State Fiscal Year 2020-21 Enacted Budget: Budgeting in a Time of Crisis

OFFICE OF THE NEW YORK STATE COMPTROLLER
Thomas P. DiNapoli, State Comptroller

April 2020

Message from the Comptroller

April 2020

New York State is facing extraordinary challenges as a result of the coronavirus pandemic. Its punishing impacts include shutting down much of the economy, throwing millions of Americans out of work, and devastating State finances. As a result, the Enacted Budget leaves greater uncertainty this year than ever before as to the level of funding the State will be able to provide for school districts, health care providers, local governments and others. The ultimate impact on essential services for all New Yorkers remains undetermined.

Among the most important unknowns is the extent to which federal funding will help fill the gaps created by the pandemic. Congress and the President have taken significant steps thus far to support unemployed workers, businesses, and, to a certain degree, state and local governments. During this nationwide emergency, Washington must do more to help ensure the continuation of vital public services, and to avoid undue barriers for New York and other states to access needed funding.

The Governor and the State Legislature deserve credit for enacting a budget during a public health crisis with little delay. The Budget entrusts the Executive with exceptional flexibility to limit spending, borrow and take other actions in response to fiscal conditions this year. Use of this increased authority should be accompanied by greater transparency and accountability.

Even amidst the difficult challenges of the current fiscal year, we must be mindful of the longer term. Tax revenues are likely to be diminished by the pandemic into the next fiscal year, and possibly beyond. The State should minimize long-term costs from any debt that might be issued for deficit financing purposes, and make a commitment to consistently build our rainy day reserves to help assure continuation of essential services during times of disruption in the future.

The themes outlined above are examined in greater detail in this report. My office will report on the Enacted Budget Financial Plan in coming weeks, and on key budget-related developments throughout this extremely challenging fiscal year.

Thomas P. DiNapoli
State Comptroller

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I. Key Findings

- **The fiscal impacts of the COVID-19 pandemic will be with us for some time.** Significant losses of State tax revenues are likely to extend into State Fiscal Year (SFY) 2021-22, and there may be further effects in the following years. There will also be upward pressure on State spending for essential services related to the ongoing public health and economic challenges.

- **More federal assistance is essential.** New funding approved for health care, education, mass transit and other purposes will be helpful, but Washington must go further to support the State and its local governments and public authorities. The Federal Reserve's new Municipal Liquidity Facility (MLF) may play an important role for the State and some local governments, given ongoing challenges within the municipal bond market.

- **The State ended SFY 2019-20 with a higher-than-projected General Fund balance of $8.9 billion, but could face a cash crunch starting early in the new fiscal year.** Significant amounts of tax revenue normally received in April – potentially as much as $9 billion to $10 billion – will instead be realized in July or later. Managing cash flow will be a high priority and may require short-term borrowing, among other actions.

- **Long-term borrowing should only be used as a last resort, and if so should be limited in scale and duration.** Plans for any short-term cash flow borrowing should be disclosed as soon as they are known. If the Division of the Budget (DOB) determines that fiscal conditions require borrowing beyond the end of the fiscal year, it should provide policy makers and the public with a detailed analysis justifying the need as compared to potential alternatives. Any such borrowing should be limited to the shortest period reasonably possible, to minimize total interest costs and undesirable impacts on future years' budgets.

- **Planned Medicaid savings remain uncertain.** The Executive Budget Financial Plan assumed more than $2.5 billion in savings this fiscal year; those identified to date are significantly lower. In addition, financial losses currently being experienced by hospitals and other health-care providers may result in pressure for additional State support.

- **Extraordinary flexibility to control spending requires extraordinary transparency and accountability.** DOB should go beyond statutory reporting requirements to provide more frequent and more detailed public updates on fiscal developments, including monthly updates on the economic and revenue outlook. Given the range of challenges facing entities that depend on State funding, stakeholder input should be considered as to the nature and timing of budgetary actions during the fiscal year.

- **The State must start as soon as possible to prepare for the next fiscal crisis.** A statutory commitment to building reserves realistically and consistently will better position the State to respond to the type of fiscal crises seen in recent decades, and assure the maintenance of essential services over the long term.

II. Revenue, Spending and Cash Flow

Economic and Revenue Outlook

The economic and revenue outlook has deteriorated sharply since the most recent forecast from the Division of the Budget (DOB) was published at the end of February. On March 17th, the Office of the State Comptroller estimated that SFY 2020-21 tax revenue would be at least $4 billion and possibly more than $7 billion below the Executive Budget projection of $87.9 billion as a result of the economic impacts of the coronavirus pandemic. Economic conditions have worsened further since that date.

