FISCAL ACCOUNTABILITY REPORT
FISCAL YEARS 2017 – 2020

OFFICE OF POLICY AND MANAGEMENT
BEN BARNES, SECRETARY
NOVEMBER 30, 2016

Presentation Overview

- Summary of OPM projections of fixed cost growth vs. revenue growth
- Economic factors and revenue trends
- Expenditures, fixed cost drivers, and long-term obligations
- Five year bond projections
- Budget Reserve Fund status

Presentation Overview

The overarching trends identified in previous Fiscal Accountability Reports remain relevant today:

- Fixed costs related to long-term liabilities continue to dominate the state budget.
- Recovery from the "Great Recession" has been uneven both nationally and in Connecticut.
- National and international factors create uncertainty and risk.

Overview of Projections

Revenue Growth vs. Fixed Cost Growth

Year-over-year growth, in millions

GENERAL FUND

	FY 2018 vs. FY 2017	FY 2019 vs. FY 2018	FY 2020 vs. FY 2019
Revenue Growth	295.2	385.3	473.9
Change in Sales Tax Transfers	(484.9)	(21.8)	(22.8)
Net Revenue Growth (Nov. consensus)	$ (189.7)	$ 363.5	$ 451.1
Fixed Cost Growth			
Debt Service	257.4	(65.8)	155.7
State Employee Pensions	78.4	33.9	46.5
Teacher Pensions	278.3	41.9	42.6
State and Teachers OPEB	206.3	77.2	36.3
Medicaid	246.7	133.3	147.7
Other Entitlements	29.0	34.8	40.4
Total Fixed Cost Growth	1,096.1	255.3	469.3
Difference	$ (1,285.8)	$ 108.2	$ (18.2)

SPECIAL TRANSPORTATION FUND

	FY 2018 vs. FY 2017	FY 2019 vs. FY 2018	FY 2020 vs. FY 2019
Revenue Growth	32.4	33.5	41.3
Change in Sales Tax Transfer	143.6	10.9	11.4
Net Revenue Growth (Nov. consensus)	$ 176.0	$ 44.4	$ 52.7
Fixed Cost Growth			
Debt Service	57.4	64.8	66.9
State Employee Pensions	5.1	6.2	5.2
Total Fixed Cost Growth	62.6	71.0	72.1
Difference	$ 113.4	$ (26.6)	$ (19.4)

Revenue Growth vs. Fixed Cost Growth

- Fixed cost growth for FY 2018 vs. FY 2017 exceeds revenue growth in the General Fund by nearly $1.3 billion.
- Biggest one-time year-over-year growth factors:
  - $484.9 million - Sales Tax revenue transfers from General Fund for Municipal Revenue Sharing and the Special Transportation Fund.
  - $278.3 million - Teachers' Retirement System contributions, chiefly due to adoption of more conservative actuarial assumptions.
  - $178.7 million - Final year of repayment of the 2009 Economic Recovery Notes.
  - $120 million - First year of state OPEB match.

Sales Tax Revenue Transfers to the Municipal Revenue Sharing Account (MRSA) and the Special Transportation Fund (STF)
($ in Millions)

	Amount Dedicated		
Fiscal Year	MRSA	STF	Total
2017*	$0.0	$197.7	$197.7
2018	$341.3	$341.3	$682.6
2019	$352.2	$352.2	$704.4
2020	$363.6	$363.6	$727.2

**General Fund revenues appropriated to the Municipal Revenue Sharing Fund for FY 2017, per PA 16-2, Sec. 46.*

- Beyond FY 2018, revenue and fixed cost growth are anticipated to be much more closely matched.

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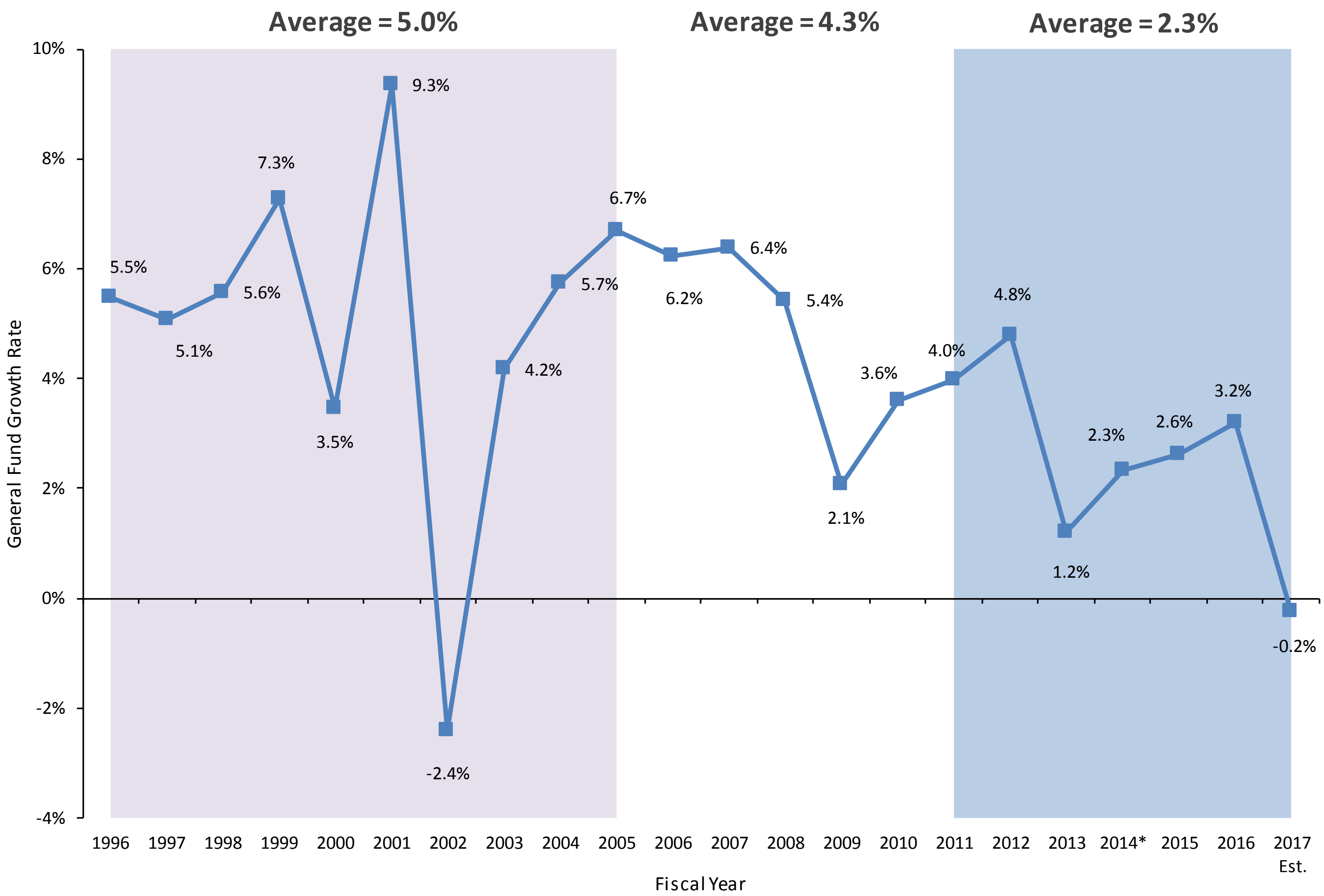
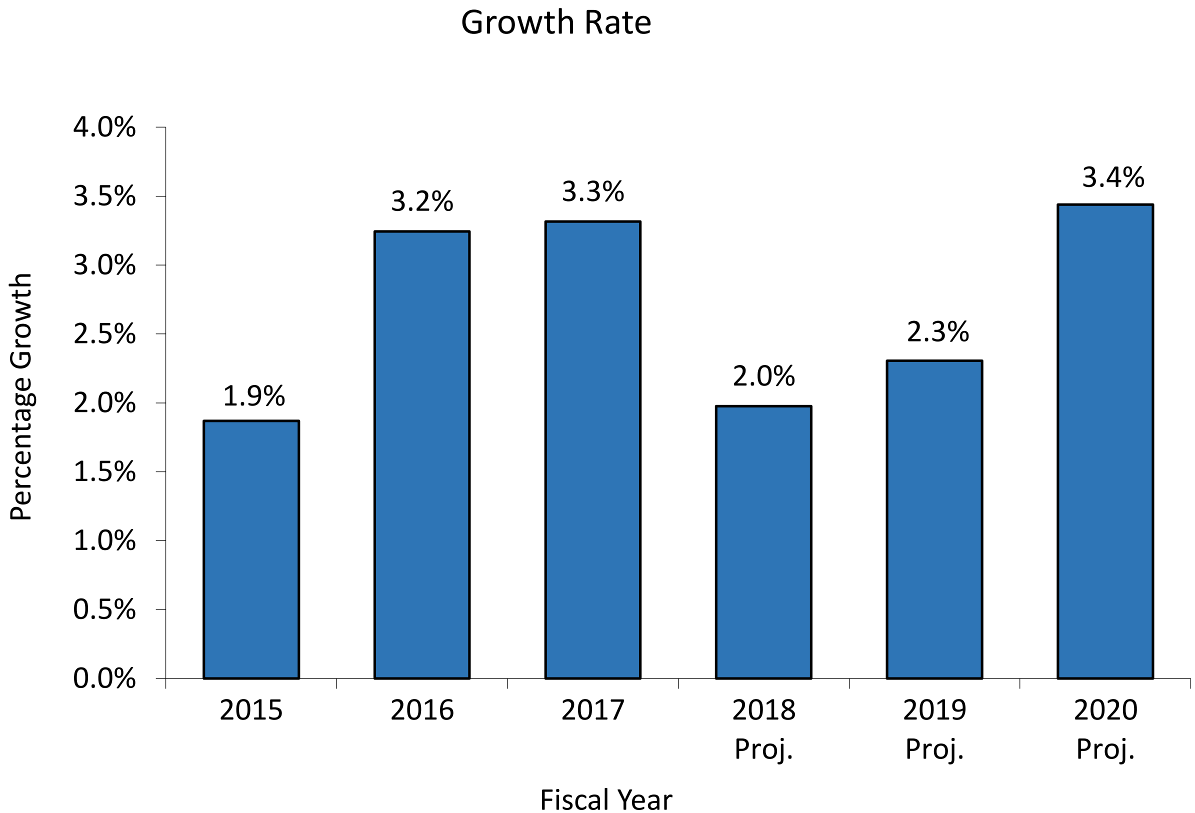
Expenditure Growth – General Fund



Average represents the compound annual growth rate of each shaded section
*2013 to 2014 growth has been adjusted to reflect the net budgeting of Medicaid.

