STATE OF NEW JERSEY
Department of the Treasury
Andrew Sidamon-Eristoff, State Treasurer
Opening Statement Before The
New Jersey Senate Budget and Appropriations Committee
May 20, 2013

Chairman Sarlo, Budget Officer Bucco and members of the Senate Budget and Appropriations Committee, thank you for this opportunity to present an update on the State's revenue position and associated adjustments to the Fiscal 2013 budget and the Governor's proposed budget for Fiscal 2014. I also understand that you will have questions concerning the Governor's proposed Fiscal 2014 budget for the Department of the Treasury and Interdepartmental Accounts.

Let me begin with the headline numbers. Despite performance of the Gross Income Tax, Sales Tax and Corporate Business Tax at levels at or above our revised budget projections in recent months, we are today recognizing a net reduction in projected revenue for Fiscal 2013 of $132 million, or 0.4 percent, from $31.32 billion as of the Governor's Budget Message in February to $31.19 billion.

At the same time, we have identified $74 million in additional lapses and a reduction in supplemental needs of $93 million. As a result, we are now projecting an increase in the State's Fiscal 2013 ending fund balance of $35 million, to $410 million.

Carrying this increased fund balance into the next fiscal year offsets a net reduction in projected revenues of $33 million in Fiscal 2014, leaving us, after some minor adjustments, with a projected ending fund balance of $301 million.

Of course, these headlines obscure a complicated series of adjustments that warrant further examination.

As I mentioned, the overall performance of the State's three major broad-based revenue streams – the Gross Income Tax, the Sales Tax, and the Corporate Business Tax – has been strong. For the ten months ended April 30, collections of these "big three" taxes were $104 million ahead of our revised projections. Their contribution to the overall revenue picture was strong enough to offset some weaker results from a range of smaller and more narrowly applied taxes, leaving us with total revenues that were $48 million ahead of our revised projections for the State's 16 major revenue sources. Indeed, the strength in these three revenue sources has enabled the State's revenues to exceed budgeted amounts for the past five months in a row.

Why, then, are we now recognizing a further reduction in net projected revenue for Fiscal 2013? Simply stated, most of the reduction is due to the fact that we quite recently received confirmation that two energy-related revenue sources will fall significantly short of our expectations: the Sales Tax on energy companies will fall short by $140 million, or over 40 percent, and the Corporation Business Tax on energy companies will fall $43 million, or 68 percent, short of expectations. These adjustments, combined with ongoing weakness in the Transfer Inheritance Tax, realty transfer taxes, and the Casino Revenue Fund, have more than offset strong performance in our "big three" revenues.

You will note that this will be the second year in a row that the two energy-related taxes have confounded our expectations with what appear to be very large negative swings against State revenue. How could this be? Forgive me for wading into the technical, but the answer lies in the extremely complicated way these two taxes are administered under current law. Several factors are at play:

First, the amount of Schedule 1 (or General Fund) revenue these two taxes generate is net of dedicated Energy Tax Receipts (ETR) revenue on Schedule 2, an amount set at $788 million. Thus, as a simple matter of mathematics, a small percentage reduction in the total amount of revenue raised will translate into a disproportionately large percentage change in Schedule 1 revenue. And, because of this structure, the State bears the entire risk of any fluctuation.

Second, under current law, these taxes are reported and paid in a way that makes it exceptionally hard to model and estimate revenues with any degree of precision prior to this point in the calendar year. Let me explain.

Most large corporations remit sales and income taxes on a monthly basis but file the associated tax information returns on a quarterly basis. However, current law requires the state's utilities to remit half their estimated sales and corporate business tax liabilities for the entire calendar year on May 15. This prepayment is called the "Uniform Transitional Utility Assessment" (UTUA). The utilities then apply the UTUA as a credit against their monthly payments beginning in August. Thus, it is generally the case that we do not receive <u>any</u> sales or corporate business tax payments from the utilities in the first half of the State's fiscal year. Only after the turn of the calendar year do we see real-time payments.

