OFFICE OF THE NEW YORK STATE COMPTROLLER

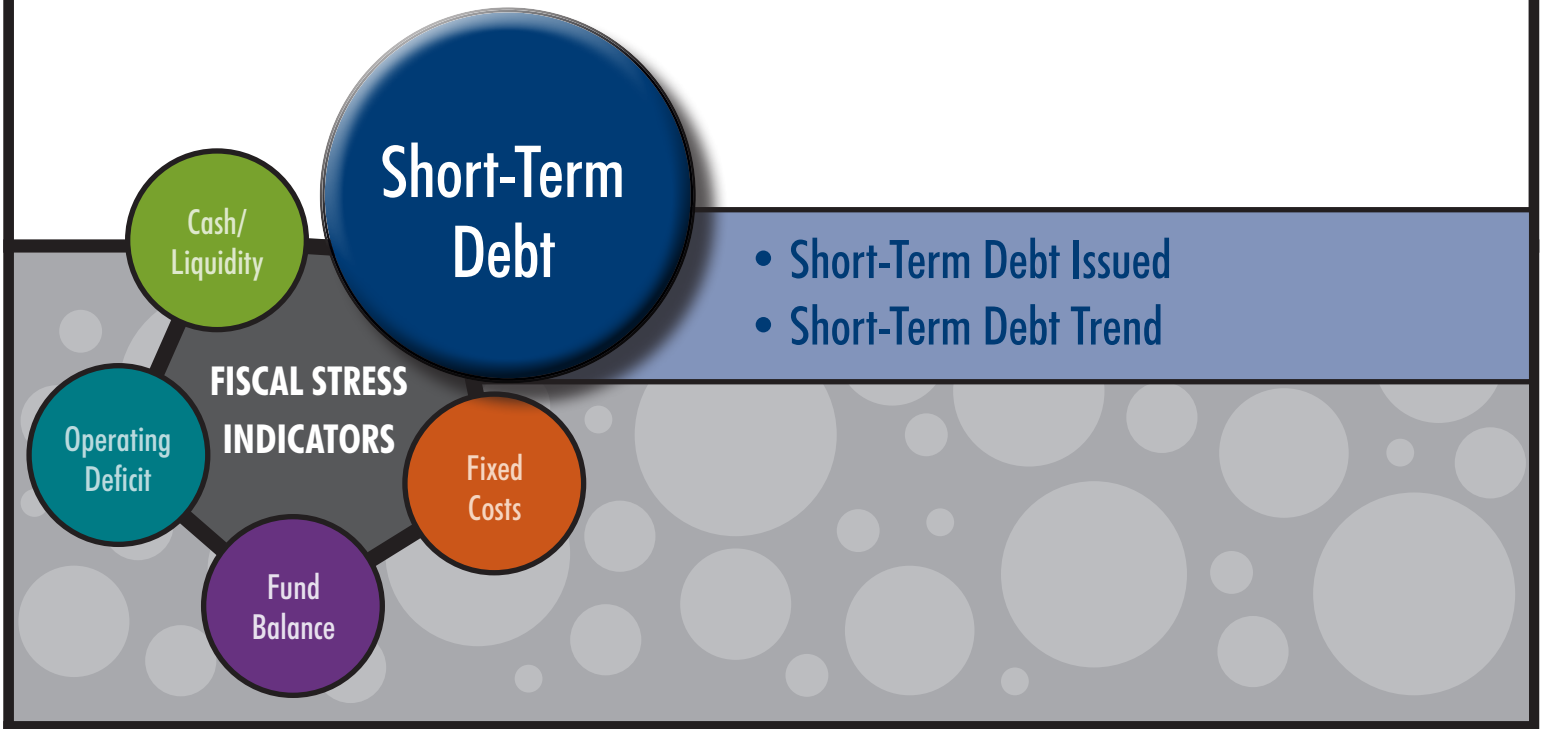
Thomas P. DiNapoli • State Comptroller

Fiscal Stress Close-Up

Short-Term Debt

Local governments issue debt for many reasons.[1] Most local debt is like a homeowner's mortgage or a car loan: the local government borrows money to finance an item, such as a building, road or truck, and then repays the money over time. Usually the local government issues a bond, which will be paid off over a maximum period equivalent to the amount of time the purchased item will last.[2] For example, a bond for police cars might have to be repaid within 3 years, while a bond for a new building might have a term of as long as 30 years. Loans and financial obligations lasting more than one year are known as *long-term* debt.

