FISCAL ACCOUNTABILITY REPORT
FISCAL YEARS 2015 – 2018

OFFICE OF POLICY AND MANAGEMENT

BENJAMIN BARNES, SECRETARY

NOVEMBER 21, 2014

Introduction

- Employment is increasing, income is rising, retail sales are growing, and the economy is rebounding
- However, adopting a balanced budget for the next biennium will be a significant challenge for the coming legislative session
- The Governor will propose a budget that is balanced, under the spending cap, and does not rely on new taxes. This proposal will include significant spending reductions

Presentation Overview

- Summary of OPM projections
- Spending cap calculation
- Economic factors and revenue trends
- Expenditures, major cost drivers and long-term obligations
- Five year bond projections
- Budget Reserve Fund status
- Summary and conclusion

Overview of Projections

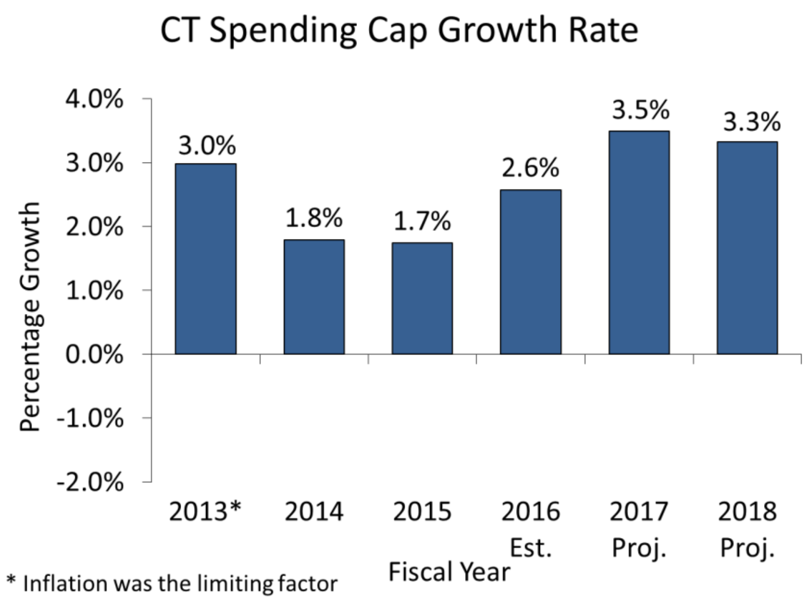
Financial Summary of Funds

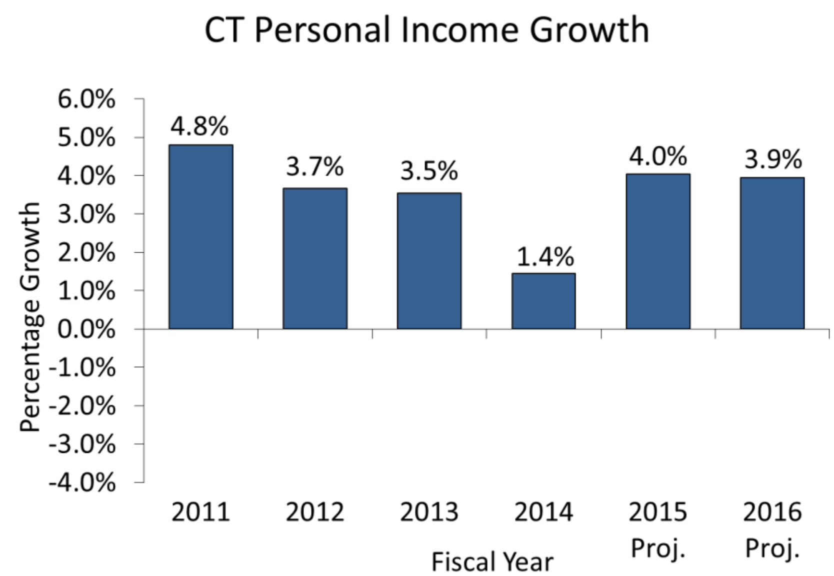
in millions

	Estimated	Projected		
General Fund	FY 2015	FY 2016	FY 2017	FY 2018
Revenues[(1)]	$ 17,398.9	$ 17,445.5	$ 18,160.0	$ 18,832.4
Expenditures	17,498.4	18,622.4	19,282.7	20,119.7
Nov. 20 Rescissions	(54.7)			
Additional Management Actions	(44.8)	-	-	-
Balance[(2)]	$ 0.0	$ (1,176.9)	$ (1,122.7)	$ (1,287.3)
Special Transportation Fund				
Revenues [(1)]	$ 1,335.4	$ 1,502.3	$ 1,512.6	$ 1,512.7
Expenditures	1,321.6	1,369.9	1,448.5	1,508.6
Balance	$ 13.8	$ 132.4	$ 64.1	$ 4.1
Other Funds [(3)]				
Revenues	$ 214.7	$ 221.4	$ 223.1	$ 229.0
Expenditures	214.5	221.1	222.8	228.8
Balance	$ 0.2	$ 0.3	$ 0.3	$ 0.2
Total All Appropriated Funds				
Revenues	$ 18,949.0	$ 19,169.2	$ 19,895.7	$ 20,574.1
Expenditures	18,934.9	20,213.4	20,954.0	21,857.1
Balance[(2)]	$ 14.1	$ (1,044.2)	$ (1,058.3)	$ (1,283.0)

(1) Revenues reflect the November 10, 2014 consensus revenue forecast.
(2) For FY 2016 through FY 2018, note that Article 3, section 18 of the State Constitution requires a balanced budget.
(3) Other funds include the: a) Mashantucket Pequot and Mohegan Fund, b) Regional Market Operating Fund, c) Banking Fund, d) Insurance Fund, e) Consumer Counsel and Public Utility Control Fund, f) Workers' Compensation Fund, g) Criminal Injuries Compensation Fund.

Spending Cap





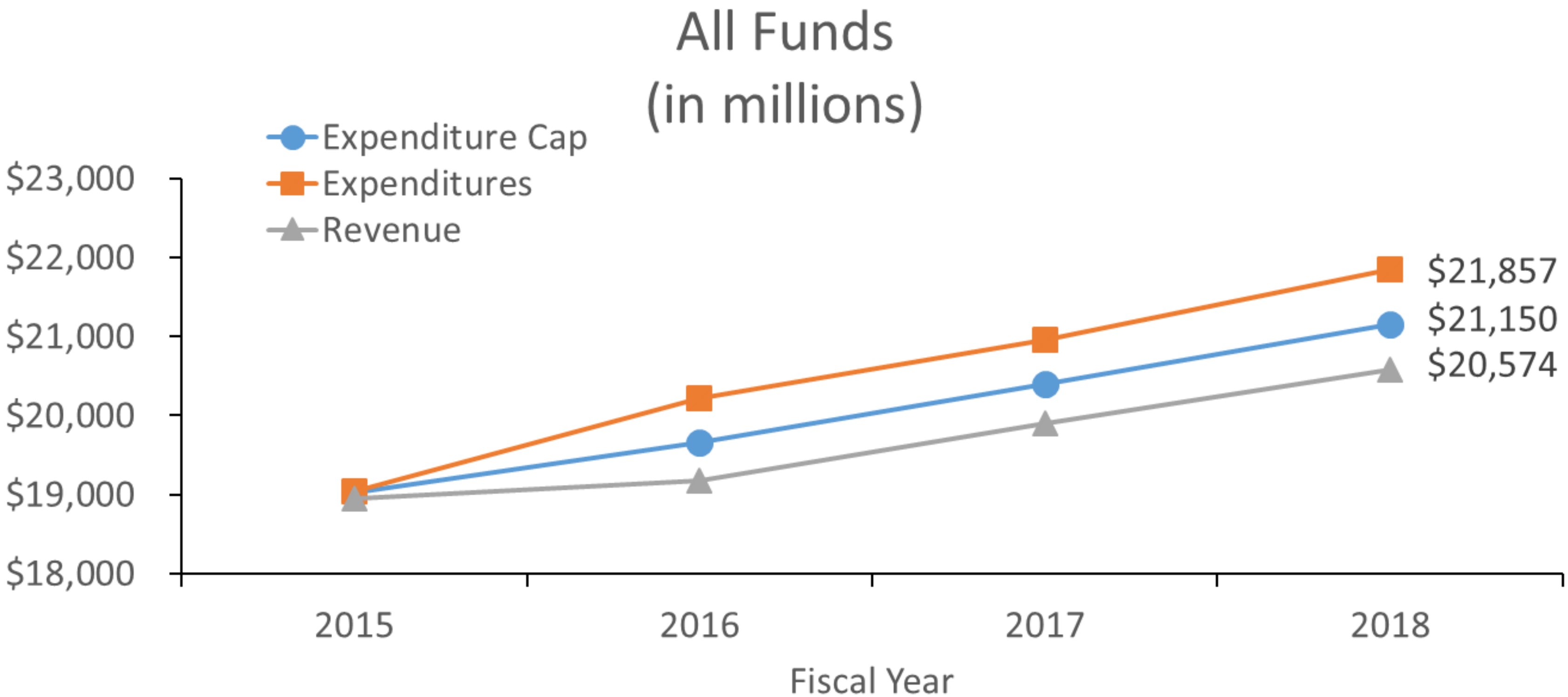
- The enacted FY 2015 budget is $26.0 million below the cap.
- Revenues, not the expenditure cap, have been the limiting factor on expenditures in recent years.
- Average personal income growth over a five year period serves as the cap's proxy for the economy's ability to pay for government services.
- The most recent recession has resulted in the lowest allowable expenditure cap growth rates since its inception.
- Because the economic expansion is forecasted to continue and recession years will no longer be included in moving average, allowable growth is projected to rise in future years

Spending Cap Projection

(in millions)

	FY 2016	FY 2017	FY 2018
Expenditure Cap Results			
Total All Appropriated Funds	$ 20,213.4	$ 20,954.0	$ 21,857.1
Allowed Appropriations per Cap	19,657.0	20,406.4	21,149.9
Over/(Under) the Cap	$ 556.4	$ 547.6	$ 707.2
Revenues and the Expenditure Cap[(2)]			
Revenues - All Funds	$ 19,169.2	$ 19,895.7	$ 20,574.1
Allowed Appropriations per Cap	19,657.0	20,406.4	21,149.9
Revenues Less Allowed Approps.	$ (487.8)	$ (510.7)	$ (575.8)

Outyear Cap and Balance

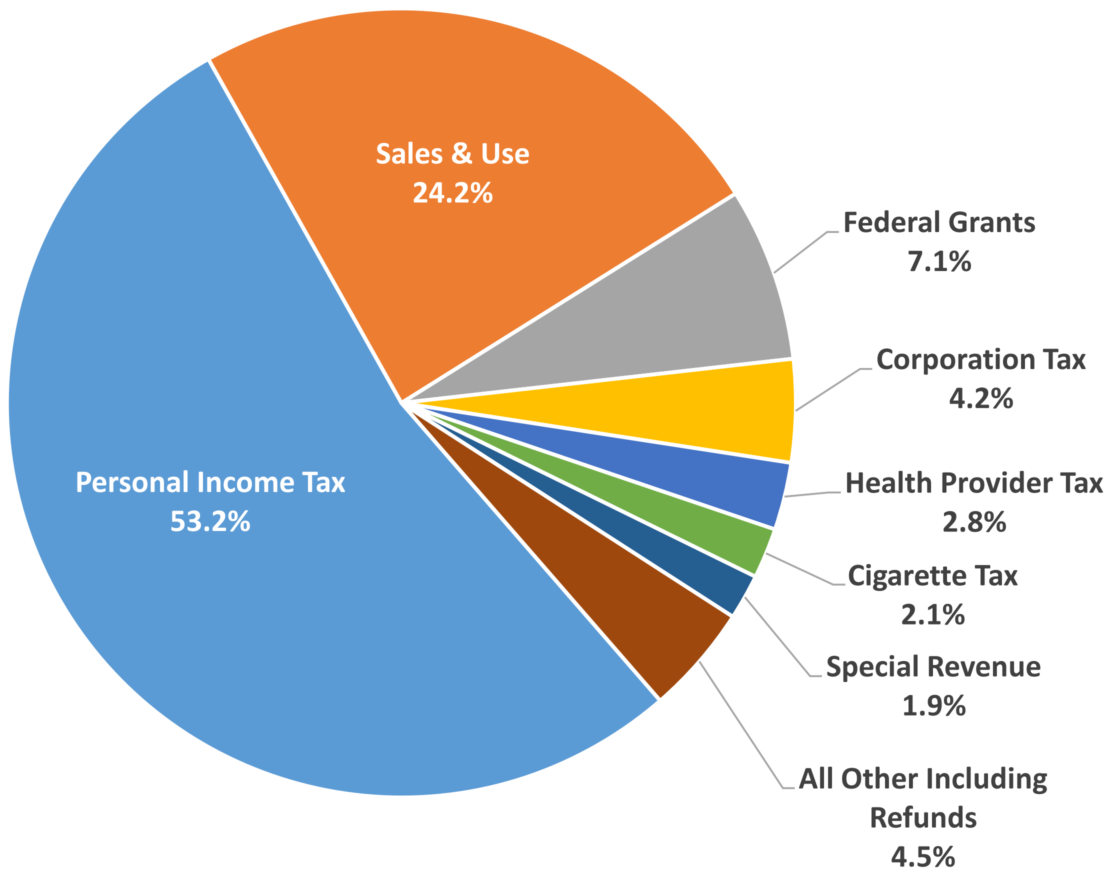


- Over the next three years revenues are projected to grow by $1.4 billion.
- The state's constitutional spending cap will permit growth of $2.1 billion.
- Expenditures and revenues will need to be aligned in order for the budget to remain in balance.