This convoluted UTUA mechanism, obviously adopted some years ago as a means to "spin up" revenue from the next fiscal year into the previous fiscal year, magnifies the challenges we face in attempting to model and project these revenues. As a practical matter, we have very little in the way of real-time data to work with when we are updating revenue estimates for the current fiscal year in advance of the Governor's Budget Message. The dynamic is even more challenging with respect to the estimating for the next fiscal year: this February, for example, we had to make a forecast as to what the utilities will estimate and pay in May 2014 in respect of the second half of calendar 2014.

The content of quarterly information returns is critical to accurate forecasting. Generally, information for the third and fourth calendar quarters is not a reliable predictor of what will happen in the winter months, when energy usage is typically high. It's only around the time that the first quarter tax filings come in, and the utilities submit their UTUA estimates, that we have a clearer notion of how the State's fiscal year will wind up.

As a result, although we may have had several months of actual winter remittances as of February – depending upon the use of UTUA credits – we don't have access to crucial return data or the utility companies' projections until mid-May, about six weeks after the first quarter of the calendar year. This supporting data is critical to our efforts to parse the relative importance of the many factors that can impact the size of a particular monthly payment. For instance, with respect to corporate business taxes, we have no way of knowing for sure whether and to what extent any corporation is using carryforward credits to offset current liabilities until we see their actual return. As it turns out, it is now clear that the use of carryforward credits has impacted this year's UTUA in respect of the Business Corporation Tax significantly.

Similarly, this year has been especially challenging with respect to the energy-related sales tax. Traditionally, the drivers of energy-related sales tax have been usage that is a function of average temperatures (e.g. degree days) and the price of energy, which in turn references the price of residential and commercial electricity and the price of natural gas. As you know, after many years of regular increases, energy prices have been falling, reflecting both the expansion in supplies of natural gas and the ongoing impact of deregulation. Deregulation has also made prices more volatile.

This year, we suspect that power outages and damage caused by Super Storm Sandy may have impacted these drivers, specifically usage, as we know that 73 percent of the state's electricity customers were without power for an extended period. Although we presume that there was at least some direct impact – no power, no usage, no tax – it is clear that the disruptions made it extremely difficult to draw hard and fast conclusions as to tax impacts without more complete data. The disruptions in electric power and natural gas supplies caused by Sandy also seriously complicated any advance interpretation of information from the fourth quarter.

At the beginning of the year, we did have access to relatively timely nontax data that suggested a swing back to normal (colder) temperatures from the exceptionally mild winter of 2011-2012. However, the price of natural gas remained flat, contrary to our expectations. For that reason, we took down our estimate for energy-related sales by $40 million as of the Governor's Budget Message.

A surprising, sustained and ultimately more significant decline in electricity prices for calendar 2013 did not become clearly apparent until late April, as national statistics are reported on a three-month lag.

We believe that what has occurred is that higher consumption of natural gas has been offset by falling prices for electricity. The latest U.S. Department of Energy figures on customer electricity prices in the state show a 4.6 percent price decline from February 2012 to February

2013 – while physical usage of electricity has been little changed. Indeed, tax payments by large, purely electric, utilities have in recent months been lower than a year ago, confirming that the factor holding down sales tax payments is electricity rates. Meanwhile the large, purely natural gas suppliers, have been remitting more sales tax than last year. This, combined with reports filed in connection with the UTUA payment, has in turn prompted us to adjust our expectations once again.

In sum, the combination of a very complex system of tax reporting and payment, very limited real time information, major changes in market conditions affecting the industry, and unpredictable weather events created an environment in which accurately projecting revenues for these taxes became extraordinarily difficult.

The structural complications and inherent unreliability I have described are more than a mutual technical frustration for analysts in Treasury and the Office of Legislative Services; they impede transparency and sound budget planning. I hope you will therefore agree that we need to find a better way to model and estimate our energy-related sales and corporate income taxes. To that end, the Governor has directed Treasury to develop and submit for your consideration a statutory amendment to rationalize the reporting and payment of these taxes by the end of the year.