Spending Cap

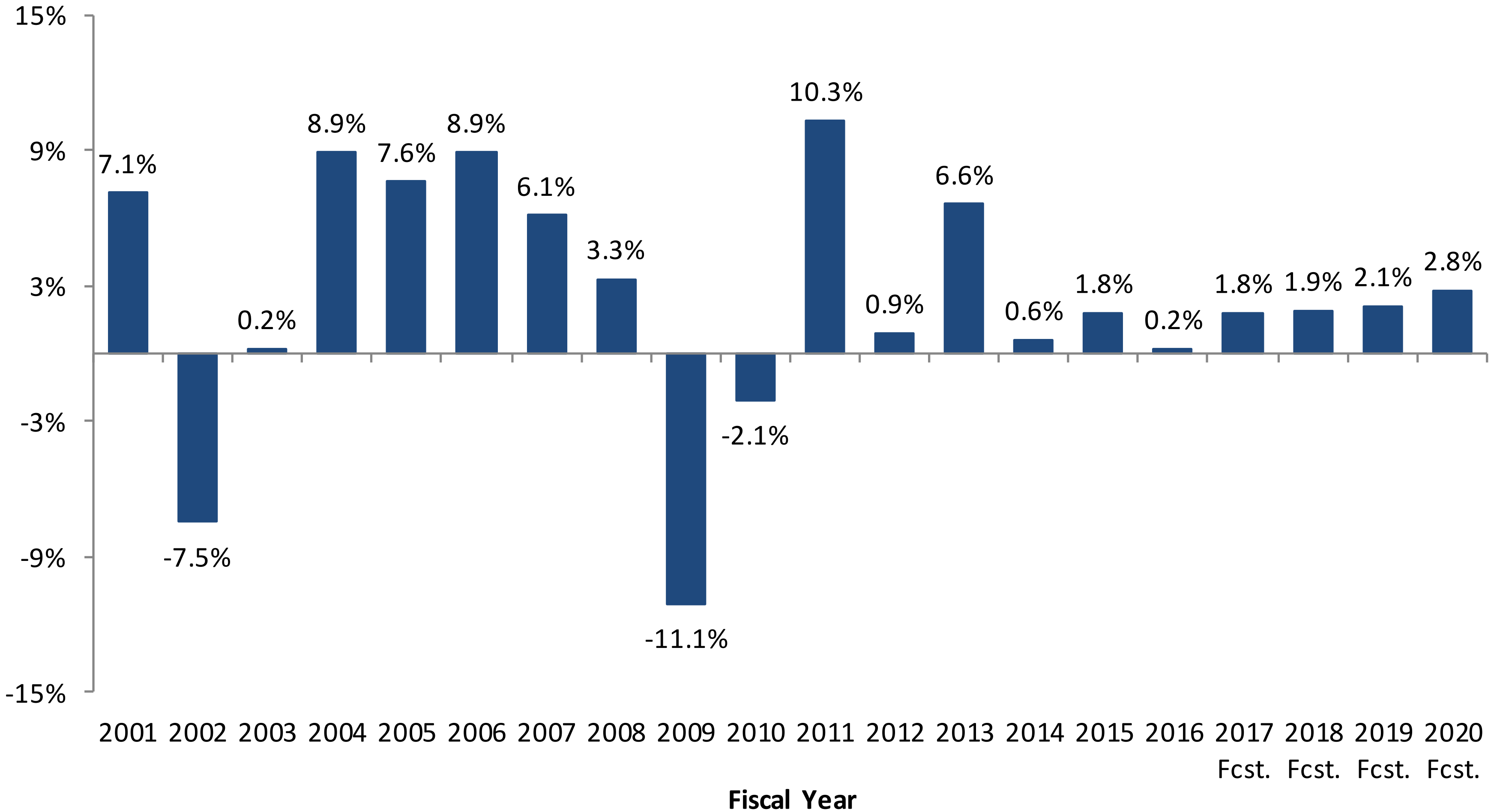


- The enacted revised FY 2017 budget is $635.3 million below the cap.
- Growth rates for FY 2015 – FY 2020 are calculated on a calendar year basis.
- For FY 2018, a growth rate of 2% would allow capped expenditures to grow by approximately $300 million over FY 2017 levels.
- For FY 2018, fixed costs subject to the spending cap will grow by more than $1 billion over FY 2017 levels, more than consuming the $300 million in allowable growth.