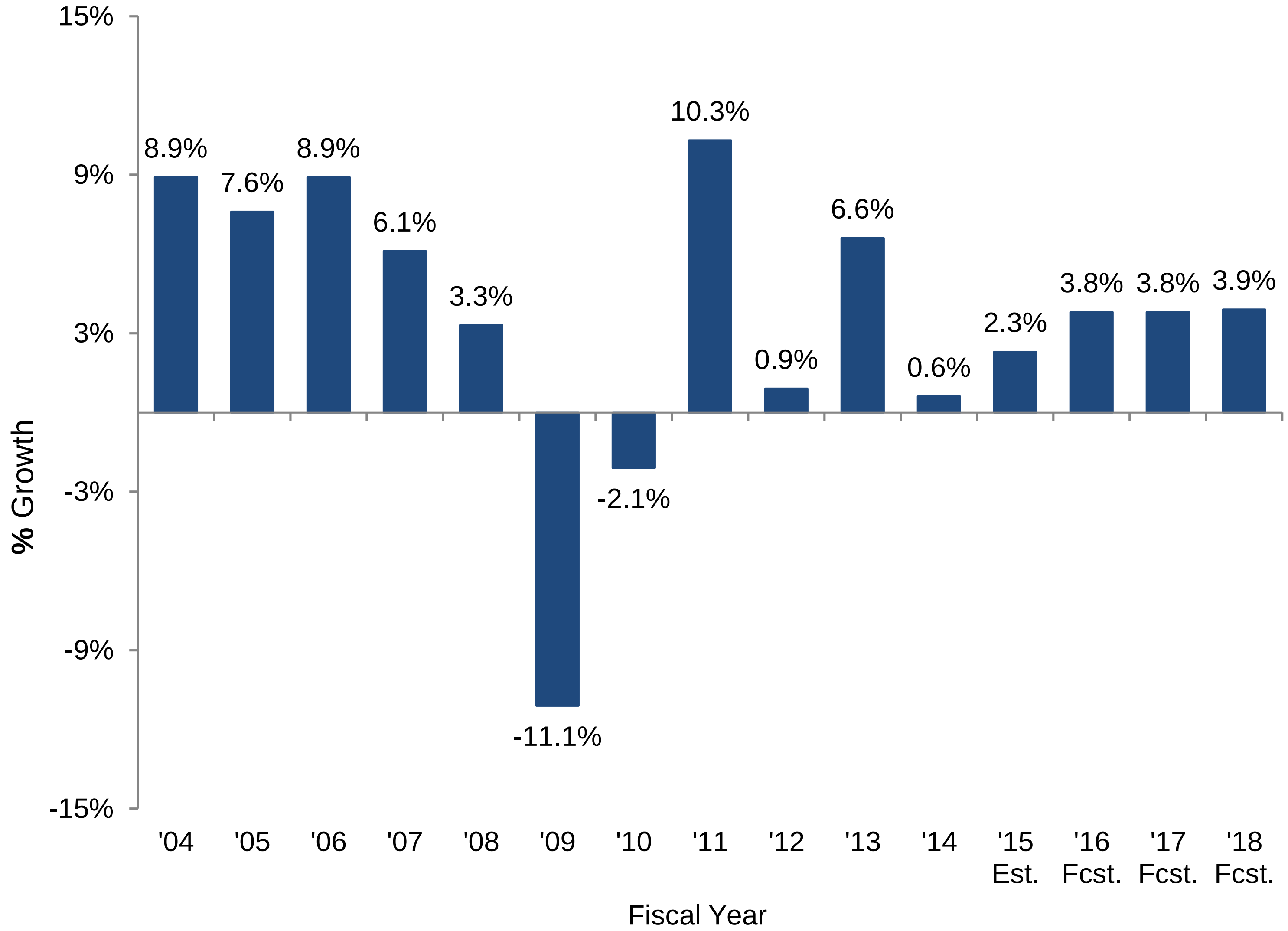
Economy and Revenue

General Fund Revenue Sources
FY 2015

Total $17,398.9 Million

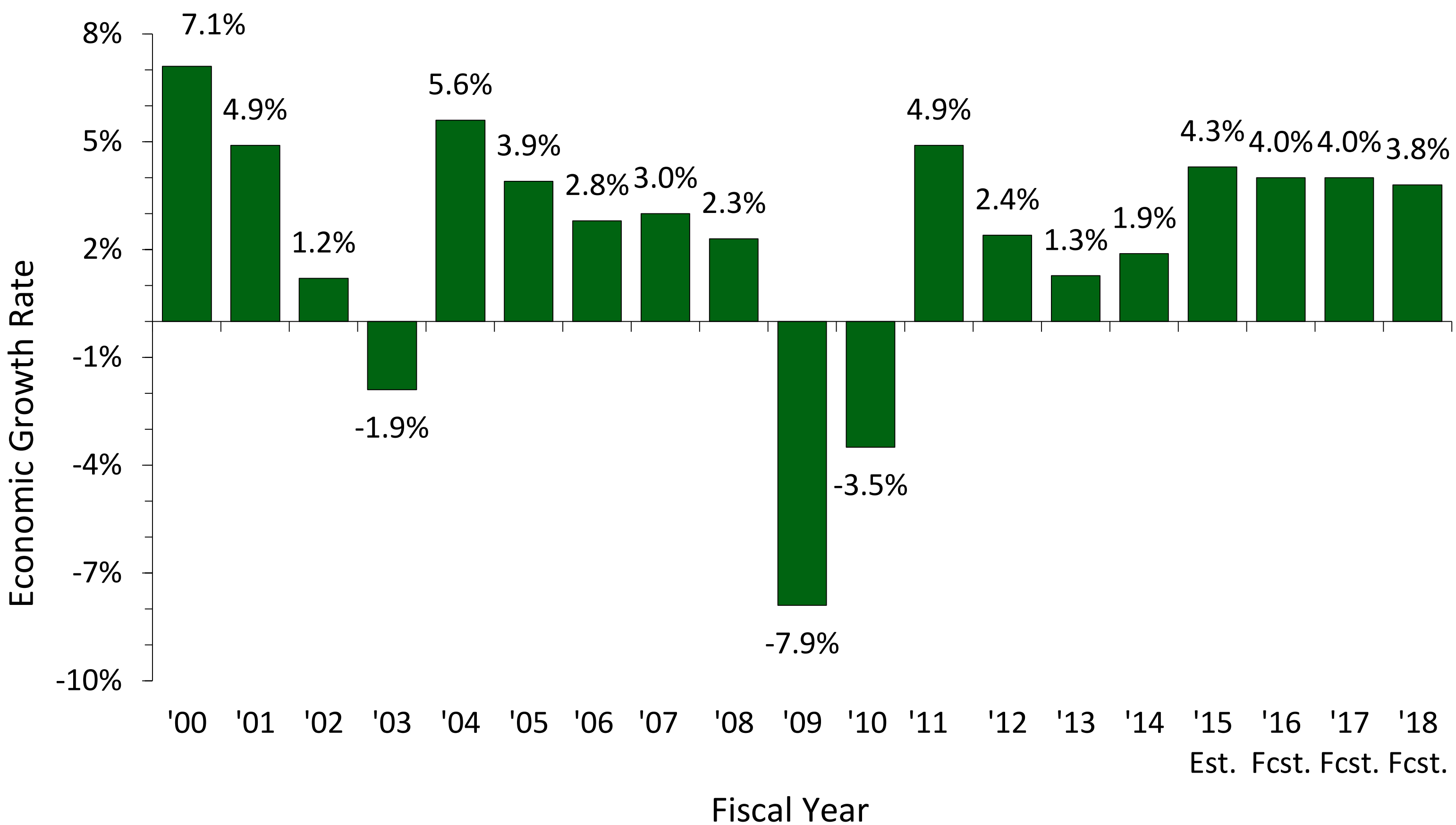


General Fund Economic Growth Rates



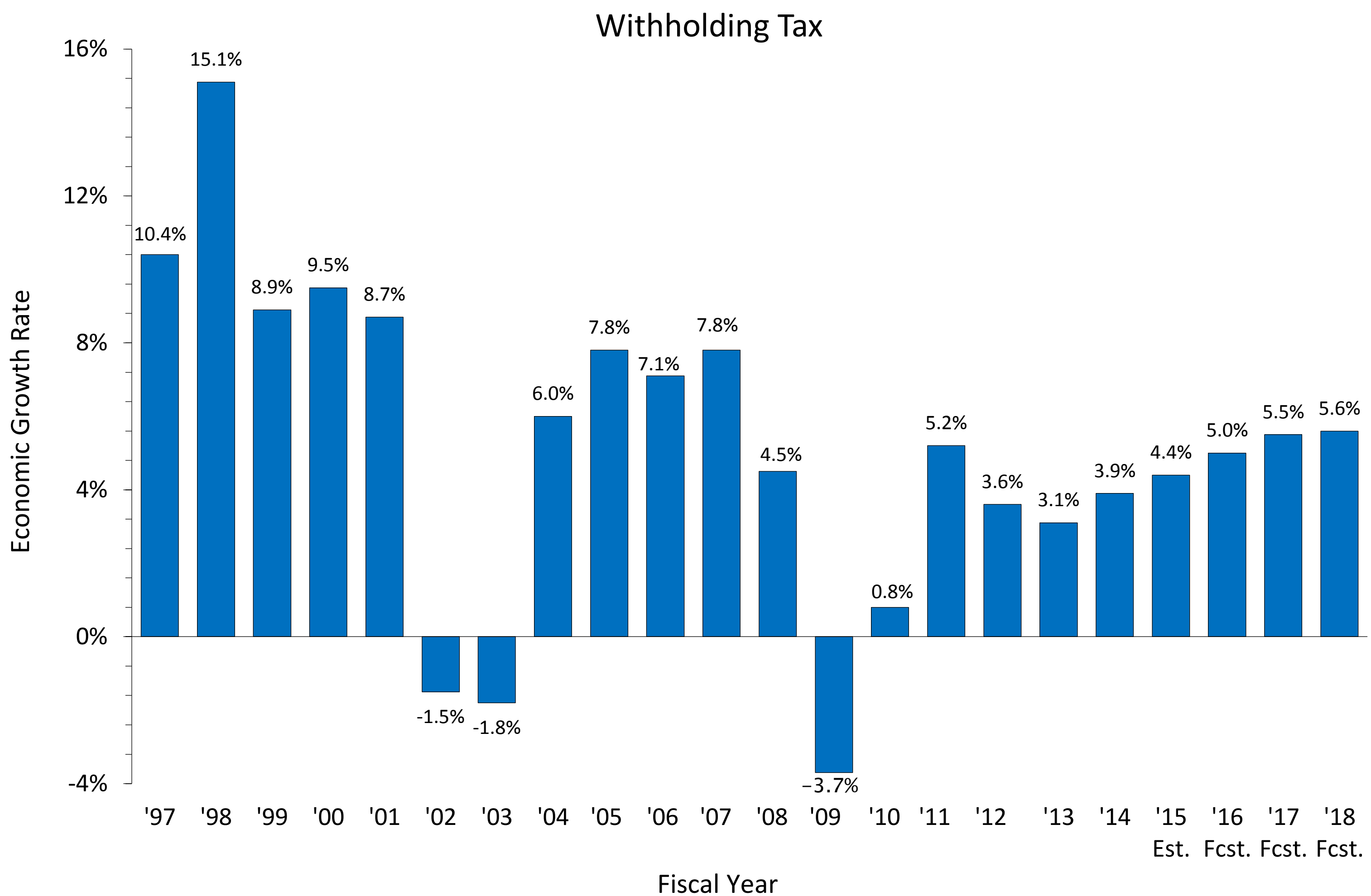
Sales Tax Trends

Economic Growth Rates



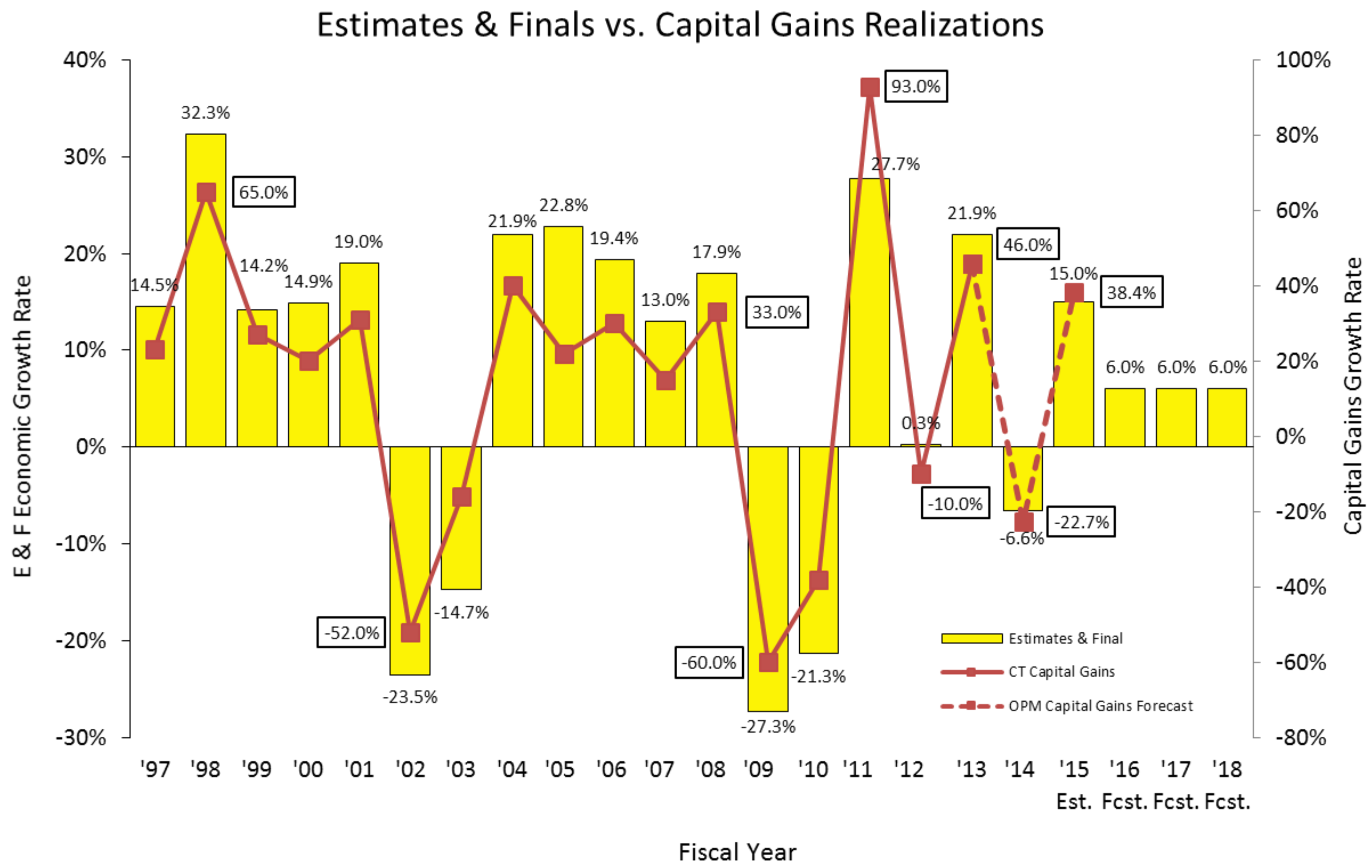
Personal Income Tax Trends

Economic Growth Rates



Income Tax

Highly Dependent Upon Capital Gains

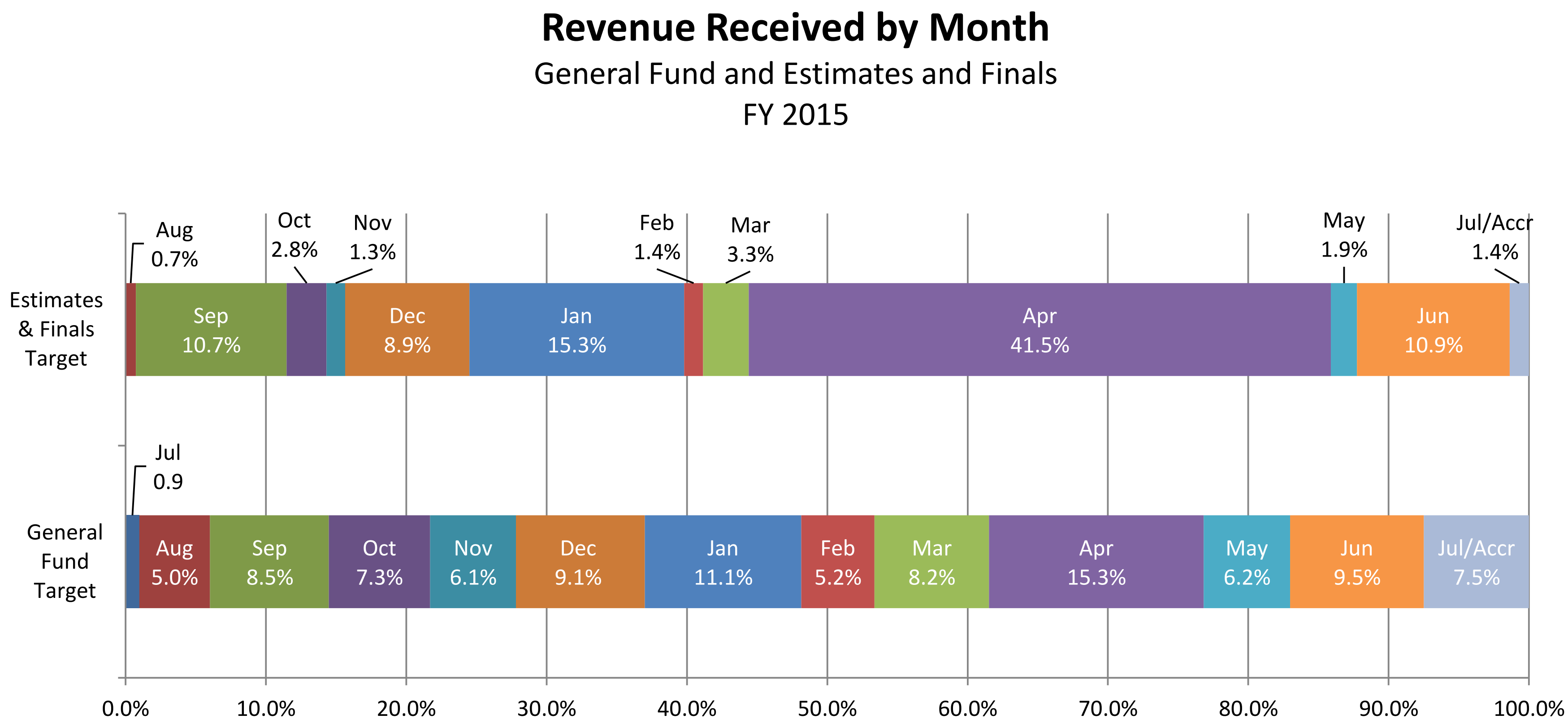


Note: Capital Gains are for the immediately preceding calendar year.