Turning back to the budget as a whole, we believe the adjustments we are proposing today are a prudent response to ongoing developments, fulfilling our constitutional responsibility to maintain a balanced budget for Fiscal 2013 and provide a solid foundation for the Fiscal 2014 budget that is now before you.

To anticipate some of your questions, we believe that our enhanced fund balance leaves us appropriately positioned to absorb known risks to the Fiscal 2013 budget, specifically the ongoing legal challenge to the budgeted plan to recognize the statutory reversion of some $165 million in uncommitted, locally-held affordable housing funds to the Affordable Housing Trust Fund and our plan to award a contract for sales and marketing services in support of the New Jersey State Lottery, pursuant to which we will expect to receive a $120 million advance guarantee payment this fiscal year. With respect to the affordable housing matter, the State is preparing an appeal of the recent Appellate Division order granting an emergent application for a stay to the New Jersey Supreme Court. With respect to the Lottery, a protest has been filed against the Division of Purchase and Property's notice of intent to award. We expect a decision on the protest shortly.

* * *

I understand that you will also be examining the Governor's Fiscal 2014 budget for the Department of the Treasury and Interdepartmental Accounts. Please allow me a few moments to turn now to the $2.16 billion in expenditures that will either pass through Treasury accounts – or pay for the many functions performed by dedicated Treasury personnel – in Fiscal 2014.

As you know, Treasury's functions are broad in scope, diverse, and often extremely complex. In addition to managing the State's budget, Treasury divisions are responsible for collecting revenue, asset management, public finance, and delivering an array of critical statewide services such as procurement and technology support.

The Governor's Fiscal 2014 budget proposal decreases the Department of the Treasury's appropriation by $45.1 million, or 2 percent. This decrease is largely due to $70.2 million in savings on general obligation debt service budgeted in the Department that we have realized due to the retirement of debt. Please note that budget adjustments we are advancing today would reduce the general obligation need by another $24.2 million, for a revised total reduction of Treasury general obligation debt service of $94.4 million

As you know, this top-level number doesn't distinguish between the majority of Treasury spending that passes through the department's accounts and the amounts dedicated to Treasury's normal operations supported by Direct State Services appropriations.

The Direct State Services appropriations, in turn, include operational funding for the "in-but-not-of" agencies that are housed under Treasury, but are not under the direct control of the State Treasurer. These include the Board of Public Utilities, the Office of Information Technology, the Office of the State Comptroller, the Public Defender, the Casino Control Commission, the Division of Rate Counsel, the Division of Elder Advocacy, the Corrections Ombudsperson, and the Office of Administrative Law.

Setting aside appropriations for these agencies, the Governor's proposed budget recommends a $212.9 million General Fund appropriation to support Treasury's core missions and operating divisions, down more than $2.9 million from our adjusted appropriation for Fiscal 2013.

