# Debt Impact Study

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# Executive Summary

New York State has relied far too heavily on debt for far too long. Ten years after enacting legislation to slow the growth in borrowing and end the use of debt for fiscal gimmicks, New York continues to rely heavily on debt. As a result, true debt reform is needed now more than ever. Despite attempted reforms, the State's debt practices remain flawed:

- Since debt reform was enacted in 2000, our debt burden has grown rapidly and voters have approved almost none of the debt issued since then.
- A significant portion of the debt issued since 2000 has been for non-capital purposes.
- New York's debt burden is among the highest of any state.
- Authority-issued debt lacks transparency and accountability in material ways.
- Capital planning is deficient.

Comptroller DiNapoli proposes a comprehensive debt reform program that corrects the fundamental deficiencies in the way New York borrows money. It imposes a real cap on debt, bans backdoor borrowing, and improves planning and transparency. Without strong reforms enacted via constitutional amendment, New York will continue its dangerous and unsustainable addiction to debt.

If used prudently and as part of a balanced strategy, borrowing is an appropriate way for governments to finance critical infrastructure. However, a high debt load significantly undermines government operations because debt service is a fixed, long-term cost that cannot be reduced during times of fiscal stress. A government using debt too heavily may be less able to respond to revenue shortfalls or fiscal pressures, a danger that is magnified when debt is issued to finance spending for non-capital purposes, such as operating expenses. Debt capacity is a limited resource and should be treated as one.

Although the Executive recommends slowing the growth in capital spending and borrowing, the State remains a national leader in debt burden with much of its debt having been issued for budget relief, not to fund capital investments. Debt service is one of the fastest growing major categories of State spending. Since the State imposed a debt cap in 2000 it has authorized more than $17 billion in bonds outside that cap. During this period, $7.6 billion in borrowing has been used to fund operating costs without making a single capital improvement to our infrastructure. Furthermore, nearly all State debt is now issued by public authorities, with little accountability and no voter input.

The Office of the State Comptroller provides the following comprehensive assessment of debt and offers an ambitious plan to reform New York's borrowing practices.

## *Rapid Growth in Debt Burden*

To accurately assess debt burden and the capacity to issue debt, it is necessary to use the most comprehensive measure of debt. This report uses a measure referred to as State-Funded Debt. State-Funded Debt includes any debt where the State provides funding to the debt issuer (e.g., public authority or local government) for the purpose of making debt service payments. Over the past five years, State-Funded Debt grew by 24.6 percent, increasing from $48.5 billion in State Fiscal Year (SFY) 2005-06 to an estimated $60.4 billion in SFY 2009-10. This is projected to rise to $67 billion in SFY 2014-15, an increase of $18.6 billion, or 38 percent, over the ten years.

Debt service on State-Funded debt also has grown significantly. Over the ten years from SFY 2005-06 through SFY 2014-15, this annual cost is expected to increase by $3.4 billion, or 77.8 percent, to $7.7 billion. This growth has worrisome implications for future State budgets. If debt service as a percentage of All Funds revenue were held to the level of SFY 2005-06, it would total $6.0 billion in SFY 2014-15, leaving $1.7 billion for other vital needs.

The State also has shifted the way it finances capital projects by relying more on borrowing and less on current State tax dollars. For example, between 1985 and 1990 an average of approximately 55 percent of all non-federal capital spending was financed with current revenue. Over the next five years that share will fall below 36 percent.

## *Debt Is High vs. Other States*

Aggressive borrowing has led to a high relative debt burden for New York, compared to the ten other most populous states. New York is third in the ratio of debt service to total revenue, surpassed by California and Illinois. On debt per capita, New York is second to New Jersey and three times the median of peer states. Finally, New York is second to New Jersey on the ratio of debt outstanding to Personal Income and more than twice the peer-state median.

## *New York's Debt Cap Is Fundamentally Flawed*

The Debt Reform Act of 2000 purported to limit new debt supported by the State but narrowly defined the debt subject to the cap. As a result, the cap covers only about 60 percent of the $60.4 billion of debt funded with State resources. Although much debt is excluded from the cap, the sharp growth in borrowing in recent years—approximately $40 billion in new debt has been authorized since SFY 2004-05—and the recent downturn in the economy means the State is rapidly approaching the cap, which will be fully phased-in during SFY 2010-11. The Division of the Budget projects that capacity under the cap will be just $1.2 billion in SFYs 2011-12 and 2012-13, limiting the State's ability to meet its myriad capital needs.

## *Debt Issued for Non-Capital Purposes*

The Debt Reform Act also purported to prohibit borrowing for non-capital purposes, but this too has proven ineffective. New York's current debt portfolio includes nearly $9.8 billion in bonds used to finance operating expenses and deficits, 16.2 percent of all State-Funded debt. In fact, $7.6 billion of this amount was issued for operating expenses after enactment of the law prohibiting such debt. Debt service on these bonds will total $1.1 billion, nearly 20 percent of all State-Funded debt service in SFY 2009-10.

Although a large portion of this non-capital debt was issued in the aftermath of the September 11, 2001 attacks in conjunction with a broader recovery plan, State choices regarding the use of debt relative to using current tax dollars must be balanced so that when extraordinary circumstances arise, needs can be accommodated.

## *Backdoor Borrowing Limits Accountability and Transparency*

New York State uses borrowing by public authorities to finance a large portion of the State's Capital Plan. "Backdoor borrowing" circumvents voter approval and has become so commonplace that authority debt accounts for 94 percent of the State's current debt burden, compared to only 60 percent in 1985. The Constitution mandates that only one bond act for a single work or purpose may be put before the voters each year. No bond act has been submitted to voters since 2005 and the Executive's Five Year Capital Plan contains no new proposals for voter-approved debt.

## *Comprehensive Capital Planning Is Lacking*

The State currently lacks a centralized and coordinated way to assess its infrastructure and prioritize its significant capital needs. Although nearly $27 billion in new State-Funded debt is projected to be issued over the next five years, it is not clear how this debt relates to our critical infrastructure needs. Although New York regularly borrows money to finance long-term projects such as roads, bridges, university buildings and mass transit, New York needs to improve the way it tracks these capital assets, plans for their maintenance, replacement or addition over time, and allocates various funding streams to address these needs.

## *Comptroller's Comprehensive Debt and Capital Reform*

Although the Debt Reform Act of 2000 was supposed to address the State's debt problem, it failed to restrain imprudent borrowing or control the growth of debt. The State's capital planning and borrowing practices must be made more transparent and accountable, and its debt burden more affordable. State Comptroller DiNapoli proposes the following comprehensive reforms to New York's debt and capital planning practices:

- Constitutionally ban backdoor borrowing and authorize new types of voter approved debt to be issued by the State Comptroller, with the same legal protections and controls that apply to General Obligation debt.

- Limit <u>all</u> State-Funded debt to 5.0 percent of personal income, with a phase-in of the cap.
- Amend the Constitution to restrict the use of long-term debt to capital purposes, with strict provisions allowing exceptions only for emergencies.
- Authorize multiple bond acts to be presented to voters each year.
- Create a Capital Asset/Infrastructure Council to develop comprehensive annual capital needs assessments and long-term strategic capital plans.

# State-Funded Debt

The Office of the State Comptroller uses the broadest measure of State debt to provide the best gauge of the State's debt burden.[1] ***State-Funded debt*** provides a more accurate measure of the representation of the debt burden of the State and is a more comprehensive measure of debt affordability than ***State-Supported debt***.

*State-Funded* debt includes borrowing that is not included in the *State-Supported* debt measure such as where debt service is paid with settlement revenues received from the tobacco litigation. State-Funded debt includes debt supported by any financing arrangement whereby the State agrees to make payments which will be used, directly or indirectly, for the payment of debt service (see footnote 1).

In contrast, State-Supported debt includes debt where payments from the State are used to pay debt service on bonds issued by the State and public authorities. This measure excludes certain public authority debt where State revenue is not directly used for debt service – the tobacco settlement bonds described above are not included because the State's future settlement revenue was transferred to the public authority created to issue the bonds. Because this device assigned State revenue to the debt issuing entity, it effectively uses State revenue for debt repayment and is therefore included in the State-Funded debt definition to provide a more inclusive and realistic measure of State debt burden.

