Fiscal Accountability Report
Fiscal Years 2020 – 2024

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Office of Policy and Management
December 5, 2019

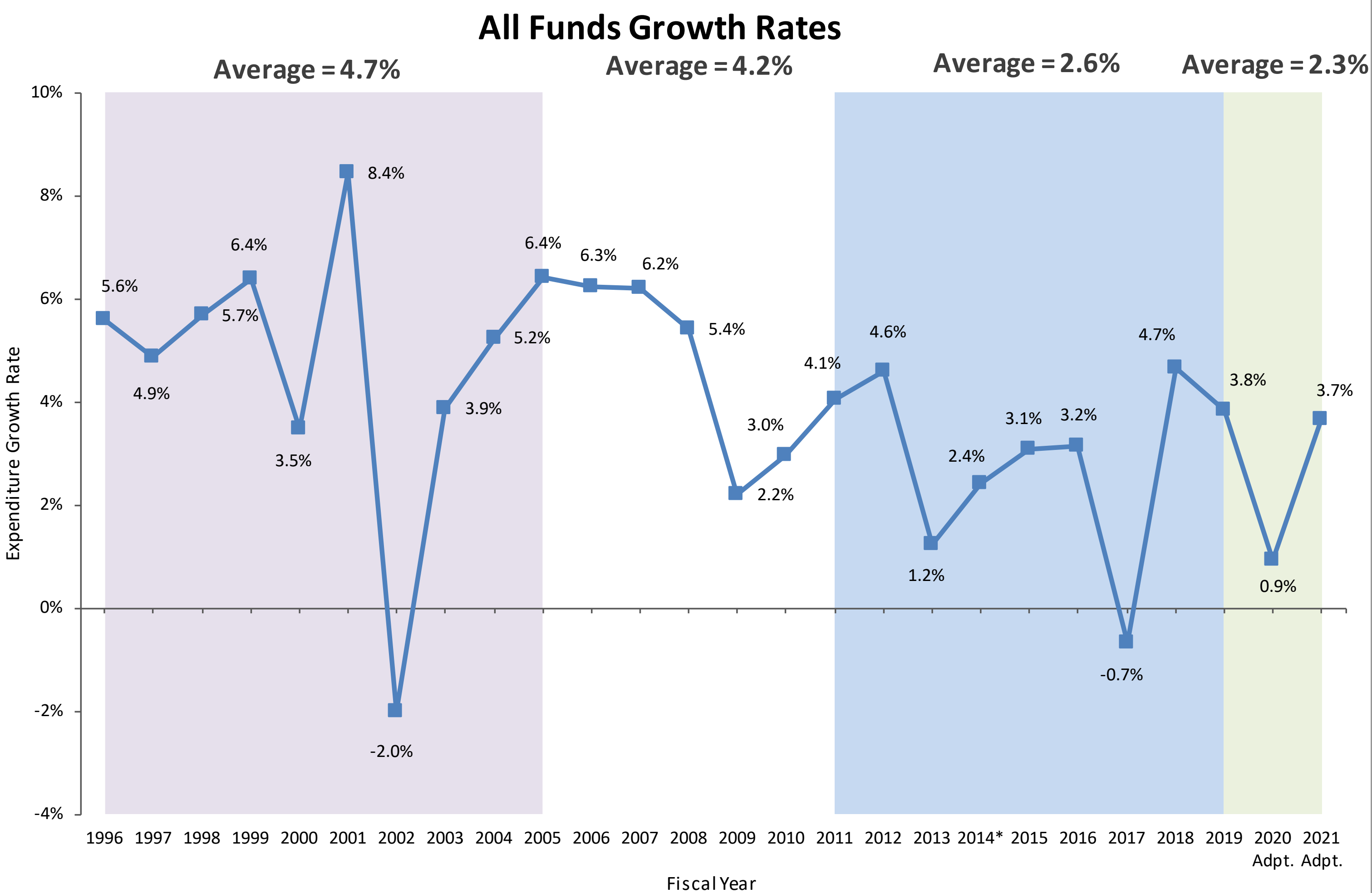
Presentation Overview

1. Budget Reserve Fund status
2. Summary of OPM projections of fixed cost growth vs. revenue growth
3. Economic factors and revenue trends
4. Long-term obligations and other topics