- Connecticut's income tax revenue has fluctuated dramatically due to the performance of the stock market and two recessions.
- A record high year for capital gains realizations can be immediately followed by a record low year, creating volatility in state finances.

Risks to FY 2015 Forecast

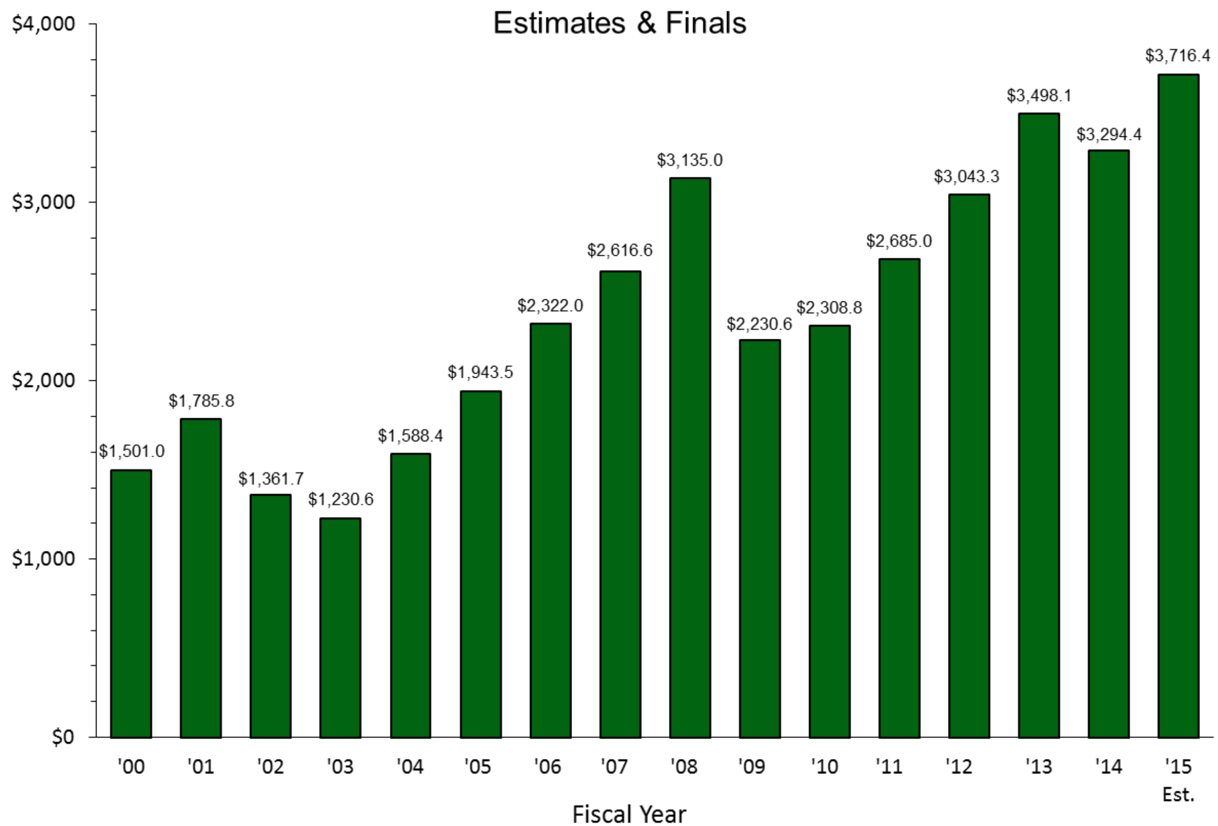
Revenue



- Most General Fund revenue is collected later in the fiscal year.
- This is especially true of the Estimates & Finals component of the Personal Income Tax.