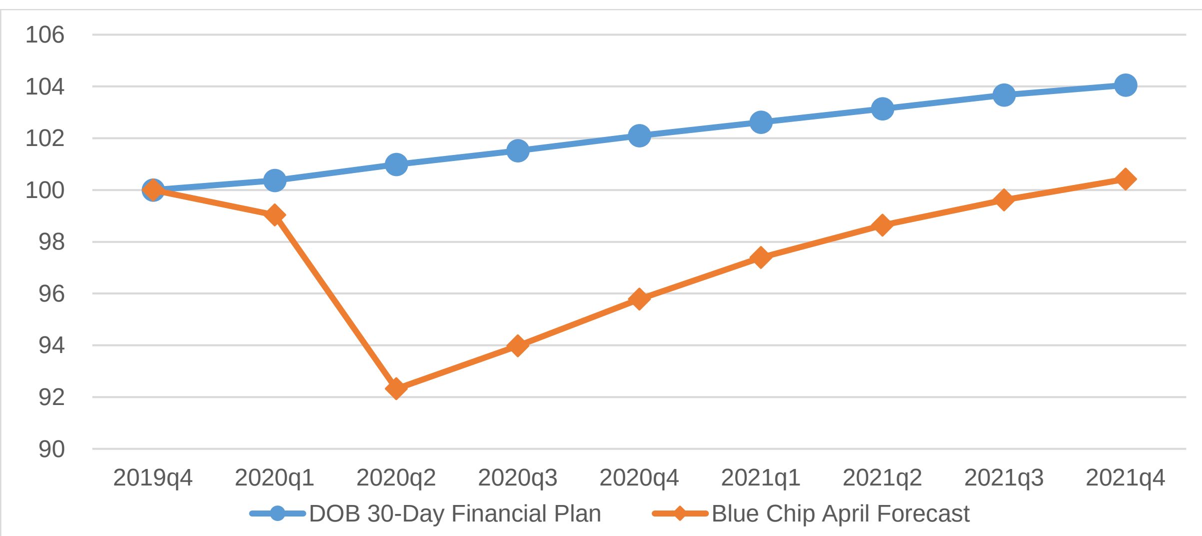
For example, in early March, IHS Markit projected that U.S. real Gross Domestic Product (GDP) would increase by 1.8 percent in calendar year 2020. An updated forecast two weeks later projected GDP would instead fall by 2.4 percent this year; IHS's April forecast downgraded expectations more, to a decline of 5.4 percent in 2020.

A wide range of economists have similarly revised their GDP projections downward this year, while sharply raising projections of unemployment. For example, Figure 1 compares the Blue Chip Economic Indicators consensus forecast of surveyed economists from the beginning of April to that made by DOB in February. The more recent indication of many economists' outlook projects a significant decline in the national economy through the second quarter, with some improvement in the latter half of the year. However, the economy is not expected to return to pre-pandemic levels until the end of 2021, and GDP at that point would be well below the level DOB projected in February.

Figure 1

Comparison of National Real GDP Forecasts, Division of the Budget and Blue Chip Economic Indicators

(GDP in fourth quarter of 2019 = 100)



Sources: New York State Division of the Budget and Blue Chip Economic Indicators

In an April 7th letter to the members of the New York Congressional Delegation, the Governor indicated that the State is facing a $10 billion to $15 billion loss in revenue as a result of the pandemic.[1] The Enacted Budget Financial Plan, scheduled to be issued in the coming weeks, is expected to include updates to key economic variables and projections for tax receipts, anticipated federal aid and other revenues.

Several past shocks to the New York economy, such as the September 11th terrorist attacks in 2001, the financial market crisis of 2008, and Hurricane Sandy in 2012, all took place several months into a State fiscal year. The onset of the COVID-19 pandemic in New York occurred just before the beginning of the new fiscal year, and associated economic impacts continue to mount during the first weeks. The timing of the pandemic is one of several factors that make forecasting New York's tax revenues this fiscal year especially difficult.

Further complicating the picture, the State has delayed the filing deadline for 2019 tax returns for individuals and corporations from April 15th to July 15th, following on actions by the U.S. Treasury Department postponing the deadline for federal tax returns. The requirement for quarterly estimated payments under the personal income and business taxes that are normally made in April to July are also delayed.

Based on these factors and DOB's cash flow projections in the Executive Budget Financial Plan, the Office of the State Comptroller estimates the amount of overall tax receipts delayed from April to July could be as much as $9 billion to $10 billion, depending largely on how many taxpayers choose to delay their filings. Contingent upon processing times, number of extension requests, and any subsequent filing delays, some receipts could be further delayed. The cash flow outlook for the fiscal year is discussed in more detail below.

Uncertainty regarding the public health threat of the coronavirus and the resulting economic impacts represents the biggest factor obscuring the outlook for tax revenues. Questions such as when stay-at-home orders will be lifted and how long will be required for the economy to "normalize" are currently unanswerable. The duration of the economic freeze and the subsequent pace of reopening will impact various measures of economic activity, including unemployment, wages, business income, and consumer spending. Other factors that will impact New York's revenues include:

- Financial market volatility: As of March 23rd, the Standard & Poor's 500, Dow Jones Industrial Average and Nasdaq Composite Index had each lost over one-third of their value. Since then, the markets have rebounded, but have not recouped all their losses, and day-to-day volatility has continued.
- Federal stimulus: The federal government has enacted three fiscal relief/stimulus packages, with the potential for more. While these measures are likely beneficial to the national and State economies, the full impact of the actions remains unclear.
- A potential "second wave" of infections: If progress in combatting the coronavirus is offset by widespread new infections, stay-at-home orders could be prolonged or renewed, leading to further retrenchment in the economy.

[1] The full text of the letter is available at: https://www.governor.ny.gov/sites/governor.ny.gov/files/atoms/files/GAMC_Letter_to_NY_Delegation.pdf.