Presentation Overview

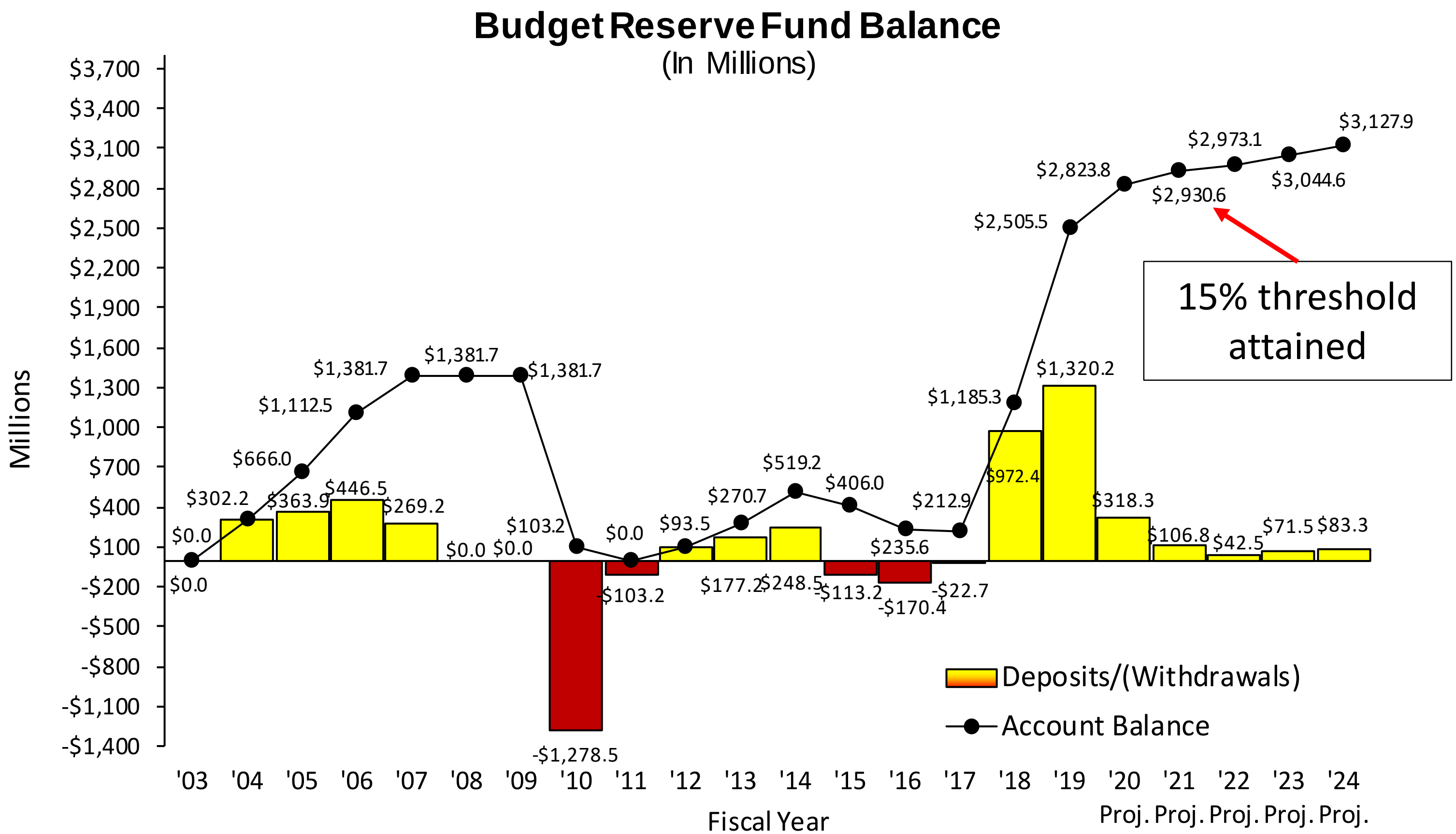
- Reduced revenues in FY 2022 relative to FY 2021, driven by enacted revenue policies, will be the primary driver of out-year budgetary imbalance
- Fixed cost growth, including increases related to long-term liabilities and entitlement spending, will continue to affect state budgetary decisions beyond FY 2021
- Revenue growth has downshifted since the end of the financial crisis
- The potential for a national recession demands a cautious approach to budgetary policy and preservation of the Rainy Day Fund