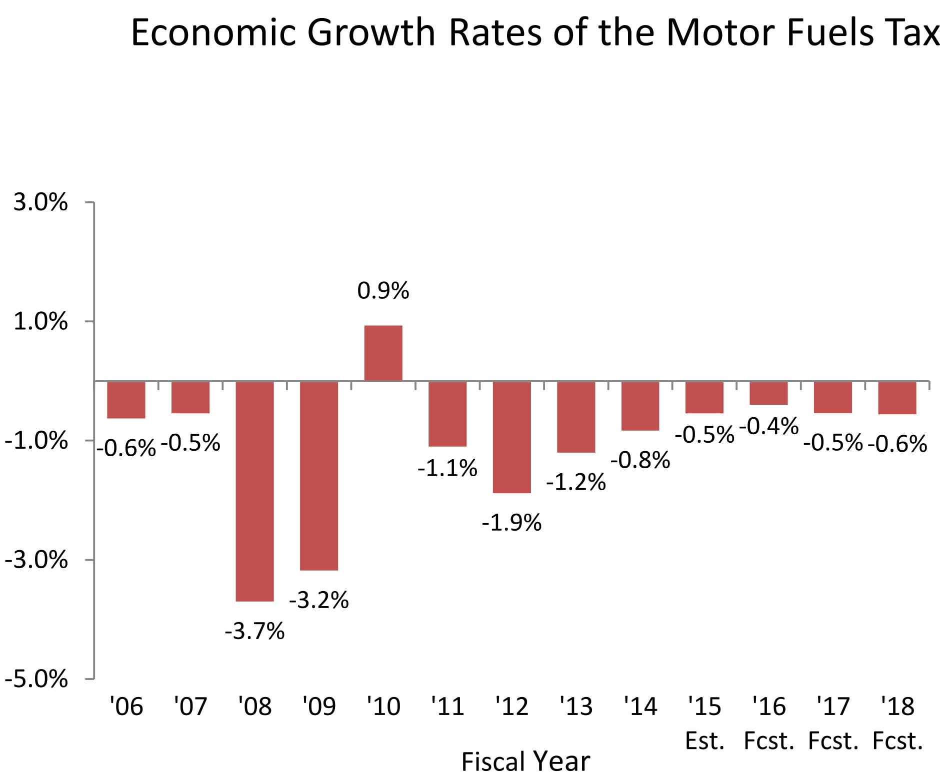
Risks to FY 2015 Forecast

Revenue



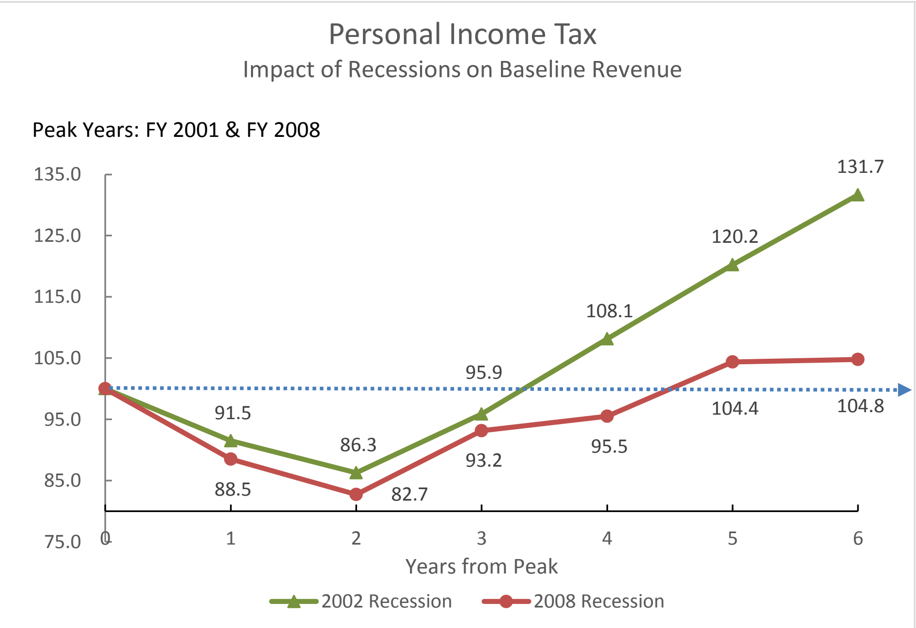
- To hit the FY 2015 forecast for estimates and finals, collections will need to surpass prior fiscal years
- Through October 31, $565.8 million has been collected, 15% of the fiscal year target.

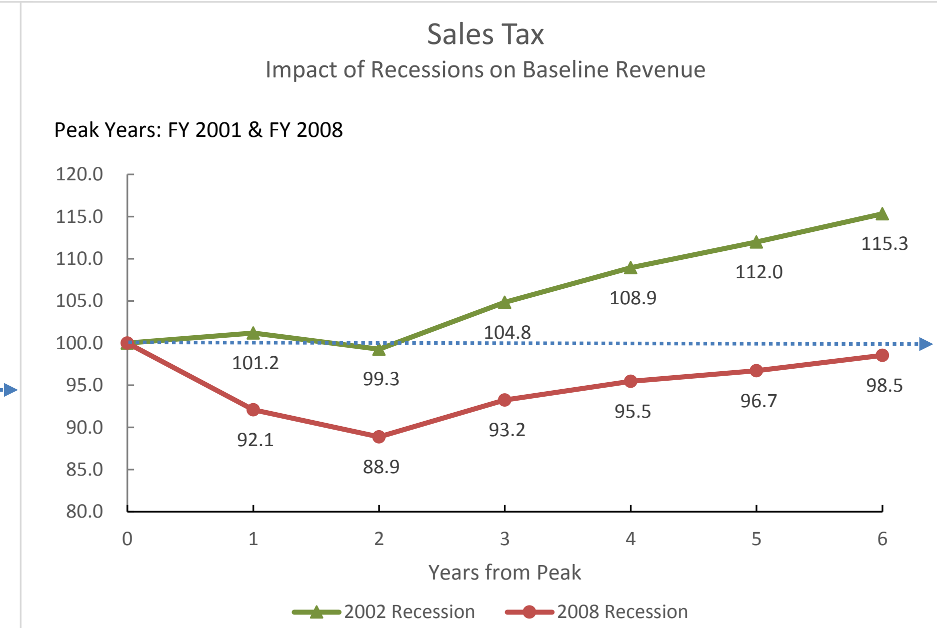
Declining Motor Fuels Consumption



- Consumers began to curtail consumption as prices began to rise.
- From FY 2006 through FY 2014, the cumulative decline in Motor Fuels Tax revenue is 11.6%.
- This is not just a cyclical change, but a major structural change on the part of consumers. The impact of lower gasoline prices has yet to be seen.
- In FY 2014, Motor Fuels Tax revenue equaled 40.5% of the total revenue of the Special Transportation Fund, down from 55.4% in FY 2003. Declining growth in motor fuels revenue has led to an increasing reliance on other revenue sources to support the fund, including transfers from the General Fund.

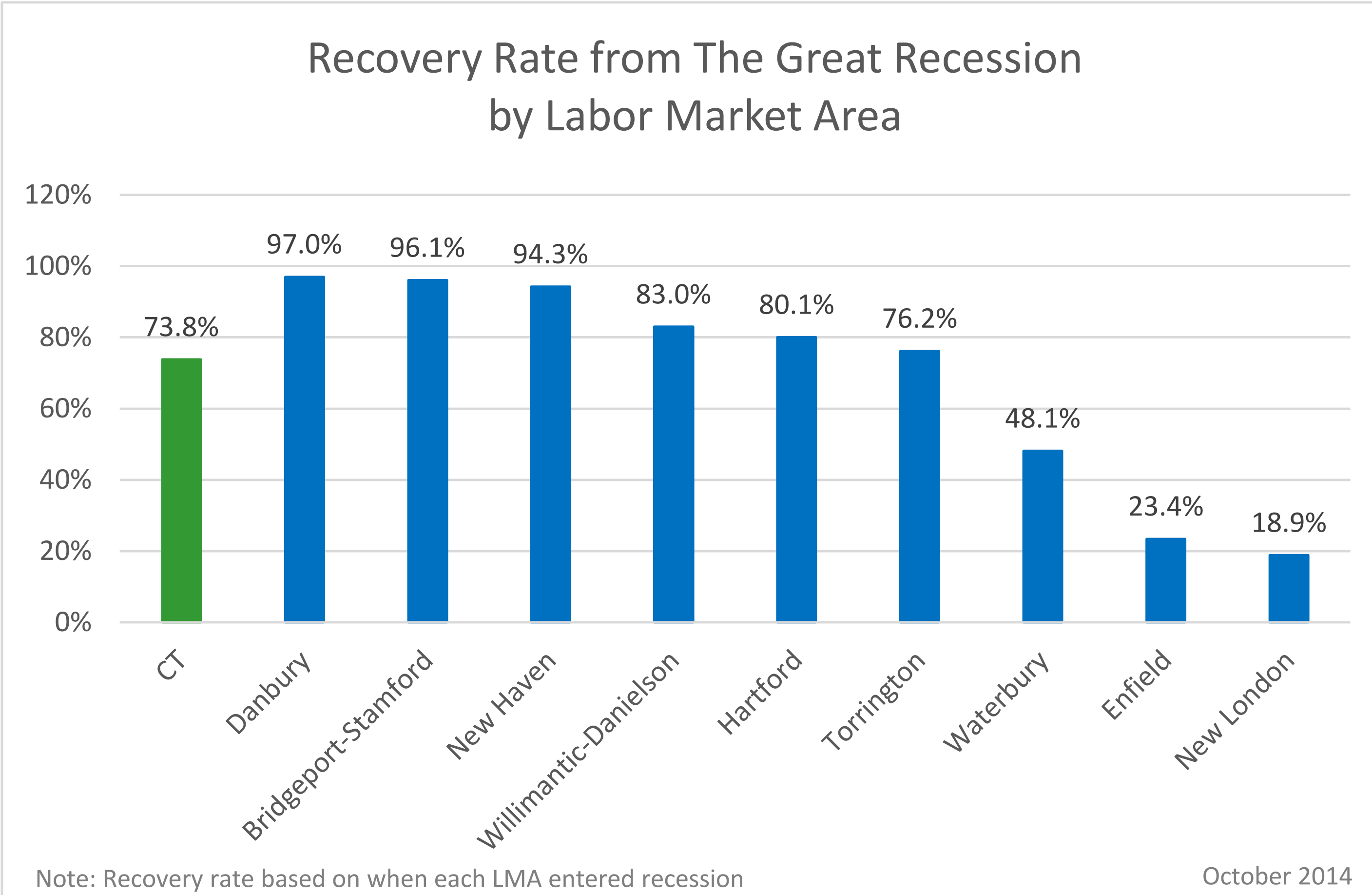
Slow Revenue Recovery





- For the two most recent recessions, revenue peaked in FY 2001 and FY 2008, respectively.
- Unlike the prior recession, Sales Tax revenue has yet to exceed its previous peak.
- If this recovery had been similar to the 2003 recovery, Income Tax revenue would be $2.0 billion higher, while Sales Tax revenue would be $600 million higher.

Employment Recovery in CT



- Connecticut's major population centers have experienced the strongest employment recovery.