Economy and Revenue

Total General Fund Revenue

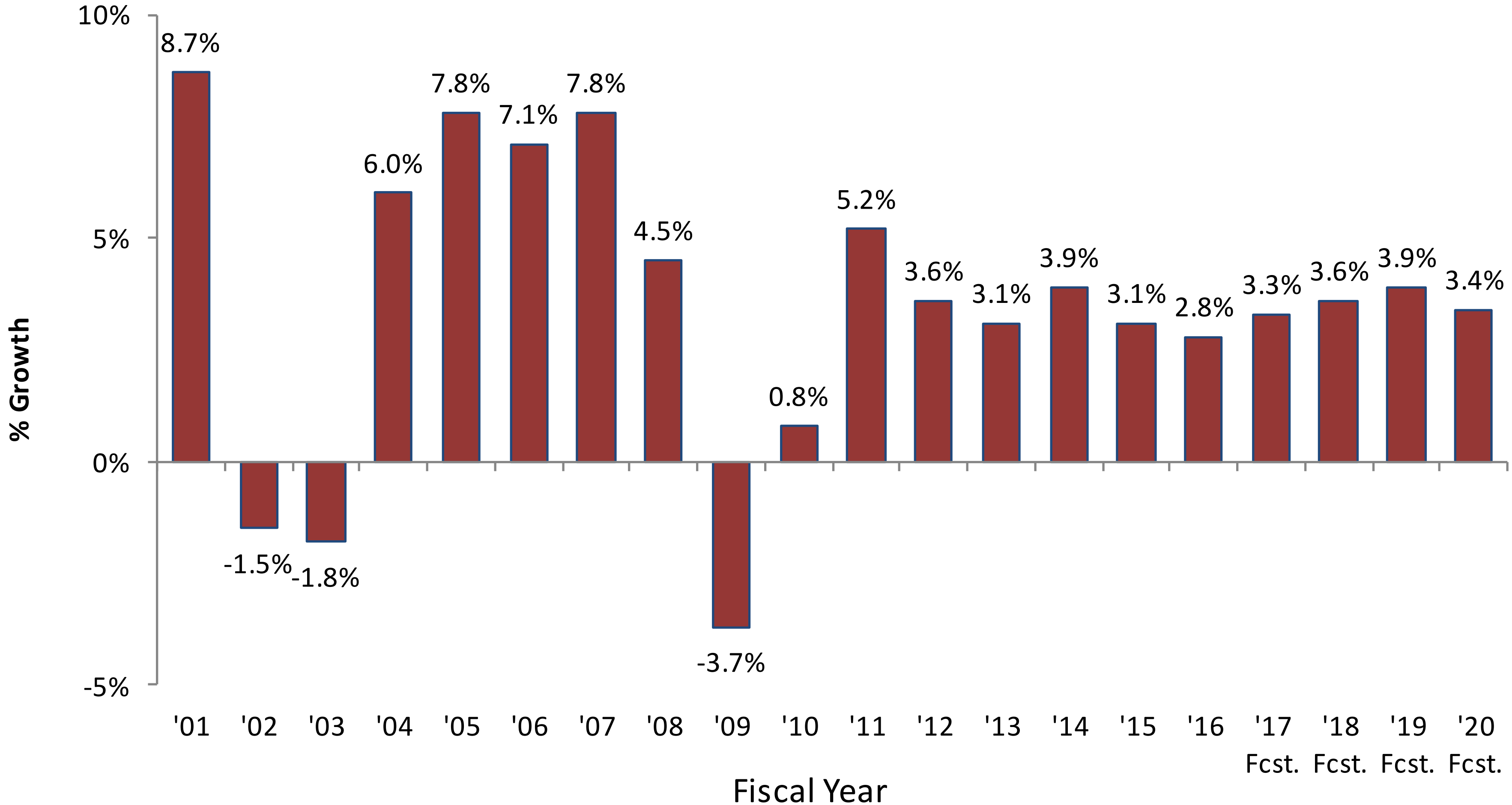
Economic Growth Rates



Personal Income Tax

Economic Growth Rates

Withholding



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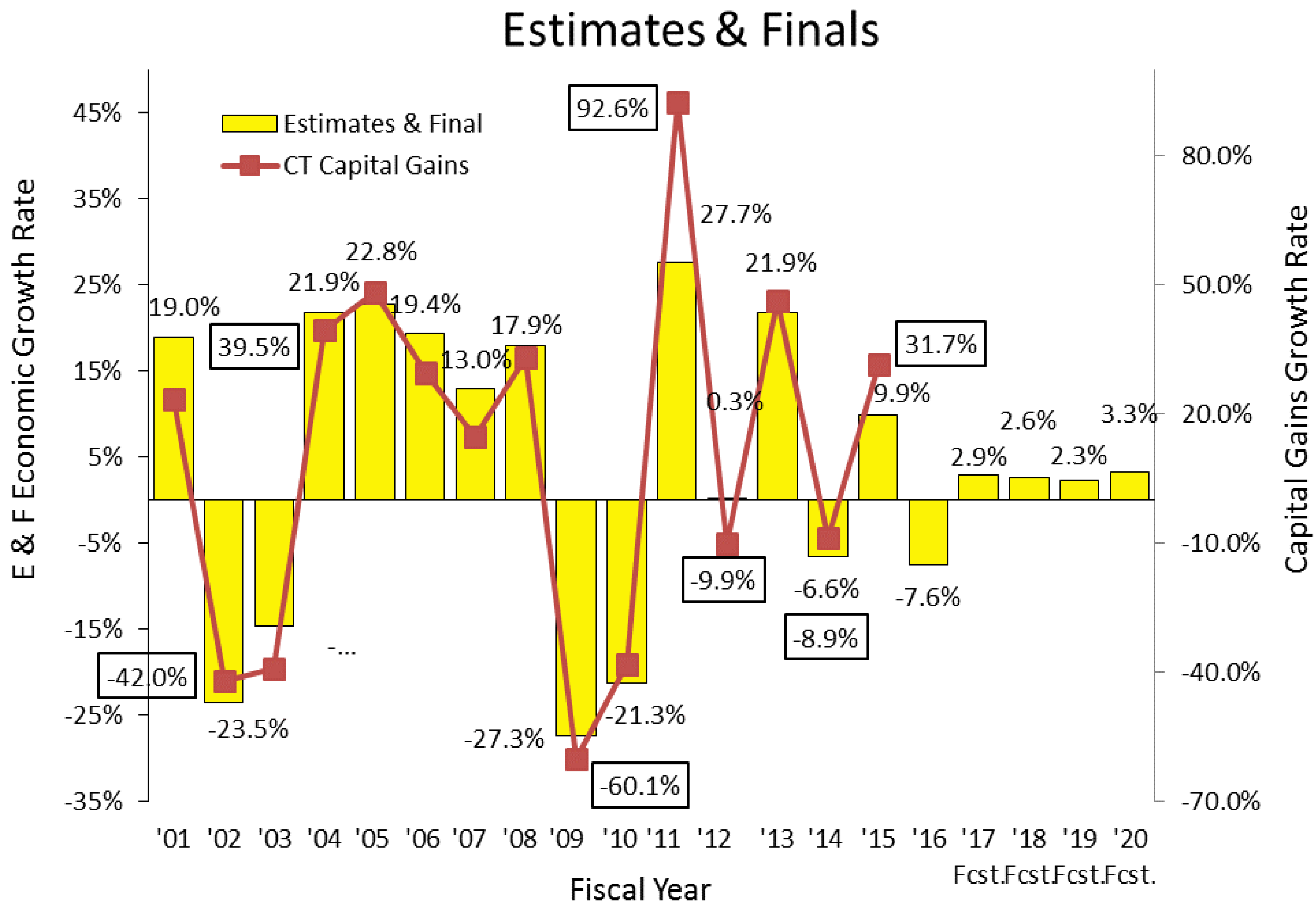
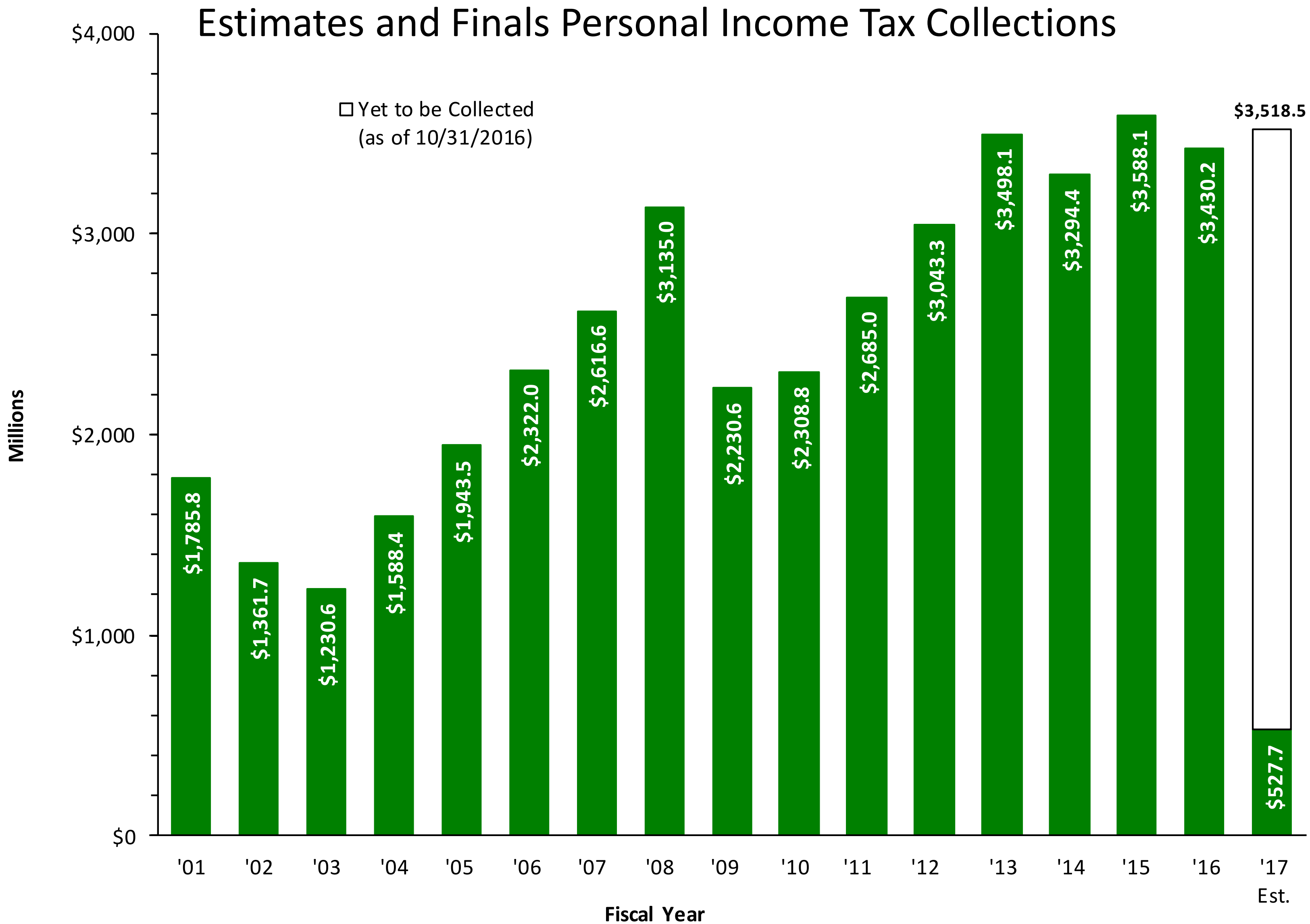
Personal Income Tax

Highly Dependent Upon Capital Gains



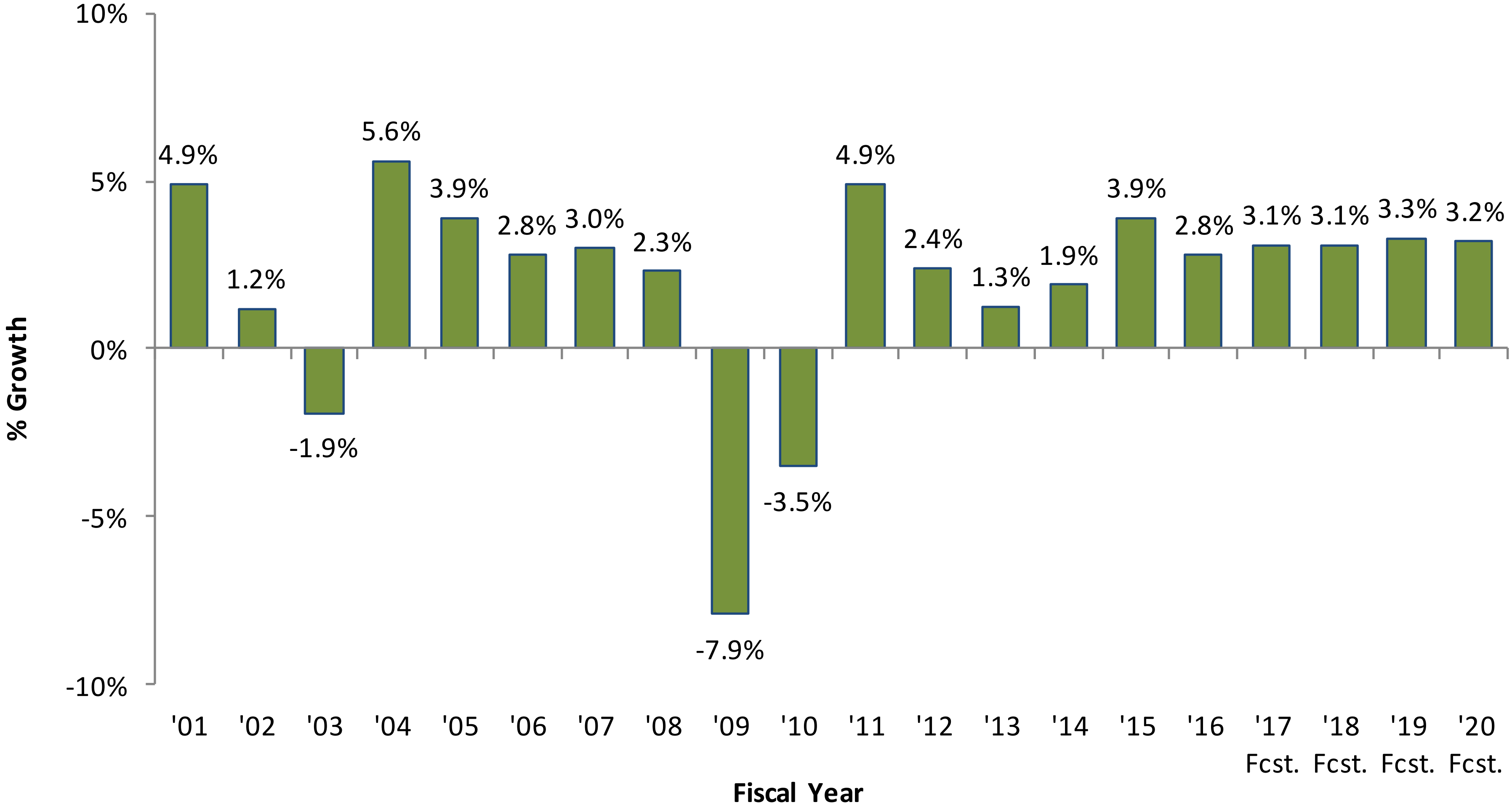
Note: Capital Gains are for the immediately preceding calendar year.