Budget Growth Rates



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.

Budget Reserve Fund History and Forecast



Outyear forecast assumes balanced budgets are enacted that adhere to the revenue, spending, and volatility caps. Projected balance reaches 15% in FY 2021, resulting in estimated deposits to SERS/TRS of $321.2 million in FY 2021, $442.6 million in FY 2022, $438.6 million in FY 2023, and $455.1 million in FY 2024.

Budget Reserve Fund Forecast

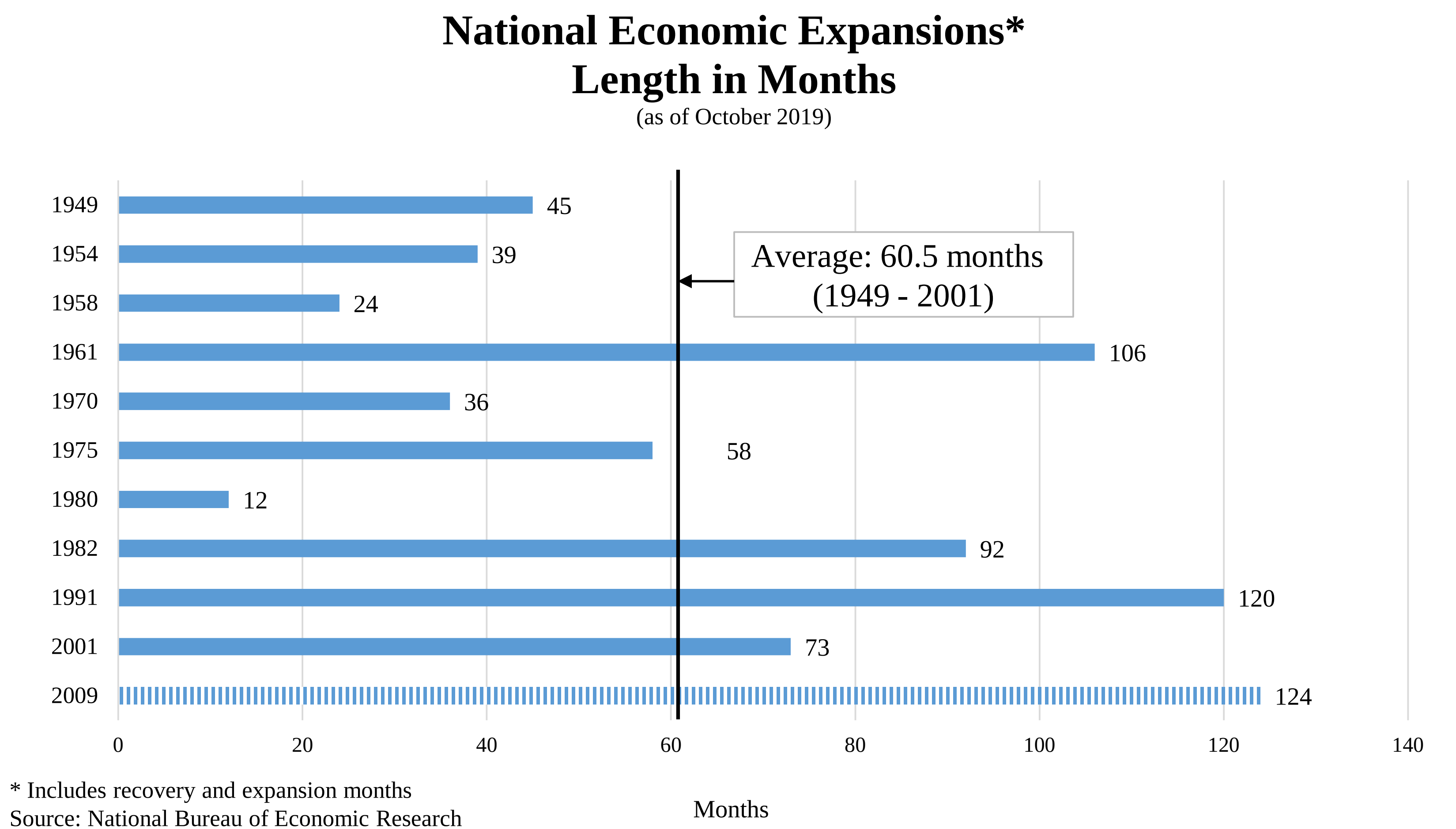
Budget Reserve Fund Projections
(In Millions)