Most of the State's debt is not voter approved General Obligation debt and is instead issued by public authorities, also known as back-door borrowing. Under these arrangements, the State is contractually obligated to make payments to public authorities or other entities equal to the debt service payments made by the issuer.

New York's State-Funded debt includes General Obligation bonds and other State-Supported debt as defined by the Debt Reform Act of 2000, as well as obligations issued to provide budget relief to the State or New York City outside the Debt Reform Act debt and debt service caps, including the following:

- Tobacco Settlement Financing Corporation (TSFC) bonds issued to securitize the State's tobacco settlement revenue stream;
- Sales Tax Asset Receivable Corporation (STARC) bonds issued to refinance New York City's Municipal Assistance Corporation (MAC) debt from the 1975 fiscal crisis;

[1] State-Funded debt includes debt supported by any financing arrangement whereby the State agrees to make payments which will be used, directly or indirectly, for the payment of principal, interest, or related payments on indebtedness incurred or contracted by the State itself for any purpose, or by any State agency, municipality, individual, public or private corporation or any other entity for State capital or operating purposes or to finance grants, loans or other assistance payments made or to be made by or on behalf of the State for any purpose. Among other provisions, the definition will apply (i) whether or not the obligation of the State to make payments is subject to appropriation, or (ii) whether or not debt service is to be paid from a revenue stream transferred by the State to another party that is responsible for making such payments.

- Municipal Bond Bank Agency (MBBA) bonds issued to amortize prior year school aid claims; and, most recently; and
- Building Aid Revenue Bonds (BARBs) issued by New York City's Transitional Finance Authority (TFA). The State authorized New York City to assign its State building aid to the TFA to secure repayment of bonds issued to finance a portion of the City's educational capital facilities program.

As of March 31, 2010, the State is projected to have approximately $60.4 billion in State-Funded debt outstanding (see Figure 1).[2] Voter-approved, General Obligation debt issued by the State comprises only 5.6 percent of this State-Funded debt burden, or approximately $3.4 billion. Total State-Funded debt outstanding, as of March 31, 2010, includes $9.9 billion of debt not counted as State-Supported, as narrowly defined in the Debt Reform Act of 2000.[3] In addition, the Act did not include debt issued before April 1, 2000 under the cap on State-Supported debt outstanding. Approximately $30 billion in State-Funded debt outstanding is not counted under the cap.

**Figure 1**

**State-Funded Debt Outstanding**
(in millions)

| | SFY 2009-10 |
|---|---|
| General Obligation Debt | $3,399 |
| State-Supported Authority Debt | 47,052 |
| Total State-Supported Debt | $50,451 |
| TSFC - Tobacco Securitization | 3,257 |
| STARC - MAC Refinancing | 2,302 |
| TFA Building Aid Revenue Bonds (BARBs) | 3,971 |
| MBBA - Prior Year School Aid Claims | 419 |
| Sub-Total - Other State-Funded Authority Debt | $9,949 |
| **Total State-Funded Debt** | **$60,400** |

Source: New York State Office of the State Comptroller

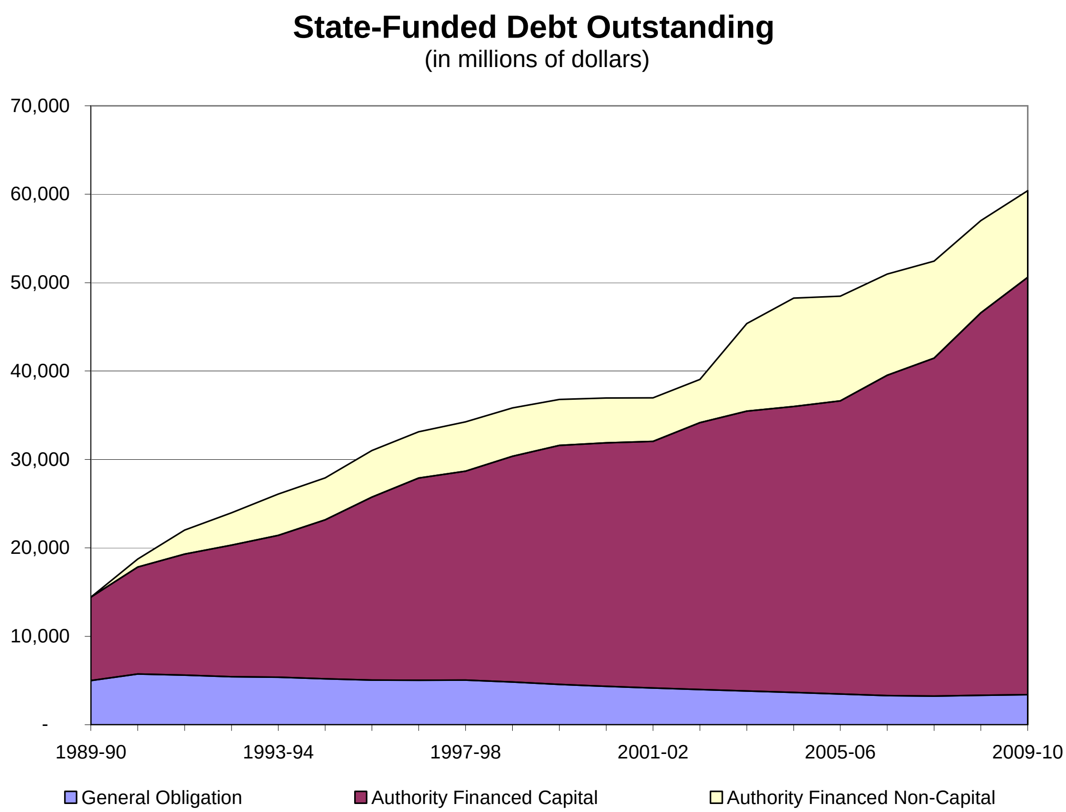
[2] Debt figures throughout this *Study*, except where noted, are the original issue par amounts that remain outstanding and do not include adjustments for premiums, discounts, accretions, deferred losses or outstanding actions from the Debt Reduction Reserve Fund. This figure includes the Sales Tax Asset Receivable Corporation (STARC), which is a government created not-for-profit corporation and not a public authority.

[3] Section 67-b of the State Finance Law states the following: "'State-supported debt' shall mean any bonds or notes, including bonds or notes issued to fund reserve funds and costs of issuance, issued by the state or a state public corporation for which the state is constitutionally obligated to pay debt service or contractually obligated to pay debt service subject to an appropriation, except where the state has a contingent contractual obligation."

Figure 2 illustrates the growth in State-Funded debt from SFY 1989-90 through SFY 2009-10. During that time, voter approved General Obligation debt outstanding decreased from slightly over $5.0 billion (34.7 percent of total State-Funded debt) to $3.4 billion (5.6 percent of total State-Funded debt). During that period, voters approved two bond acts totaling $4.65 billion (Clean Water/Clean Air in 1996 and Rebuild and Renew New York Transportation in 2005) and rejected nearly $9.0 billion in four other acts for environmental, transportation, job creation and education purposes.

While voter approved debt declined, debt issued on behalf of the State by public authorities increased from $9.4 billion in SFY 1989-90 to $57 billion projected for the end of SFY 2009-10—an astounding 504 percent, or 9.7 percent on average annually. Furthermore, of the $60.4 billion projected to be outstanding as of March 31, 2010, $9.8 billion, or 16.2 percent, was issued for non-capital purposes.[4] None of this debt was approved by voters and the associated debt service will total more than $1.1 billion in SFY 2009-10. The Debt Reform Act of 2000 specifically restricted State-Supported debt to capital purposes; however, $7.6 billion in State-Funded debt has been issued for operating needs since that Act was passed in 2000.