Expenditures:

Major Cost Drivers & Long Term Obligations

Risks to FY 2015 Forecast

Agency Deficiencies

Recognized General Fund Deficiencies	Amount
DSS – Medicaid	$30.0 million
DESPP – Personal Services	$4.0 million
PDSC – Assigned Counsel, Expert Witnesses	$4.7 million
OSC – Miscellaneous – Adjudicated Claims	$2.0 million
Total Projected Deficiencies	**$40.7 million**

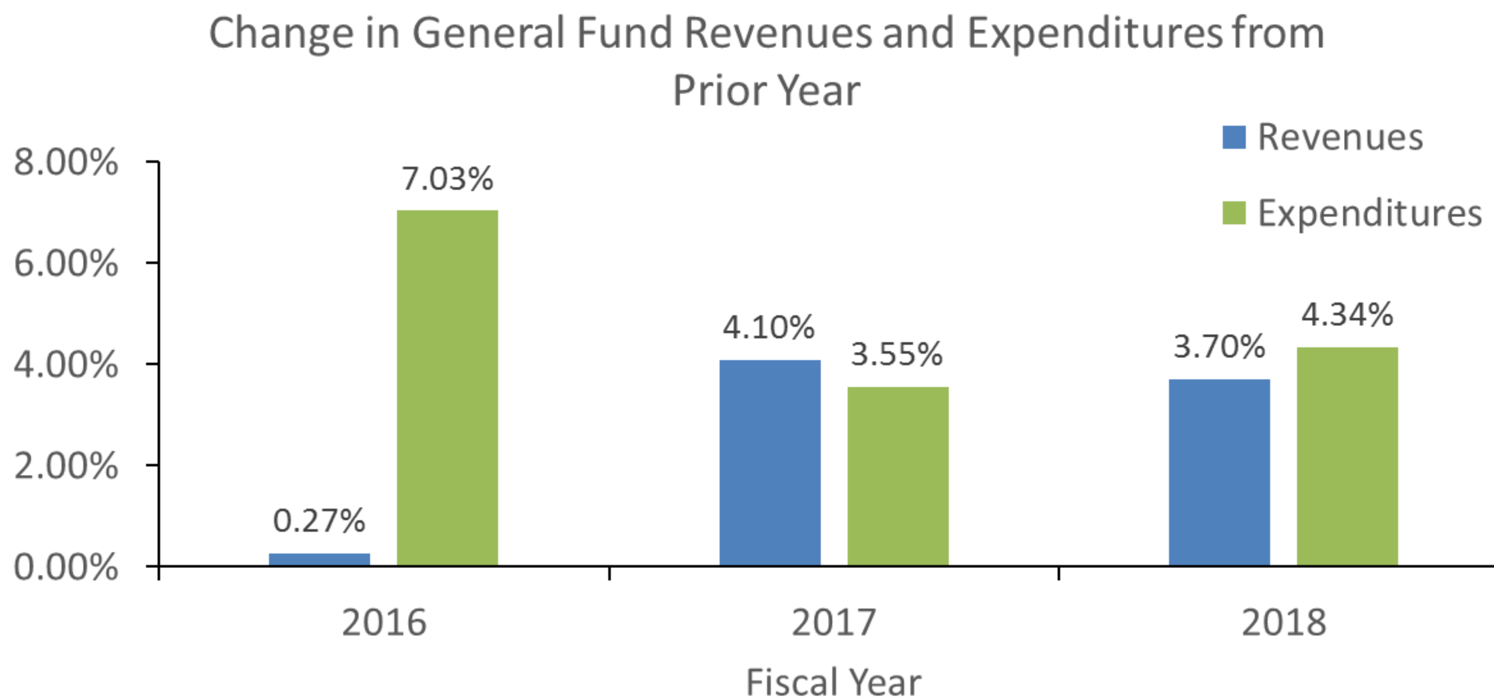
Additional "Watch Areas"

- DOC – Personal Services and Other Expenses
- OSC – Retiree Health Care costs
- DSS – Outstanding Medicaid waivers and state plan amendments
- DOT – Metro North costs (STF)

Management Actions to Address the FY 2015 Forecast

- Immediate action has been taken to address the projected FY 2015 General Fund shortfall:
  - $54.7 million in rescissions
  - Hiring limitations
  - Contracting restrictions
- These actions are anticipated to address the shortfall

Drivers of Outyear Budget Shortfalls



- FY 2016 revenues are projected to grow by $46.6 million
- FY 2016 expenditures are projected to grow by $1,223.5 million

Drivers of Outyear Budget Shortfalls

Revenues

Significant General Fund revenue adjustments in FY 2016 relative to FY 2015 include:

Sales and Use Tax	Exempt clothing and footwear under $50	$ (138.0)
Sales and Use Tax	Exempt non-prescription drugs	(13.0)
Personal Income Tax	Exemption of Teachers' Pensions	(10.6)
Personal Income Tax	EITC (27.5% to 30%)	(11.0)
Corporation Tax	Business Employment Tax	(40.0)
Corporation Tax	20% Corporate Surcharge	(44.4)
Insurance Premiums Tax	Insurance Credit Limitations	(22.7)
Sales/Corporation Tax	CT Aerospace Reinvestment Act	(20.0)
Transfers	Increased subsidy to the STF	(152.8)
		$ (452.5)

Drivers of Outyear Budget Shortfalls

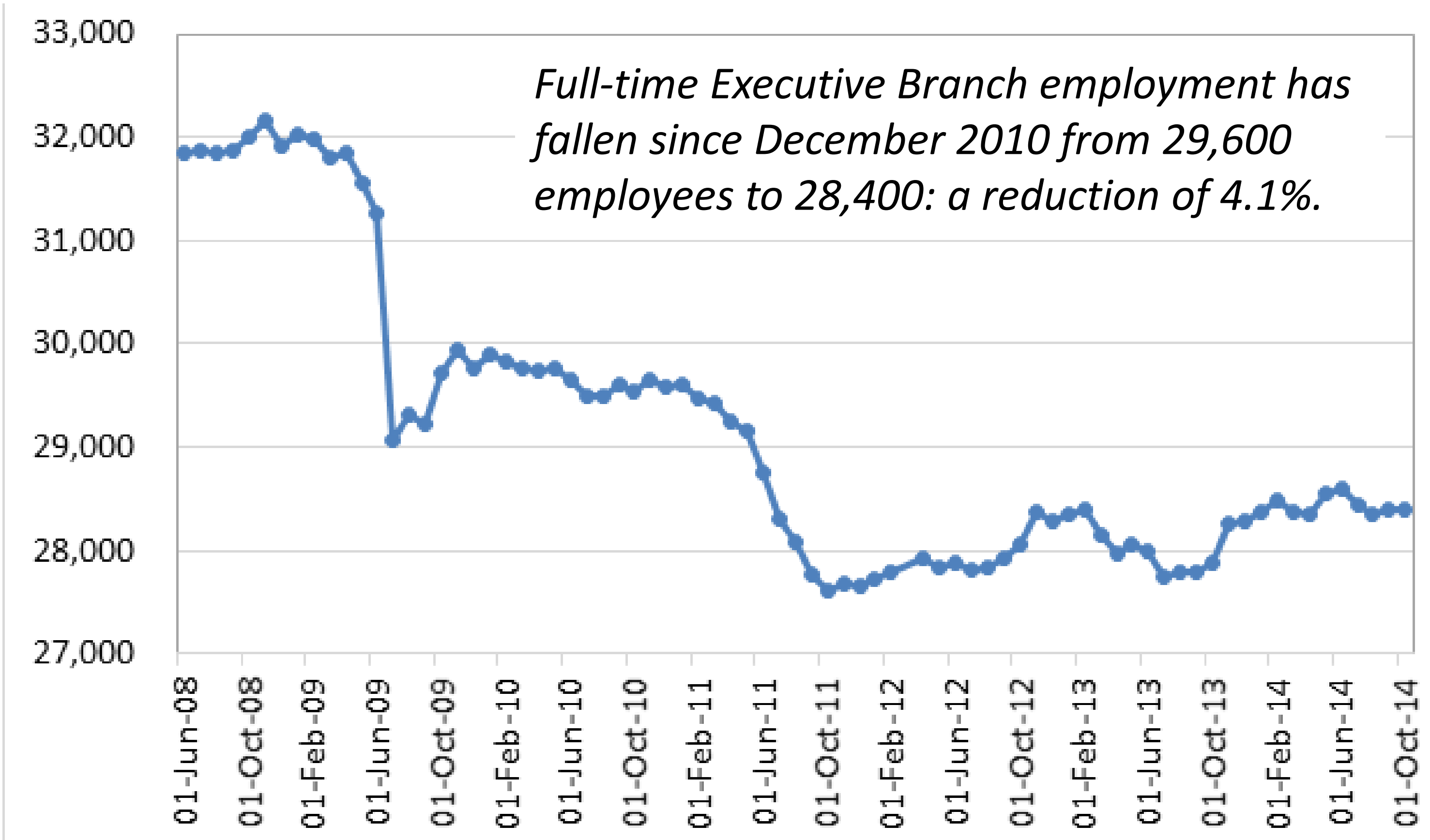
Expenditures

Major cost increases in FY 2016 General Fund budget Include:

- $192.3 million for Medicaid
- $178.4 million in debt service, driven by Economic Recovery Notes (ERNs)
- $170.0 million for retiree and active employee healthcare
- $138.3 million for Personal Services, including Reserve for Salary Adjustment
- $127.0 million for State Employee Retirement System
- $90.6 million for GAAP (including amortization of liability)

The above six items represent approximately 73% of the increase in General Fund expenditures in 2016

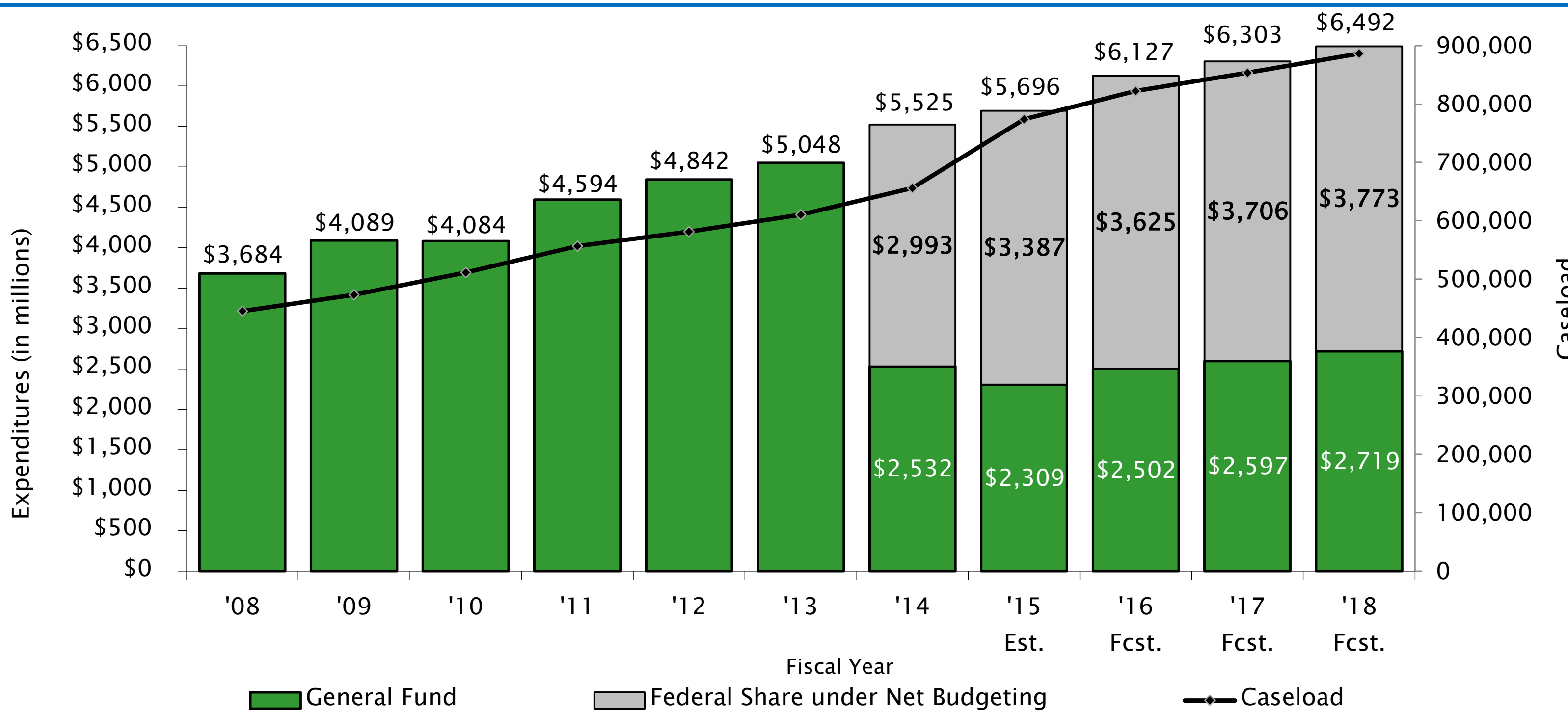
Reduced Executive Branch Workforce



Based on full-time Executive Branch employees on the last payroll of each month. Includes all appropriated funds; excludes constituent units of higher education.