Fiscal Year	Beginning Balance	Volatility Cap Transfer	Revenue Cap Transfer	Surplus/ (Deficit)	BRF Limit Transfer to SERS/TRS	Ending Balance	% of Net Appropriations
2019	$ 1,185.3	$ 949.7	$ -	$ 370.5	$ -	$ 2,505.5	13.0%
2020	2,505.5	318.3	-	-	-	2,823.8	14.1%
2021	2,823.8	276.6	151.5	-	(321.2)	2,930.6	15.0%
2022	2,930.6	287.7	197.3	-	(442.6)	2,973.1	15.0%
2023	2,973.1	259.2	250.9	-	(438.6)	3,044.6	15.0%
2024	3,044.6	229.4	309.1	-	(455.1)	3,127.9	15.0%
Totals:		**$ 2,320.8**	**$ 908.8**	**$ 370.5**	**$ (1,657.4)**		

Under current law (CGS Sec. 4-30a), unappropriated surpluses and volatile revenues above a certain threshold are committed to the Budget Reserve Fund until reaching the maximum 15% authorized by law. Once the 15% maximum is reached, surplus funds are directed toward:

- **Reducing the unfunded liability of the State Employees Retirement Fund**
- **Reducing the unfunded liability of the Teachers' Retirement Fund**
- **Reducing bonded indebtedness**

Overdue for a Recession



* Includes recovery and expansion months
Source: National Bureau of Economic Research

The current economic expansion is the longest since the end of World War II.

Consequences of an Insufficient Budget Reserve Fund – 2008 Recession

Connecticut's Response to the 2008 Economic Downturn
Revenue Measures and Deficit Financing Implemented
FY 2009, FY 2010, FY 2011, FY 2012
(in millions)

Revenue Measure	Fiscal 2009	Fiscal 2010	Fiscal 2011	Fiscal 2012	Total	% of Total
1. Deplete Budget Reserve Fund	$ -	$ 1,278.5	$ 103.2	$ -	$ 1,381.7	14.3%
2. Federal Assistance-ARRA	407.7	878.9	960.4	-	2,247.0	23.2%
3. Tax Increases	-	845.0	586.7	2,417.7	3,849.4	39.7%
4. Fee Increases	-	108.5	104.0	111.6	324.1	3.3%
5. Fund Sweeps	250.8	89.8	76.9	(97.9)	319.5	3.3%
6. Other Revenue Measures	18.3	96.7	280.7	253.4	649.1	6.7%
7. Economic Recovery Notes (ERNs)	915.8	-	-	-	915.8	9.5%
Total	$ 1,592.6	$ 3,297.4	$ 2,111.9	$ 2,684.8	$ 9,686.6	100.0%

Note: According to the National Bureau of Economic Research (NBER), the 2008 economic downturn began in December 2007 and ended June 2009.

