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New York: Sound budget management enhances flexibility

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New York State is a prolific issuer of municipal debt. Heavy dependence on the financial services industry persists, and the downstate economy continues to be the state's growth engine. The state has tools to maintain fiscal stability, including raising taxes, reducing or deferring expenditures and engaging in short-term borrowing. And reserves sit at record highs after multiple years of better-than-anticipated tax receipts, federal stimulus and conservative budgeting.

NEW YORK IS A MAJOR ISSUER OF MUNICIPAL BONDS

New York State participates extensively in the municipal market. Issuance of new municipal debt in New York State, including state and local issues, registered $42 billion in 2023, according to The Bond Buyer. That represented 11% of 2023 issuance nationwide and made New York State the third largest issuer of municipal debt in the nation (trailing California and Texas). Such a dependence on the capital markets reduces the risk that New York State would imperil its access to the market by defaulting on any of its debt. A rating reduction is more probable than an outright default.

As is the case with all states, the state of New York itself is not authorized to file for Chapter 9 bankruptcy. New York State does, however, allow most of its political subdivisions (except school districts) to file for Chapter 9 bankruptcy.

Even so, New York State has a track record of imposing state financial control boards on its troubled subdivisions before conditions reach such a point. Examples include New York City in the 1970s, Yonkers in the 1980s and Buffalo in the early 2000s. While a government entity can default without filing Chapter 9 (and, conversely, file Chapter 9 and continue to pay its bonded debt), New York State is nowhere near that for reasons outlined below.

The state itself issues debt under a variety of programs, including general obligations and dedicated revenue obligations. Most New York State debt is well-secured.

The state's general obligation (GO) bonds carry the state's strongest security pledge. New York State GO bonds are rated Aa1 by Moody's, AA+ by Standard and Poor's and AA+ by Fitch. Prior to issuance, GO debt of the state of New York must be approved by the citizens of New York State in a general election. Under Article VII, Section 16 of the New York State constitution, if state GO debt service is not paid, the state comptroller is required to set aside sufficient funds from the first revenues received by the general fund to pay that debt service. New York State GO debt does not need a formal appropriation or enacted budget to get paid, and, in essence, enjoys a constitutionally protected first lien on taxes levied on the 10th largest economy in the world.

TWO LARGEST DEBT PROGRAMS ARE SECURED BY DEDICATED TAXES

However, most debt issued by the state of New York is not GO debt. The state's two largest debt programs are secured by dedicated taxes – the personal income tax and the sales tax bonds. Strong set-aside mechanisms and bondholder protection provisions are included in both programs.
The personal income tax (PIT) bonds are the state's largest borrowing program, representing approximately 78% of the state-supported debt. PIT bonds are secured by a set-aside of 50% of the state's personal income tax revenues.

The New York State comptroller indicates that PIT revenues have come in approximately 8.0% lower in FY24, as opposed to FY23, partially due to lower middle-class tax rates and the timing of payments. FY24 pledged PIT revenues covered maximum annual debt service by 8.4 times. Coverage of anticipated maximum annual debt service is projected to remain above 6.4x through FY29.

The sales tax bonds are secured by a set-aside of two cents of the state's four cent sales tax revenue. The state comptroller indicates that sales tax revenues increased 5.1% in FY24, as opposed to FY23, with pledged revenues covering maximum annual debt service by 8.6 times. Coverage of anticipated maximum annual debt service is projected to remain above 5.9x through FY2029. At one point, New York State mostly issued debt secured by annual appropriations. With the advent of the PIT and sales tax programs, use of appropriation debt has been greatly reduced.

NEW YORK'S DEBT LOAD IS HEAVY

In relation to other states, New York State is considered heavily indebted. New York State has the second highest amount of tax-supported debt outstanding at $69.6 billion, according to Moody's. On a per capita basis, the state's debt burden is sixth highest among the 50 states at $3,539 versus the Moody's median of $1,178.

Net tax-supported debt as a percentage of personal income was eighth highest in the nation, at 4.5%, versus the Moody's median of 2.2%. Net tax-supported debt as a percentage of state GDP was the thirteenth highest in the nation, at 3.4%, versus the Moody's median of 2.0%. All of these ratios have improved since FY13.

