LEGISLATIVE FISCAL ESTIMATE

ASSEMBLY, No. 4175

STATE OF NEW JERSEY
219th LEGISLATURE

DATED: JUNE 9, 2020

SUMMARY

Synopsis: "New Jersey COVID-19 Emergency Bond Act," authorizes issuance of State bonds totaling $5 billion and authorizes borrowing from federal government.

Types of Impact: Multi-year State expenditure and revenue increases. Indeterminate multi-year impact on expenditures of certain local governments.

Agencies Affected: Department of the Treasury. Department of Community Affairs. Certain local governments.

Office of Legislative Services Estimate

Fiscal Impact	
Multi-Year State Expenditure Increase	Indeterminate
Multi-Year State Revenue Increase	Indeterminate
Multi-Year Local Government Expenditure Impact	Indeterminate

- The Office of Legislative Services (OLS) cannot project the total debt service cost the State would incur from issuing different forms of indebtedness to address State and local government funding needs related to the COVID-19 pandemic. This is so because the final debt service cost would be a function of the amounts, structures, and terms of the authorized debt instruments, of which many elements remain to be determined. For instance, while the bill authorizes the issuance of $5 billion in general obligation bonds, it does not restrict the amount of permitted short-term borrowing, including from the federal government.

- The State would incur indeterminate expenditures in administering a limited-duration program under which unspecified amounts would be borrowed from the federal government to make loans to and purchase securities issued by qualifying local governments to address their funding needs related to the COVID-19 pandemic. The OLS cannot forecast whether the State would fully recover its cost of capitalizing and administering the program, incur net losses, or achieve net gains because of uncertainty regarding certain key variables, such as the terms and conditions of the financial assistance and the scale of any payment defaults by local government borrowers.

- The OLS cannot determine the impact of the bill on debt service payments of local governments participating in the financial assistance program, as the impact would depend on each entity's specific circumstances. Debt service expenditures would increase for local governments that absent the program would not issue debt to manage the fiscal fallout of the pandemic. On the other hand, local governments that otherwise would access capital markets at conditions less favorable than those offered by the State would lower their debt service payment obligations as a result of program participation.

- Annual State revenues would increase by an indeterminate amount over several years from interest earned on unexpended borrowed funds and local government loan repayments.

BILL DESCRIPTION

The bill permits the issuance of the following State debt instruments without voter approval to address State and local government funding needs arising from the COVID-19 pandemic: a) $5 billion in general obligation bonds for State use, which may mature no later than 35 years from the date of issuance; b) an unspecified amount of borrowing from the federal government, as may be available and on such terms as the federal government stipulates, for State use and to establish a State-operated financial assistance program for certain local governments; and c) an unspecified amount of short-term notes to be sold to capital market participants for State cash flow management purposes in FY 2020 and FY 2021. Any debt issuance may subsequently be refunded. The State would back all debt instruments with its taxing powers, pledging its full faith and credit to the required semiannual debt service payments. Any interest the State may earn on any unexpended principal amount would be deposited into the State General Fund.

The Department of Community Affairs (DCA) would develop and administer the financial assistance program for local governments that would be capitalized by an unspecified amount the State would borrow from the federal government. Only local governments experiencing serious financial distress due to the COVID-19 pandemic could qualify for financial assistance, and only if they are ineligible to borrow directly from the federal government for that purpose. The financial assistance may be in the form of loans to or the purchase of any securities issued by qualifying local governments. The DCA would set the terms and conditions of the financial assistance, including the terms of securing local government repayment obligations. Local government loan repayments would be deposited in the State General Fund.

FISCAL ANALYSIS

EXECUTIVE BRANCH

None received.

OFFICE OF LEGISLATIVE SERVICES

The OLS determines that the bill would produce indeterminate multi-year State expenditure and revenue increases with expenditure growth widely outpacing added revenue. In addition, the bill would produce an indeterminate impact on annual debt service payment obligations of local governments that would participate in the limited-duration financial assistance program the State would set up to make loans to and purchase securities issued by qualifying local governments.

State Debt Service Payments: The OLS cannot project the total debt service cost the State would incur from issuing different forms of indebtedness to address State and local government funding needs related to the COVID-19 pandemic. This is so because the final debt service cost would be a function of the amounts, structures, and terms of the authorized debt instruments, of which many elements remain to be determined. For instance, while the bill limits the issuance of general obligation bonds to $5 billion, it does not restrict the amount of permitted short-term borrowing, including from the federal government.

General Obligation Bonds: Although the bill allows the issuance of $5 billion in general obligation bonds, the Executive may not exercise the full authority. With the amount, structure, and terms of the general obligation bond issuance unknown, the OLS conducts a sensitivity analysis that identifies possible State debt service payment scenarios for each $1 billion in general obligation bonds issued. In performing the analysis, the OLS makes the following simplifying assumptions: a) the bonds' maturity period will be 20 years; b) two debt service payments will be made each year; c) the debt service payments will be level until maturity; and d) the bond issuance will have a basic structure without any credit enhancements or original issue premiums or discounts.

For each scenario, the table below displays annual debt service payments as well as total debt service and interest payments until the bonds are paid off. The adjustable variable is the annual interest rate, which ranges from 4.0 percent to 6.0 percent. Regarding the interest rate choice, the OLS places a one-percent band around the 5.0 percent rate the State secured in January 2020 for debt service payments for those series of a $150 million tax-exempt general obligation bond sale that have the latest maturity dates. The OLS cautions, however, that conditions actually existing in the bond market at the time of issuance may dictate interest rates outside of the OLS' band.