- **In aggregate, it took approximately $9.7 billion in revenue measures, including federal ARRA assistance and deficit financing, to help address budgetary imbalance. This sum does not include significant spending cuts that were implemented!**

Federal ARRA assistance included $1.6 billion in enhanced Medicaid and Title IV-E matching funds and $540.0 million in education support ("State Fiscal Stabilization Fund")

Consequences of an Insufficient Budget Reserve Fund – 2008 Recession

- **Spending cuts – frequent and significant**
  - **$314.5 million in reduced contributions to SERS, exacerbating the already low funded status of the pension fund ($50 million in FY 2009, $164.5 million in FY 2010, and $100 million in FY 2011)**
  - **2009 Retirement Incentive Plan - $147.5 million in near-term savings, but further strained the pension fund**
  - **Employee concessions in 2009, 2011 and 2017**
  - **Multiple deficit mitigation plans enacted (table at right)**
  - **Reductions to all aspects of the budget, including:**
    - **municipal aid**
    - **human services**
    - **private providers**
    - **arts and tourism**
  - **Substantial and repeated reductions to discretionary spending via rescissions (table below)**

Session Year	Deficit Mitigation Legislation	Spending Cuts* ($M)
2008	PA 08-1, Nov. SS	$25.6
2009	PA 09-1	$44.2
2009	PA 09-1, Dec. SS	$12.4
2010	PA 10-3	$89.6
2010	PA 10-2, June SS	Net zero
2012	PA 12-1, Dec. SS	$221.5
2015	PA 15-1, Dec. SS	$214.3
2016	PA 16-1	$150.8
2017	PA 17-51	$2.3

Rescissions	FY09	FY10	FY12	FY13	FY15	FY16	FY17
# of Occasions	5	2	1	1	3	2	1
Total ($M)	$201.6	$51.1	$78.7	$170.4	$99.9	$181.5	$77.2

* Source: OFA fiscal notes

Reasons to Preserve the Budget Reserve Fund

Moody's Analytics - October 2019 report regarding state preparedness to withstand fiscal stress

Recession Scenario	Required Reserves	CT's Preparedness
Moderate	10.1%	Relatively well-positioned (ranked 18th of the 50 states)
Severe	14.8%	Insufficient resources without having to raise taxes or cut spending (ranked 21st of the 50 states)

"How policymakers prepare for downturns matters a great deal in the pace of economic recovery. Unpreparedness can lead to disruptive decisions to drastically cut spending or raise revenues just at the time the economy can least afford it. Preparedness, on the other hand, can lend stability to a struggling economy and help conditions recover more quickly." (p. 9)

Reasons to Preserve the Budget Reserve Fund

The Moody's analysis attempts to adjust for state variances, but Connecticut has reasons for a conservative approach to recession-readiness:

- **Highly progressive (and therefore more volatile) personal income tax structure**
- **Heavy reliance on personal income tax as a proportion of all state revenues (approx. 50% of General Fund), and therefore on the economic fortunes of extremely high-wealth taxpayers**
- **Relatively high "fixed" costs (debt, pension, OPEB)**