Risk to FY 2017 Revenue Forecast



Sales Tax

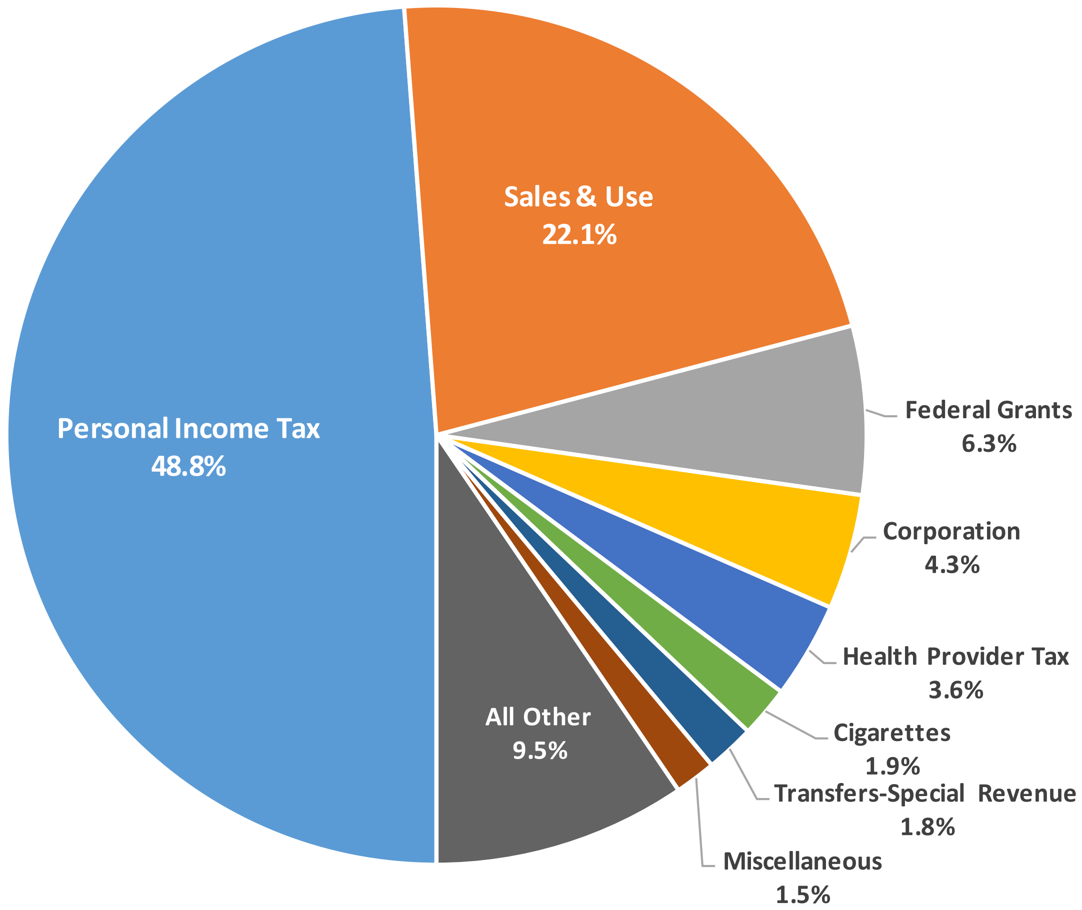
Economic Growth Rates



General Fund Revenue Sources

Fiscal Year 2017

Total $17,840.8 million



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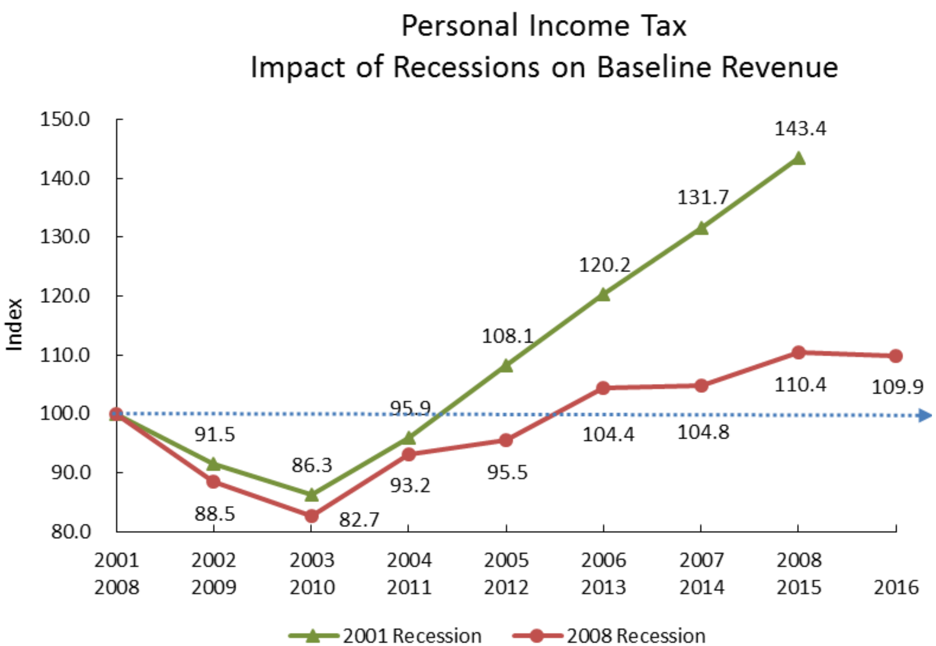
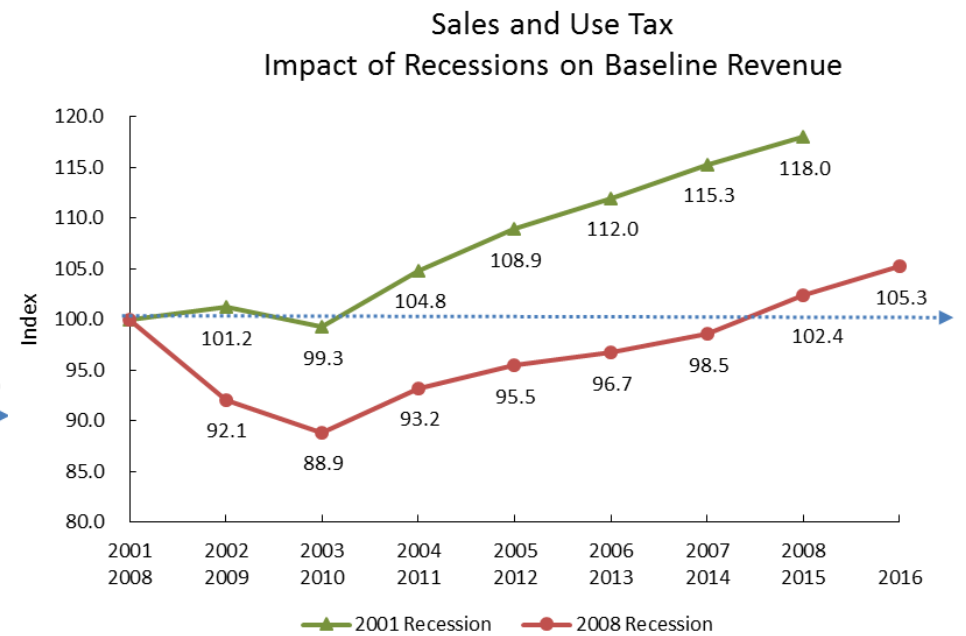
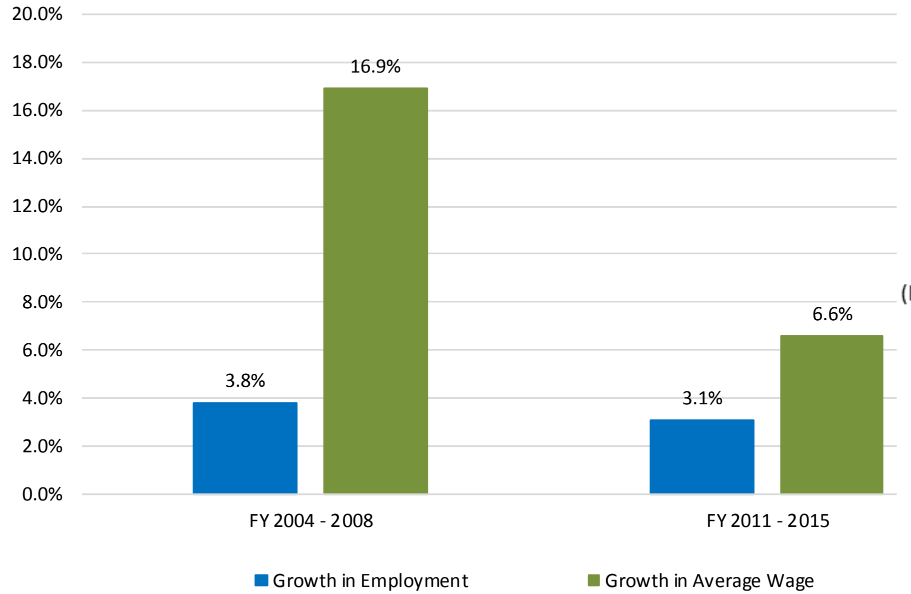
Post-Recession Revenue Recovery

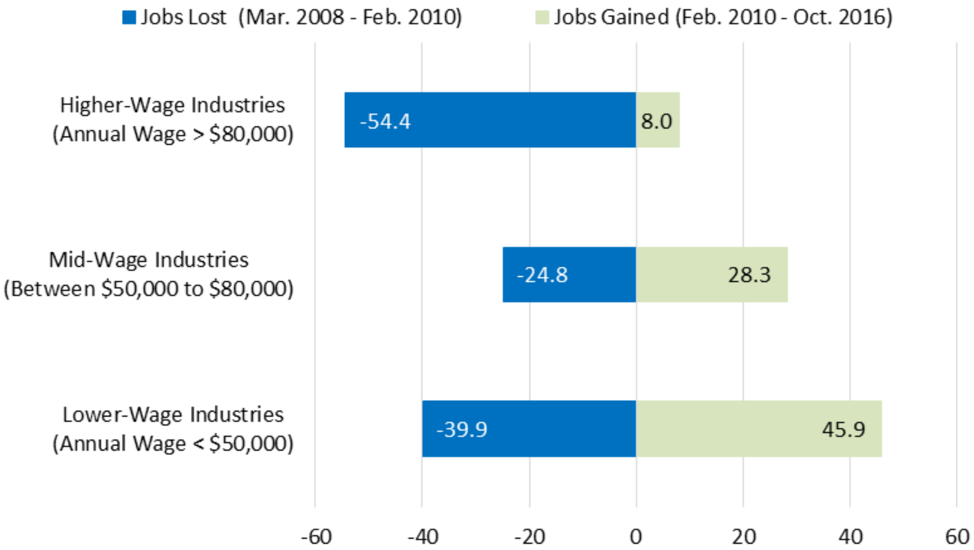




- Income tax revenues have exceeded their pre-recession peak for the last four fiscal years, and sales tax revenues exceeded their pre-recession peak the last two years.
- If this recovery had been similar to the 2003 recovery, income tax and sales tax revenues would have been about $3.0 billion higher in FY 2015.

Employment and Wages





- Connecticut's average employment growth is approximately the same pre- and post-recession.
- However, average wage growth has slowed post-recession from 16.9% to 6.6%.
- In FY 2016, employment grew 0.7% while the average annual wage grew 1.9%.
- As of October 2016, Connecticut has recovered 69.0% of jobs lost during the recession.

