August 2017

Monthly Report

Cash Flow Crisis in the General Fund

The state Treasurer and Auditor General, on July 8, issued a warning to members of the General Assembly about dangerously low cash balances in the Commonwealth's General Fund. According to projections completed by the State Treasurer's Office, the General Fund will have a negative cash balance for about eight months of this fiscal year based on the 2017-18 spending package that became law in early July and baseline revenue estimates, since a revenue package to balance the spending plan has not yet been enacted.

It is important to note that a cash flow shortfall is different from a budgetary deficit. Even with balanced budgets, organizations large and small routinely experience periods when their spending outpaces their revenues. When that occurs, organizations draw on cash reserves or borrow money from banks for a short period of time. The Commonwealth is no different and regularly experiences cash flow shortages since its largest revenue collection months are in March and April, which are towards the end of its fiscal year.

Chart 1 (Below) shows the Commonwealth's June 30 cash balances since 2005. As shown in the chart, the Commonwealth ended last fiscal year with $2.3 billion of cash on hand, the lowest balance over the period, including 2008 and 2009 during the depth of the Great Recession. Without additional revenue, that balance is projected to drop to $1.8 billion by the end of this fiscal year, a balance that would be 50 percent lower than the average ending balance from 2005 through 2015.

Continued on Page 2

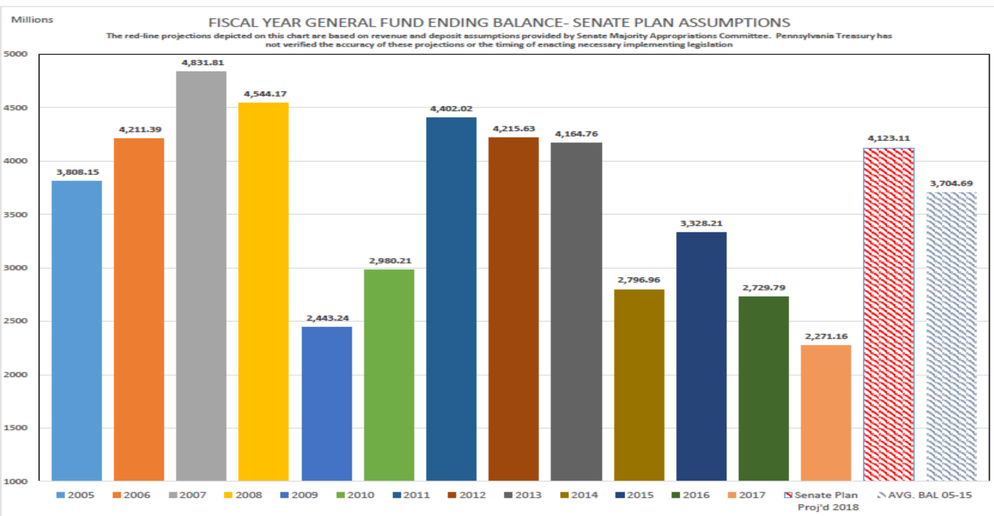

CHART 1

Inside This Issue

Treasurer Statement on Cash Flow

"This is deeply troubling. While our lending is expected to be for a short two-week period, I am extremely concerned that without action from the General Assembly this month, we will face a more difficult problem within weeks. Our projections continue to show that – without corrective action – the General Fund balance will become negative in early September and will remain so for two-thirds of the fiscal year, with the projected overall borrowing need potentially as much as $3 billion."

- **PENNSYLVANIA TREASURER JOE TORSELLA**

For the full statement by Treasurer Torsella visit: www.patreasury.gov.

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Cash Flow Crisis in the General Fund Continued

While cash flow shortages are normal in financially healthy organizations, the Commonwealth has begun experiencing cash flow crunches earlier in its fiscal year and at increasing dollar amounts over the last few years, both of which signify a worsening of the Commonwealth's financial position.

As the Treasurer predicted, the state Treasury will run out of cash in mid-August, less than seven weeks into the fiscal year. While the initial cash flow shortfall is only projected to last a couple of weeks, the greater concern is that the Commonwealth will run out of cash in mid-September and remain in a negative cash position until March of 2018. The Commonwealth's baseline cash flow projection is detailed as the blue line in chart 2 (Below).