Local government *short-term* debt is different, and can be compared to a "bridge loan" for a business or an individual. Money is borrowed for an immediate need and will ultimately be paid back from future taxes, or other kinds of revenue. There are many reasons why local governments utilize this type of borrowing. Sometimes short-term debt is used in cases of an emergency such as a natural disaster, when a clean-up must be completed and paid for much sooner than a local government can expect to receive federal or State disaster assistance. More often, however, short-term debt is used to pay for normal operating expenses when local governments are having cash flow issues. Cash shortfalls occur when bills must be paid before revenue is received to pay them, or when expenditures exceed revenues in a fiscal year. Borrowing for operating expenses is not advised, since it means that the local government would be paying interest and other related expenses (e.g., legal and financial advisor fees) instead of maintaining sufficient cash flow to pay for expenses as they occur.



Since the use of short-term debt may be tied to cash flow problems, the presence of short-term debt is measured in the Office of the State Comptroller's (OSC's) Fiscal Stress Monitoring System (FSMS).[3] [See "Fiscal Stress Monitoring System: What Does It Measure?" below for details.]

The FSMS includes two indicators relating to short-term debt:

- Amount of short-term debt issued in the most current fiscal year – a local government with more debt will receive a higher score; and
- Short-term debt issued over the last three fiscal years – a local government that has issued debt more frequently will receive a higher score.[4]

What types of short-term debt are available and how are they used?

Several kinds of short-term debt are authorized under New York State law, including:

- **Tax Anticipation Notes (TANs):** Issued to cover expenses in anticipation of the collection of budgeted real property taxes and assessments.
- **Revenue Anticipation Notes (RANs):** Issued to cover expenses in anticipation of the collection of certain kinds of future revenues, such as State aid.
- **Budget notes:** Most commonly issued to finance expenditures required by unforeseeable public emergencies or to finance higher-than-expected expenditures that were not provided for in the annual budget.
- **Deficiency notes:** Issued to help address situations where revenues are coming in lower than what is estimated in the annual budget.[5]
- **Bond Anticipation Notes (BANs):** Typically issued in anticipation of issuing long-term bonds. They may be renewed for up to five years, after which bonds usually must be issued. Since BANs are essentially issued for long-term debt purposes, they are not included in the FSMS short-term debt category and will not be discussed in this report.

Fiscal Stress Monitoring System (FSMS): What Does It Measure?

"Fiscal stress" refers to the difficulties in generating enough revenues to meet expenditures in the long term. OSC's FSMS measures a local government's ability to balance its budget, pay its bills, keep its debt in check and have some funds left over at the end of the fiscal year. It does not measure the quality or quantity of services provided, their cost-efficiency or how hard local officials have worked to achieve this balance given the local economic climate.

FSMS has five categories of indicators: fund balance, liquidity, short-term debt, operating deficits, and fixed costs. These indicators contribute to a local government's final classification of Significant Stress, Moderate Stress, Susceptible to Stress or No Designation. More information on the scoring system for each of the indicators can be found in OSC's "Fiscal Stress Monitoring System" report.

This report, which focuses on short term debt indicators, is one of a series examining each of the five FSMS categories. These reports will discuss the circumstances under which a high score in any category is cause for concern.

How common is short-term debt?

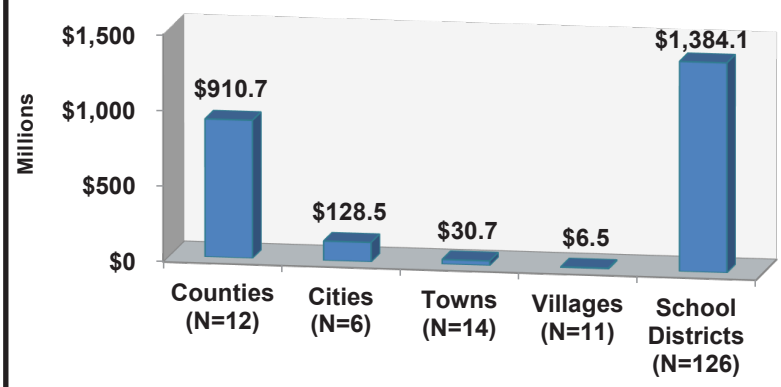
Counties and school districts are by far the biggest issuers of short-term debt, accounting for 93 percent of the $2.5 billion issued by 169 local governments in fiscal year 2013. Counties and school districts typically use short-term debt to bridge financial gaps caused by poor timing of revenue receipts (generally property taxes or State aid).

By contrast, very few towns issue short-term debt, but those that do are likely to borrow a lot. Short-term debt as a percentage of total revenues for the median town with such debt was 47.6 percent. Usually this debt covers emergency disaster recovery spending, which is eventually reimbursed by the Federal Emergency Management Agency (FEMA). This is also true for villages, although generally their short-term debt for these purposes was less (relative to revenues) than that of towns.