**Figure 2**




Source: New York State Office of the State Comptroller

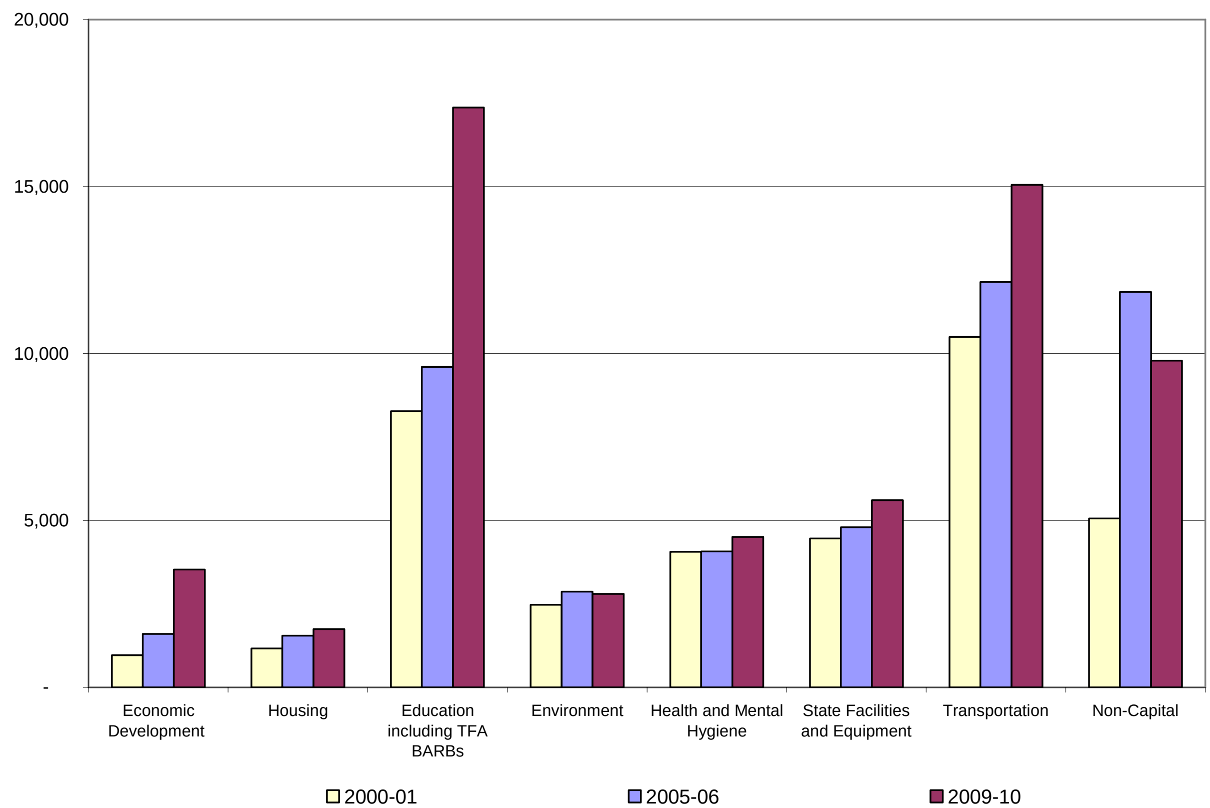
[4] The Office of the State Comptroller has identified debt from the Local Government Assistance Corporation (LGAC), Tobacco Settlement Financing Corporation (TSFC), Sales Tax Asset Receivable Corporation (STARC), Municipal Bond Bank Agency (MBBA) bonds for prior year school aid claims, Urban Development Corporation (UDC) bonds for both the sale of Attica and the refinancing of the Empire State Plaza as non-capital debt.

Figure 3 illustrates how the uses of debt have changed since SFY 2000-01, by issue area. Debt associated with education and transportation comprises 53.7 percent of the total. Since SFY 2000-01, the largest share of growth in State-Funded debt was associated with education ($9.1 billion, or 38.8 percent of total growth). This was primarily from the Expanding Our Children's Education and Learning (EXCEL) program authorized in SFY 2006-07 as well as BARBs issued by the New York City TFA.

The second largest source of increase ($4.7 billion, or 20.2 percent of the total) was not used for capital purposes, but instead paid for budget relief and other non-capital needs. Finally, debt associated with transportation increased nearly $4.6 billion, making up 19.4 percent of the total growth.

**Figure 3**

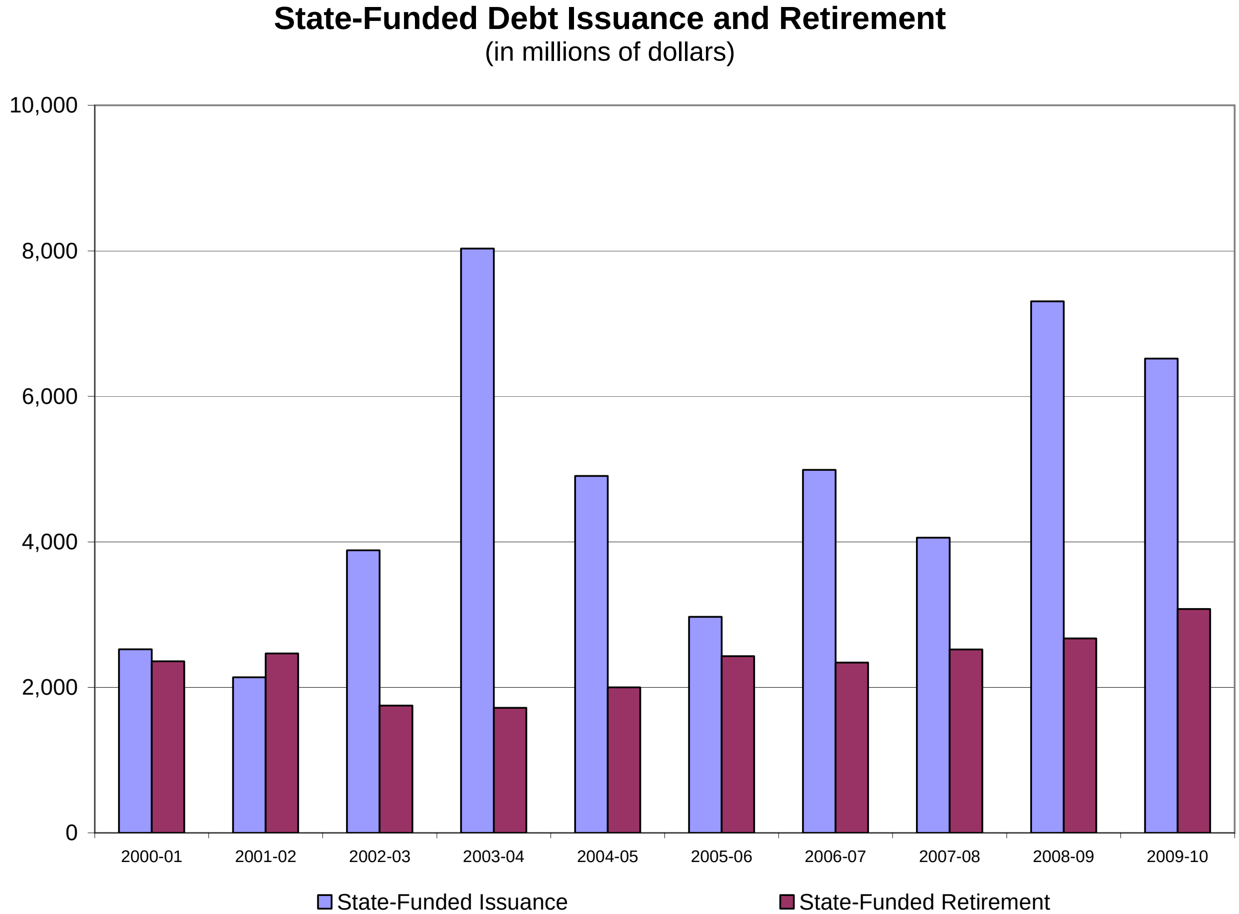
**State-Funded Debt Outstanding by Purpose**
**SFY 2000-01, SFY 2005-06 and SFY 2009-10**
(in millions of dollars)




Source: New York State Office of the State Comptroller

The growth in State-Funded debt outstanding is also due to significant increases in new debt issuance without a corresponding increase in debt retirement. Figure 4 illustrates that since SFY 2000-01, the State has issued over $47.3 billion in new State-Funded debt while only retiring $23.3 billion.  In other words, almost twice as much debt is being issued than is being paid down.