Department of Social Services

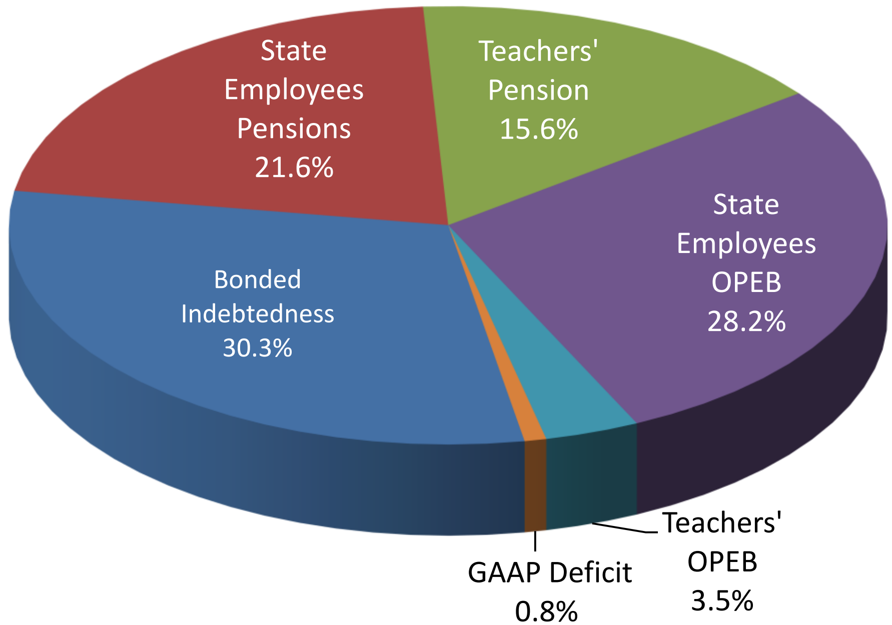
Medicaid



- Beginning in 2013, the budget "net appropriates" the Medicaid account in the Department of Social Services. A total of $2,768.7 million was removed from both budgeted revenues and appropriations to accomplish this transition in FY 2014.
- Increases in “Federal Share under Net Budgeting” reflect the impact of federal health care reform, which expands Medicaid coverage to childless adults with income up to 133% of the federal poverty level beginning January 1, 2014. (Costs are 100% federally reimbursed through 2016, after which reimbursement is phased down to 90% in 2020.)

Long Term Obligations

(in billions)



Bonded Indebtedness - As of 7/31/14	$ 20.9
State Employee Pensions - Unfunded as of 6/30/14	14.9
Teachers' Pension - Unfunded as of 6/30/14	10.8
State Employee Post Retirement Health and Life - Unfunded as of 6/30/2013	19.5
Teachers' Post Retirement Health and Life - Unfunded as of 6/30/2014	2.4
Cumulative GAAP Deficit - As of 6/30/13 adj. for GAAP bonds	0.6
Total	$ 69.1

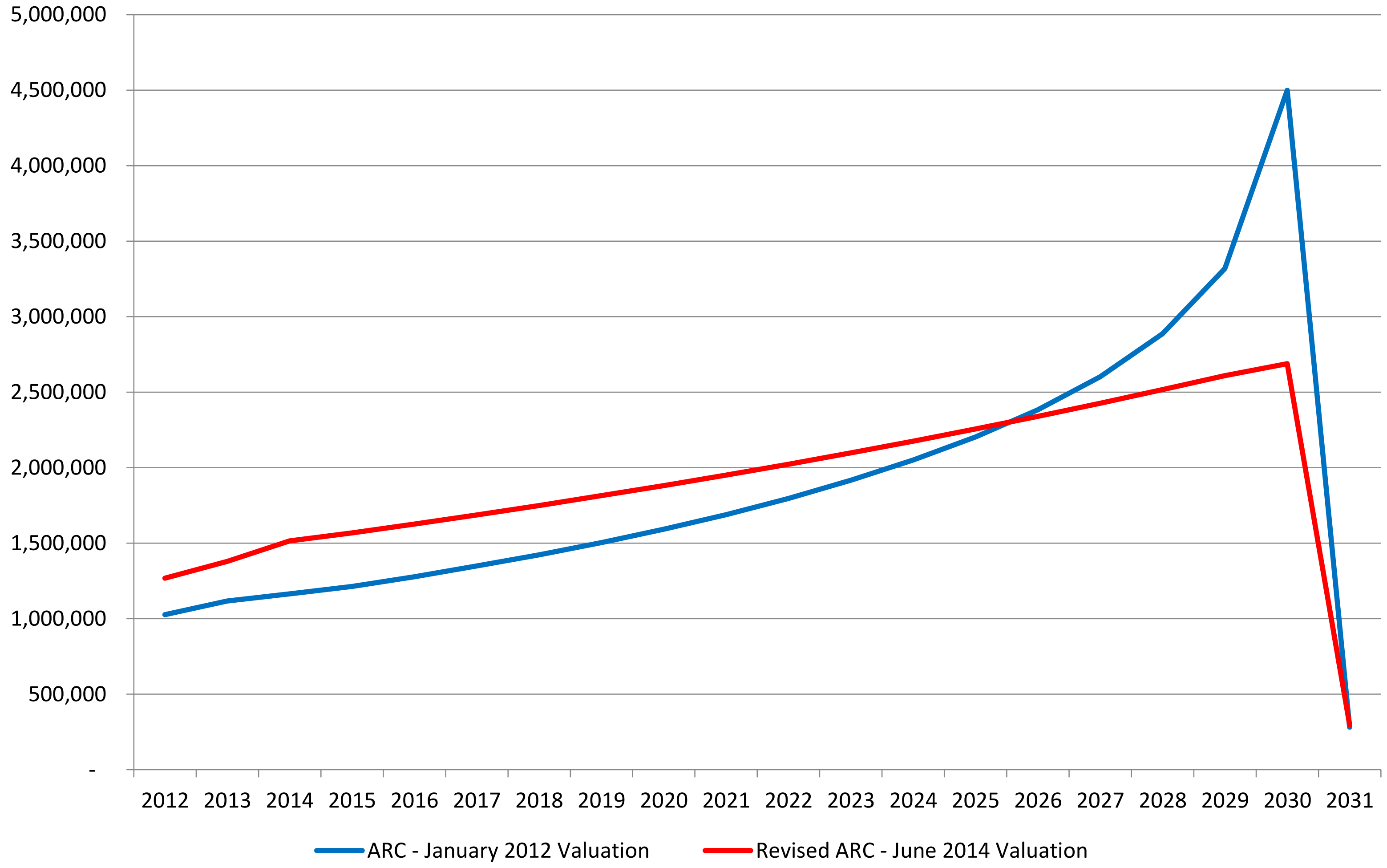
State Employees Retirement System Contributions

Fiscal Year	Actuarially Determined Employer Contribution (millions)	Actual/Est. Employer Contribution (millions)	Percent	Rate of Return Market Value Basis
2001-02	$415	$415	100%	-6.6%
2002-03	$426	$421	99%	1.9%
2003-04	$474	$470	99%	15.2%
2004-05	$516	$516	100%	10.5%
2005-06	$623	$623	100%	11.0%
2006-07	$664	$664	100%	17.1%
2007-08	$717	$712	99%	-4.8%
2008-09	$754	$700	93%	-18.3%
2009-10	$897	$721	80%	12.9%
2010-11	$944	$826	88%	21.2%
2011-12	$926	$926	100%	-0.9%
2012-13	$1,060	$1,060	100%	11.9%
2013-14	$1,269	$1,269	100%	15.6%
2014-15 est.	$1,379	$1,379	100%	
2015-16 est.	$1,514	$1,514	100%	
2016-17 est.	$1,569	$1,569	100%	
2017-18 est.	$1,663	$1,663	100%	

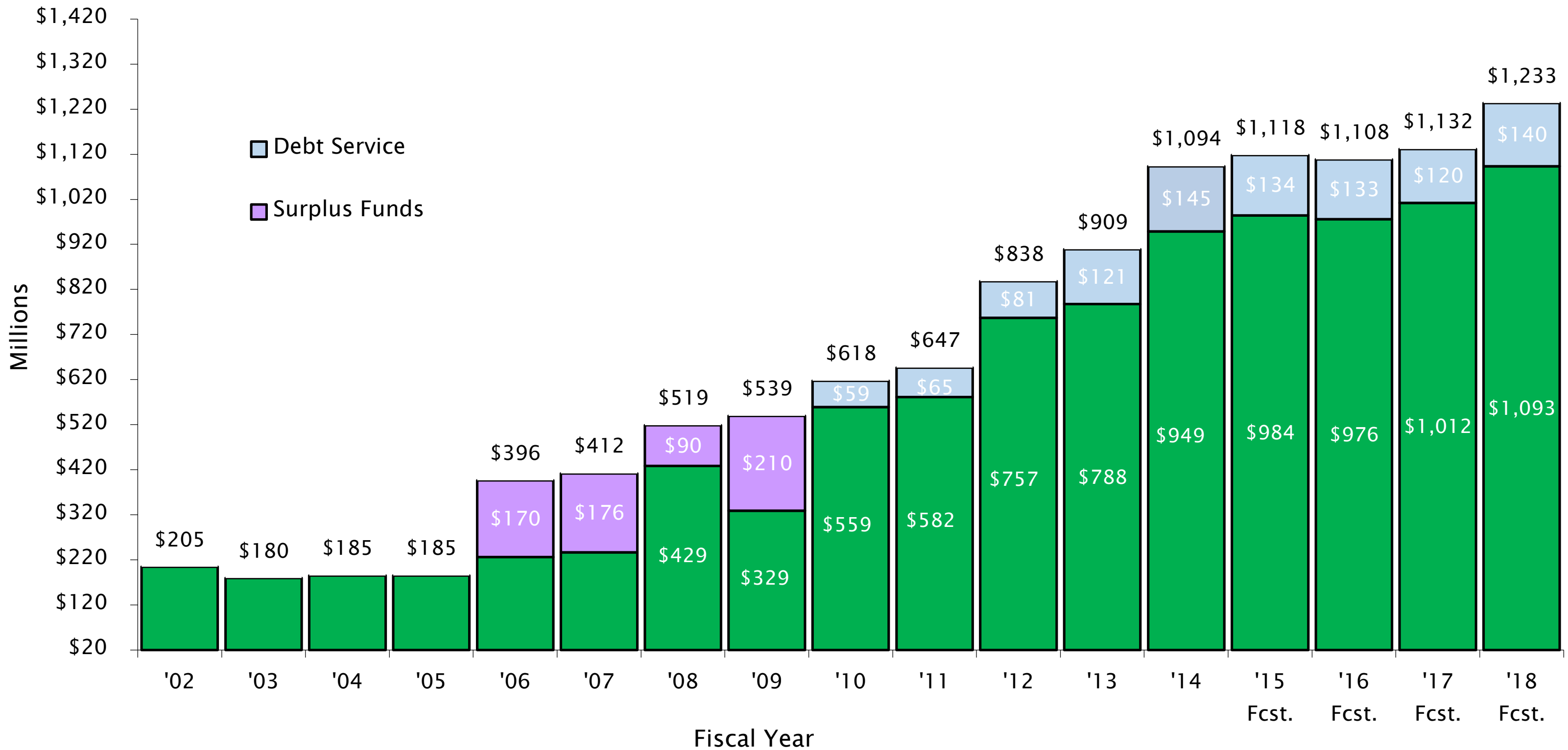
- The deferral of the SERS contribution was $50 million in FY 2009, $164.5 million in FY 2010 and $100 million in FY 2011.
- Starting in FY 2013, the SEBAC IV & V actuarial adjustments were eliminated.
- Through FY 2008, the assumed rate of return was 8.5%. In FY 2009 it was reduced from 8.5% to 8.25%.
- Starting in FY 2014, the assumed rate of return was reduced from 8.25% to 8%.