Even if the national and State economies return to normal in the second half of 2020, a period of economic weakness lasting several months would likely have negative impacts on many taxpayers' income for the current tax year. The full extent of these effects, including those related to securities industry bonuses and capital gains, would not be realized until the end of the current State fiscal year. While some bonuses are paid throughout the year, the majority, especially in the financial services industry, are based on performance for the entire year and are paid within the January to March period of the following year. Similarly, taxes on capital gains are based on realizations for the year as a whole, and payments on these gains tend to be realized towards the end of the calendar year, as taxpayers assess their income and associated tax circumstances.

For example, after the financial market crisis of 2008, the bonus pool for the securities industry in New York City decreased by 47 percent.[2] The resulting decline in withholding taxes from this and other factors in the January to March 2009 period was $1.6 billion. In addition, capital gains for 2008 decreased by nearly 56 percent from those in 2007, resulting in estimated tax payments made at the end of SFY 2008-09 that were over $660 million lower.[3]

Tax payments in April 2021, associated with the filing deadline for the 2020 tax year, will be affected as well, as taxpayers reconcile their incomes from 2020 with the amount of tax owed. This will result in depressed revenue at the start of the next fiscal year. The scope of such an impact is difficult to project, but will likely be significant.

Certain non-tax revenues will likely also be well below levels projected for the current fiscal year in the Executive Budget. Due to the State's overall effort to prevent spread of COVID-19, the State's video-lottery terminal (VLT) facilities and commercial casinos have been closed since March 16th. Receipts from these facilities were projected at a combined $1.2 billion in SFY 2020-21. In SFY 2019-20, State revenues from casinos and VLTs averaged $95 million per month.[4] In addition, the Native American casinos in the State are closed, reducing receipts from tribal-State compacts which were projected at $219 million in SFY 2020-21, including funding for local host governments. Lottery receipts including Quick Draw rely heavily on sales through retail outlets, as well as restaurants and bars. These receipts, which were projected to generate $2.5 billion for the State this year, are also likely to be affected by diminished consumer traffic in those businesses.

Uncertain outlook for spending

The outlook for depressed revenues and a three-month delay in receipt of significant amounts of tax collections pose twin challenges for New York State in SFY 2020-21. The reduction in tax revenue relative to Executive Budget projections leaves uncertain the State's ability to fund Enacted Budget appropriations for school aid, Medicaid, State operations and other programs. The shift of billions of dollars in tax receipts from April to July represents a clear cash flow challenge early in the fiscal year, absent other actions. In addition, depending on the timing

[2] Office of the New York State Comptroller, *New York City Securities Industry Bonus Pool and Average Bonus,* March 11, 2019, at https://www.osc.state.ny.us/press/docs/wall-street-bonuses-2018.pdf.
[3] New York State Department of Taxation and Finance, *Analysis of 2008 Personal Income Tax Returns,* April 2011, at https://www.tax.ny.gov/pdf/stats/stat_pit/pit/analysis_of_2008_personal_income_tax_returns.pdf.
[4] This excludes March 2020, which only realized two weeks of collections.

and levels of other receipts as well as disbursements, weakness in revenues resulting from underlying economic conditions could produce cash flow issues later in the fiscal year.

Funding provided through newly enacted federal relief and stimulus programs will help to address the State's budgetary pressures to a certain extent. However, in some instances, limitations on use of these resources may hamper the State's flexibility to use the funds as a budget management tool. Federal aid has begun to flow to the State, including receipt of nearly $3.8 billion in Coronavirus Relief Fund resources on April 17th. Such funding is to be used for expenses related to the COVID-19 pandemic. The overall scope and timing of the relief and stimulus funding flowing to the State budget remains uncertain, as detailed elsewhere in this report.

In response to these fiscal challenges, the Enacted Budget provides the Executive with extraordinary flexibility to manage spending, including authority to make broad reductions in most local assistance spending as needed to maintain budget balance and to withhold some or all local assistance appropriations if specified conditions occur. Separate provisions authorize the Executive to reduce Medicaid spending, in particular, if disbursements are expected to exceed projections or certain other developments occur. Various capital appropriations prohibit obligation or spending until the Budget Director certifies that it can be accommodated within the State's Financial Plan without adversely affecting capital projects essential for either the health and safety of the public or government services. Some of these spending management provisions provide a role for the Legislature, while others do not.

Cash flow challenges

The General Fund balance at the end of SFY 2019-20 was $8.9 billion, $2.4 billion higher than projected in the Executive Budget Financial Plan issued in February. The Executive Budget Financial Plan projected that combined General Fund disbursements in SFY 2020-21 in April and May would exceed receipts by $2.8 billion, including positive cash flow of $4.5 billion in April and a negative $7.2 billion in May. The Financial Plan assumed healthy General Fund balances through the fiscal year, with the lowest end-of-month total at $3.4 billion for August. Major expenditures projected in the February Financial Plan for these months include $4 billion in school aid payments in May and $6.6 billion in Department of Health (DOH) Medicaid expenditures from April through June.

However, the Executive Budget Financial Plan projected $11.8 billion in tax receipts from All Governmental Funds in April, including $9.6 billion in personal income taxes. While some taxpayers have filed returns in April, most of the originally expected April income tax revenues are now assumed to be delayed until July, creating potential cash flow issues absent other actions.