**Figure 4**

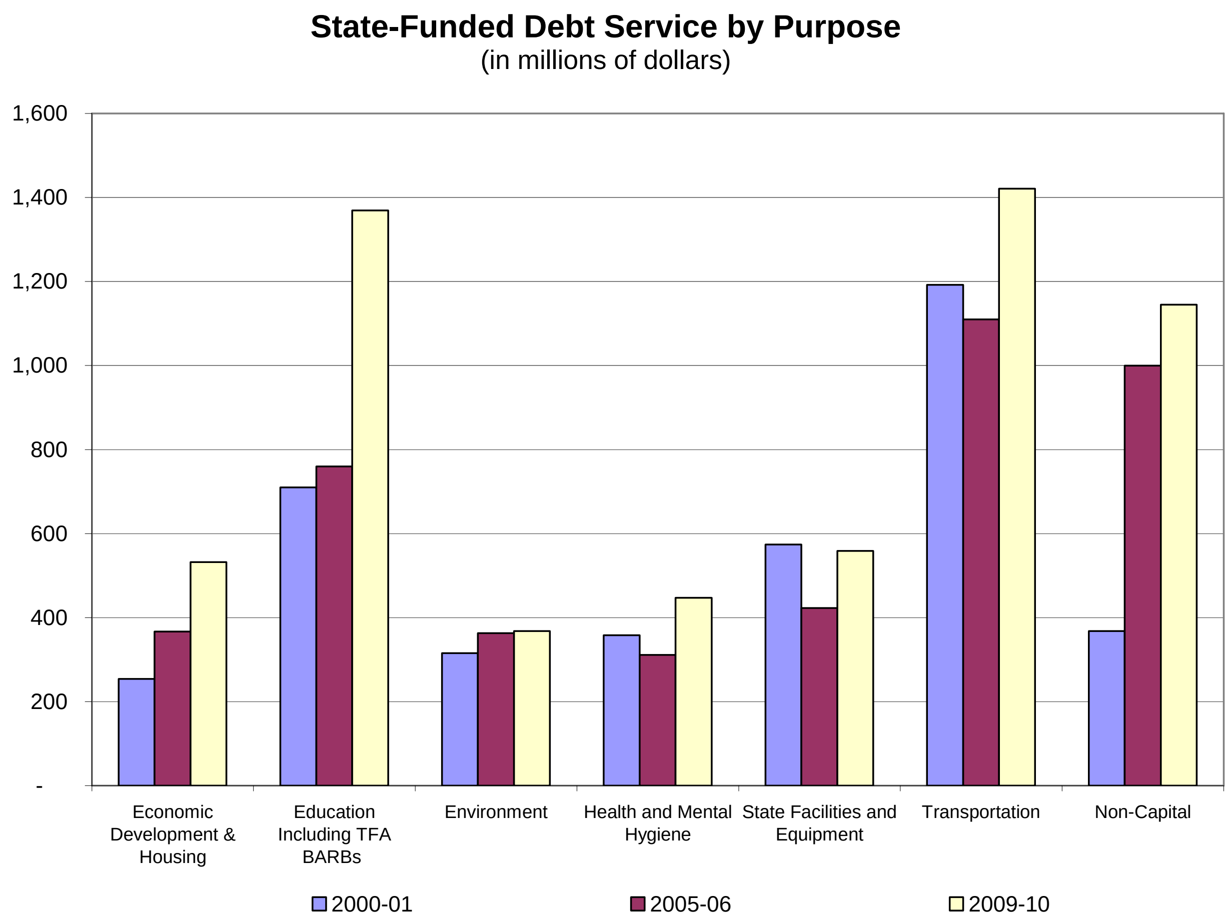



Source:  New York State Office of the State Comptroller

With the increase in debt outstanding, the annual debt service cost also increases. According to the Executive's proposed SFY 2010-11 Financial Plan, debt service is projected to be one of the fastest growing major categories of spending, outpacing growth in Medicaid and school aid—the two largest costs in the Budget. State-Funded debt service increased by approximately $1.5 billion, or 34.8 percent, from SFY 2005-06 to SFY 2009-10.  This represents average annual growth of 7.5 percent.  Since SFY 2000-01, State-Funded debt service has increased nearly $1.8 billion, or 43.1 percent.

The largest driver of growth in State-Funded debt service is attributable to new debt issued for non-capital purposes, including deficit financing and budget relief.  Figure 5 illustrates the growth in debt service by purpose.  In SFY 2000-01, debt service related to non-capital purposes totaled $368 million and represented approximately 9.0 percent of all State-Funded debt service. By the end of SFY 2009-10, debt service for this purpose will increase to $1.1 billion, or 211.2 percent, from SFY 2000-01 and will represent nearly 20 percent of total State-Funded debt service.

**Figure 5**




Source: New York State Office of the State Comptroller

The changes in distribution of debt service by functional area over the time period were also affected by $18 billion in debt refundings and restructurings, including approximately $2.7 billion in debt issued by the Thruway Authority for the Dedicated Highway and Bridge Trust Fund.

From SFY 2002-03 through SFY 2005-06, the State took advantage of historically low interest rates by refinancing certain existing obligations. The State also replaced debt service reserves with surety bonds and reduced the required amount of cash in such reserves, thus providing short-term fiscal relief. In one refunding, the Thruway Authority restructured $2.7 billion of debt, providing immediate debt service relief, but increasing costs in subsequent years.

# Proposed Capital Program and Financing Plan

The Executive is statutorily required to annually submit to the Legislature a five-year Capital Program and Financing Plan with the proposed State Budget.[5] According to issuance and retirement assumptions in the Plan, as well as scheduled retirements for the TSFC, STARC and the MBBA (Prior Year School Aid Claims) and projected issuance and retirements for TFA BARBs, the State will directly or indirectly issue $6.4 billion more than it will retire over the next five years (see Figure 6).

Consequently, the State is projected to end SFY 2014-15 with $67 billion in outstanding State-Funded debt—representing an increase of 11 percent from the $60.4 billion outstanding at the beginning of SFY 2010-11.

**Figure 6**

**Projected State-Funded Debt Outstanding**
(in thousands of dollars)

| | SFY 2010-11 | SFY 2011-12 | SFY 2012-13 | SFY 2013-14 | SFY 2014-15 | Increase 2010 Beginning - 2015 End |
|---|---|---|---|---|---|---|
| State-Funded Debt at Beginning of Period | 60,399,789 | 63,670,807 | 65,767,726 | 66,871,760 | 67,588,191 | N/A |
| Issuance | 6,555,136 | 6,040,011 | 5,238,177 | 4,996,183 | 3,778,458 | 26,607,965 |
| Retirement | 3,284,118 | 3,943,091 | 4,134,143 | 4,279,751 | 4,325,932 | 19,967,037 |
| **Projected State-Funded Debt at End of period** | **63,670,807** | **65,767,726** | **66,871,760** | **67,588,191** | **67,040,717** | **6,640,928** |

Sources: New York State Office of the State Comptroller, New York State Division of the Budget and New York City Office of Management and Budget

Annual State-Funded debt service is estimated to exceed $7.7 billion by the end of SFY 2014-15, assuming projected bond issuances of nearly $26.6 billion and retirements of just under $20 billion over the next five fiscal years. This represents average annual growth of approximately 5.8 percent. Debt service as reported in the State's Financial Plan is one of the fastest growing major categories of spending.

Figure 7 shows projected debt service over the next five years, including debt service on current debt outstanding and projected new debt issuances.

[5] Section 22-c of the State Finance Law.