State Employees Retirement System

Flatter, more sustainable pension ARC ($000)

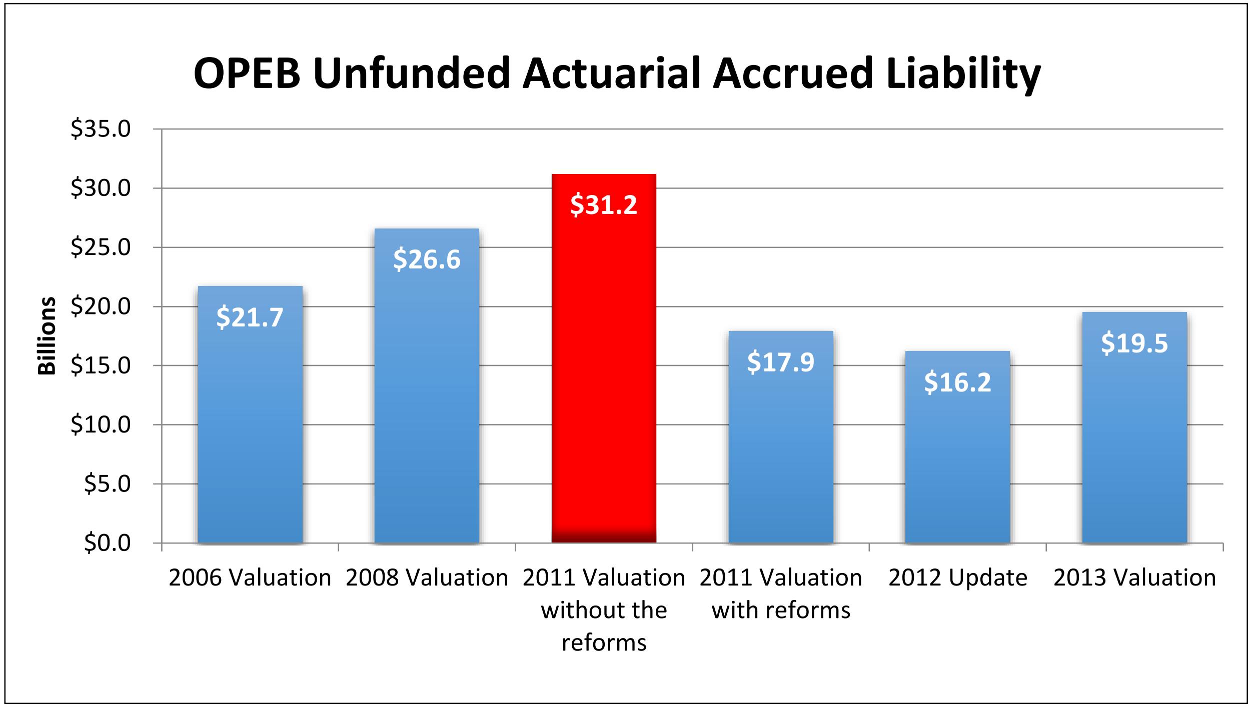


Teachers' Retirement System Contributions



FY 2010 and beyond includes debt service on the $2.3 billion in pension obligation bonds issued on April 30, 2008 on behalf of the Teachers' Retirement System.

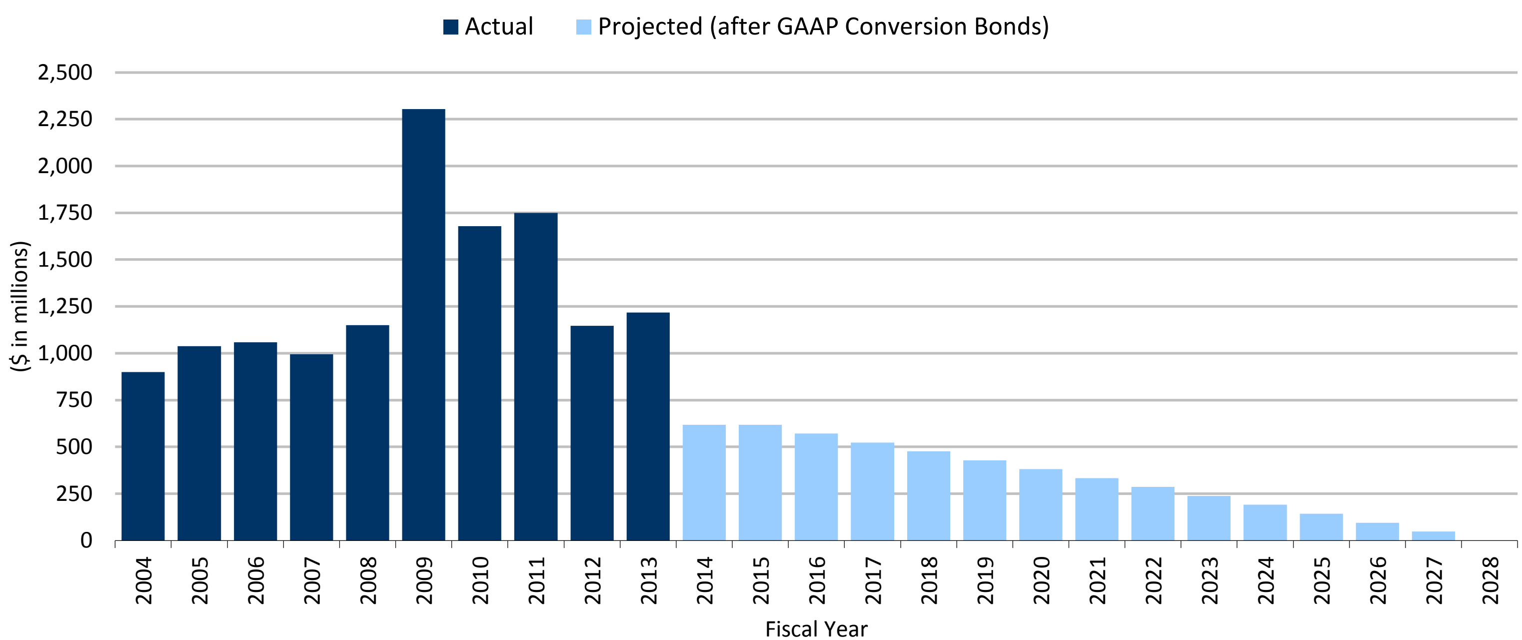
Other Post Employment Benefits



- The 2013 OPEB valuation, received in February of 2014, shows an increase in the state's unfunded liability to $19.5 billion. This compares to an expected unfunded accrued actuarial liability (UAAL) of $17.9 billion under normal plan operations.
- The difference between the actual ($19.5 billion) and expected ($17.9 billion) UAAL is mainly due to valuation assumption changes. Per the actuary, these changes are mainly the result of:
    1. Per capita health costs and the future trend for such costs, and
    2. Updated demographic assumptions based on the latest experience study completed by the pension actuary.

GAAP

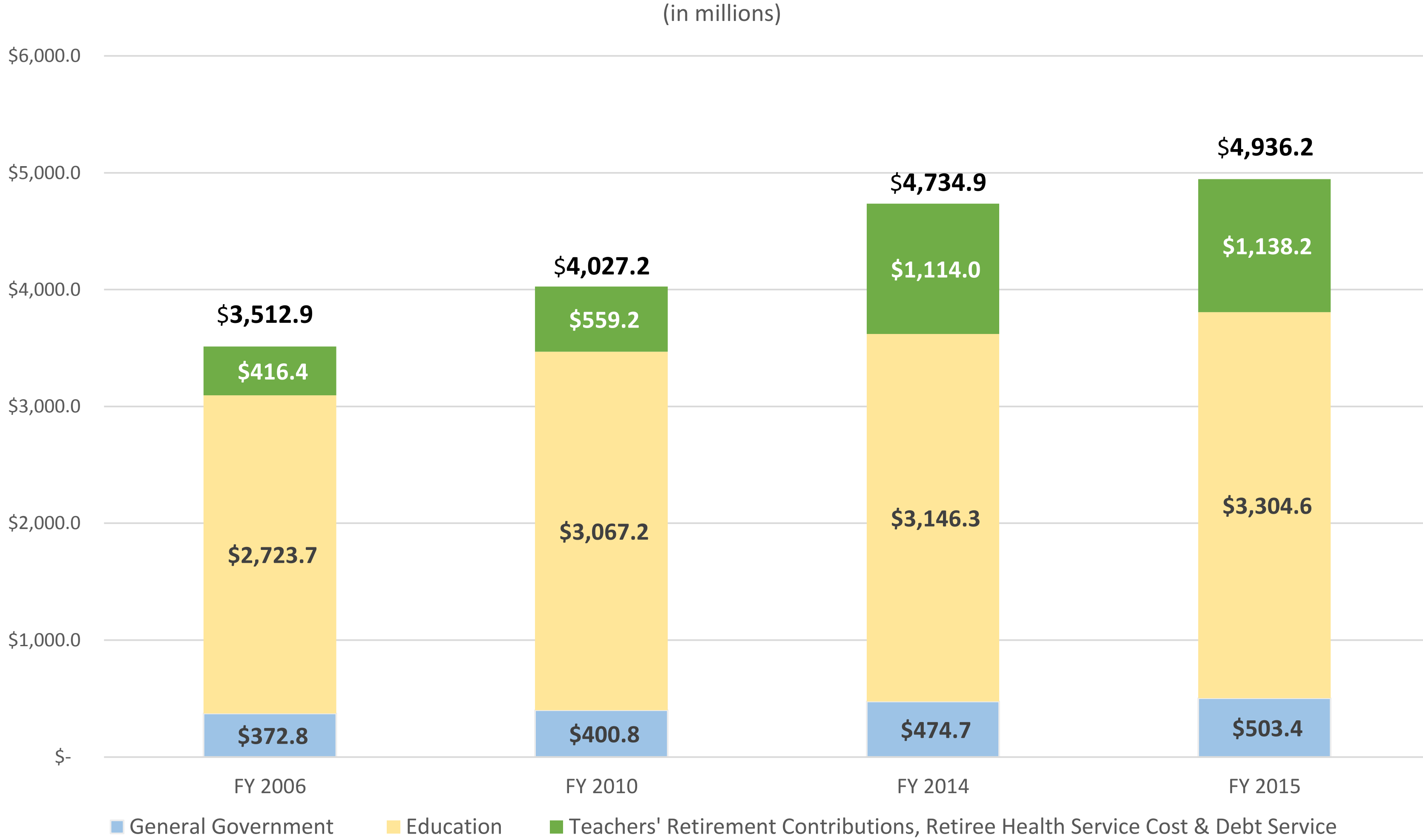
- The state's plan to address the cumulative GAAP deficit:
  - Issuance of General Obligation GAAP Conversion Bonds in October 2013, resulting in $598.5 million toward the GAAP deficit. These bonds will be amortized through 2028.
  - Funding the remaining accumulated GAAP deficit over time through amounts deemed appropriated ($47.6 million annually from 2016 to 2028).