The State last encountered severe cash flow issues in the wake of the 2008 financial crisis. Reduced tax revenues and diminishment of the General Fund resulted in delays to required payments for school aid and other purposes, as well as other budget management actions, in 2009 and 2010. The fiscal environment in the first quarter of SFY 2020-21 differs from that period in one important respect: while tax revenues this year are now expected to be significantly lower than projected just a short time ago, the cash flow challenges in coming weeks predominantly result from timing issues. Nonetheless, those challenges, as well as others that may arise during the year, will require close, ongoing monitoring of cash flow, as well as timely and judicious decisions by the Executive regarding spending and potential cash flow borrowing.

The Enacted Budget authorizes a total of $11 billion in State-supported borrowing for cash flow and deficit financing purposes, as detailed in the Debt Impacts section of this report. The Dormitory Authority of the State of New York (DASNY) is expected to issue notes, bonds, lines of credit and/or other financing vehicles, possibly using the MLF established by the Federal Reserve. The amount of any cash flow borrowing may reflect short-term cash needs based on factors including the level of revenues in the first quarter of the fiscal year (and possibly beyond), federal relief and stimulus funding anticipated to be received, and the Executive's decisions regarding levels and timing of spending. Interest costs for any such borrowing are not yet known.

III. Debt Impacts

The Enacted Budget included an additional $21.4 billion in total new and increased State-supported debt authorizations, including $11 billion for cash flow or deficit financing purposes.

Cash Flow and Deficit Financing Purposes

In light of the anticipated severe impacts on the State's finances resulting from the COVID-19 pandemic, the Enacted Budget authorizes a total of $11 billion in State-supported borrowing for cash flow and deficit financing purposes. These include:

- DASNY and the Urban Development Corporation (UDC) are authorized to issue up to $8 billion in notes or bonds for State cash flow or deficit needs under the Personal Income Tax (PIT) Revenue Bond program. These notes can be issued no later than December 31, 2020, and have an initial final maturity of no later than March 31, 2021. The notes can be renewed or refunded once, for up to one additional year. If the Director of the Budget determines that the notes shall be refunded on a long-term basis, then PIT deficit bonds can be issued.
- DASNY and UDC are also authorized to issue up to $3 billion in lines of credit or other similar arrangements with financial institutions. The lines of credit are to be secured by a service contract structure, subject to appropriation, and can have an initial final maturity of up to one year, which can be renewed for up to two additional one-year terms. If the Director of the Budget determines that the lines of credit shall be refunded on a long-term basis, then PIT revenue or service contract bonds can be issued.

The State last issued notes to finance its short-term cash flow needs in 1993 with Tax and Revenue Anticipation Notes (TRANs). Short-term borrowing may again be needed to address the State's immediate cash flow requirements this year, and the Federal Reserve's new MLF program may be well-suited to this purpose.

COVID-19's ultimate impact on the State's overall finances remains to be seen, and is likely to extend beyond the current fiscal year. Any decision by DOB to issue longer-term deficit bonds should be subject to a rigorous determination of need; such borrowing should only be employed as a last resort after other revenue and spending options have been considered. If such a determination is made, deficit bonds should be issued in the lowest amount necessary to assist the State's recovery and with the shortest maturity reasonably possible.

Deficit Financing Considerations

With traditional bonds, generally, the State issues long-term debt that is offset by the long-lived capital assets being financed. This is a sound fiscal practice which balances assets and liabilities. It also provides for intergenerational equity, whereby those who will benefit from the use of such capital assets in the future will also contribute to paying a portion of their costs. In contrast, deficit bonds create long-term obligations to pay for current operating costs.

In the wake of past significant economic downturns or catastrophic events such as the 9/11 attacks, the State has issued long-term bonds to limit difficult budget choices and pay for then-current operating costs. The State's last deficit financings were done in the early 2000s, when bonds were issued to securitize the State's tobacco settlement revenues. Those bonds were finally paid off in SFY 2016-17.

In recent years, the State has made significant progress in paying down past deficit financings, such as tobacco bonds. Given that economic and revenue impacts of the COVID-19 pandemic are likely to extend beyond the current fiscal year, borrowing to balance the budget could leave larger structural gaps in coming years. Credit rating agencies have consistently indicated that a return to deficit financing practices could lead to downgrades in the State's credit ratings, which in turn could increase the cost of future borrowing. If the Division of the Budget determines that new deficit financing is required, minimizing the impacts of any such borrowing should be a priority.

For example, based on recent trends, if the State were to issue deficit bonds totaling $1 billion, with repayment over five years, debt service costs (principal and interest) could total approximately $1.1 billion. On the other hand, if the bonds matured in 20 years, those costs could approach $1.5 billion, and over 30 years, more than $1.8 billion. Such costs would multiply for each additional $1 billion of borrowing.

Ideally, the State will commit in coming years to a disciplined practice of building rainy day reserves that could be drawn upon the next time an economic downturn or catastrophic event depresses revenues or results in extraordinary expenses. Such reserves would accrue interest that would add to the State's resources – the opposite of interest payments that add to the cost of borrowing.

State Debt Limits Suspended

Under the State's Debt Reform Act, the total amount of State-supported debt outstanding issued after April 1, 2000 is capped at no more than 4 percent of State personal income. State personal income typically experiences healthy annual growth, averaging over 4 percent during the past twenty years. However, in the midst of the Great Recession, this measure actually declined by 3.0 percent in 2009. The Executive Budget projected increases in State personal income, and thus growth in the allowable level of debt outstanding, in each year of the Financial Plan.