Debt Service Payment Scenarios for Issuance of $1 Billion in Bonds, 20-Year Maturity Period (In Millions)

	Annual Interest Rate				
	4.0%	**4.5%**	**5.0%**	**5.5%**	**6.0%**
Annual Debt Service	**$73.1**	**$76.4**	**$79.7**	**$83.1**	**$86.5**
Total Debt Service Payments	**$1,462.2**	**$1,527.1**	**$1,593.4**	**$1,661.3**	**$1,730.5**
A) Total Principal Payments	$1,000.0	$1,000.0	$1,000.0	$1,000.0	$1,000.0
B) Total Interest Payments	$462.2	$527.1	$593.4	$661.3	$730.5

Accordingly, the OLS calculates that for each $1 billion borrowed the State might incur total debt service costs ranging from $1.5 billion to $1.7 billion spread over 20 years, which includes total interest payments ranging from $462.2 million to $730.5 million (46.2 percent to 73.1 percent of the $1 billion borrowed). The lower bound represents a 4.0 percent annual interest rate and the upper bound a 6.0 percent annual interest rate. If the assumptions hold, annual debt service payments could be as low as $73.1 million at a 4.0 percent interest rate and as high as $86.5 million at a 6.0 percent interest rate. The OLS further notes that total debt service would be lower if bonds were issued for a shorter term and all other assumptions remained the same, and the converse.

Federal Borrowing: The bill authorizes an unspecified amount of borrowing from the federal government, as may be available and on such terms as the federal government stipulates, for State use and to establish a State financial assistance program for certain local governments. The bill does not set a maximum or minimum for either component of the federal borrowing. Currently, one such federal program is available.

Under the Municipal Liquidity Facility, the Federal Reserve Bank of New York will purchase up to $9.25 billion of eligible short-term notes with a maturity period not to exceed 36 months directly from the State of New Jersey at the time of issuance, if requested by the State. The State may use the proceeds to manage its cash flow pressures resulting from the COVID-19 pandemic, to pay the origination fee equal to 0.1 percent of the par amount issued, and to assist local governments with the management of their pandemic-induced cash flow effects.

Interest rates would vary depending on the term of the short-term notes. Currently, New Jersey could expect an interest rate of just under three percent for three-year notes. For the issuance of $1 billion in three-year notes at an interest rate of three percent with interest-only payments every six months and the $1 billion repaid in full at maturity, the State would owe $30 million in interest per year, and $90 million in total interest over the three-year term of the borrowing.

Short-Term Notes: The bill also authorizes the State to borrow an unspecified amount of short-term notes from capital market participants for State cash flow management purposes in FY 2020 and FY 2021. It is expected that the State would only do so if market conditions were more favorable than the terms offered by the federal government or if the State intended to borrow any amounts in addition to any general obligation bond issuance and any federal borrowing. The OLS adds that like any debt issuance under the bill, the short-term notes may be refunded.

State Costs of Local Government Assistance Program: In addition to higher debt service payments, the State would incur increased indeterminate costs from operating a limited-duration program that would use an unspecified amount to be borrowed from the federal government to make loans to or purchase securities issued by certain local governments to address their financial imbalances caused by the COVID-19 pandemic.

Currently, the Municipal Liquidity Facility is the only available federal lending program. As explained above, the maximum allotment to the State of New Jersey is $9.25 billion, to be repaid over a term not to exceed 36 months, but the State may refund the borrowed amount at any time.

Participation in the financial assistance program is restricted to local governments that are barred from borrowing directly from the federal government for COVID-19 pandemic financial relief. Under the terms of the Municipal Liquidity Facility, nine New Jersey counties and two municipalities may borrow directly from the Federal Reserve, thereby rendering them ineligible for the bill's financial assistance program: the counties of Bergen, Camden, Essex, Hudson, Middlesex, Monmouth, Ocean, Passaic, and Union as well as the cities of Jersey City and Newark.

The DCA would incur additional expenditures to administer the temporary financial assistance program. The OLS, however, is unable to quantify this fiscal effect, as the amount that would be borrowed to capitalize the program, the number of applications for assistance to be reviewed, and the number of assistance agreements to be managed are unknown.

Furthermore, the OLS lacks the informational basis to gauge whether the State would fully recover its cost of capitalizing and administering the program, incur net losses, or even achieve net gains. Specifically, the DCA would set the terms and conditions of the financial assistance, including the terms of local government repayment obligations. Considering the substantial discretion granted to the DCA, it is unclear what terms the department would impose on borrowers. As a result, and in conjunction with the flexibility the bill grants the Executive in determining the size of the program, the OLS is unable to forecast program participation, interest rates, the number of local government securities that would be purchased, and the scale of any defaults by local government borrowers, as the State - and not the federal government - would bear the credit risk.

State Revenue Increases: An annual State revenue increase would occur over several years from local government debt service payments to the State and interest earned on unexpended borrowed funds. Insufficient information precludes the OLS from quantifying the revenue gains, as they hinge on future Executive determinations as to the parameters of the local government assistance program and the promptness of the disbursement of bond proceeds.

Local Government Debt Service Payments: The impact of the bill on debt service expenditures of local governments participating in the financial assistance program would largely depend on each entity's specific circumstances. Debt service expenditures would increase for local governments that absent the program would not issue debt to manage the fiscal fallout of the COVID-19 pandemic. On the other hand, local governments that otherwise would access capital markets at conditions less favorable than those offered by the State would lower their debt service payment obligations as a result of program participation. The OLS cannot ascertain which local governments would participate in the program and the manner in which program participation would affect their debt service payment obligations.

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This fiscal estimate has been prepared pursuant to P.L.1980, c.67 (C.52:13B-6 et seq.).