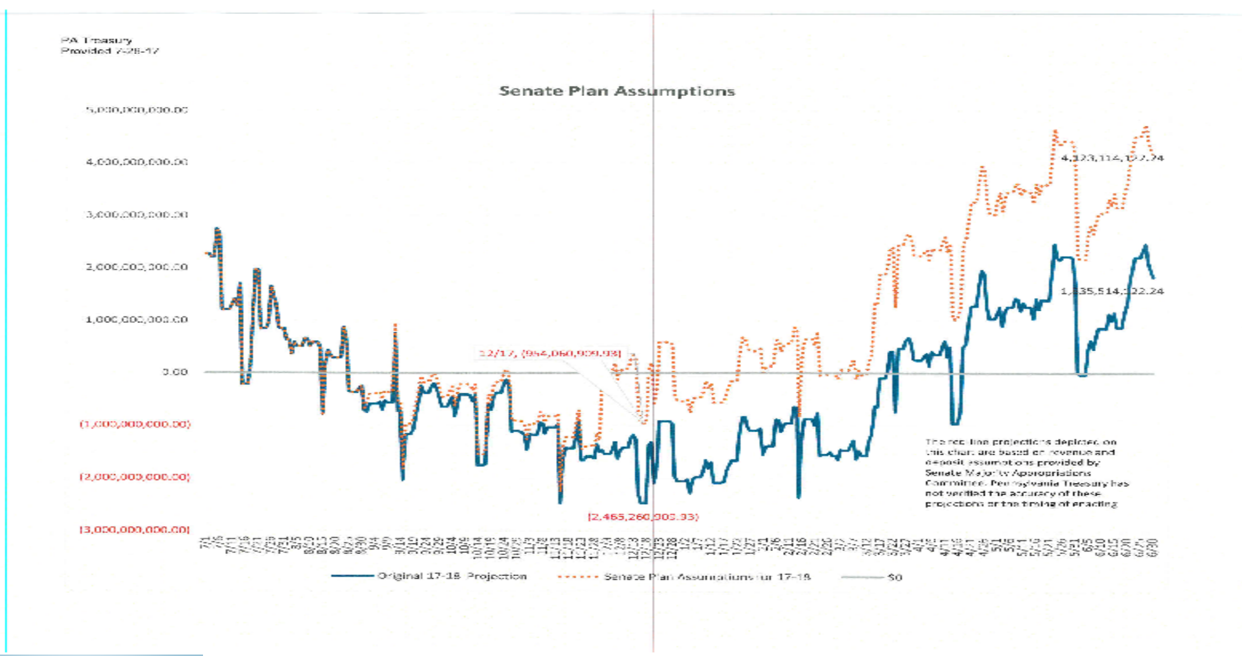
According to the Treasury Department, this year's cash flow situation differs from previous occasions when the Commonwealth had to borrow money early in the new fiscal year. In the past, the state's cash flow balance had an ebb and flow between negative and positive over the course of 12 months. This cash flow shortfall, however, is expected to remain negative for two-thirds of the fiscal year.

What You Need to Know About the Commonwealth's Cash Flow Crisis

- Like most organizations, the Commonwealth regularly experiences short-term cash flow shortages.
- These cash flow shortages have been occurring earlier and at increasing amounts in recent years.
- This year's shortage was worsened by last year's $1.5 billion budget deficit and could be as much as $3 billion. This would force the Commonwealth to go to a bank for a loan or to hold payments until there is sufficient revenue to pay its bills.
- The Senate's responsible revenue package fixes last year's budget deficit and returns the Commonwealth's cash flow to more historic levels.

In order to continue making timely payments to schools, nonprofits and vendors, the state Treasury has historically provided temporary bridge loans from other funds that have available cash balances. The state Treasury authorized, on August 3rd, a $750 million line of credit to the General Fund.

However, this year, the General Fund cash flow shortfall could be as much as $3 billion, significantly more than the State Treasury has historically been able to provide. If a cash flow shortfall of this magnitude occurs, the Commonwealth will have to secure a temporary loan from an outside financial institution.



This year's cash shortfall has been significantly worsened because the Commonwealth ended last year with a $1.5 billion budgetary deficit. In response to that deficit, the Senate passed a responsible revenue package that will bring the Commonwealth's annual budget into balance and vastly improve its cash flow position. That package includes $1.225 billion of one-time revenue generated by monetizing a portion of payments made by major tobacco companies to the Commonwealth.