While specific impacts are not yet quantifiable, the economic effects of COVID-19 are likely to place downward pressure on State personal income. Such a development could significantly reduce the State's debt capacity under the statutory cap in SFY 2020-21 and for each year thereafter. For example, if State personal income were to decline by 3.0 percent in 2020 (as happened in 2009) but all other factors were held the same, the State would exceed its debt limit in SFY 2020-21 and every other year in the Financial Plan period. By law, if the debt limit is met or exceeded, no more State-supported debt can be issued until the State is back in compliance with the cap. A change of this magnitude could bring the financing of the State's capital plan to a halt.

The Enacted Budget contains provisions to address this risk by excluding an estimated $18.7 billion of debt from the statutory cap. This amount encompasses the $7.7 billion of new debt estimated to be issued for traditional capital purposes during SFY 2020-21. Also excluded is the $11 billion total cash flow and deficit borrowings authorized in the Budget – along with any future note renewals and long-term bonding, regardless of when they are issued. However, the Act's 30-year limit on the final maturity of bonds still applies.

A hypothetical 3.0 percent decline in 2020 personal income would remove about $4.3 billion in available debt cap room by SFY 2024-25. The Enacted Budget provisions add back an estimated $6.1 billion in such capacity, excluding potential deficit bonding, resulting in about $2.7 billion in debt capacity as of SFY 2024-25.

As the State moves forward with the Debt Reform Act exclusions enacted this year, policy makers should consider additional changes that could allow more effective management of debt capacity in the future. For example, a multi-year rolling average of annual changes in personal income could be used to determine each year's debt cap. This would have the effect of "smoothing" year-to-year volatility and would allow New York to better accommodate such downturns over a longer-term planning horizon.

Capital Purposes

The Enacted Budget increases State-supported borrowing authorizations to finance capital purposes by $10.4 billion.

The capital purpose bond authorizations include the $3 billion Restore Mother Nature general obligation (GO) bond act for the State, subject to voter approval in November, as recommended in the Executive Budget with certain revisions. The Director of the Budget must certify that this debt will not adversely impact funding for essential capital projects and governmental services, or the act will not be submitted to the voters and will be deemed repealed. The bond act would authorize State debt for specified environmental purposes, including at least $1 billion for restoration and flood risk reduction, up to $700 million for climate change mitigation, up to $550 million for open space land conservation and recreation, at least $550 million for water quality improvement and resilient infrastructure, and $200 million to preserve, enhance, and restore natural resources and reduce the impact of climate change.

IV. Federal Relief and Stimulus Funding

Through recently enacted laws and other measures responding to the effects of the COVID-19 pandemic, the federal government has provided a range of direct and indirect support for New York State and its municipal entities and public authorities. While such funding totals multiple billions of dollars, the total amount to be received by New York is difficult to estimate due to questions regarding potential hurdles to obtaining new funding for Medicaid and certain other purposes.

This new funding will undoubtedly be helpful, as the State and its municipalities work to address the public health crisis and related spending increases stemming from it. However, additional support is urgently needed, and federal constraints may impede the overall effectiveness of the funds provided thus far.

In certain areas, such as primary and secondary education and election assistance, New York State will need to provide a matching share to receive supplemental funds. In the case of Coronavirus Relief Fund resources and disaster relief, funding may only be used for activities and costs occurring in specific periods or associated with specific purposes, thus limiting the State's ability to use these resources for fiscal relief. For certain areas such as public transit, it is not yet clear whether additional federal support may be used to reduce or replace State spending for such purposes. Provisions tied to receipt of funding from a temporary increase in the federal medical assistance percentage (FMAP) matching rate for state Medicaid programs restrict the State from implementing certain Medicaid cost saving measures during the period when such funds are received, and limit the higher federal matching rate to certain Medicaid recipients.

Beyond the fiscal impact, robust federal support sufficient to stabilize state and local governments, in New York and elsewhere, will be critical to achieving overall economic recovery. State and local governments, collectively, are one of the largest contributors to GDP, both nationally and in New York. In 2019, state and local governments provided 8.5 percent of the nation's GDP.[5] While such spending pays for a wide range of essential State and local government services, it also represents an important contributor to overall employment and other economic activity. According to the U.S. Bureau of Labor Statistics, state and local governments provided over 13 percent of the total jobs in 2019. In New York, this number was higher, at 14 percent.

[5] U.S. Department of Commerce, Bureau of Economic Analysis, News Release, BEA 20-17, *Gross Domestic Product by Industry Fourth Quarter and Year 2019*, April 6, 2020.

V. Selected Program Area Highlights

Medicaid

State-share Medicaid spending was projected at $26.0 billion in the Executive Budget Financial Plan, representing almost one-quarter of anticipated State Operating Funds spending. Over three-quarters of this amount comes from the General Fund and approximately 19 percent comes from Health Care Reform Act (HCRA) resources, with the remainder from health care provider assessment revenue.

The Executive Budget Financial Plan projected a $3.1 billion gap in the Medicaid program for the current year. Anticipated savings of $2.5 billion from recommendations to be made by the Medicaid Redesign Team (MRT) constituted the lion's share of planned steps to address the gap, while continuation of steps implemented last year were also anticipated to lower costs. Other proposed savings, which were omitted from the Enacted Budget, were to come from linking State funding of certain county/New York City Medicaid costs to the State's property tax cap, and withholding from localities certain federal Medicaid funds associated with the Affordable Care Act.