**Figure 7**

**Projected State-Funded Debt Service**
(in thousands of dollars)

| | SFY 2009-10 Projected | Proposed Capital Plan SFY 2010-11 | SFY 2011-12 | SFY 2012-13 | SFY 2013-14 | SFY 2014-15 | Total Percent Change 2009-10 - 2014-15 | Total Dollar Change 2009-10 - 2014-15 |
|---|---|---|---|---|---|---|---|---|
| General Obligation | 484,218 | 502,687 | 521,368 | 525,519 | 518,135 | 510,550 | 5.44% | 26,332 |
| Other State-Supported | 4,457,832 | 5,263,770 | 5,566,328 | 5,837,311 | 5,976,754 | 5,984,630 | 34.25% | 1,526,798 |
| **2009-10 Capital Plan (State-Supported)** | **4,942,050** | **5,766,457** | **6,087,696** | **6,362,830** | **6,494,889** | **6,495,180** | **31.43%** | **1,553,130** |
| TSFC | 517,895 | 491,500 | 489,834 | 495,396 | 500,794 | 506,086 | -2.28% | (11,809) |
| TFA BARBs | 166,334 | 240,761 | 291,598 | 347,979 | 416,004 | 493,682 | 196.80% | 327,347 |
| STARC | 170,000 | 170,000 | 170,000 | 170,000 | 170,000 | 170,000 | 0.00% | - |
| MBBA | 45,182 | 45,189 | 45,182 | 45,192 | 43,891 | 41,265 | -8.67% | (3,917) |
| **Total Other** | **899,411** | **947,450** | **996,614** | **1,058,567** | **1,130,689** | **1,211,033** | **34.65%** | **311,621** |
| **Projected Debt Service (State-Funded)** | **5,841,461** | **6,713,907** | **7,084,310** | **7,421,397** | **7,625,578** | **7,706,213** | **31.92%** | **1,864,751** |

Sources: New York State Office of the State Comptroller and New York State Division of the Budget.

By SFY 2014-15, State-Funded debt service is projected to be 5.4 percent of All Funds revenue, up from 4.5 percent in SFY 2009-10. In SFY 2009-10, State-Funded debt service is projected to equal 7.7 percent of State operating funds receipts. This ratio is projected to grow to 8.7 percent in SFY 2013-14, the last year this receipts information is available in the Executive's proposed SFY 2010-11 Financial Plan.

## *Current State Resources – Pay-As-You-Go*

The Capital Plan is financed by four major sources of funds: current resources of the State (often referred to as pay-as-you-go, or PAYGO), federal funds, General Obligation bonds and bonds issued by public authorities on behalf of the State. The use of current State resources to support a portion of the Capital Plan is critical to achieving a balanced approach to meet the State's capital purposes.

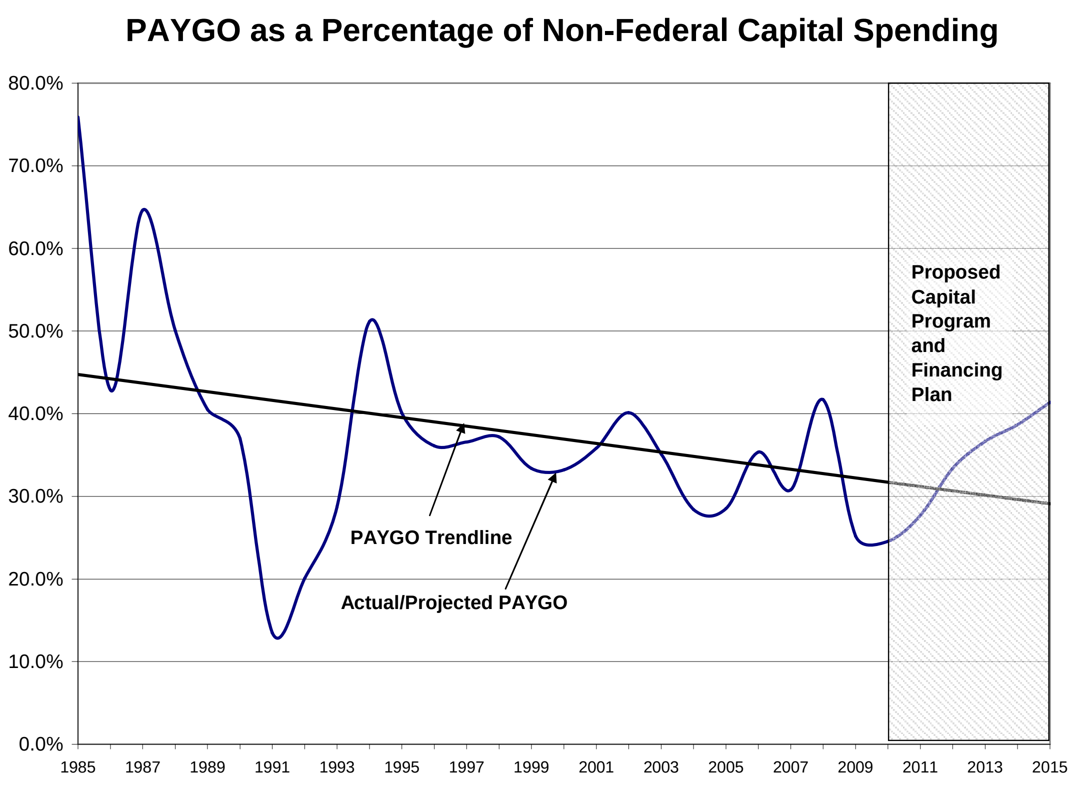
During the second half of the 1980s, the State used PAYGO financing for an average of 55 percent, and as much as 75 percent, of the Capital Plan. During the first half of the 1990s, which was a recessionary period, the amount of PAYGO declined to an average of 30 percent, with a low of 13.5 percent in 1991, indicating the diversion of current resources to other budget areas. The use of current resources for State-Funded capital spending did increase somewhat during the latter half of the 1990s and into the current decade.

Even though the State experienced the largest economic expansion in history and a number of multi-billion dollar surplus years, the average annual use of PAYGO did not increase above 36.7 percent in the latter half of the 1990s. If historical levels of PAYGO financing had been used during the expansion of the late 1990s, the State's debt outstanding and debt service levels would be lower today and the State would not be facing rapidly declining capacity for new debt. The State continued the same trend of reduced use of PAYGO through the first decade of the 21st century.

Utilizing current revenues for capital projects reduces the need to issue debt, thereby reducing future debt service, and is viewed positively by rating agencies. Increasing the use of PAYGO conserves debt capacity and reduces the burden passed to future generations. Furthermore, the increased debt capacity that results from increased use of PAYGO creates a buffer for those years when spending capacity is limited due to a downturn in the economy or other constraining circumstances.

The Capital Plan projects increases in the use of PAYGO over the next five years, as State PAYGO resources are forecast to average 35.6 percent and climb to 41.4 percent in SFY 2014-15. Figure 8 illustrates New York's historic downward trend in the use of PAYGO as a percentage of non-federal capital spending as well as the planned increase through SFY 2014-15.

**Figure 8**




Source: New York State Office of the State Comptroller.

# State Debt Ratios

To facilitate peer group comparisons and better monitor debt burden, it is useful to review debt ratios and analyze their change over time. The following key ratios are used in this report to assess the financial burden of debt outstanding: (1) debt outstanding as a percentage of Personal Income, (2) debt outstanding per capita, and (3) debt service as a percentage of revenues.

The debt to Personal Income ratio indicates the burden a state's debt places on the income tax base, which is a primary source of revenue for New York State. Outside of federal funds, New York's Personal Income Tax is the State's largest revenue source, comprising approximately 26 percent of All Funds receipts in SFY 2009-10. The debt per capita measure allows the issuer to assess the actual and relative debt burden per taxpayer compared to other states. The level of debt service to All Funds revenue indicates the amount of flexibility in the issuer's budget.

Figure 9 provides a presentation of the State's indebtedness and debt ratios as of March 31, 2010 compared to March 31, 2006 and March 31, 2008. State-Funded debt outstanding increased by $11.9 billion, or 24.6 percent, between 2006 and 2010 and increased $8.0 billion, or 15.2 percent, from 2008. State-Funded debt outstanding to Personal Income declined from 6.5 percent to 6.2 percent between SFY 2005-06 and SFY 2007-08 but then increased to 6.4 percent in SFY 2009-10.