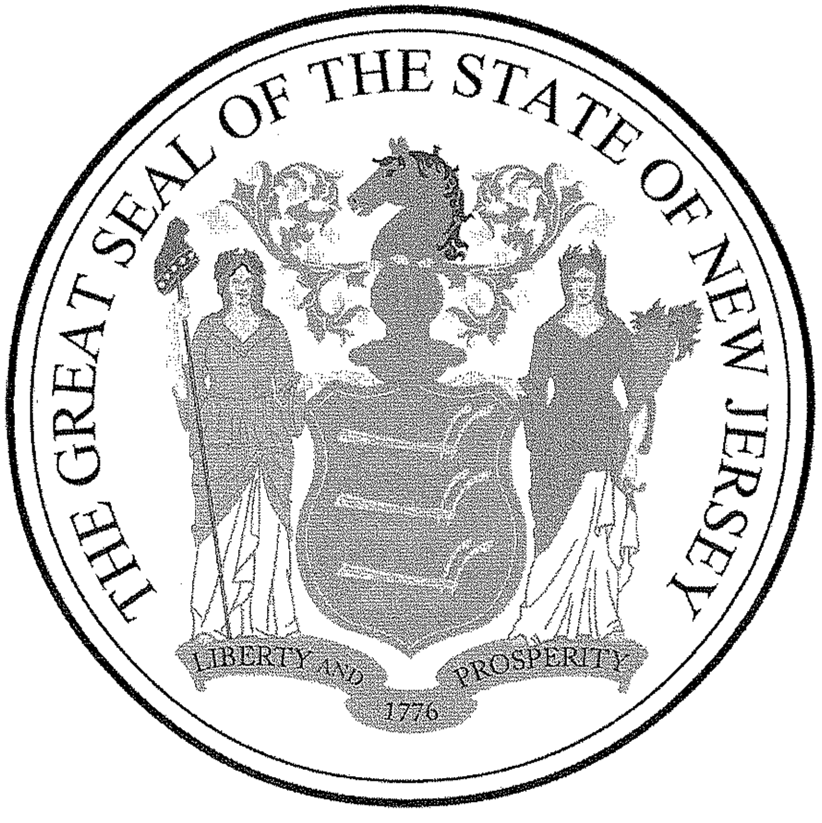
This does not include programs supported by revolving fund and internal services fund resources, such as Central Motor Pool, Distribution Center, Print Shop, Capital Post Office, Unclaimed Property and the fee-supported portion of the Division of Property Management and Construction related to statewide construction activity. In addition, the budget appropriates $46.5 million to the Division of Pensions and Benefits and $12.9 million to the Division of Investment from the Pensions and Health Benefits Trust Funds.

Currently, Treasury's work force includes approximately 3,177 full-time employees. Most of these employees — about 2,481 — are supported through the General Fund, while the rest are supported by fee-based or revolving funds. This represents a reduction of 121 positions, or 3.7 percent, from our staffing level of 3,298 when the administration took office and reflects a continuing high level of retirements by long-service employees as well as the impact of our ongoing efforts to achieve greater efficiencies in the delivery of government services.

I am extremely proud of everything Treasury staff members have accomplished, and continue to accomplish, notwithstanding ongoing fiscal and staffing constraints.

Thank you for your time and attention. I am happy to entertain your questions.

FY 2014 Budget



May 20, 2013

FY 2013 Fund Balance

(In Millions)

	July 2012 Approp. Act	Feb 2013 Revised	May 2013 Revised	Difference May vs. Feb
Opening Surplus	**$ 570**	**$ 447**	**$ 447**	**$ -**
Revenues				
Income	$ 11,767	$ 12,173	$ 12,193	$ 20
Sales	8,423	8,216	8,241	25
Corporate	2,566	2,232	2,257	25
Other	8,977	8,705	8,503	(202)
Total Revenues	$ 31,733	$ 31,326	$ 31,194	$ (132)
Lapses		377	449	72
Homestead Benefits Aug 2013		392	394	2
Total Resources	**$ 32,303**	**$ 32,542**	**$ 32,484**	**$ (58)**
Appropriations				
Original	$ 31,655	$ 31,655	$ 31,655	$ -
Supplemental		512	419	(93)
Total Appropriations	**$ 31,655**	**$ 32,167**	**$ 32,074**	**$ (93)**
Fund Balance	**$ 648**	**$ 375**	**$ 410** *	**$ 35**

* $1.5 million is in the Casino Control Fund.

Changes in FY 2013 Lapses

(In Thousands)