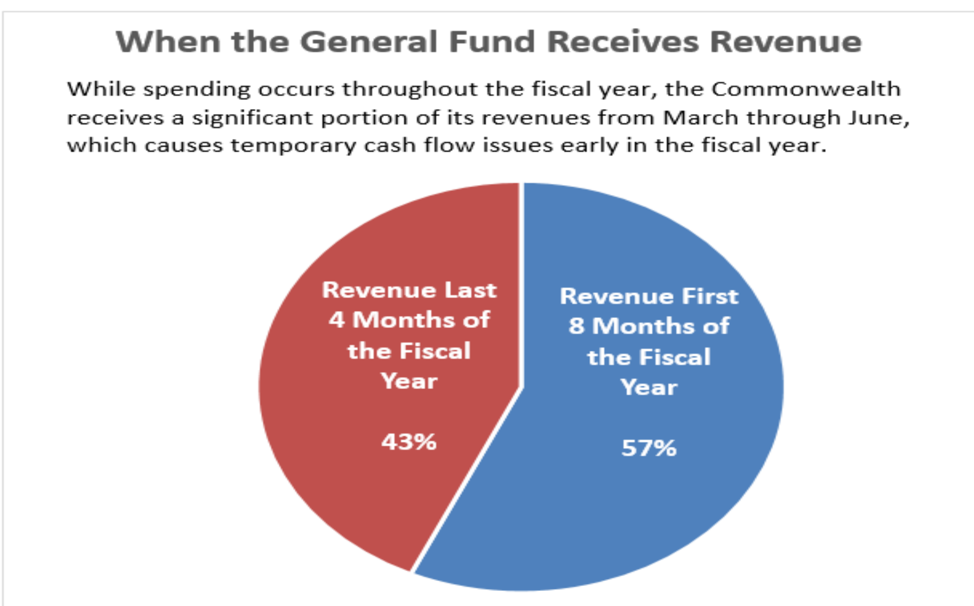
This revenue will be used to offset most of last year's deficit. In addition, the package includes recurring revenue changes like a modest severance tax on natural gas companies that will bring in $80 million this year and $43.5 million by requiring online retailers to collect sales tax owed by Commonwealth residents. A full list of revenues is included in Table 3 (Below).

With these revenue changes, the Commonwealth's cash flow position will improve dramatically as shown by the red line in chart 2 (On page 2) and will return to more historic levels. As a sign of the improvement in the Commonwealth's financial position, the negative cash position is expected to last only four months of the fiscal year with enactment of the revenue package the Senate passed, rather than eight months under the baseline estimate. The revenue package is currently awaiting action by the House of Representatives.

It is imperative that a revenue package be acted on by the end of August. In the absence of a timely revenue package, it is possible the Commonwealth will be unable to secure a loan from an outside financial institution for short-term borrowing. If the Commonwealth is unable to secure sufficient funding from the State Treasurer or a financial institution, it will become necessary to temporarily suspend Commonwealth payments until there is sufficient revenue or to permanently suspend some payments if no revenue package is enacted.

Table 3 – Senate Revenue Package ($ in millions)

Tobacco Revenue Bonds	$1,225.0
Gross Receipts Tax Changes	$405.8
Gaming Expansion	$200.0
Fund Transfer	$200.0
Severance Tax	$80.0
Collecting Sales and Use Tax from Online Retailers	$43.5
Revenue Maximization	$40.0
Fireworks Tax	$2.8
Other	($0.6)