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Expenditures:

Fixed Cost Drivers & Long-Term Obligations

FY 2017 Shortfall

(in millions)

- Components

Revenue (Nov. 10, 2016 consensus vs. budget)	-$45.9
Agency deficiencies	-38.5
Subtotal	-$84.4
Lapses beyond budget plan	16.7
Net Total	-$67.7

- Agency deficiencies

• OCME (Personal Services, Other Expenses)	-0.3
• OEC (Birth to Three, Care4Kids)	-13.5
• PDSC (PS, Assigned Counsel, Expert Witnesses)	-3.7
• OTT – Debt Service	-12.0
• Adjudicated Claims	-9.0

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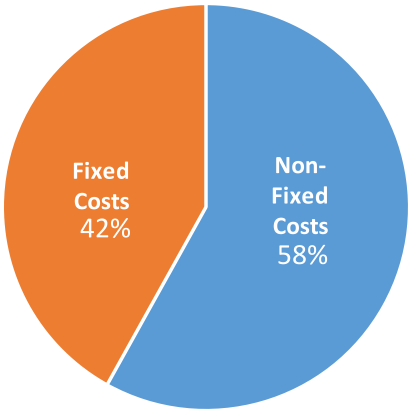
Drivers of Budget Growth

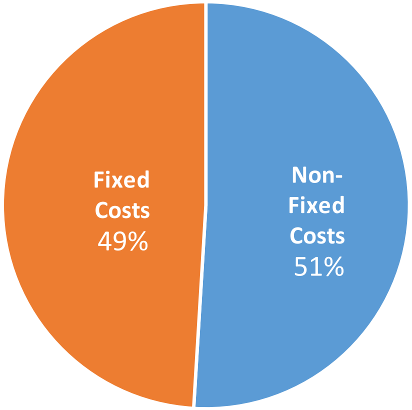
	FY06 - 11 Annual Growth Rate	FY11 - 17 Annual Growth Rate
All "Non-Fixed" Costs	3.0%	0.8%
Fixed Costs:		
Debt Service	4.5%	4.1%
Teachers' Pensions	8.0%	9.7%
State Employees Retirement System	4.7%	12.2%
Other State Pensions	-9.6%	-0.4%
State and Teacher OPEB	3.6%	7.3%
Medicaid *	7.3%	1.5%
Other Entitlement Accounts	2.2%	-0.6%
Total "Fixed" Costs	5.0%	4.1%
General Fund Total	3.8%	2.3%

* Medicaid estimate based on 50% of gross General Fund expenditures for FY 2013 and earlier.

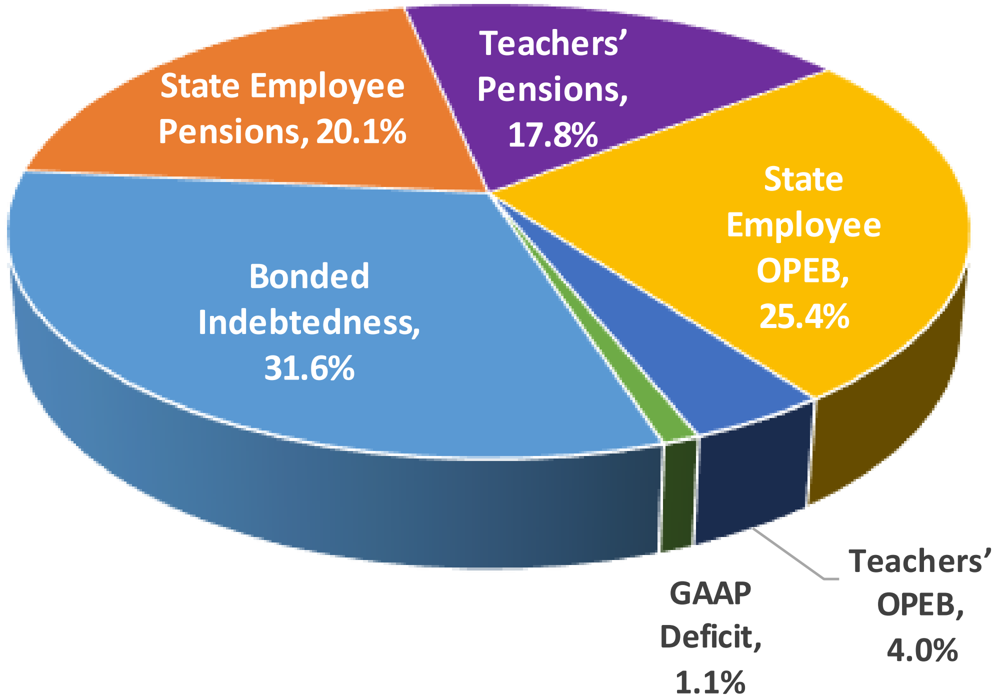
FY 2006



FY 2017



Long-Term Obligations



	in billions
Bonded Indebtedness – As of 8/31/16	$23.5
State Employee Pensions – Unfunded as of 6/30/14	14.9
Teachers' Pension – Unfunded as of 6/30/16	13.2
State Employee Post-Retirement Health and Life (OPEB) – Unfunded as of 6/30/15	18.9
Teachers' Post-Retirement Health and Life (OPEB) – Unfunded as of 6/30/16	3.0
Cumulative GAAP Deficit – As of 6/30/15	0.8
Total	$74.3

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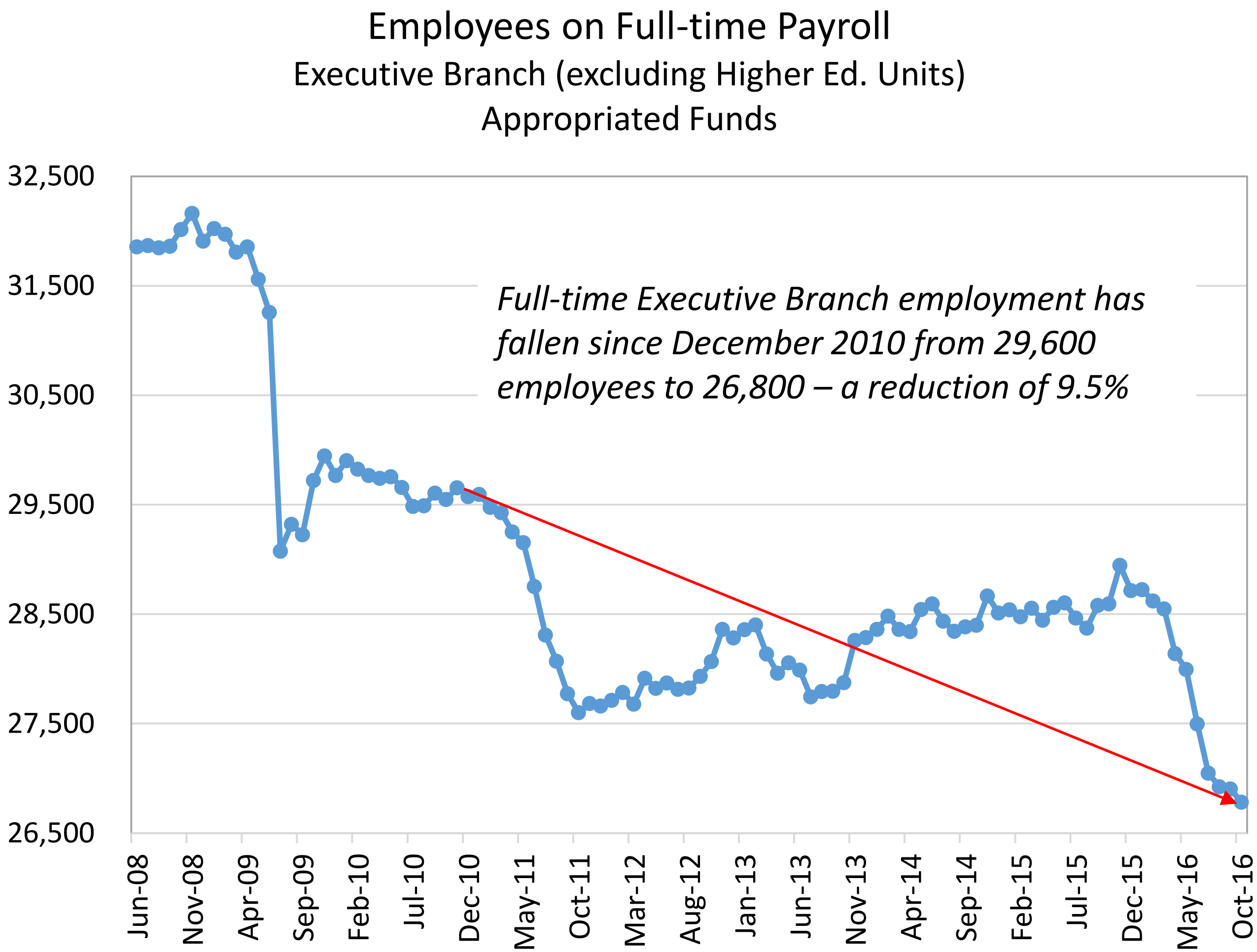
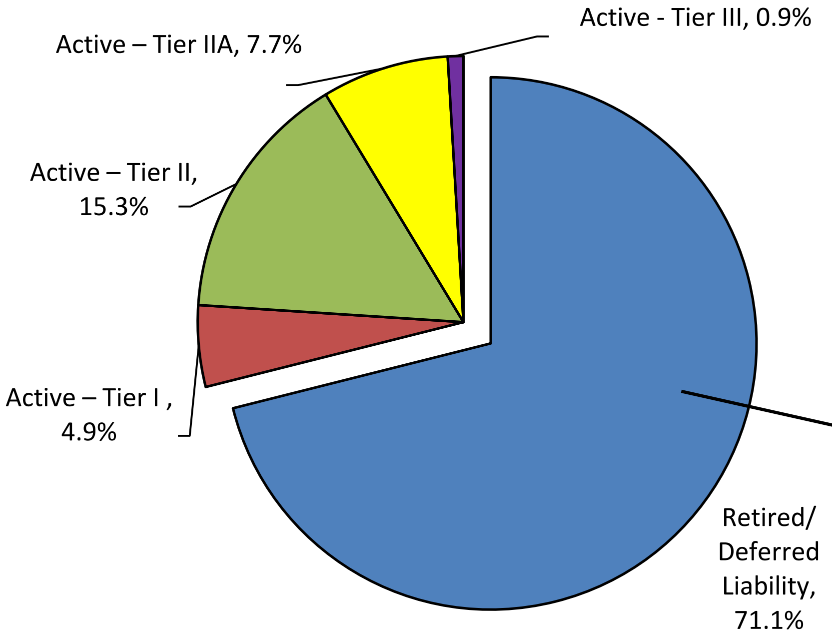
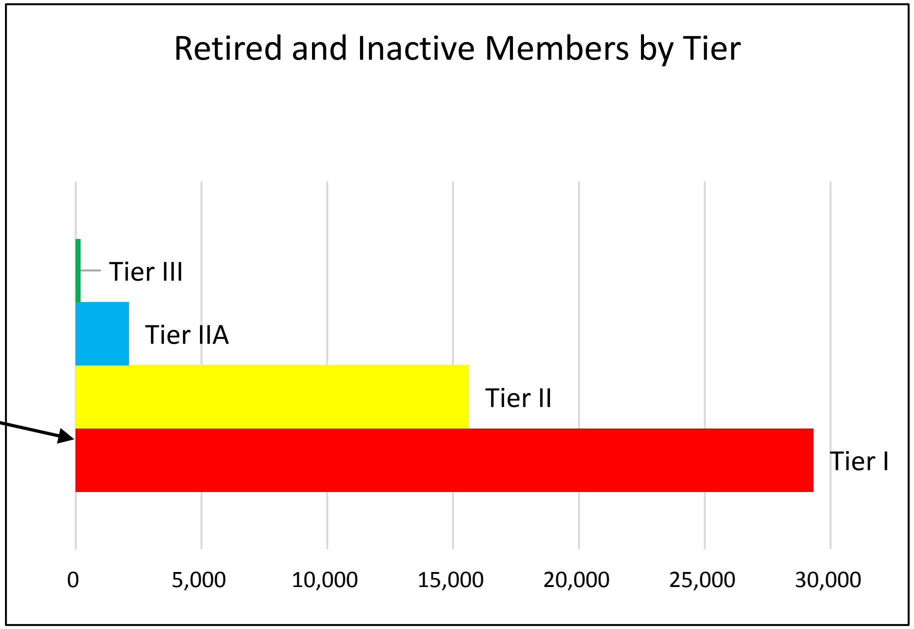
Reduced Executive Branch Workforce



- Since FY 2011, the number of budgeted state agencies has been reduced by 28%, from 81 to 58, through consolidations and mergers.
- Excluding higher education, the Executive Branch now employs more than 5,000 fewer employees than during calendar year 2008, and is at its lowest level since the early 1980s.
- Relative to state population, Executive Branch staffing (excluding higher education) is likely at its lowest point in more than six decades.