	Feb 2013 Revised	May 2013 Revised	Difference May vs. Feb
Lapses	**$ 769,405**	**$ 843,223**	**$ 73,818**
Significant Changes in Lapses			
Higher Education Capital Improvement Fund and Dormitory Safety Trust Fund			$ 20,950 *
TTF Debt Service - Savings			15,153
Motor Vehicle Commission - Available Balance			11,500
Workers' Compensation Self-Insurance Fund - Surplus			8,600
Prior Year Lapse			6,747
Refunded BEIP Disbursements			6,118
Department of Corrections / State Parole Board Surplus			4,400
Homestead Benefit Program - Additional Administrative Savings and Prior Year Refunds			2,400
Vehicle Rental Surcharge - Surplus Balance			2,000
Unused Sick Leave Trend			1,900
NJ Build			1,495
Bond Defeasance and Residual Balances - Additional Savings			1,332
Interdepartmental - Reduced Energy Costs			1,000
Department of Children and Families - Adjustment to Previously Identified Lapses			(1,281)
New Health Lab - Utility Funding Surplus			(1,500)
TTF Debt Service - Build America Bonds Subsidy - Impact of Federal Sequester			(1,685)
PAAD - Loss of Pharmaceutical Rebates			(8,218)
Miscellaneous - None Greater than $1 million (net)			2,907
Net Change in Lapses			**$ 73,818**

* Offset by revenue decrease.

Changes in FY 2013 Supplementals

(In Thousands)

	Feb 2013 Revised		May 2013 Revised		Difference May vs. Feb		
Supplementals	**$**	**512,509**	**$**	**419,348**	**$**	**(93,161)**	
Significant Changes in Supplementals							
Department of Transportation - Winter Operations					$	13,295	
Department of Children and Families - Federal Funds Shortfall						10,604	
NJ SMART						7,901	*
Nonpublic Handicapped and Auxiliary Services Aid						6,468	*
Taxation - Fees for Collection Services						5,427	*
SEMI/MAC Administrative Reimbursement						3,533	*
State and Higher Education Employer Taxes and Employee Benefits - Trend						2,748	
PAAD - Loss of Pharmaceutical Rebates						2,271	
Old Health Lab - Decommissioning Costs						1,000	
Department of Corrections - Medical Costs						1,000	
Department of Corrections - Corrections Officers Back Pay Settlement						(1,980)	
Senior and Disabled Citizens' Property Tax Freeze Trend						(2,200)	
Tort Claims Liability						(2,650)	
Interdepartmental - Reduced Supplemental Need						(3,000)	
Interest on Short Term Notes						(3,150)	
State Health Benefits - Rebalancing of Need Across FY 2013 and FY 2014						(35,500)	
Medicaid, FamilyCare, and Disability Services - Additional Non-State Resources						(37,926)	
State Social Security Taxes - Offset with State Health Benefits Surplus and Trend						(60,971)	
Miscellaneous - None Greater than $1 million (net)						(31)	
Net Change in Supplementals					**$**	**(93,161)**	

* Offset by revenue increase.

FY 2014 Revised Budget

(In Millions)

	FY 2013 May Revised	FY 2014 Budget	FY 2014 May Revised	FY 2014 Difference
Opening Surplus	**$ 447**	**$ 375**	**$ 410**	**$ 35**
Revenues				
Income	$ 12,193	$ 12,969	$ 13,039	$ 70
Sales	8,241	8,606	8,676	70
Corporate	2,257	2,388	2,413	25
Other	8,503	8,883	8,685	(198)
Total Revenues	$ 31,194	$ 32,846	$ 32,813	$ (33)
Lapses	449			
Homestead Benefits Aug 2013	394			
Total Resources	**$ 32,484**	**$ 33,221**	**$ 33,223**	**$ 2**
Appropriations				
Original	$ 31,655	$ 32,921	$ 32,922	$ 1
Supplemental	419			
Total Appropriations	**$ 32,074**	**$ 32,921**	**$ 32,922**	**$ 1**
Fund Balance	**$ 410** *	**$ 300**	**$ 301**	**$ 1**

* $1.5 million is in the Casino Control Fund.

FY 2014 Budget Changes

(In Thousands)

	FY 2014		
	Feb Budget	**May Revised**	**Difference**
FY 2014 Budget	**$32,921,362**	**$32,922,192**	**$ 830**
Significant Changes in Budget			
State Health Benefits - Rebalancing of Need Across FY 2013 and FY 2014			$ 26,500
Unused Sick Leave Payments - Trend			(1,500)
General Obligation Bonds - Use of Premium to Offset Debt Service Appropriation			(24,170)
Net Change in FY 2014 Budget			**$ 830**