



# UNDERSTANDING THE NEW HAMPSHIRE STATE BUDGET

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## *Mortgaging the Future*

*Can New Hampshire borrow its way to a balanced budget?*

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Summary: Governor John Lynch’s proposed solution to New Hampshire’s current budget crisis includes three major provisions to borrow money: refunding current debt, issuing new bonds to meet next year’s debt service payments, and borrowing money from the University System of New Hampshire. This report examines those three ideas, how much they would increase New Hampshire’s debt level, and the arguments for and against new borrowing to meet short term budget pressures.

### **BACKGROUND**

Increased spending, rising caseloads, and failure to meet revenue estimates have left New Hampshire government with a looming budget deficit. On April 8, 2010, Governor John Lynch proposed a series of budget cuts and revenue increases totaling \$220 million.

The Governor’s proposal includes spending cuts and tax increases and anticipates additional funds from the federal government. These steps account for about \$140 million. To reach \$220 million, Governor Lynch borrows the rest. The Lynch package includes three bonding provisions, generating \$82 million to help balance the FY10-11 budget.

### **REFUNDING BONDS- \$6 million**

New Hampshire routinely refinances its existing debt in order to take advantage of lower interest rates. State Treasurer Catherine Provencher issued “Refunding Bonds” in 2006, 2008, 2009, and 2010. On April 8, 2010 Provencher issued \$153 million in refunding bonds, and used the proceeds to call existing higher-interest bonds before their scheduled maturity date.

<b>Proposal</b>	<b>Amount</b>	<b>Status</b>
<b>Refunding Bonds</b>	\$6 million	Issued April 8, 2010
<b>FY11 Debt Service</b>	\$51 million	SB 450
<b>USNH</b>	(\$39 m GF)	House Finance
	\$25 million	SB 450 House Finance

Locking in the lower rate will save the state \$6 million in interest payments. Normally, those lower payments would be spread over the ten-year life of the bonds, but Provencher accelerated the savings into FY10 and FY11, resulting in \$3 million in savings each year. The state's bond payments for the rest of the decade are unchanged. Unlike the other two proposals to be examined, this bond issue did not increase the state's long-term debt, or postpone existing debt past the current budget window.

In briefing a joint hearing of the House and Senate Finance Committees, Provencher said that she has already refinanced as much of the state's current debt as she can, and doesn't expect to be able to squeeze much more savings out of refunding bonds before rates start to rise again.

**RESTRUCTURING- \$51 million (\$39 million General Fund)**

While reissuing current debt at lower interest rates is routine for the State Treasurer, the Lynch Proposal also includes the unprecedented step of issuing new debt to pay for current debt service.

"This has not been done in New Hampshire before," Provencher explains. "And this is not something we would want to get into the habit of doing."

Provencher says New Hampshire has traditionally been very conservative in its borrowing practices, and she says bond rating agencies have given states a little more slack as they face tough decisions during the current recession.

The largest bonding provision in the Lynch Proposal calls for issuing \$51 million in new bonds, and using the proceeds to make the state's general obligation bond payments in FY 11. This money would not lower the state's debt, or address the long term budget problem, but postpones it until after the current budget closes in June 2012. Since approximately 80% of the state's borrowing goes toward General Fund spending, Provencher calculates that the new bonds would pay off \$39 million in General Fund debt in FY 11, lowering that year's deficit by that amount. This proposal is under consideration by the House Finance Committee as an amendment to SB 450.

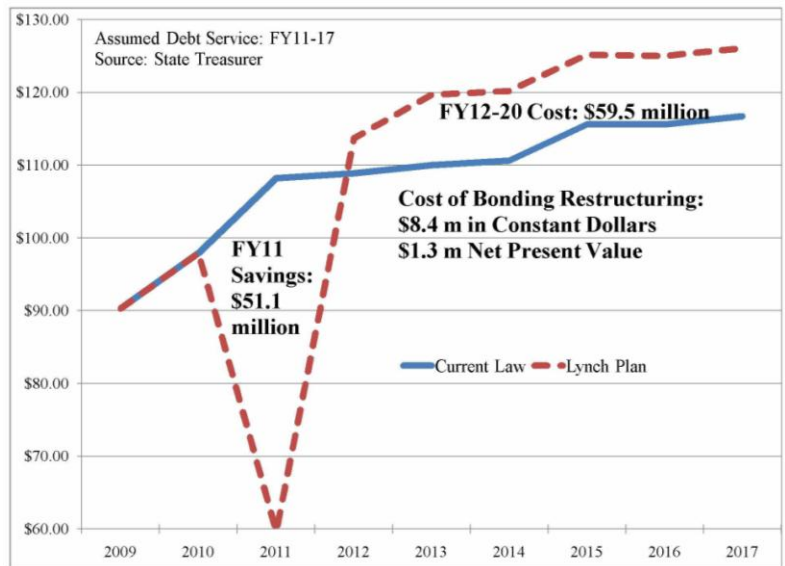
Traditionally, bonding is reserved for long-term capital projects, such as highway construction and new court houses. Provencher stresses that in normal economic times, bond rating agencies are highly critical of states borrowing to pay for their operating expenses, including meeting their outstanding loan obligations when the notes come due. She likens the debt service plan to refinancing a home mortgage, not to add value to the house but simply to put off the current mortgage payments.

While the refunding proposal saves the state \$6 million over the next two years, and adds no long term costs, the refinancing proposal will increase the state's bond payments in the future. Provencher calculates that refinancing \$51.1 million in debt service payments next year will cost a total of \$8.4 million over the life of the loan.

The real cost of this debt, when adjusted for inflation, is much lower. The Net Present Value of the new debt is \$1.3 million, just over \$1 million of which will come from the General Fund.