Despite being more heavily indebted than most states, principal and interest on New York State's bonded debt comprised only 2.6% of the state's total governmental funds' expenditures in FY24. This has as much to do with New York State's level of total expenditures being high as it does with the state's actual debt service expense being low.

Taking New York State's total governmental funds' expenses in FY24 ($255.8 billion) and dividing them by the current population (19.6 million) produces an expenditure per capita of $13,083. The same ratio for Florida, with a larger population, is roughly $5,380. It is $11,471 for California and $5,764 for Texas. No one can credibly accuse New York State of being a bare-bones, low-cost provider. This might suggest room for economizing before the state would move to impair debt service.

A BALANCED BUDGET IS REQUIRED

The New York State constitution requires that the governor submit a balanced budget, and New York State law requires that the legislature enact a balanced budget. The budget is due by the start of the state's fiscal year, which begins 01 April. Because New York State's politics and budget adoption process are sometimes chaotic, New York State has often missed the mandated 01 April deadline and adopted its budget late.

The FY24 budget was signed more than a month late, and the FY25 budget was approved 20 days late. In years when the budget was delayed, the legislature enacted a separate debt service bill by 31 March to ensure timely, uninterrupted payment of the state's debt obligations. The rest of the budget may be months late, but historically New York State has always provided for the punctual payment of its public debt. We expect that will continue to be the case going forward.

The state's general fund posted a $7.4 billion (GAAP basis) surplus in FY24, equal to 7.9% of general fund revenues, reflecting multiple years of conservative budgeting and better than anticipated revenues leading to positive year end results. General fund tax revenues came in approximately $3.6 billion (6.5%) ahead of the initial estimate. In addition, general fund expenditures came in $5.0 billion lower than initially budgeted. As a result, the total general fund balance increased to a strong 53.6% of general fund revenues (GAAP basis).

The $237 billion FY25 budget was adopted in late April 2024. It is roughly 3.5% larger than the adopted FY24 budget and increases spending for state services such as Medicaid and school aid, while also establishing new funding and policy changes aimed at spurring new housing construction. Through the first quarter of FY25, General Fund tax receipts were $628 million, or 2.2% above initial estimates, contributing to a positive overall operating variance of $2.1 billion, or 4.3% for the quarter.

Unlike FY24, the state's Enacted Budget Financial Plan reflects the intent of the state to deposit $1.5 billion in its rainy day fund, which would increase rainy day reserves to $7.8 billion. This deposit is in part due to the recognition of additional revenues and prepayment of subsequent year expenses at the close of FY24.

Notably, the state maintains roughly $20 billion in available reserves. Despite a balanced budget in FY25, a cumulative gap totaling $13.9 billion is forecast for the remainder of the financial plan period through FY28. It is important to remember that the state always has a looming deficit to be trimmed, and it has done what is necessary to balance the budget.

New York State's pensions have traditionally been well funded. The funded ratios for the Employee Retirement System (ERS) and the Teacher's Retirement System (TRS) were 90.3% and 97.4%, respectively, as of FY23. New York State is not pressured in that regard relative to so many other states. New York State's total fixed costs, including debt service, plus pension contributions, plus retirement health care (commonly referred to as other post-employment benefits or OPEB), are low at 4.6% of total governmental funds' expenditures in FY24.

NEW YORK IS A HIGH WEALTH STATE

New York State is a wealthy state. For 2023, New York State's per capita income ($79,581) was sixth highest among the 50 states, at 116% of the U.S. average ($68,531). That ratio stood at 117.7% in 2000, so New York has lost a little ground. Although its pandemic recovery has been slower than for almost all states, New York State finally recovered all jobs lost due to the pandemic as of April 2024. Unemployment for the state stood at 4.2% in June 2024, above the national average of 4.1% for the same period.

The state's economy is deep and diverse, though financial services exert an outsized influence. The upstate economy is more dependent on manufacturing and had been sluggish even before the pandemic. The downstate economy, anchored by financial, professional and business services, has been the state's growth engine. New York State's $1.8 trillion economy represents 7.9% of

U.S. real GDP. On a stand-alone basis, according to the International Monetary Fund (IMF), New York State's economy would be the tenth largest in the world.