Budgetary Cost Drivers During the Cash Flow Crisis

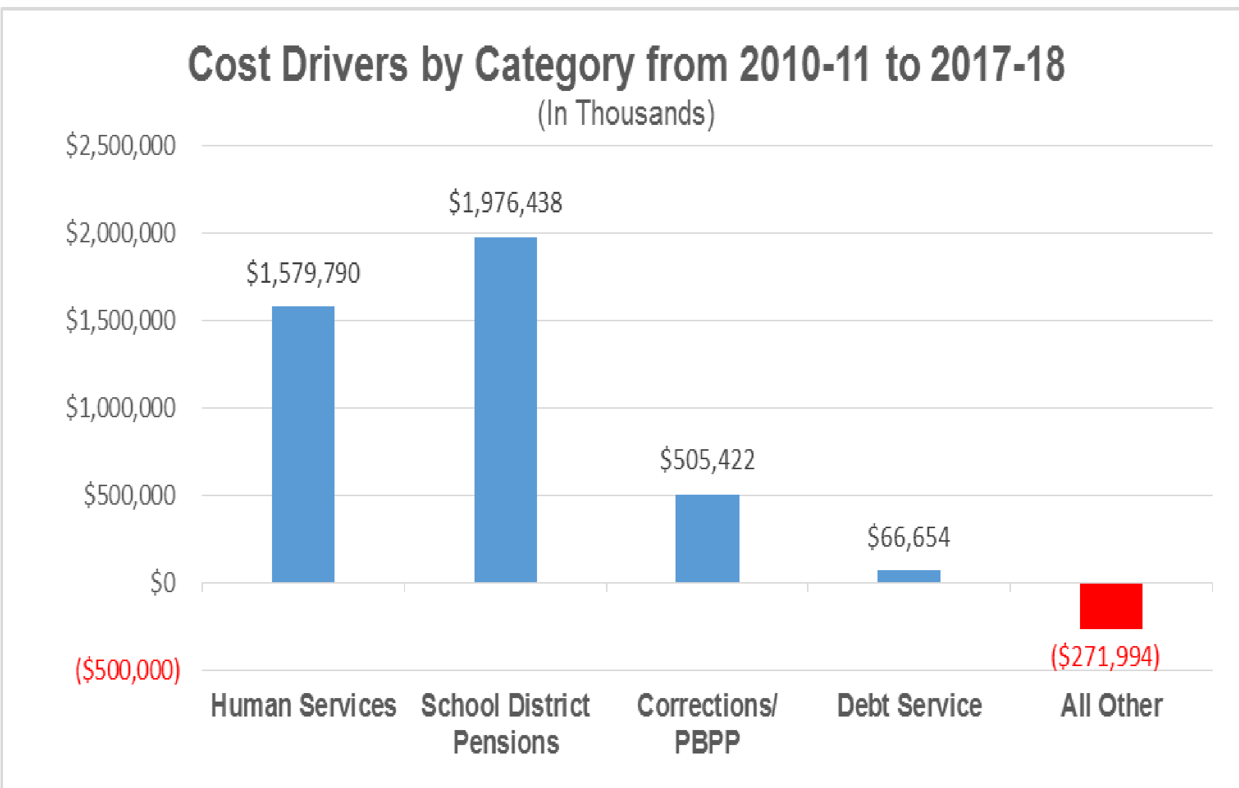
While the Commonwealth is experiencing a cash flow crisis, the Senate has gone to great lengths to control spending in non-mandated areas. As noted in the table and chart below, spending on mandated programs in human services, pensions and corrections has been the primary cost driver over the last seven years. Over the same time, all other spending has actually decreased by nearly $300 million. The Senate has also worked to reduce the number of government employees, which has decreased by 2,200 since June of 2011.

FY 2017-18 Budget Growth by Cost Driver Category

	FY 2010-11			FY 2017-18	Difference	
	GF	ARRA	Total		$	%
Human Services	$ 8,796,489	$ 1,756,520	$ 10,553,009	$ 12,132,799	$ 1,579,790	*15%*
School District Pensions	287,562	-	287,562	2,264,000	1,976,438	*687%*
Corrections / PBPP	1,781,402	172,911	1,954,313	2,459,735	505,422	*26%*
Debt Service	1,053,346	-	1,053,346	1,120,000	66,654	*6%*
All Other	13,155,272	1,136,289	14,291,561	14,019,567	(271,994)	*-2%*
Total	**$ 25,074,071**	**$ 3,065,720**	**$ 28,139,791**	**$ 31,996,101**	**$ 3,856,310**	***14%***

Staff Under the Governor's Jurisdiction

	June 2011	June 2017	Difference $	Difference %
Staffing Positions	75,500	73,300	(2,200)	-3%



During the Commonwealth's financial challenges through the Great Recession, state support for the State System of Higher Education, the Department of Community and Economic Development and for State-Related Universities has sharply decreased. As shown by the three graphs below, only FY 2017-18 funding for the State System of Higher Education and Lincoln University are at higher levels than they were in FY 1998-99.