State Employees Retirement System
Components of Pension Liability

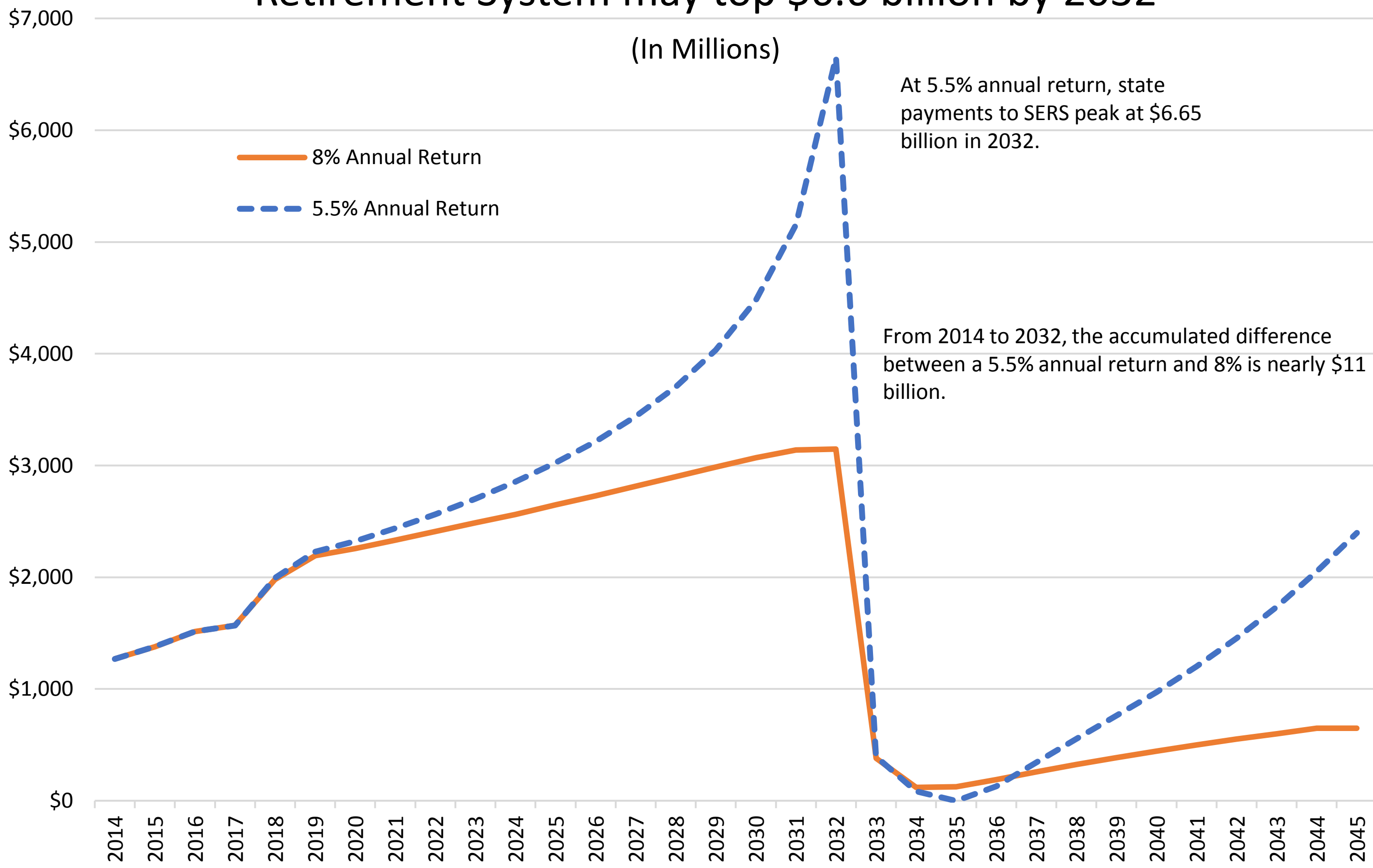




- $25.5 billion total liability.
- $14.9 billion unfunded liability.
- Most of that liability is related to already retired employees.
- 82.5% of the actuarially determined employer contribution is for the unfunded accrued liability.

Our Pension Challenge - SERS

Without changes, projected annual payments for the State Employees Retirement System may top $6.6 billion by 2032



Source: Final Report on Connecticut's State Employees Retirement System and Teachers' Retirement System, by CRR

Fixing Our Pensions - SERS

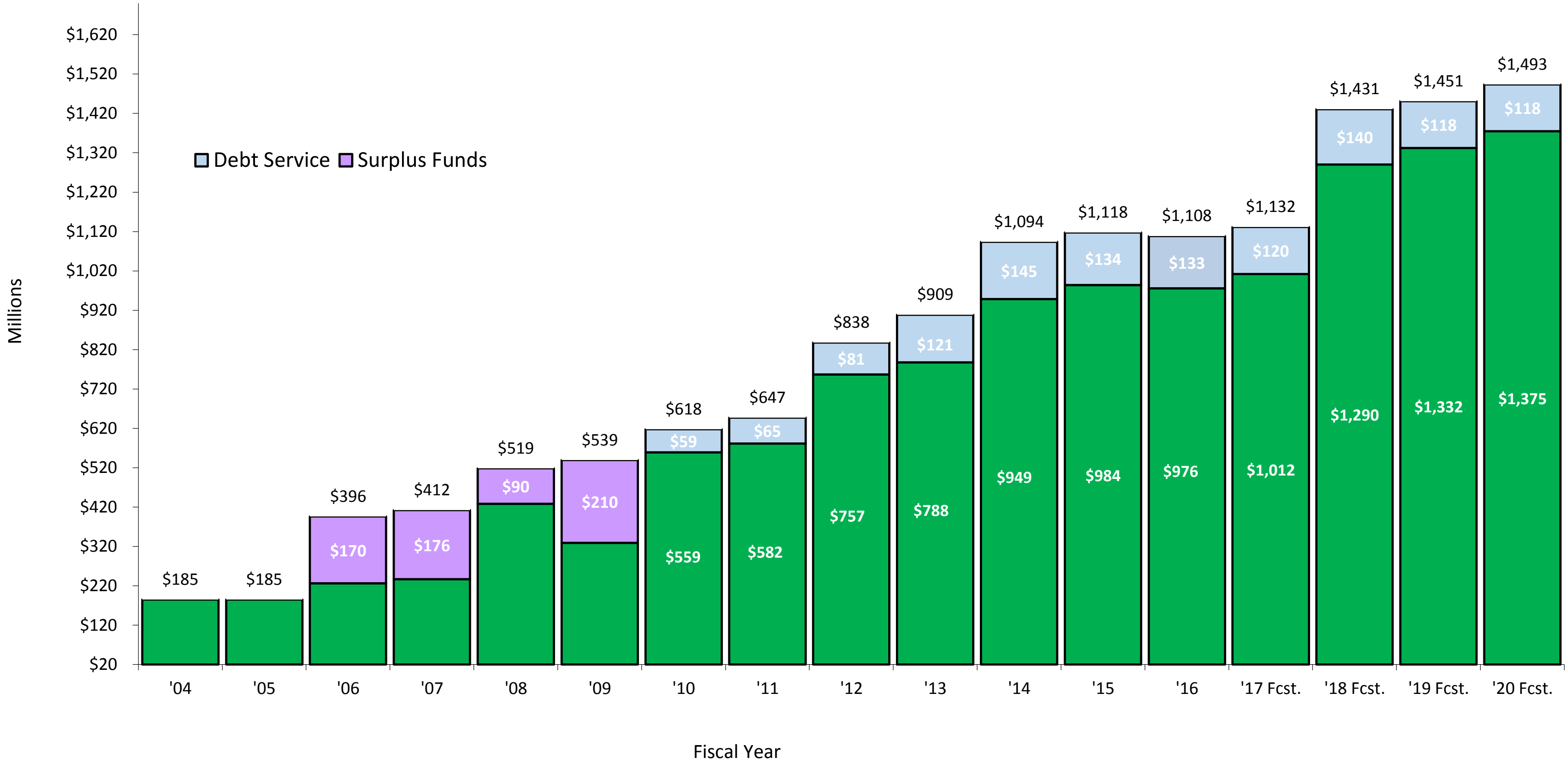
Recent steps to address liability include both benefit and funding changes:

1. The 2011 SEBAC agreement trimmed retirement benefits, resulting in a $700 million reduction in unfunded pension liability and a $67 million reduction in normal costs.
2. In 2012, more conservative actuarial assumptions were adopted which included lowering the assumed rate of investment returns from 8.25% to 8%.
3. The State increased its annual required contribution to the pension system by eliminating the SEBAC IV and V adjustments.
4. OPM engaged the Center for Retirement Research at Boston College to assess both SERS and TRS. This study identified risks related to the 2032 payoff date.