**Figure 9**

**State-Funded Debt Ratios**

| | State-Funded Debt Outstanding (millions) | State-Funded Debt to Personal Income | State-Funded Debt Per Capita | Debt Service to All Funds Revenue |
|---|---|---|---|---|
| SFY 2005-06 | $48,464 | 6.54% | $2,506 | 4.05% |
| SFY 2007-08 | $52,445 | 6.16% | $2,698 | 4.18% |
| SFY 2009-10 | $60,400 | 6.36% | $3,089 | 4.46% |

State-Funded debt outstanding per capita increased by $583, or 23.3 percent, from $2,506 in SFY 2005-2006 to $3,089 in SFY 2009-10, with a 14.5 percent increase from $2,698 in SFY 2007-08. The State-Funded debt service to All Funds revenue ratio increased from 4.1 percent in SFY 2005-06 and 4.2 percent in SFY 2007-08 to nearly 4.5 percent in SFY 2009-10.

To correspond to the limits established in the Debt Reform Act of 2000 and for comparison purposes, the ratio of State-Funded debt service as a percentage of All Funds receipts is used to measure annual debt burden. While it is reasonable to use All

Funds receipts as a basis of comparison, included in this revenue is federal funding, much of which is earmarked for specific purposes and cannot be used for debt service needs.

For a more thorough and comprehensive assessment of the State's debt service burden, the State could begin measuring debt service against State operating receipts.[6] This would more adequately measure the State's debt service burden compared to State generated revenues available for repayment. If the ratio of State-Funded debt service to State operating receipts were used, the State would have a ratio of 7.7 percent, compared to 4.5 percent of All Funds Revenue (as of March 31, 2010).

If the ratio of State-Funded debt service to State operating receipts were used, the ratio would grow from 7.7 percent in SFY 2009-10 to 8.7 percent in SFY 2013-14, the last year for which information regarding State operating receipts is available in the Executive's proposed SFY 2010-11 Executive Budget Financial Plan.

## *Comparison of Peer State Debt Ratios to Selected Medians*

A comparison to national and peer group medians is useful to provide context to New York's debt burden in relation to other states. The peer group includes states with the largest populations—California, Texas, Florida, Illinois, Pennsylvania, Ohio, Michigan, Georgia, New Jersey and North Carolina. In July 2009, Moody's published the *2009 State Debt Medians* report, which included its annual analysis of state debt medians. As shown in Figure 10, New York's State-Funded debt to Personal Income ratio, the State-Funded debt per capita ratio and the State-Funded debt service to All Funds revenues ratio are all significantly above peer and national medians.

Figure 10 also details the peer group comparison for the three debt ratios evaluated. The debt to Personal Income and debt outstanding per capita ratios for peer states are taken from Moody's *2009 State Debt Medians* report, while the debt service to revenue ratio has been calculated using data from the most recent Comprehensive Annual Financial Report available for each state. Ratios for New York use the State Comptroller's measure of SFY 2008-09 State-Funded debt, rather than Net Tax-Supported debt as presented in the Moody's report, because State-Funded debt provides a more accurate measure of New York's debt burden.[7]

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[6] State operating receipts include all General Fund revenues excluding transfers to the General Fund, special revenue funds and debt service funds as detailed in the Executive's proposed SFY 2010-11 Executive Budget Financial Plan as amended by the 21-day amendments. Receipts for capital spending and federal funds are excluded.

[7] Moody's measure of Net Tax-Supported debt includes State-Guaranteed Job Development Authority debt, Moral Obligation debt and debt associated with the State Secured Hospital Program. The Comptroller's State-Funded debt measure does not include these obligations because they are not directly supported with State resources. In addition, Moody's measures Net Tax-Supported debt on a calendar year basis as compared to the State Fiscal Year used for New York State throughout this report. As a result, Moody's Net Tax-Supported debt measure for New York State is $56.9 billion as of December 31, 2008.

Within the peer group, New York's debt as a percentage of Personal Income, at 6.2 percent, was second to New Jersey, at 7.3 percent. New York's debt as a percentage of Personal Income was more than two times the median, as compared to both the ten other largest states and the nation. In terms of debt per capita, New York's $2,925 debt burden was second only to New Jersey, at $3,621, within the peer group. New York's debt per capita was more than three times the peer group median and the national median.

As shown in Figure 10, at 4.6 percent New York follows California with the second highest debt service as a percentage of All Funds receipts in the peer group. New York's ratio was 1.5 times higher than the peer group median and 1.3 times higher than the national median as last measured by Moody's Investors Service.

**Figure 10**

**Peer Group Comparisons**

(high values *italicized*)

| | 2008 Debt ($000) | 2008 Debt Per Capita ($) | 2008 Debt as % of 2007 Personal Income | 2008 Debt Service as % of All Funds Receipts * |
|---|---|---|---|---|
| California | *66,363,000* | 1,805 | 4.4% | *7.0%* |
| Texas | 12,646,297 | 520 | 1.4% | 1.1% |
| Florida | 20,444,760 | 1,115 | 2.9% | 3.1% |
| Illinois | 24,212,758 | 1,877 | 4.6% | 4.0% |
| Pennsylvania | 11,828,000 | 950 | 2.5% | 1.8% |
| Ohio | 11,048,935 | 962 | 2.8% | 4.2% |
| Michigan | 7,663,085 | 766 | 2.2% | 1.5% |
| Georgia | 9,531,999 | 984 | 3.0% | 3.7% |
| New Jersey | 31,438,000 | *3,621* | *7.3%* | 3.0% |
| North Carolina | 7,670,275 | 832 | 2.5% | 2.0% |
| **Peer Median** | **12,237,149** | **973** | **2.9%** | **3.1%** |
| **National Median** | **3,995,598** | **865** | **2.4%** | **3.5% ** ** |
| **New York - 2008-09** | **57,014,733** | **2,925** | **6.2%** | **4.6%** |

* Note that Debt Service and All Funds Revenue are from each state's Statement of Revenues, Expenditures, and Changes in Fund Balances contained within the state's 2008 Comprehensive Annual Financial Reports. Consequently, reported debt service does not include payments reported in proprietary funds that are supported by proprietary fund resources. New York's debt service includes SUNY and

** Last Published by Moody's in 1996.

Sources:
Comprehensive Annual Financial Reports from Fiscal Years Ending in 2008 for listed states
Moody's Investors Service, *2008 State Debt Medians* , July 2009
US Census Bureau
US Bureau of Economic Analysis
Global Insight, Inc.
New York State Division of the Budget, *2010-11 Proposed Budget Capital Program and Financing Plan,* January 2010

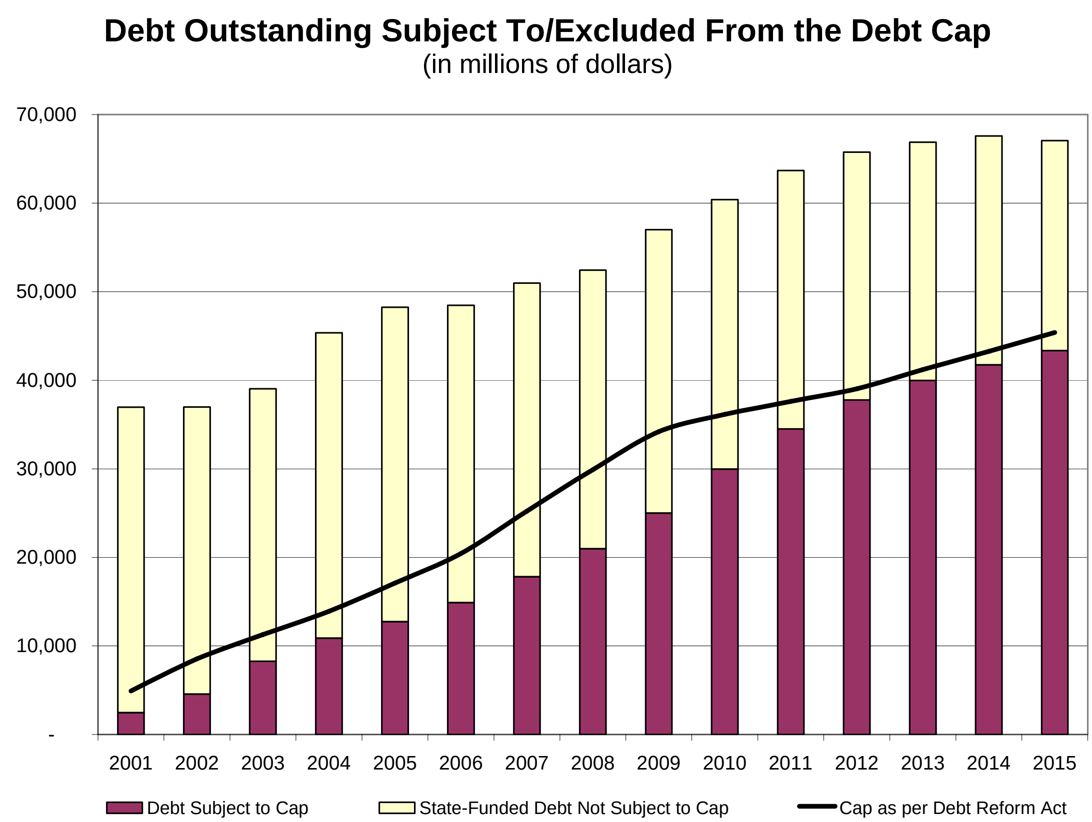
# Flawed Reform – The Debt Reform Act of 2000