GAAP (cont'd)

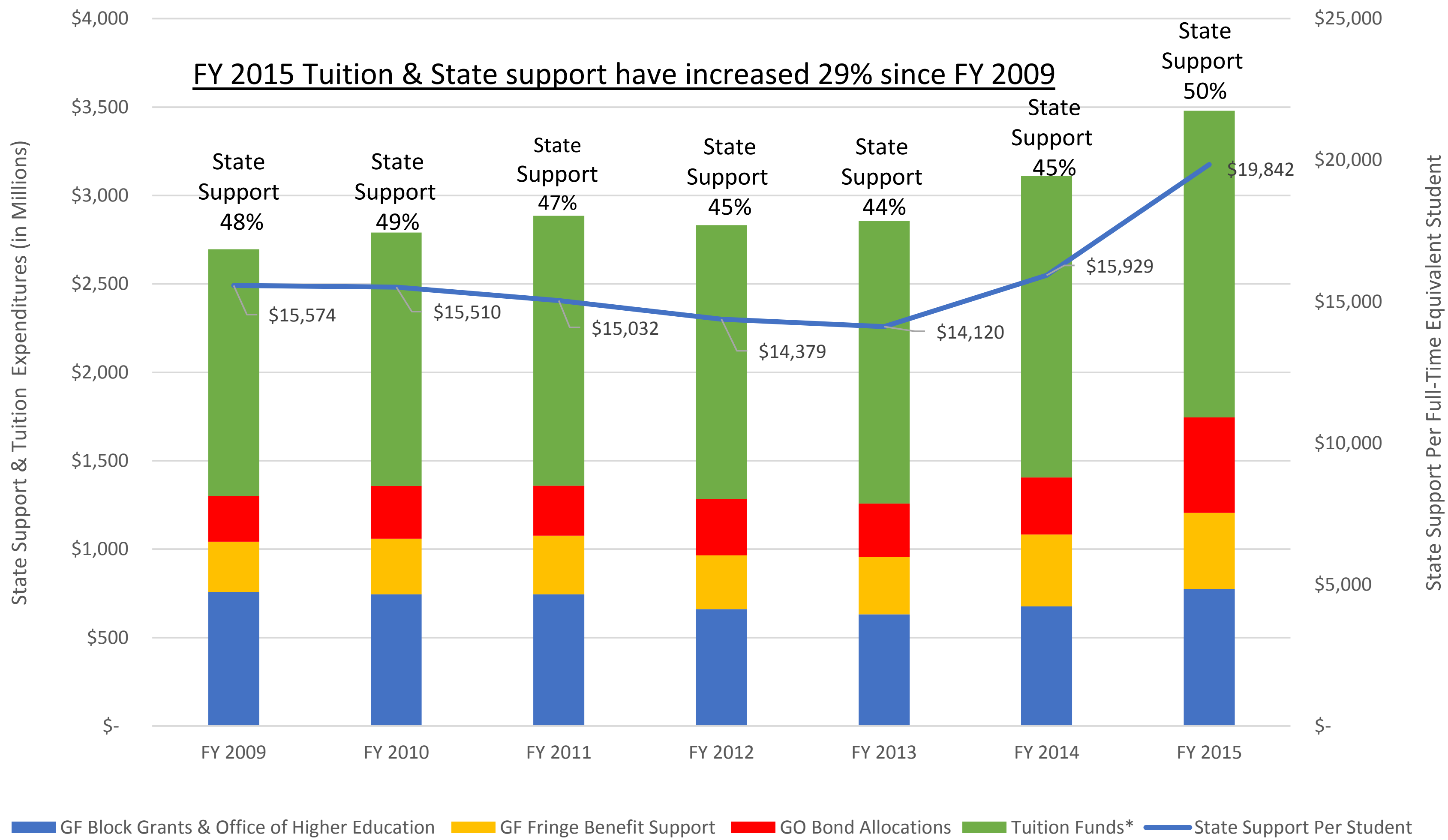
- Bond covenants are required by the GAAP bonding legislation
  - Annual debt service of GAAP Conversion Bonds is deemed appropriated
  - Annual appropriation of non-bonded portion of the accumulated GAAP deficit is also deemed appropriated
  - GAAP Conversion Bond proceeds cannot be counted as General Fund revenue
  - GAAP Conversion Bonds must be repaid over 15 years
- Appropriations to cover accruals started in FY 2014 (to cover difference between cash basis budgeting and modified accrual basis)
- Requirement to address any future GAAP shortfall from operations in succeeding year's budget

State Aid to or on Behalf of Local Governments



*FY 2015 total expenditures include a $10 million General Fund lapse savings related to Municipal Opportunities and Regional Efficiencies.
FY 2010 includes $270 million in ARRA funding for education.

Increasing State Support for Public Higher Education



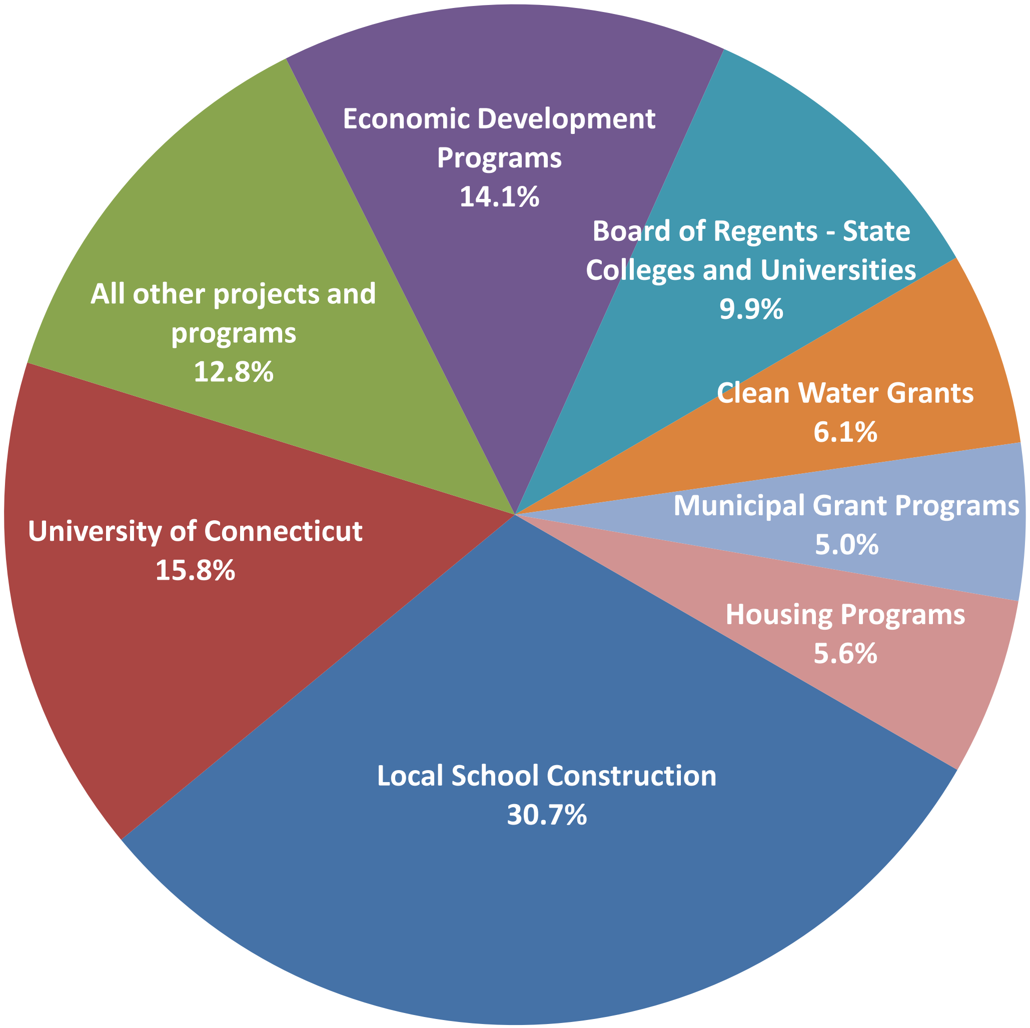
* Includes only operating fund expenditures and excludes auxiliary functions (food and housing), research and clinical funds.

Federal Budget and Policy Issues

- Federal budget for FFY 2015 has not been adopted. Continuing Resolution expires Dec. 11, 2014
- Impending expiration of program authorizations
  - Temporary Assistance to Needy Families (TANF) — Dec. 11, 2014
  - Qualifying Individuals (Medicare buy-in) — Apr. 1, 2015
  - Transitional Medical Assistance — Apr. 1, 2015
  - Home Visiting — Apr. 1, 2015
  - CHIP (HUSKY B) allotments — Oct. 1, 2015
- Federal debt limit must be reinstated on March 15, 2015
- Highway Trust Fund (HTF) is estimated to become insolvent by June 1, 2015

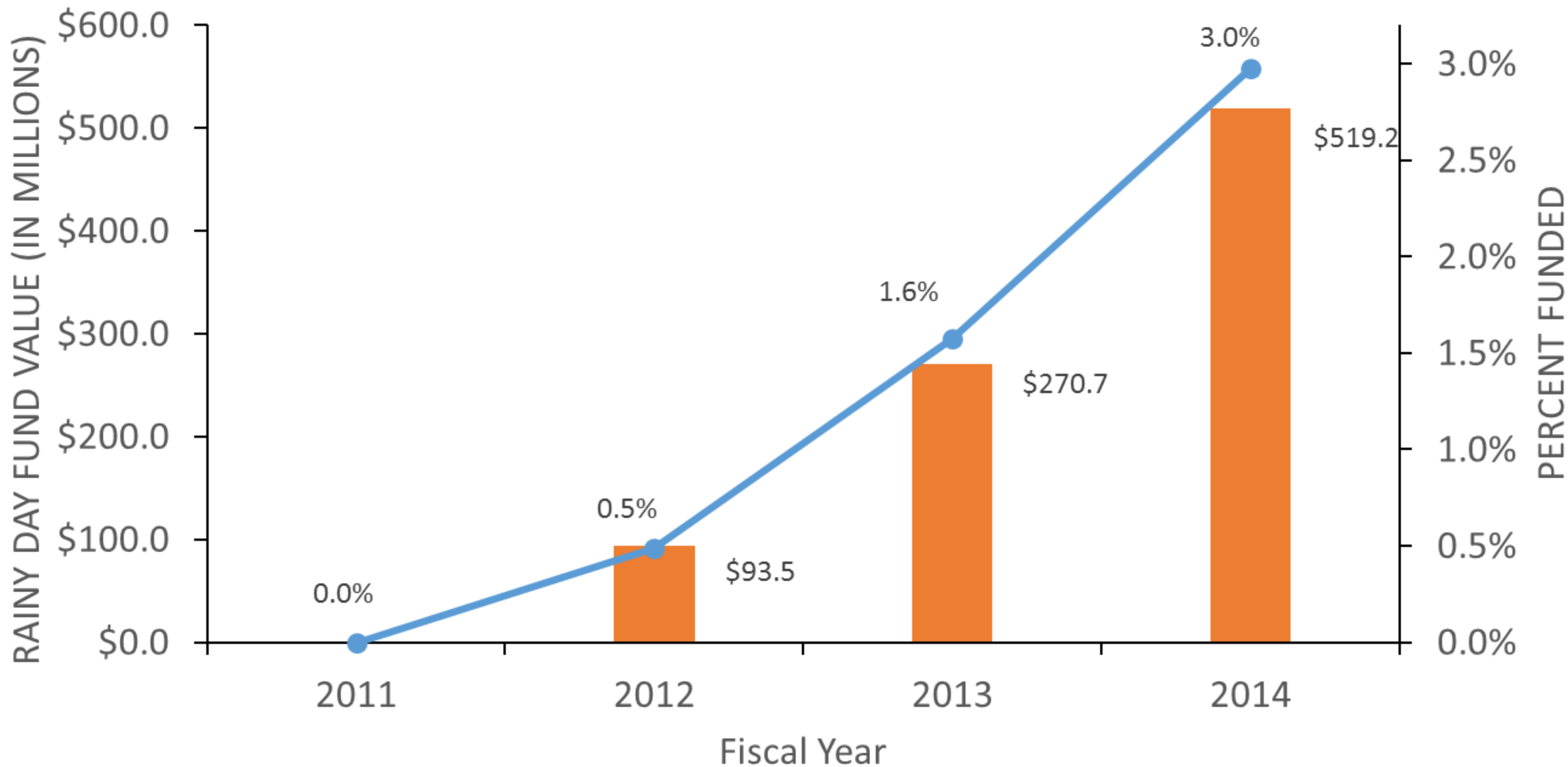
Five Year Bond Projections

Projected GO Bond Allocations FYs 2015-2019



Budget Reserve Fund

Budget Reserve Fund Balance
(in millions)



- Deposits in FYs 2012 through 2014 have allowed the state to begin rebuilding reserves.

Conclusion

Conclusion

Governor Malloy continues to meet Connecticut's economic and fiscal challenges head-on

- Employment is increasing, income is rising, retail sales are growing, and the economy is rebounding
- Long term obligations are being addressed while new pension and healthcare obligations are constrained
- Steps have already been taken to address the FY 2015 projected shortfall:
  - Rescissions
  - Limitations on
    - Hiring
    - Contracts, and
    - Discretionary spending
- The Governor will propose a budget that is balanced, under the spending cap, and does not rely on new taxes. This proposal will include significant spending reductions
- Adopting a balanced budget for the next biennium will be a significant challenge for the coming legislative session