Fixing Our Pensions - SERS

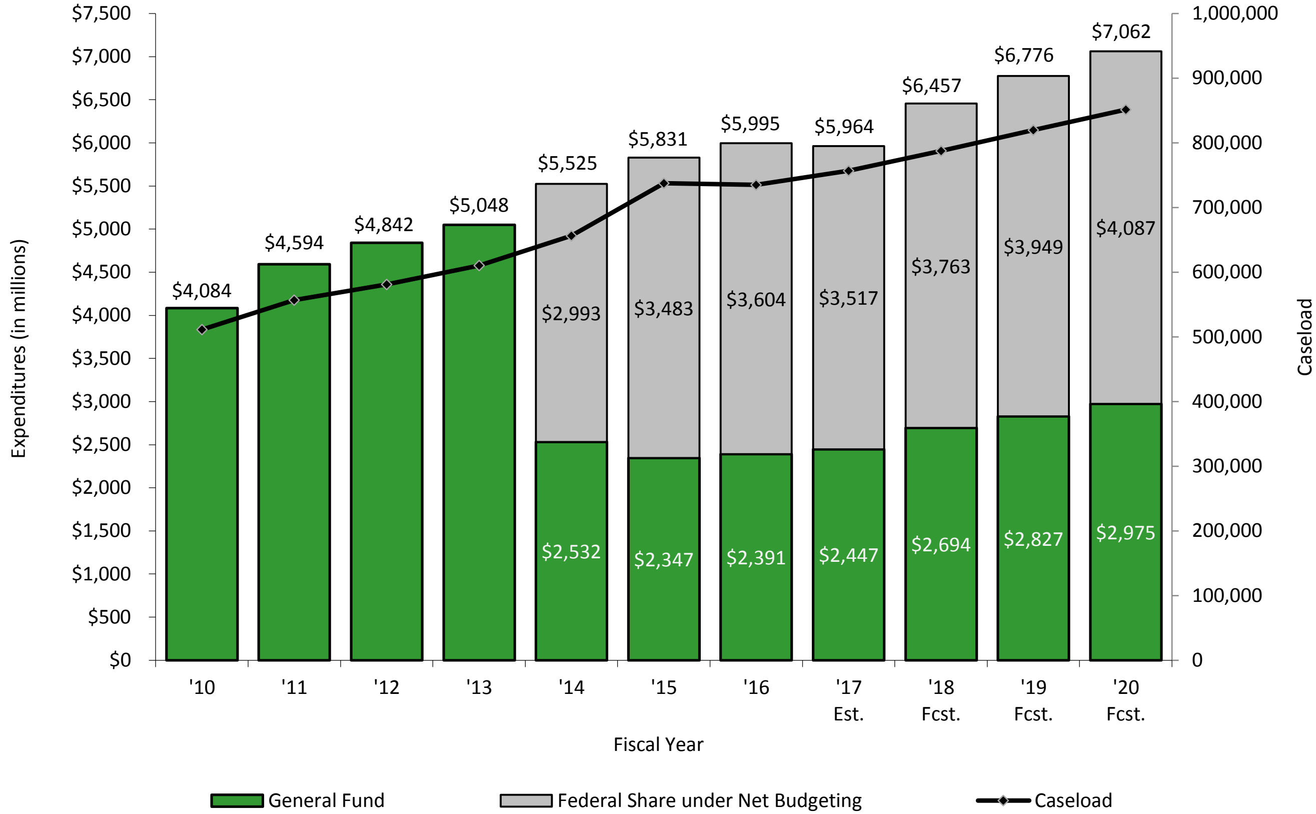
- OPM, in consultation with other stakeholders, is pursuing the following changes to address our long-term pension funding challenge:
  - Continuing to pre-fund all liabilities in a defined benefit plan structure.
  - Reducing the assumed rate of return (currently 8%).
  - Transitioning from level percent of payroll to level dollar amortization for unfunded liabilities.
  - Transitioning the actuarial cost method from Projected Unit Credit to Entry Age Normal.
  - Maintaining the original 40 year amortization schedule for the current unfunded liability attributable to Tier I employees and amortizing the remaining unfunded liability over a new period.
  - Transitioning to a layered amortization of future gains and losses consistent with the model funding approach developed by the Conference of Consulting Actuaries.
  - *If implemented, these changes will require increased state contributions and over a longer period of time, but will provide more budgetary certainty while at the same time lessening the likelihood of missing the assumed rate of return due to bad market experience.*

Teachers’ Retirement System Contributions



- FYs 2006 through 2009 contributions were supplemented by the use of surplus funds.
- FY 2010 and beyond include debt service on the $2.3 billion pension obligation bonds issued on April 30, 2008 on behalf of the Teachers’ Retirement System.
- FY 2018 and beyond reflect the impact of lowering the assumed rate of investment return to 8% from 8.5%.

Medicaid



- Beginning with the FY 2014 budget, only the state's share of the Medicaid account in the Department of Social Services is appropriated.
- The Medicaid expansion for low-income adults, which was approved by the federal government in June 2010, has resulted in significant increases in caseload and program costs.
- Under the Affordable Care Act, these costs are 100% reimbursed by the federal government beginning January 1, 2014 through 2016, after which the federal reimbursement will be phased down to 90% in 2020.

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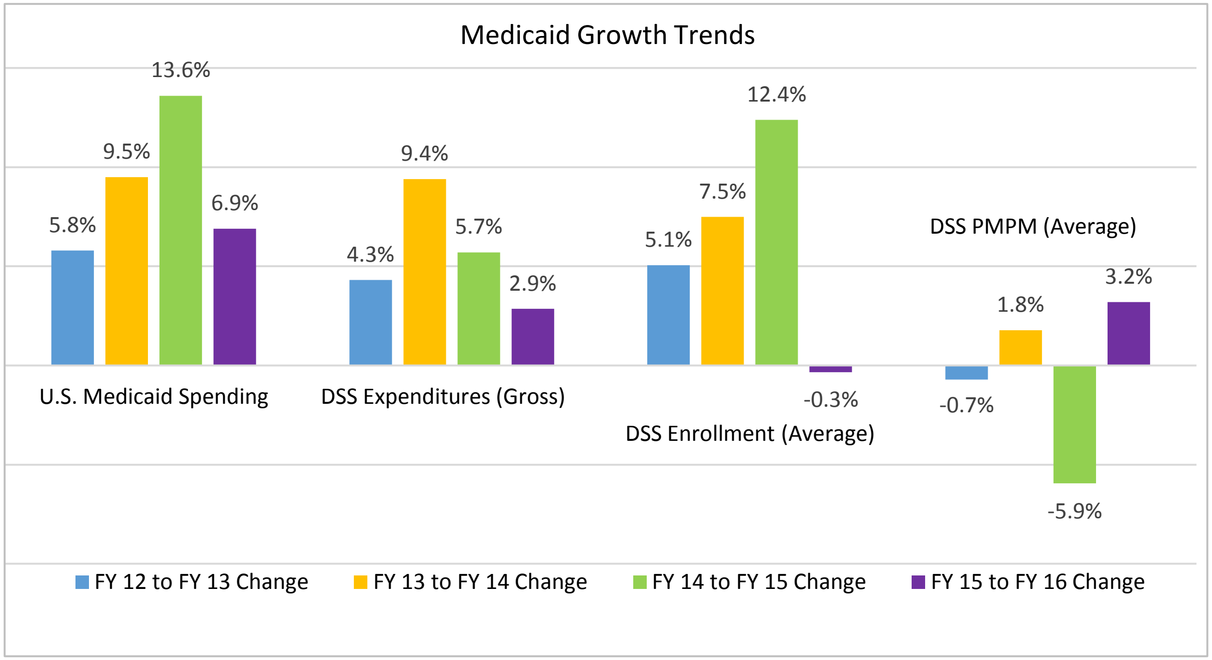
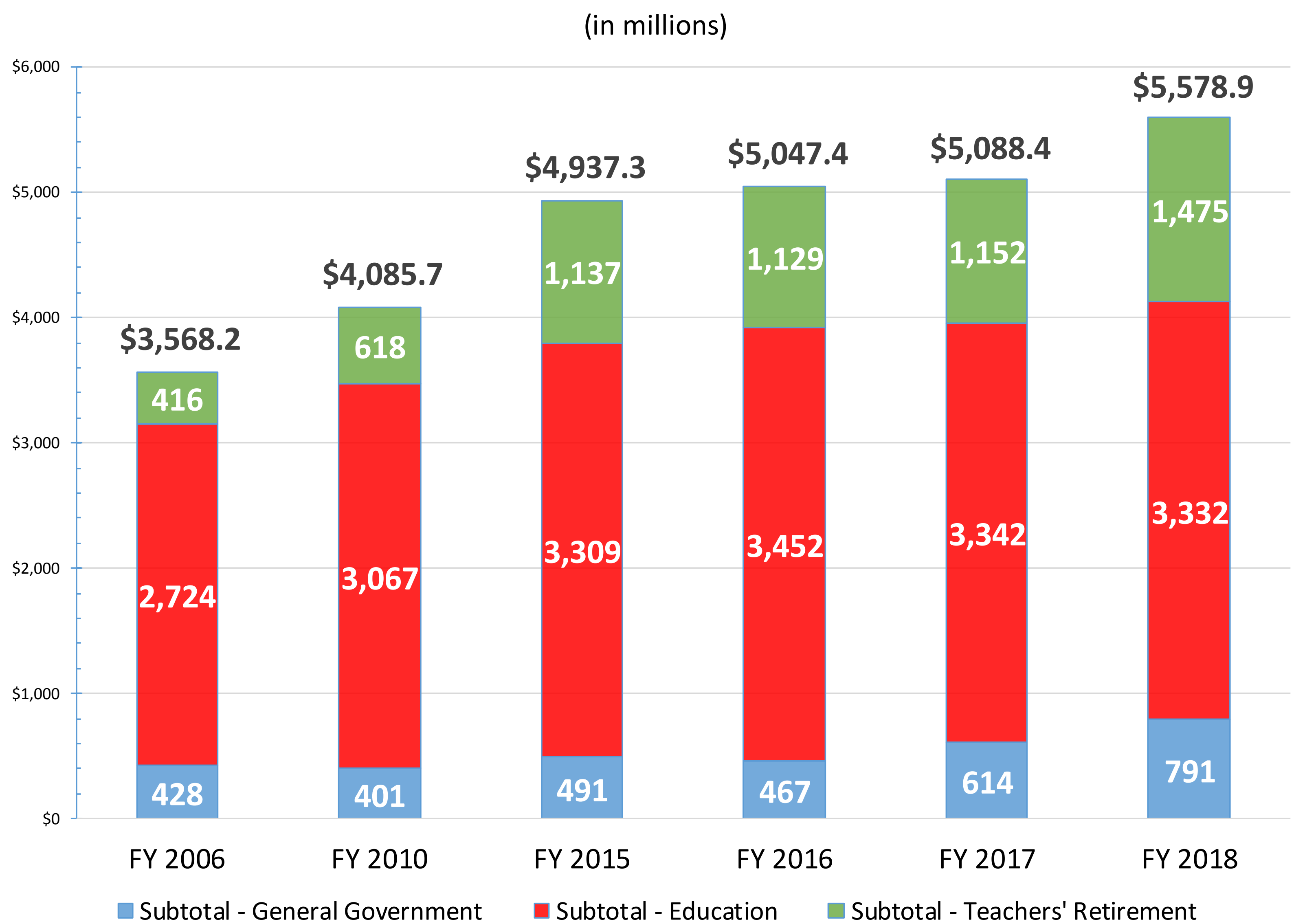
Medicaid

- DSS is employing diverse strategies to achieve improved health outcomes and cost efficiencies in the Medicaid program, including:
  - use of an administrative services organization (ASO) platform to promote efficient, cost-effective and consumer/provider responsive Medicaid medical, behavioral health, dental and non-emergency medical transportation services;
  - use of data analytics to improve care;
  - activities in support of improving access to preventative primary care;
  - efforts to support integration of medical, behavioral health, and long-term services and supports;
  - initiatives designed to "re-balance" spending on long-term services and supports; and
  - efforts to promote the use of health information technology.