Recently released estimates indicate savings of $1.5 billion in SFY 2020-21 from administrative or statutory actions resulting from MRT efforts. As a result, savings fall short of Executive Budget Financial Plan estimates for the MRT by $1.0 billion in the current year.

The savings estimates include effective dates associated with each action, although the timing for implementation remains unclear. The MRT's recommendations acknowledged that both its process and monetary targets were established before the outbreak of the COVID-19 public health emergency, which has created significant disruption to the health care system and the broader economy. Given this, the MRT proposed that the Executive be provided with full discretion with regard to effective dates of its proposals. The Enacted Budget includes language to allow the MRT statutory actions to be delayed up to 90 days after the State's COVID-19 disaster emergency is over, a date that is not yet known.

Federal legislation enacted in response to the COVID-19 pandemic increased the federal Medicaid matching rate for certain state Medicaid expenditures by 6.2 percentage points, but included provisions restricting states' ability to implement certain changes to the program. The Governor has estimated the State benefit to be $1.3 billion over six months, based on federal guidance that does not cover all New York Medicaid recipients and requires the State to either delay certain State Medicaid savings actions included in the current year budget or implement them and not receive the benefit of the enhanced federal reimbursement.

DOH statistical reports indicate the State has begun taking advantage of the enhanced federal funding: State-share Medicaid costs for certain services decreased by $615 million for the quarter ending March 31, 2020 due to the higher federal matching rate, while county and New York City Medicaid costs decreased by $299 million, according to these statistical reports.

These reports also indicate that total statewide Medicaid claims costs for the first three months of 2020 increased by $774 million or 4.5 percent to $17.8 billion, as compared to the same period last year. It is not clear whether these increases are related to COVID-19. The countercyclical nature of the Medicaid and other social safety net programs – enrollment and spending increase when the economy weakens – is likely to increase State spending pressures further if the current downturn continues.

Hospitals are already feeling the financial pinch because of the State decision to cancel all elective, non-critical surgeries – which tend to be some of their most profitable procedures – during the COVID-19 pandemic. Many hospital systems in New York are already strained, including those in New York City at the epicenter of the pandemic. Recent federal stimulus legislation includes a $100 billion relief fund for hospitals and other health care providers, but distributes initial funding based on Medicare payments. This puts hospitals in New York City, whose patients tend to rely more on Medicaid, at a disadvantage in allocation of those resources.

Local Governments and School Districts

The Enacted Budget includes over $29.5 billion for local governments (outside New York City) and school districts through a variety of programs. While the Budget held most aid programs flat at prior year levels, the current economic and revenue uncertainty along with the budget reduction flexibility provided to the Executive leave open the possibility of significant mid-year budget actions to reduce State funding for most local assistance.

State aid is an important revenue source for New York's schools and local governments. As shown in Figure 2, this is especially the case for school districts, whose $15.7 billion in State aid in 2018 outside of New York City accounted for nearly 38 percent of their revenue. School aid has been a particularly vital source for districts with lower property tax bases, where it can represent 60 percent of revenue or more.[6]

Counties received nearly $3.1 billion in State aid in 2018, mostly to fund social, health and transportation services. Cities outside of New York City primarily receive aid through general-purpose Aid and Incentives for Municipalities (AIM) payments, and rely on State funding for a significant portion (averaging nearly 18 percent) of their revenue.

The potential for mid-year reductions in State aid presents difficult challenges for school districts and local governments. School districts are currently preparing their budgets for the coming year, as are some local governments (primarily villages and some cities), with no certainty as to how much State aid ultimately will be available. Other local governments (including all counties and towns) are in the second quarter of their fiscal years. For all these entities, mid-year reductions may be especially difficult to absorb.

[6] Excluding the New York City School District.

Figure 2

State Aid as a Share of Total Revenue by Class of Government, Fiscal Year 2018

Class of Government	State Aid (In Millions)	State Aid as a Share of Total Revenue
Counties	$3,089.6	12.4%
Cities	$878.3	17.8%
Towns	$585.4	7.5%
Villages	$167.0	5.7%
School Districts	$15,734.8	37.7%
Fire Districts	$3.2	0.4%
All Classes	**$20,458.2**	**24.6%**

Source: Office of the New York State Comptroller
Notes: Does not include New York City or its school district. Some forms of State Aid, especially for counties, are not classified by the State as local assistance.

Education

The Enacted Budget includes $27.9 billion for General Support for Public Schools in School Year (SY) 2020-21, which reflects modest growth of $104 million or 0.4 percent over the previous year, and significantly less than the 3 percent growth proposed in the Executive Budget.

The Enacted Budget includes a Pandemic Adjustment which reduces State aid to school districts by $1.1 billion. However, School Aid estimates prepared by the State Education Department based on the Budget anticipate that this reduction for each district will be fully offset by new federal funding from the Education Stabilization Fund established in the Coronavirus Aid, Relief and Economic Security (CARES) Act of 2020.[7,8] Certain provisions tied to this new funding create uncertainty about the level of funding school districts can expect to receive. These include questions about how a maintenance of effort (MOE) provision requiring all states to maintain a certain level of aid in order to be eligible for these funds is to be calculated. Different interpretations of this provision could drive different levels of aid to districts. States may request a waiver from the U.S. Secretary of Education and, if granted, could also impose greater funding reductions on school districts without losing federal stimulus aid.[9]

Local Governments

For the second year in a row, the Budget relies on sales tax revenues from counties to support State spending. In addition to last year's continuing requirement that county revenues be tapped to make $59 million in AIM-related payments to certain towns and villages, this year's

[7] The School Aid estimates (known as "runs") released with the Enacted Budget detail the reduction from the Pandemic Adjustment for each school district. The School Aid runs are accessible at www.budget.ny.gov/pubs/archive/fy21/enac/2020-21-enacted-schoolaid-runs.pdf.
[8] Public Law 116-136.
[9] Id, at Section 18008.

budget requires that counties collectively contribute an additional $50 million per year for two years toward a State fund for “distressed hospitals and nursing homes.”