Net Present Value discounts future obligations against inflation, since \$1 ten years from now is worth significantly less than \$1 today.

The following chart illustrates the short term savings and long term costs of refinancing \$51 million in FY 11 debt service payments.



**UNIVERSITY SYSTEM BONDING- \$25 million**

The final piece of Governor Lynch’s three-part bonding plan would essentially borrow \$25 million from the University System of New Hampshire. The University System would transfer \$25 million from its cash reserves to the General Fund, subject to approval of its Board and the Legislative Fiscal Committee. Upon receipt, the money would be put towards paying down the FY10 deficit.

In exchange, an amendment to SB 450 would add \$25 million to the state’s Capital Budget to pay for deferred maintenance on building across the University System. The Capital Budget is funded through bonding, generally issued each December, and pays for long-term construction projects such as roads, bridges, and state buildings.

In adding \$25 million to the Capital Budget to be spent by the University System, the state’s General Fund would pay back the newly issued bonds over the next twenty years. In effect, the state would be borrowing \$25 million from the University System to pay for current operating expenses, since the General Fund would receive \$25 million up front, and be responsible for paying back the notes over the next two decades.

This proposal would expand the University System’s share of the state’s total capital expenditures. In 2005, the New Hampshire Legislature authorized the Knowledge Economy Education Plan (KEEP-NH), under which the University System could use \$109.5 over eight years from the state’s Capital Budget to renovate and expand academic facilities on University System campuses. This proposal would increase the University’s share of the Capital Budget to \$134.5 million.

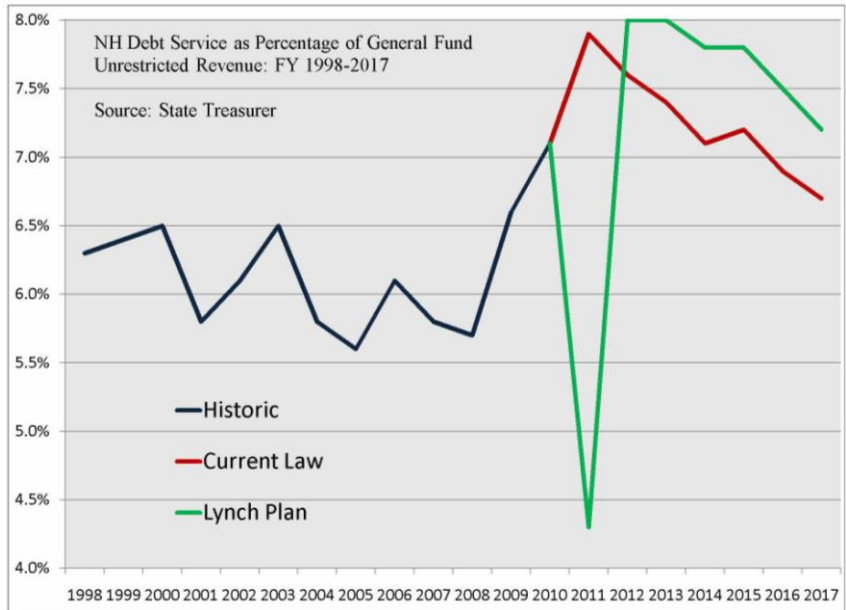
Both this and the Restructuring proposal add to New Hampshire’s long term debt in order to pay current General Fund expenses. While the Restructuring is targeted to current year debt service, the \$25 million from the University System is not dedicated to any specific program, but would offset General Fund spending as a whole.

**NEW HAMPSHIRE’S DEBT SERVICE RATIO**

Provencher says bond rating agencies check to see how much each state borrows as a percentage of its General Fund expenditures, and that 10% raises red flags. Since 1987, New Hampshire’s

debt service ratio has never topped 7.3%. According to projections provided by the Treasurer’s Office to the Legislature, the state’s debt service ratio is likely to hit 7.9% next year, and would crack 8% for the first time if the Lynch Restructuring and University System bonds are issued.

Making some of next year’s bond payments with borrowed money would drop the FY11 ratio to 4.3%, the lowest rate in the twenty years covered in this report. But the ratio would quickly jump to the highest in state history, and remain higher than current projected levels for the foreseeable future.



Since 1998, New Hampshire’s debt service ratio has remained within the relatively narrow range of 5.6% to 6.6% percent, jumping to 7.1% this year.

Under current projections, the ratio would spike at 7.9% in 2011, but return quickly to historic levels. If the Lynch Proposal is adopted in full, the ratio would peak at 8% in 2012 and remain above New Hampshire’s historic range through 2017.

### PROS AND CONS

The main argument in favor of New Hampshire borrowing its way out of the current budget crisis is that historically low interest rates make taking on new debt more attractive now than it usually is. By borrowing “cheap money”, budget writers can wait for the economy, and state revenues, to recover before having to pay it back. When the state’s fiscal condition improves, they would have sufficient revenue to service the higher debt levels included in the Lynch Proposal.

Postponing the budget crisis might give lawmakers an opportunity to undertake fundamental budget reforms at the beginning of the FY12-13 budget cycle, generating greater savings than the stop-gap solutions currently under consideration.

But “cheap money” still isn’t free. Borrowing to pay for current expenses is rarely sound fiscal policy. New Hampshire has refinanced its existing debt four times in recent years through Refunding Bonds. But issuing new debt to pay off next year’s bond payments does nothing to address the state’s underlying fiscal problems. Borrowing from the University System will also squeeze out future Capital Budget needs, while obligating future Legislatures to pay back this year’s borrowing. Rather than help solve the state’s budget problems, two of the bonding provisions in the Lynch Proposal merely postpone them. They leave the truly tough decisions to future budget writers, and in fact, make the long term problem worse.