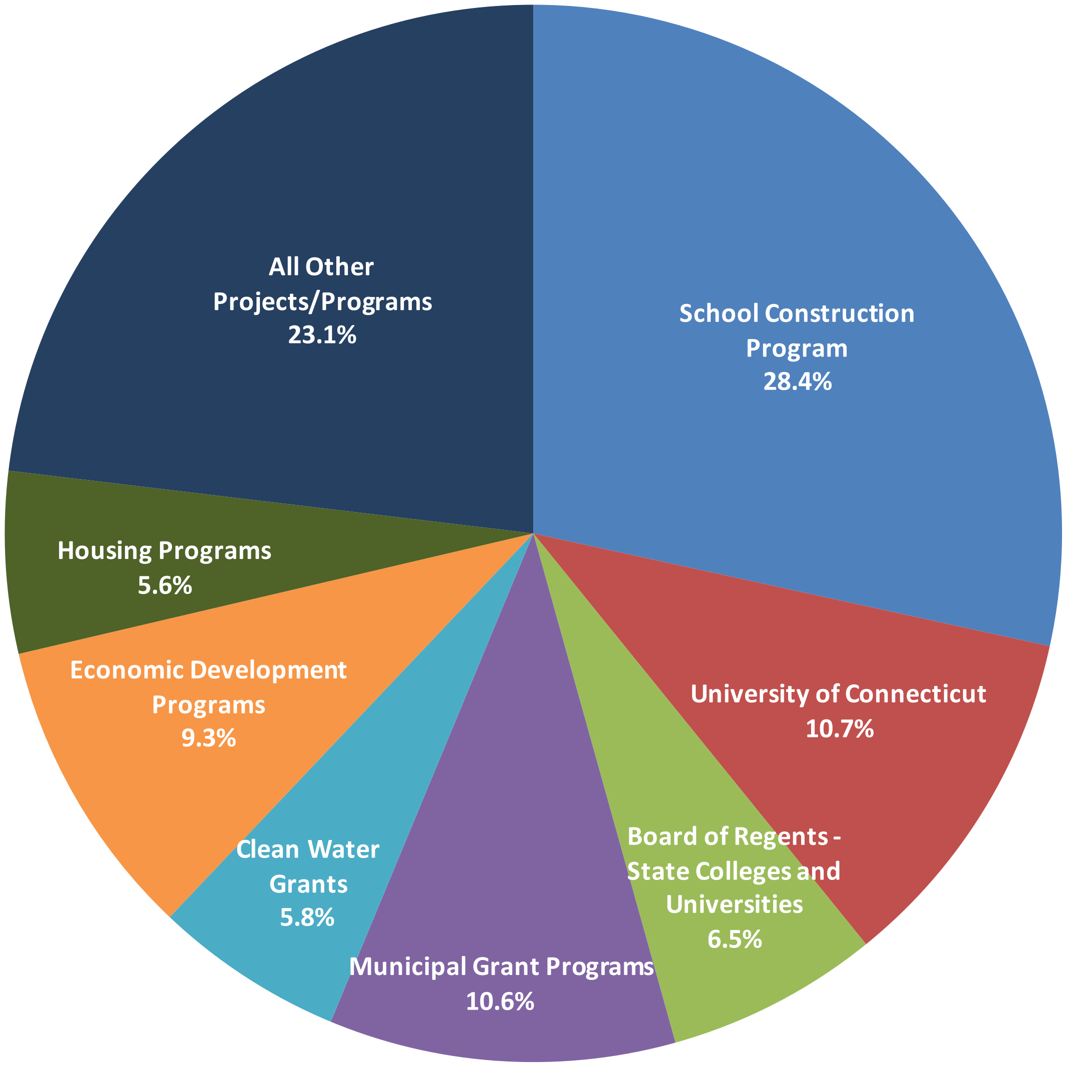
- In contrast to almost all other Medicaid programs across the nation, Connecticut Medicaid uses a managed, fee-for-service program rather than a managed care arrangement. It is one of the very few Medicaid programs with relatively steady expenditures on a per member, per month (PMPM) basis.

State Aid to or on Behalf of Local Governments



Five Year Bond Projections

Projected GO Bond Allocations
FY 2017 – FY 2020



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Statutory GO Bond Debt Limit

	FY 2017	FY 2018	FY 2019	FY 2020
Revenues 11/10/2016 Consensus	$15,519,900,000	$15,244,000,000	$15,673,300,000	$16,066,100,000
Multiplier	1.6	1.6	1.6	1.6
100% Limit	24,831,840,000	24,390,400,000	25,077,280,000	25,705,760,000
Bonds Subject to Limit	$21,886,730,888	$21,659,930,900	$22,220,825,331	$22,709,270,288
Debt Incurring Margin	$ 2,945,806,459	$ 1,672,744,100	$ 1,726,659,669	$ 1,888,799,712
Percentage of Limit	88.14%	93.14%	93.11%	92.65%
Margin to 90% Limit	$462,622,459	$(766,295,900)	$(781,068,331)	$(681,776,288)

- In accordance with the General Statutes, the Treasurer computes the aggregate amount of indebtedness as of January 1, and July 1 each year and certifies the results of such computation to the Governor and the General Assembly. If the aggregate amount of indebtedness reaches 90% of the statutory debt limit, the Governor is required to review each bond act for which no bonds, notes or other evidences of indebtedness have been issued, and recommend to the General Assembly priorities for repealing authorizations for remaining projects.
- In order to remain under the 90% limit, bond authorizations would need to be reduced by approximately $766.3 million in FY 2018.

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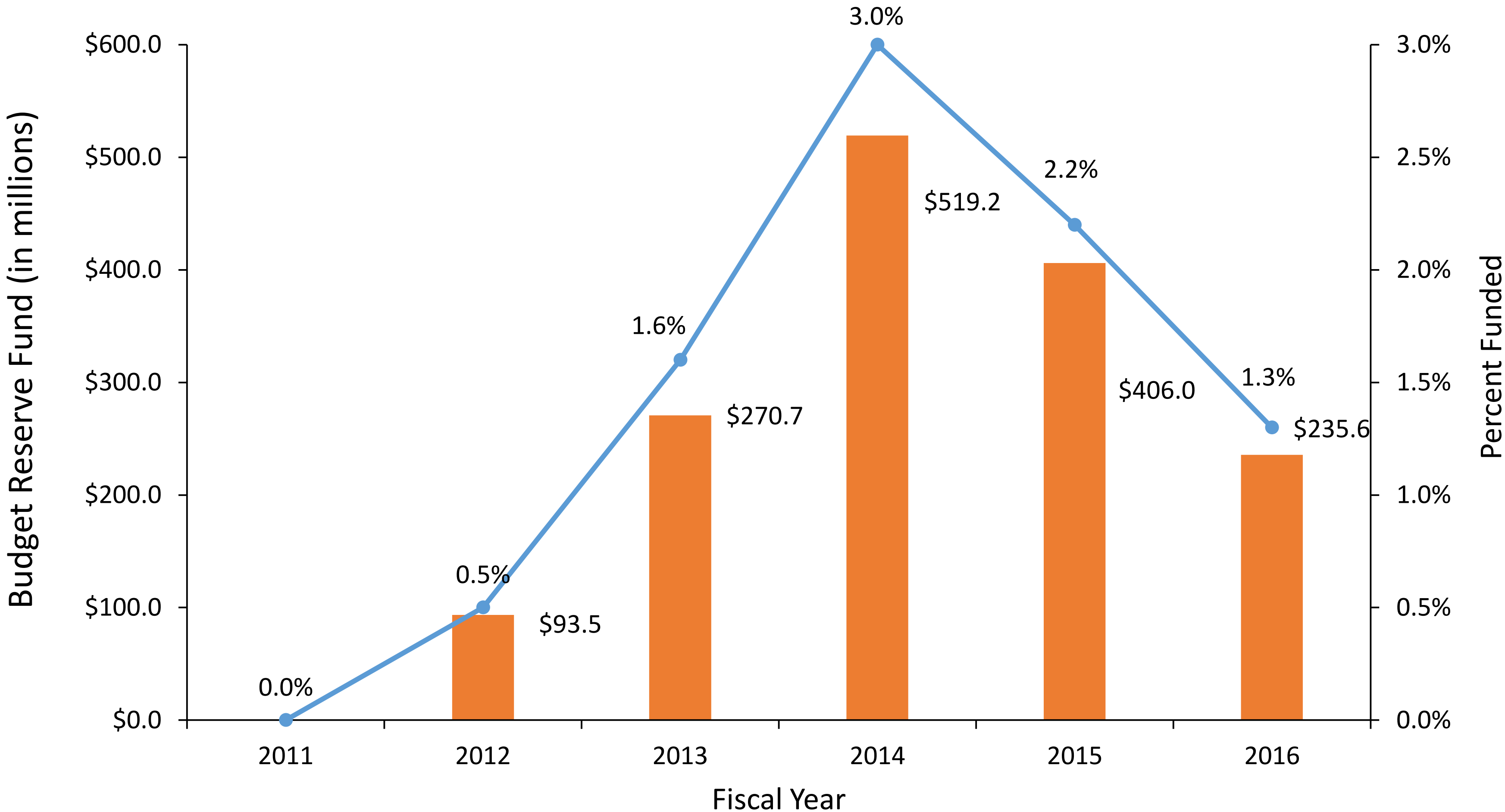
Budget Reserve Fund

Budget Reserve Fund Balance



Budget Reserve Fund

- Current law (CGS 4-30a) directs unappropriated surpluses to the Budget Reserve Fund.
- Credit rating agencies note that lack of improvement in available reserve levels could lead to deterioration of the state's rating.
- Replenishment of the Budget Reserve Fund to the current 10% statutory maximum would require approximately $1.8 billion.
- Once the BRF is fully funded, other possible uses of surplus funds could include:
  - Reducing bonded indebtedness;
  - Reducing the unfunded liability in the State Employees Retirement Fund;
  - Reducing the unfunded liability in the Teachers' Retirement Fund;
  - Reducing the unfunded liability for Other Post Employment Benefits; or
  - Providing funds for Higher Education Matching Grants as per sections 10a-77a, 10a-99a, 10a-109c, 10a-109i and 10a-143a of the General Statutes.

Conclusion

- In FY 2018 we face significant pressure from the following:
  - The slow-growing economy is producing slow-growing revenues.
  - The state is aggressively ramping up our payments against long-term liabilities to remedy historic underfunding.
  - The state is paying for historic increases in municipal aid and transportation funding.
- If we can make recurring adjustments in FY 2018, we will be able to balance FY 2019 and FY 2020 with much less difficulty as revenue and fixed-cost growth become better aligned.