In fiscal year 2013, 7.9 percent of all local governments scored had issued short-term debt in the most current fiscal year; 5.9 percent of units scored had done so in each of the previous three fiscal years.

Even though there are many issues that may contribute to the overall level of fiscal stress for school districts, such as a deteriorating economic situation and reductions in State school aid, the total number of school districts that have issued short-term debt has been decreasing over the past decade. This may be due to several factors, not the least of which is that State budgets have been

Total Short-Term Debt Issued by Class (millions)



Source: Office of the State Comptroller (OSC).
Only includes local governments with short-term debt in fiscal year 2013.

Audit Findings: Counties

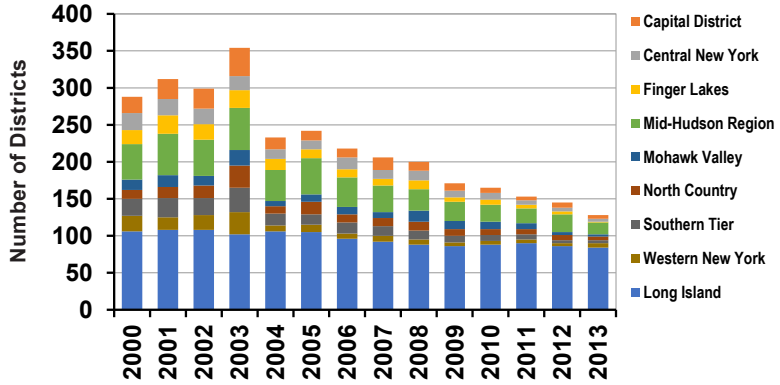
A 2013 OSC audit found that one county's use of fund balance to finance operations critically impacted the county's cash flow. Consequently, the county had to issue short-term debt in order to cope with a delay in State aid payments. The audit noted that, had the County maintained healthier fund balances, it could have had sufficient resources to sustain operations until aid was received.

A 2010 OSC audit of real property tax collections in another county found that town tax collectors did not always collect and remit property tax moneys to the county in a timely manner. The delay in receiving tax revenue contributed to cash flow problems that required the county to issue TANs totaling $4.5 million dollars in January 2009 and to incur $33,000 in related fees and interest expenses.

enacted on time since 2011. Aside from a very late budget in 2010, State budgets have been no more than a few days late since 2004. Prior to that, in 2003, the number of school districts issuing RANs increased by 18 percent over 2002. The amount of those RANs increased by 72 percent, or by over $300 million more in debt that school districts had to finance in that year.

The Long Island region has traditionally had the greatest number of school districts that have issued short-term debt. While other regions have seen a decline in the number of school districts that have issued short-term debt, the number has been much more stable in the Long Island region over the last decade.

Number of School Districts Issuing Short-Term Debt by Region, 2000-2013 (Excludes Deficiency Notes)



Source: OSC

Suffolk County accounted for $515 million (57 percent) of the $911 million in short-term debt issued by counties in 2013. Rockland County accounted for 18 percent. Over the past decade, only a small number of counties have issued short-term debt every year or nearly every year: Monroe, Nassau, Putnam, Rockland and Suffolk counties. But, more recently, Albany, Broome, St. Lawrence, Sullivan and Westchester counties have been issuing short-term debt on a yearly basis.

Audit Findings: Municipalities[6]

A 2012 OSC audit found that one city's poor financial records prevented officials from making sound financial decisions. In November 2009, city officials issued a TAN for $5.6 million and renewed it in November 2010 and 2011 without a comprehensive cash flow analysis, which would have shown that the city could have paid off or retired the TAN and still had sufficient cash available. Instead, the TAN was renewed in November 2011 at an interest rate of 5.25 percent, leading to $271,489 in unnecessary interest costs.

A 2013 audit of a town's financial condition by OSC found that poor budgeting practices, including unrealistic revenue estimates, led to a fiscal decline. Cash flow problems led to the issuance of RANs for three consecutive years, as well as the issuance of deficiency notes in the third year. Since deficiency notes must be repaid with revenues from the following year, the audit anticipated that operating expenses would be even more difficult to fund in that year.

Why is short-term debt considered a symptom of fiscal stress?

While there are some exceptions, a heavy or ongoing reliance on short-term debt indicates that the government has cash flow issues that are not being resolved. Borrowing to balance an operating budget with no realistic plan to replace such temporary resources in subsequent years is especially problematic. Repeated use of this type of borrowing may lead to a fiscal crisis. Another problem with a dependence on short-term debt is that interest rates and market access are not always ideal. For part of 2008, temporary disruptions in the credit markets made the issuance of short-term debt difficult or impossible. In such a situation, a local government or school district that relies on short-term debt may find itself suddenly unable to meet payroll or cover other operating expenses.[7]

For these reasons, credit rating agencies may characterize the existence of this type of debt as a "credit negative," raising the possibility that it could lead to higher borrowing costs for local governments.