The Debt Reform Act of 2000 established a definition for State-Supported debt and statutory limitations on such debt, to be phased-in beginning April 1, 2000. Unfortunately, this Act did little to provide fiscal discipline or ensure that future debt is affordable. The legislation:

- Capped the level of debt outstanding at 4.0 percent of personal income for debt issued after April 1, 2000. This cap is phased-in over 10 years and will be fully phased-in during SFY 2010-11.
- Capped debt service on new debt issued after April 1, 2000 at 5.0 percent of All Funds receipts. This cap is phased-in over 13 years and will be fully phased-in during SFY 2012-13.
- Provided that debt can only be used for capital works or purposes and that debt cannot have a maturity longer than 30 years.

According to the Division of the Budget (DOB), at the end of SFY 2009-10 the State will have approximately $6.2 billion of capacity under the cap on State-Supported debt outstanding. However, the State is rapidly approaching the cap on debt outstanding.

**Figure 11**




Note: Debt Subject to Cap and Cap as per Debt Reform Act are Division of the Budget estimates in SFYs 2010-15. See Page 80 of the SFY 2010-11 Proposed Five-Year Capital Program and Financing Plan.

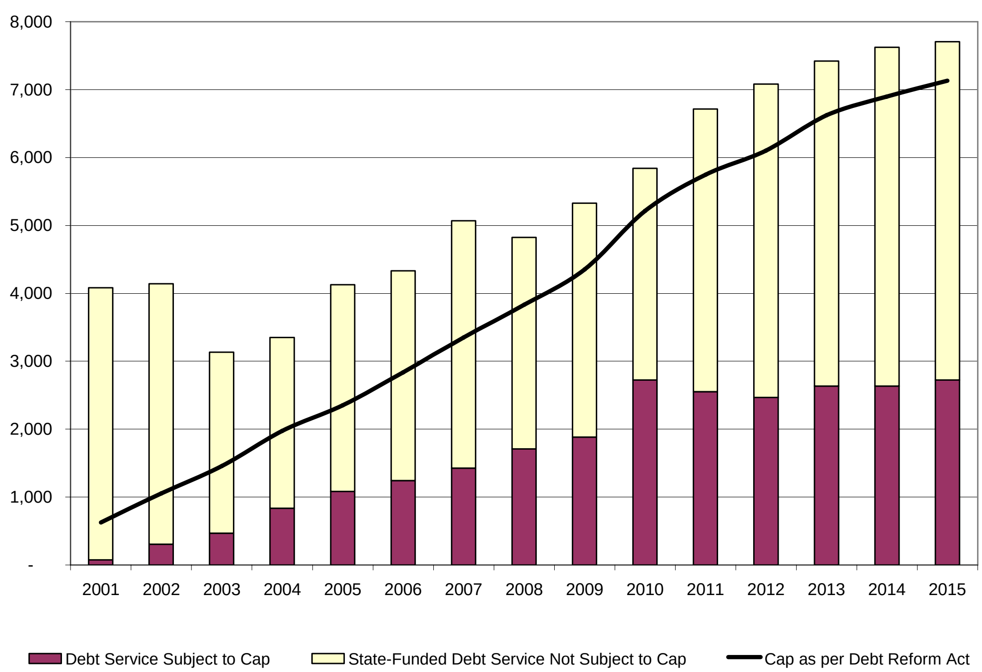
Based on the most recent projections for Personal Income from DOB, the State is projected to have between $1.2 billion and $1.3 billion in available debt capacity between SFY 2011-12 (only one year after the cap is fully phased-in) and SFY 2012-13.[8] This is primarily attributable to two reasons: first, the State is issuing significantly more debt annually than what is retired and second, economic declines have caused significant reductions in projected Personal Income.

Furthermore, the debt counted under these statutory State-Supported debt caps does not include all borrowing funded with State resources, due to the narrowly constructed definition of State-Supported debt. There are two broad categories of debt excluded from the caps. The Debt Reform Act excluded from its statutory caps all debt that was outstanding at the time of enactment. This debt totals $20.5 billion. Also, $17 billion in new debt has been authorized to be issued since 2000 not subject to these caps, but whose repayment comes from State resources. This debt now totals $9.9 billion.

Certain of these new debt authorizations also circumvented the provision of the Act that limits the issuance of debt to capital purposes. As a result of this loophole, approximately $7.6 billion has been issued for non-capital purposes since 2000. As of March 31, 2010, over 16 percent of the State's debt burden will be for non-capital purposes.

**Figure 12**

**Debt Service Subject To/Excluded From the Cap**
(in millions of dollars)




Note: Debt Service Subject to Cap and Cap as per Debt Reform Act are Division of the Budget estimates for SFYs 2010-15. See Page 80 of the SFY 2010-11 Proposed Five-Year Capital Program and Financing Plan.

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[8] DOB is required to calculate the caps on State-Supported debt outstanding and debt service every October 31 and report in the most proximate quarterly Financial Plan update, although these caps are often updated in other quarterly Financial Plan and Capital Program and Financing Plan updates based on more up-to-date information.

To get a comprehensive picture of the State's obligations, it is necessary to consider all State-Funded debt. For example, the debt outstanding subject to the statutory debt cap in SFY 2009-10 will total $30 billion; however, State-Funded debt will total $60.4 billion, or $30.4 billion higher than the amount subject to the statutory cap. Approximately 49.7 percent of all State-Funded debt and associated debt service is not counted under the statutory debt caps.

Figure 12 illustrates that the State has significant room under the cap on State-Supported debt service. However, if all State-Funded debt were subject to this cap, the State would have exceeded the cap since inception. Additionally, State-Supported debt service is projected to be one of the fastest growing major spending areas over the next four years, with average annual growth of 7.2 percent.

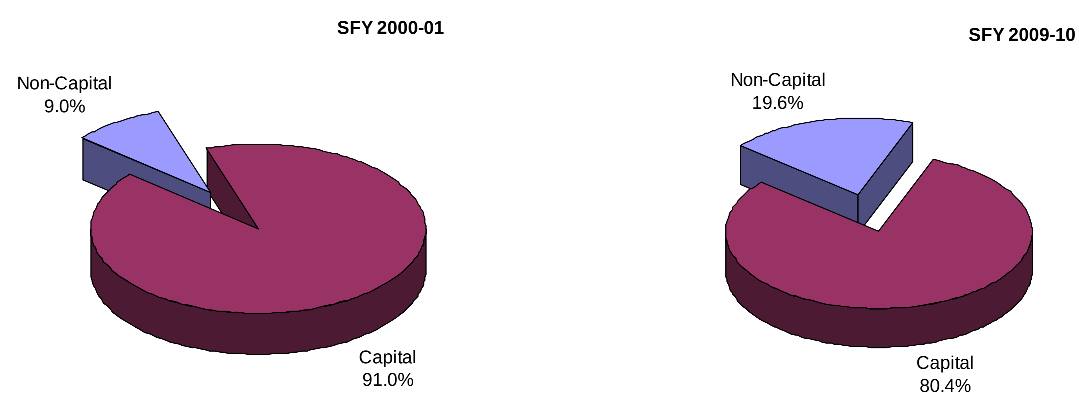
Based on the Executive's proposed Five-Year Capital Program and Financing Plan and updated projections for personal income, the cap on State-Supported debt service does not appear to be an issue in the near future. However, it is not a comprehensive cap on all debt service and the significant growth of debt service is a concern as it continues to require a larger share of the State's limited resources.