As shown in Figure 3, sales taxes are a major source of funding for many municipal budgets, representing 26 percent of county revenues, 19 percent of revenues for cities outside New York City, and just under 10 percent of town revenues. This revenue stream will very likely decline in the coming year due to the economic impacts stemming from COVID-19. The combination of economic effects and the Enacted Budget provisions related to local sales tax revenue are likely to cause budgetary challenges for many localities.

Figure 3

Sales Tax as a Share of Total Revenue by Class, Fiscal Year 2018

Class	**Amount** (In Millons)	**Sales Tax as a Share of Total Revenue**
Counties	$6,492.9	26.1%
Cities	$931.7	18.9%
Towns	$742.0	9.5%
Villages	$173.2	5.9%
School Districts	$290.7	0.7%
All Classes	**$8,630.5**	**10.5%**

Source: Office of the New York State Comptroller
Notes: Does not include New York City or its school district. Sales tax revenue includes use taxes and utility gross receipts taxes. County sales tax revenue does not include sales tax distributions made to other local governments.

Federal relief and stimulus resources that will benefit certain local governments include the Coronavirus Relief Fund, which provides funding for states as well as for local governments with populations over 500,000. Only seven jurisdictions in New York – New York City, the counties of Erie, Monroe, Nassau, Suffolk, and Westchester; and the Town of Hempstead – are eligible for such funding.

New York City

In January 2020, the City of New York projected a surplus of $2.7 billion for the current fiscal year and a balanced budget for City fiscal year (CFY) 2021, which begins on July 1, 2020. On April 16, 2020, the Mayor released his executive budget for CFY 2021 and an associated four-year financial plan (the “April Plan”). The April Plan reflects the City’s estimates of the potential impact of the COVID-19 pandemic on the City’s financial plan. The City expects revenues to fall short of the estimates in the January Plan by a total of $7.9 billion over the balance of this fiscal year and next, aside from actions in the enacted State budget.

The City estimates that actions included in the enacted State budget will increase the City’s operating budget costs by almost $800 million during this period. The largest impact comes from a shortfall in anticipated education aid. The State budget includes $11.3 billion in education aid for New York City (including $717 million in federal aid under the CARES Act), which the City estimates is $360 million less than the amount it anticipated for CFY 2021. In addition, the City will be required to forego a total of $400 million of City sales tax collections over a two-year period ($250 million in CFY 2021 and an additional $150 million in CFY 2022). The funds will be deposited into the State fund mentioned in the "*Local Governments"* section above to help distressed hospitals and nursing homes throughout the State. Some of these funds could be distributed to facilities in New York City.

The State budget also requires the City to fund half of the net cost (i.e., after fare collections and subsidies) of the MTA's paratransit program, although the City's contribution would be capped through 2023. The City estimates that its costs will increase by $63 million in CFY 2021 on the assumption that ridership will be held down because of COVID-19. The City also will be required to match the State's $3 billion contribution to the MTA's 2020-2024 capital program, although these costs will likely be funded through the City's capital budget. The State budget includes a number of additional actions that will shift costs from the State to the City.

Metropolitan Transportation Authority (MTA)

Even before the COVID-19 pandemic, the MTA budget was balanced precariously. In February 2020, the MTA released a financial plan covering calendar years 2020 through 2023 that projected balanced budgets for 2019 through 2022 and a budget gap of $130 million in 2023. These estimates assumed biennial fare and toll increases of 4 percent beginning in 2021 and the successful implementation of the MTA's transformation plan.

In response to the pandemic, nonessential businesses were forced to close and many people are working from home. As a result, utilization of the MTA's services has dropped precipitously and tax collections are expected to decline. The MTA expects to receive $3.8 billion in grants from the recently enacted federal CARES Act, but it does not expect this aid to be sufficient to make up for expected declines in fare and dedicated tax revenue. The MTA's transportation revenue bonds have been downgraded by three major rating agencies, with the agencies citing the impact of further reductions in ridership and lower than expected tax collections. The MTA is now seeking an additional $3.9 billion in federal assistance.

The Enacted Budget also included an additional $44.6 billion in total new and increased borrowing authorizations for the MTA. The MTA is authorized to borrow up to $10 billion during calendar years 2020 through 2022 to offset decreases in revenue or increases in operating costs that are due, in whole or in part, to the emergency caused by the pandemic. In addition, the MTA's bond cap for capital purposes was raised to a total of $90.1 billion, a $34.6 billion increase. This is to support financing of the Authority's approved capital program plans through 2024.

