returns are known, it may be difficult to assess the amount of borrowing needed. The budget relief borrowings are expected to have maturities of three to 10 years, although they could be longer. It is unclear whether the proposed borrowings can pass legal muster, since the state's constitution requires GO bonds to be approved by popular vote except in the event of "emergency." The state Office of Legislative Services has raised questions as to what might be permissible. However, we believe that even if courts disallow a GO bond, the state would still have the ability to issue short-term, within-the-fiscal-year cash flow notes, or refund long-term annual appropriation secured debt under a "scoop and toss" structure for near-term budget relief without a popular vote, although perhaps at less favorable interest rates. The state could also defer cash payments across fiscal years, although we would view this as a sign of significant fiscal pressure. No legislation has actually been enacted at this point authorizing the proposed GO bonds, but legal challenges are expected once the proposed bill passes. THE THREE-MONTH ENACTED BUDGET The state extended its fiscal year that normally ends June 30, to Sept. 30, 2020, to allow $1.5 billion of current cash flow borrowing to remain outstanding while it collects in July on income tax payments coming due under the extended July 15 income tax filing deadline, as well as to have more time to assess the effect of the pandemic on revenue before enacting a final fiscal 2021 budget for the nine-month period ending June 30, 2021. The current cash flow notes have a renegotiated final maturity of Sept. 25, 2020, just before the end of the state's newly extended fiscal year. In our view, the enacted extended three-month budget puts off hard decisions regarding cutting expenditures or raising revenue. The state will need to address these issues in its nine-month fiscal 2021 budget that must be adopted before the end of September. The current three-month budget solves cash shortfalls, after repayment of $1.5 billion of outstanding cash flow notes due at the end of September, by deferring substantial expenses for one month in September into October of the next fiscal year. However, this is not a long-term solution. The enacted three-month budget is similar to the governor's proposal (see "New Jersey's Revised Fiscal 2021 Budget: A Work In Progress," published June 15, 2020, on RatingsDirect), with slightly higher revenues and expenditures, reflecting slightly improved tax collections, and with a slightly higher fiscal end Sept. 30, 2020, fund balance equal to $957 million, or what we calculate as a modest 3.1% of annualized appropriations, compared to the $494 million fund balance projection in the governor's original proposal. However, without the one-month cash deferrals of expenditures, the state would have a negative ending fund balance at Sept. 30, 2020. (For more information as to the nature of what payments are temporarily deferred, please refer to our earlier report.) Our credit focus remains on the size of the state's ongoing structural budget deficit between long-term revenues and expenditures, including the significant shortfall in funding of the state's pension contribution on an actuarial basis. The state has indicated that despite projected budgetary deficits it will increase its annual pension contribution from to 80% of actuarially determined contribution from 70% for the 12 months ending June 30, 2021. In our view, however, funding an increased pension contribution by deficit borrowing for it does not change the size of the structural deficit. We expect the state's fiscal 2021 budget to provide clues as to the state's willingness to implement ongoing expenditure cuts or revenue increases. In this respect, a budget that relies primarily on large one-time deficit financing could indicate significant credit pressure.

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