The Debt Reform Act of 2000 has also failed to limit new debt issuances to capital purposes. As a percentage of State-Funded debt outstanding, debt that was issued for non-capital purposes, including deficit financing and budget relief, increased from 13.7 percent in SFY 2000-01 to 16.2 percent in SFY 2009-10. While debt outstanding for non-capital needs has increased since SFY 2000-01, Figure 13 illustrates that debt service costs associated with non-capital needs as a percentage of total debt service has more than doubled, from 9.0 percent of State-Funded debt service to nearly 20 percent, exceeding $1.1 billion in SFY 2009-10.

**Figure 13**

**Percentage of State-Funded Debt Service for Non-Capital Purposes**

**SFY 2000-01 and SFY 2009-10**



# Comptroller's Debt Reform Proposal

The Comptroller's debt reform provisions, including constitutional amendments would restore control to the voters for approving virtually all debt and eliminate backdoor borrowing, ensure debt remains within affordable limits through a new cap that includes *all* debt supported entirely by State resources and create an effective, transparent long-term capital planning process. The reforms would:

- **Impose a Real Debt Cap on all State-Funded Debt.** Limit all State-Funded debt to 5.0 percent of Personal Income to be phased-in and prohibit the use of State-Funded debt for non-capital purposes. The restriction on use of debt and the cap will help New York further rein in its debt load.

- **Ban Backdoor Borrowing.** Ban the issuance of State-Funded debt by the State's public authorities and other entities and require State-Funded debt to be issued by the Comptroller, following voter approval (except for $250 million in non-voter approved debt annually and emergency debt to be issued only under extraordinary circumstances within strict guidelines).

  This proposal would not affect public authorities' ability to issue bonds for their purposes where State funds are not used for debt service, such as the Thruway Authority for its toll road or the Dormitory Authority for private colleges.

  This proposal authorizes a new category of voter approved revenue debt to be issued by the State Comptroller, subject to the same constitutional and statutory controls applied to General Obligation debt. These reforms will restore voter control over debt issued in New York and help the State regain control of its debt burden.

- **Create a New York State Capital Asset/Infrastructure Council.** This Council would provide an inventory and status of all capital assets of the State, its public authorities and local governments, which receive a significant State investment.

- **Establish a Statewide Capital Needs Assessment.** Significant elements of the State's infrastructure are in need of repair and rehabilitation. Yet, no comprehensive planning structure exists to identify current needs across all areas, including transportation, education, environment and energy.

  Such an assessment, to be undertaken by the Council, would allow policymakers to prioritize those capital projects most in need of repair and critical to the economic recovery of New York. This assessment would lead to a Five-Year Capital Program adopted by the Legislature.

# Conclusion

Based on this *Debt Impact Study*, it is evident that New York needs to enact fundamental reforms in how it uses, and issues, debt.

Notwithstanding the State's attempt to enact debt reform ten years ago, debt levels have risen rapidly and are high compared to both peer states and the national median. Although the cap excluded pre-existing debt, the State is rapidly exhausting its ability to issue new debt to make needed capital investments, leading the Executive to recommend a slowdown in capital spending. Current dollar, or pay-as-you-go, funding for capital spending is well below the level of the 1980s. New York's excessive debt burden constrains effective capital investment, limits the State's financial flexibility and could harm its future credit position.

Debt service is consuming an increasing share of the State's revenue and its projected growth will further impede New York's ability to meet other spending priorities within a balanced Financial Plan. And even though the 2000 debt reform effort sought to ban the issuance of debt for non-capital purposes, $7.6 billion in bonds to fund operating expenses and obtain budget relief have been issued since the ban was imposed. Faced with a growing budget imbalance, New York will spend $1.1 billion in SFY 2009-10 for principal and interest payments on debt issued years ago for budget relief and other non-capital purposes.

Debt and capital planning should provide a framework to ensure that the issuance of additional debt is affordable. The State should prioritize capital and infrastructure needs, and decrease its reliance on debt, while increasing the use of pay-as-you–go spending.

Sweeping reforms of the State's debt policy and capital planning practices are necessary to ensure that New York can address its capital infrastructure needs over time, while keeping debt costs affordable and prohibiting the use of debt for non-capital purposes.

## Appendix A

Rating agencies determine the credit ratings of the debt issuer. Credit ratings assess a debt issuer's ability to repay debt on a timely basis. They are a primary factor in determining the interest cost that debt issuers are required to pay when they go to market, as well as the ongoing costs of liquidity support agreements associated with certain variable rate debt. Rating agencies have indicated that prudent debt management practices, including the use of debt affordability guidelines and reviews, are positive factors in assigning credit ratings.

### Standard and Poor's Ratings of State General Obligation Bonds
**(as of January 2010)**

| *AAA* | *AA+* | *AA* | *AA-* | *A+* | *A* | *A-* |
|---|---|---|---|---|---|---|
| Delaware | Alaska | Alabama | Arizona | Illinois | | California |
| Florida | Kansas | Arkansas | Kentucky | | | |
| Georgia | Nebraska | Colorado | Louisiana | | | |
| Iowa | Nevada | Connecticut | Michigan | | | |
| Indiana | New Mexico | Hawaii | | | | |
| Maryland | North Dakota | Idaho | | | | |
| Minnesota | Ohio | Massachusetts | | | | |
| Missouri | Oklahoma | Maine | | | | |
| North Carolina | South Carolina | Mississippi | | | | |
| Utah | Tennessee | Montana | | | | |
| Virginia | Texas | New Hampshire | | | | |
| | Vermont | New Jersey | | | | |
| | Washington | **New York** | | | | |
| | Wyoming | Oregon | | | | |
| | | Pennsylvania | | | | |
| | | Rhode Island | | | | |
| | | South Dakota | | | | |
| | | West Virginia | | | | |
| | | Wisconsin | | | | |

Source: Standard and Poor's Ratings Services.

## Moody's Ratings of State General Obligation Bonds
**(as of October 2009)**

| *Aaa* | *Aa1* | *Aa2* | *Aa3* | *A1* | *A2* | *A3* | *Baa1* |
|---|---|---|---|---|---|---|---|
| Delaware | Florida | Alabama | Arizona | Illinois | | | California |
| Georgia | Indiana | Alaska | Connecticut | Louisiana | | | |
| Maryland | Iowa | Arkansas | Maine | | | | |
| Missouri | Kansas | Hawaii | Michigan | | | | |
| North Carolina | Minnesota | Idaho | Mississippi | | | | |
| South Carolina | New Mexico | Kentucky | New Jersey | | | | |
| Utah | Tennessee | Massachusetts | **New York** | | | | |
| Vermont | Texas | Montana | Oklahoma | | | | |
| Virginia | Washington | Nevada | Rhode Island | | | | |
| | | New Hampshire | West Virginia | | | | |
| | | North Dakota | Wisconsin | | | | |
| | | Oregon | | | | | |
| | | Ohio | | | | | |
| | | Pennsylvania | | | | | |

Source: Moody's Investors Services

## Fitch Ratings of State General Obligation Bonds
**(as of February 2010)**

| *AAA* | *AA+* | *AA* | *AA-* | *A+* | *A* | *BBB* |
|---|---|---|---|---|---|---|
| Delaware | Florida | Maine | Hawaii | Michigan | | California |
| Georgia | Iowa (implied) | Alabama | Louisiana | | | |
| Maryland | Tennessee | Alaska | New Jersey | | | |
| Minnesota | Texas | Connecticut | **New York** | | | |
| Missouri | Vermont | Illinois | Rhode Island | | | |
| North Carolina | | Massachusetts | West Virginia | | | |
| South Carolina | | Mississippi | Wisconsin | | | |
| Utah | | Nevada | | | | |
| Virginia | | New Hampshire | | | | |
| | | Ohio | | | | |
| | | Oklahoma | | | | |
| | | Oregon | | | | |
| | | Pennsylvania | | | | |
| | | Washington | | | | |

Source:  Fitch Ratings Ltd.