The State budget also authorizes the MTA to use congestion pricing lockbox revenues during 2020 and 2021 to mitigate the operating budget impact of the pandemic. These revenues were previously earmarked for the MTA's 2020-2024 capital program. The MTA is required to repay any lockbox funds used for operating purposes from any federal funds or insurance proceeds received as a result of the pandemic, but only after the MTA repays all of the other funds used to respond to the pandemic and only if there are excess funds available. The Enacted Budget also commits the State and the City to each provide $3 billion for the MTA's 2020-2024 capital program. While a capital appropriation for the State's commitment is included in the budget, the sources of funding have not been identified.

VI. Looking Ahead

Like countless New Yorkers, the State has experienced sudden and dramatic disruption in its financial outlook. External factors – the course of the COVID-19 pandemic and its resulting effects on the economy, as well as the scope of federal relief and stimulus actions – will do much to determine the severity of harmful budgetary impacts, both this fiscal year and going forward. The Enacted Budget takes multiple steps, including authorization for unprecedented levels of spending reductions and borrowing, to address the uncertainty of those factors. Some of these steps, in turn, create new uncertainty for recipients of State spending programs.

Congressional leaders continue to discuss additional federal stimulus actions, but consensus on specifics has not yet emerged in Washington. Significant additional funding is essential for states, local governments and certain public authorities, and should be a key part of any further stimulus. At the same time, Congress and the President should make sure that needless hurdles do not prevent states, localities and others from accessing funding. This concern applies, as well, to the new MLF the Federal Reserve has established to help state and local governments access the credit markets.

The economic disruption that began barely a month ago is likely to continue well into the State's current fiscal year, even if conditions improve in coming weeks and months. Significant impacts on State tax revenues are likely in SFY 2021-22, and perhaps beyond – a factor that must be considered as policy makers make budgetary decisions for the current year.

Delay of significant amounts of tax revenue, as outlined earlier in this report, from April to July or later would be expected to result in significant cash flow challenges, barring other developments. While the State has started to receive certain federal funding for the crisis, it is not yet certain how much these resources will offset cash flow risks created by the disruptions in tax and other revenues. Short-term borrowing for cash flow needs, authorized by the Enacted Budget and repaid later in the fiscal year, can be an appropriate vehicle to ensure continuation of essential spending should other measures be insufficient.

The Enacted Budget also authorized conversion of such short-term debt to longer-term bonds. Any consideration of such long-term debt should be informed by the State's past history of borrowing to pay for current operating expenses. The State has spent billions of dollars in recent years on debt service for such borrowing, including debt dating back to the early 1990s. Any use of debt for budget-balancing purposes should be done as a last resort and for as short a term as possible, to minimize added costs and the use of future resources for services delivered in prior years. Policy makers must assume that economic downturns and other events that significantly diminish revenues and/or require increased spending will continue to occur periodically. Debt from cash flow or deficit borrowing should be retired as soon as possible to prevent debt service for past operating costs creating additional fiscal strain during a future budgetary crisis.

DOB deposited $678 million to the Rainy Day Reserve Fund in the past two fiscal years, positive steps that must continue in the future. To help assure that future fiscal challenges do not force cuts to essential services or deferral of operating costs through borrowing, the State must make a firm and ongoing commitment to building reserves, starting with significant annual deposits as soon as practicable.

The extraordinary grants of authority to the Executive require new approaches to maintain transparency and accountability, incorporate stakeholder perspectives and keep the public informed. Useful steps may include:

- Maximizing notice of any planned spending reductions or other budgetary actions. In certain instances, the Enacted Budget requires DOB to provide limited notice before implementing reductions, while in other cases no advance warning is required. Full and public disclosure of planned reductions should be provided with as much advance notice and detail as possible. This would allow school districts, health care providers, local governments and other entities that rely on State funding to better plan their responses in ways that may limit or alleviate negative impacts on New Yorkers. These practices should also be applied for other budgetary provisions authorizing spending adjustments, including those related to capital spending and Medicaid. Making such notice widely available will allow the public to better understand how the budget is being managed.

- The Budget requires DOB to assess revenues and spending at various points in the year. DOB should issue monthly updates on economic conditions and provide figures on key revenue, spending, cash-flow, out-year gap, and borrowing measures, along with additional details as soon as possible after each assessment and with each quarterly financial plan update.

- The statutorily required "Quick Start" process is intended to assure a shared understanding among policy makers of the State's financial condition and outlook at the midpoint of the fiscal year. Unfortunately, not all required reports have been issued and required public meetings have not occurred in recent years. The Executive and the Legislature should ensure that all statutorily required "Quick Start" activities occur this year and going forward. Conducting a similar public discussion of the State's revenues, spending and outlook at the end of the first quarter of the current fiscal year – in July or early August – should also be considered.

While the Budget authorizes a process for potential spending reductions, cuts to the most essential services should be minimized by reprogramming available funding where possible. Examples of such resources may include funding previously allocated to certain economic development programs, and monetary settlement resources that have not yet been spent.

Along with the State, local governments and school districts face severe fiscal challenges due to the pandemic. These entities, which directly provide many essential public services, will likely need to manage the effects of the crisis well beyond the current year. While federal relief and stimulus funding will help certain localities address immediate budgetary needs, such assistance represents only a partial solution to the broad scope of challenges.

To address the tremendous challenges and uncertainty arising from the ongoing public health crisis, the Enacted State Budget takes an approach that differs dramatically from previous years. Continued close attention to economic and fiscal developments, and well-planned response as needed, will be essential to meeting key goals including minimizing harm to essential services and long-term impacts on the State’s financial condition.

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Prepared by the Office of Budget and Policy Analysis

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