Wall Street activity has traditionally generated a disproportionate share of total state tax revenues because of its high levels of compensation, profitability and capital gains. While Wall Street represents about 4% of the state's job total, it can typically account for 15%-20% of total tax revenues realized by the state. However, in FY23 this figure increased to 27.4%. After having banner years in 2020 and 2021 with the stock market setting record highs, Wall Street's 2022 pretax profits fell approximately 56% from the prior year due to steep declines in investment banking fee revenues driven mostly by Federal Reserve interest rate hikes and inflation. As a result, Wall Street's bonus pool erased prior year gains and returned to pre-pandemic levels. Pretax profits increased by 1.8% in 2023, but the bonus pool remainedon par with 2022.

New York State's two largest sources of local revenue are the personal income tax (PIT) and the sales tax, accounting for 34.8% and 10.0% of the state's general fund receipts in FY24, respectively. The state's somewhat steep income tax structure further concentrates the PIT on the highest earners, making it sensitive to swings in asset prices and capital gains tax receipts. In 2022, the latest year available, the top 1.2% of New York State income tax filers accounted for roughly 50% of the state's PIT collections.

LOOKING AHEAD: WEATHERING POTENTIAL HEADWINDS

New York State's population dropped 2.7% between April 2020 and July 2023, the largest numeric (approximately 533,000) and percentage decline among the 50 states. However, the population loss has slowed for two consecutive years since the onset of the pandemic, falling 0.9% and 0.5% in 2022 and 2023, respectively. The overwhelming majority of the decline can be attributed to city dwellers fleeing New York City, where population declined an estimated 6.0% over the same period. While the pandemic may explain a good part of this, especially in New York City, other factors could be in play and bear watching. Remote work has reshaped the way many commute in and out of New York City, directly impacting the city's economic recovery. Manhattan office workers have returned to their workplaces at 72% of pre-pandemic levels, according to a Partnership for New York City Return to Office Survey.

Notably, just 11% of employees reported being back in the office five days per week. As a result, the Metropolitan Transportation Authority (MTA), a component unit of the state, continues to experience depressed ridership and farebox revenues. The state has routinely supported the MTA through various subsidies, and a recent increase in the Payroll Mobility Tax is expected to yield an additional $1.1 billion annually dedicated to the MTA.

On 05 June, Governor Kathy Hochul announced her intention to suspend indefinitely implementation of the MTA's Central Business District Tolling Program (CBDTP), the country's first congestion pricing program. The program was anticipated to be implemented on 30 June and forecasted to generate $1.0 billion annually, while also securing up to $15.0 billion in new bonds for the MTA's 2020-2024 capital program.

This pause means the MTA will defer $16.5 billion in less-urgent capital projects while prioritizing state-of-good-repair works. According to Governor Hochul, the state intends to find an alternate revenue source for the MTA. However, CBDTP could eventually be implemented if no other funding mechanism is approved. Although the MTA poses some contingent liability risk, the overall impact to the state's credit profile from absorbing current and future funding gaps would likely be minimal.

New York State has a wide array of tools at its disposal to adapt and maintain financial stability, and has demonstrated a willingness and ability to use them. Additional flexibility has been afforded to the state by strong financial performance in the years following the pandemic, positioning the state for stability moving forward.

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Endnotes

Sources

State of New York Fiscal Year 2024 Comprehensive Annual Financial Report; New York State Annual Information Statement; New York State Constitution; New York State Comptroller Reports; New York State Division of the Budget; New York State Teachers' Retirement System Fiscal Year 2023 Comprehensive Annual Financial Report; New York State and Local Retirement System Fiscal Year 2023 Comprehensive Annual Financial Report; Moody's Investors Service; Standard & Poor's; Fitch Ratings; The Bond Buyer; Moody's 2022 State Debt Medians Report; International Monetary Fund data base; U.S. Bureau of Economic Analysis; U.S. Bureau of Labor Statistics; The Tax Foundation; U.S. Internal Revenue Service.

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