STATE OF THE STATES 2025 – POISED FOR FISCAL STABILITY

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Fiscal conditions across state governments remain healthy as the sector heads into 2025. The majority of states expect to add to their rainy-day funds (RDFs) due to a combination of "normal" revenue growth and subdued spending. Balances have already grown to historical highs, and we believe this continued trend puts states in a sturdy financial position while providing budget officers plenty of flexibility to manage through any potential fiscal stress.

One of the best ways to determine a state's overall fiscal health is to examine trends within its general fund. As the main operating fund of each state, it collects a variety of tax revenues, spends these resources to finance a broad array of services, and can apply any surplus revenues towards its RDF. According to the National Association of State Budget Officers' (NASBO) latest edition of its Fiscal Survey of the States, general fund revenues grew 1.5% in fiscal 2024. This was a modest gain when compared to the three prior years that saw the pandemic and elevated inflation take hold of year-over-year trends. The growth was also despite a variety of tax cuts that lowered potential collections by an estimated $13.3 billion, the second-highest amount ever recorded by NASBO. Revenue collections exceeded budgeted expectations in 39 states and reinforced our notion that many state officials institute conservative estimates as part of their budget process. Based on enacted budgets for fiscal 2025, general fund revenues are estimated to grow 1.9% to $1.21 trillion. With tax changes adding only $3.9 billion in revenues and coupled with a lack of pandemic and inflation-related factors, the current fiscal year reflects a return to a more normal revenue environment relative to historical standards.

State Nominal and Real Annual Revenue Changes, Fiscal 2016 to Fiscal 2025

	State General Fund	
Fiscal Year	Nominal Increase	Real Increase
2025	1.9%	N/A
2024	1.5	0.8%
2023	-1.2	-5.2
2022	16.3	8.1
2021	16.6	12.1
2020	-0.6	-2.5
2019	5.7	2.7
2018	6.9	3.4
2017	2.4	1.8
2016	1.8	4.0

Source: NASBO, 2024 Fall Fiscal Survey

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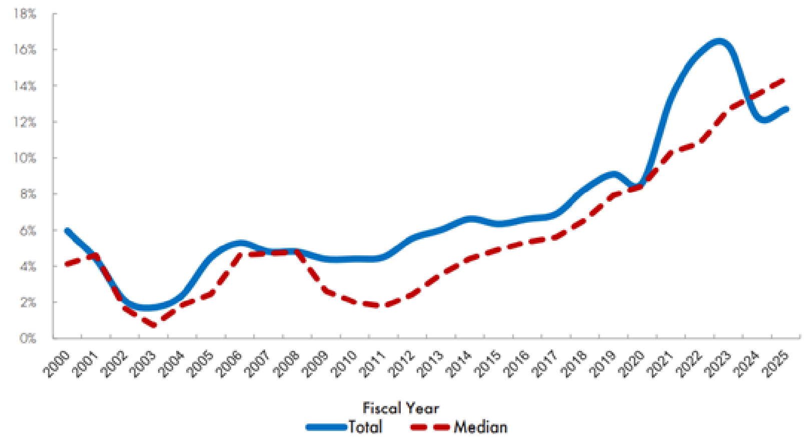
General fund expenses grew 11.8% in fiscal 2024 and were mostly in line with original spending plans. Though elevated compared to historical standards, this spending growth was not a major cause for concern. Many states seized on the opportunity to accumulate substantial balances outside of their RDFs in previous years, due to a mix of pandemic-era stimulus measures and tax windfalls, and applied these surplus funds for one-time programs and uses. With these programs no longer a significant expense item, fiscal 2025 general fund spending is expected to decline 0.3% to $1.26 trillion.

RDF balances increased across 35 states by the end of fiscal 2024 even though the total RDF balance dropped to $155.5 billion from $182.8 billion. The overall decline was mainly because of California, which still held the largest nominal balance among states despite using a portion of its reserves. Exclusive of California, RDF balances increased to $129.1 billion from $115.3 billion while the median value across all states grew to 13.5% of expenditures. Officials continue to follow through on state policies that set deposit guidelines and reserve targets, with 31 states expecting to add to their RDFs in fiscal 2025. This would bring the median balance to 14.4% and mark another all-time high.

Rainy Day Fund Balances as a Percentage of Expenditures Fiscal 2000 to Fiscal 2025



Source: NASBO, 2024 Fall Fiscal Survey

The RDF balance accumulation over the last few years leaves states well positioned to manage through any potential economic slowdown, especially when judged against previous downturns. By comparison, the states headed into the Great Recession and the Covid-19 pandemic with median RDF balances of 4.8% and 7.9%, respectively. We currently own 33 different states and recognize that they all have their distinct economic landscapes and fiscal priorities. As such, and despite broadly positive credit overtones over the last few years, we remain diligent in evaluating their individual credit fundamentals and continue to assess their appropriateness across our Strategies.

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