RANs and **TANs** are sometimes used for several consecutive years because a government repeatedly has a particularly difficult period when incoming bills exceed cash on hand. In some instances, short-term notes may even be rolled over year to year, essentially turning them into long-term debt for operating expenses. The entity's ongoing revenues may be insufficient to cover ongoing expenditures, and the "short-term" debt is being used to temporarily cover the problem.

Budget notes are not as common as RANs or TANs, being used in only two towns and six villages in 2013. However, since they are usually issued to fund unbudgeted expenditures, they may indicate poor budget practices.

Deficiency notes were authorized in 2010 and began being used in 2012, when they were issued by only one town. None were issued in 2013. They are designed to handle situations where revenue falls short of what is expected in the budget, such as when the last recession caused county sales tax collections to drop in 2009.

Audit Findings: School Districts

A 2011 financial condition audit by OSC found that poor revenue projections and budget monitoring had caused one school district to rely on RANs to finance operations and alleviate cash flow problems in two consecutive years. Interest costs for RANs amounted to $15,000 for one year.

A 2011 OSC audit of another school district faulted the district for relying on annual RAN borrowings not only to alleviate cash flow difficulties, but to finance operations. It also found that the district failed to set aside revenues in a special bank account to pay the principal on the notes.

Is short-term debt ever justifiable?

The issuance of short-term debt alone cannot determine the level of stress a municipality is facing. In fact, there are some instances in which the use of short-term debt is justifiable and may be necessary.

An example of this can be found on Long Island. Unlike school districts in most other parts of the State, school districts in Nassau and Suffolk counties do not receive the bulk of their real property tax revenue during September. Instead, they get two payments, one approximately midway through the school fiscal year – January in Suffolk, November in Nassau – and the other in May, near the end. Since school districts must have money for expenditures throughout the fiscal year, this makes short-term debt a reasonable option, even when the school districts are not in fiscal stress by other measures. In order to bridge the gap between when expenditures must be made and when revenues come in, many of these districts depend regularly on issuing TANs.

Another appropriate use of short-term debt is for payment of emergency and disaster-related costs in anticipation of federal or State reimbursement. In these circumstances, RANs or budget notes may be issued in anticipation of FEMA aid. Necessarily, this kind of short-term debt is included in the indicator scores. However, if a local government with such emergency/disaster-related costs does not have other kinds of stress indicators, it would not receive a high FSMS score for fiscal stress based on this indicator alone.

Recurring Debt: A Caution

Even when recurring short-term debt is not a sign of immediate stress, it can increase costs unnecessarily, possibly contributing to stress in future years. Like long-term bond debt for capital improvements, short-term debt involves the payment of interest, which adds to the cost of government. However, while this additional cost may be justified for long-term projects which will benefit the taxpayers of the local government over the period of the capital improvement's life, the same cannot be said of short-term interest expenditures. Therefore, local governments should be cautious in the use of short-term debt.

Notes

[1] Counties, cities, towns, villages and school districts are all referred to as "local governments" in this report.

[2] This period of time is determined by State law in accordance with Article VIII, section 2 of the State Constitution.

[3] The FSMS financial indicators are calculated using data that is filed by local governments in annual update documents (AUDs) and by school districts in annual financial reports (ST-3s). All data in this report relates to each local government's fiscal year ending in 2013.

[4] For more detail on the FSMS indicators, see Office of the State Comptroller, *Fiscal Stress Monitoring System,* at **http://www.osc.state.ny.us/localgov/pubs/fiscalmonitoring/pdf/fiscalstressmonitoring.pdf**.

[5] Deficiency notes were not included in the first year of the FSMS system. They will be part of the scores in future years.

[6] The audit findings discussed in this report are from the following OSC audits: *Saugerties Central School District: Financial Condition and Internal Controls Over Information Technology (2011M-50), Town of Oyster Bay: Financial Condition and Selected Financial Operations (2013M-54), Clinton Central School District: Financial Condition (2011M-133), Warren County: Financial Condition (2011M-31), Broome County: Financial Condition (2013M-224), City of Newburgh: Council Oversight and Revenue Enhancement Opportunities (2012M-77).* OSC audits of local governments are available online at: **http://www.osc.state.ny.us/localgov/audits/index.htm.**

[7] Office of the State Comptroller, *The Credit Crunch: Implications of Local Government Short-Term Debt,* November 2008, at **http://www.osc.state.ny.us/localgov/pubs/research/creditcrunch.pdf**.

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