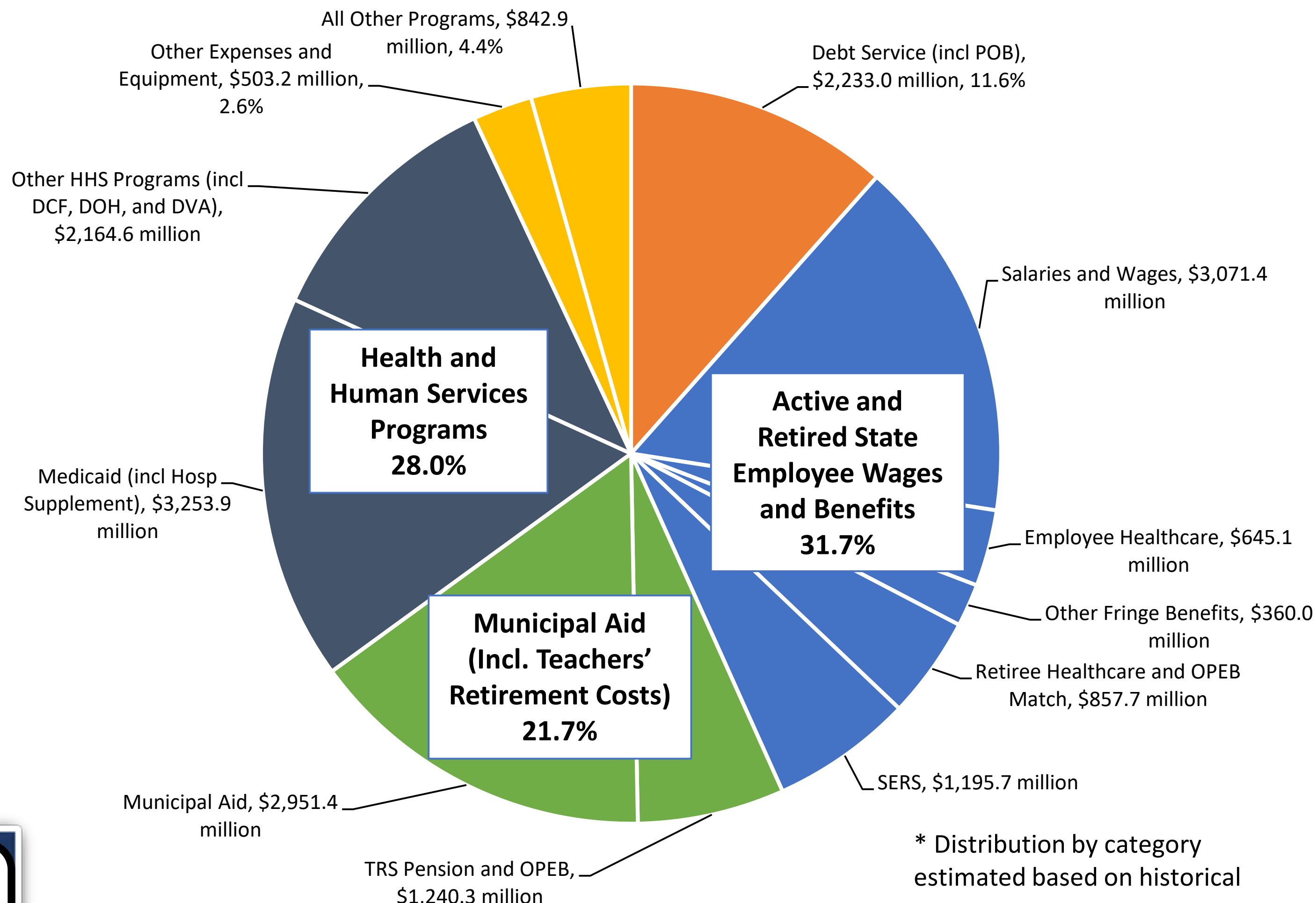
Reasons to Preserve the Budget Reserve Fund

At least $1.3 billion of the $2.5 billion BRF balance is due to one-time, non-repeatable factors:

- **$750 million from repatriation of overseas hedge fund deferred profits**
  - IRS Code 457A required repatriation of overseas hedge fund profits by December 31, 2017 for activity that had occurred prior to 2008 when the federal government disallowed sheltering of such income
  - One time revenue for economic activity that occurred a decade or more ago
- **$570 million from the initial proceeds of the new Pass-through Entity Tax (PET)**
  - CT passed the PET in response to federal capping of the SALT deduction
  - FY 2019 was the first year of collections and initial estimates were based on conservative budgeting and also did not fully account for 18 months of payment – estimated payments for 2 income years, and final payment for 1 income year
- Additionally, some (inestimable) revenue related to repatriation of overseas deferred profits under the Tax Cuts and Jobs Act of 2017
  - TCJA required individuals and businesses to pay a transition tax on untaxed foreign earnings as if those earnings had been repatriated to the U.S., generally affecting income year 2017 (SFY 2018)

Difficult Choices for Aligning General Fund Revenue and Expenditure Growth

Total FY 2020 General Fund Appropriations = $19,319.1 million*



* Distribution by category estimated based on historical

Summary of OPM Projections of Fixed Cost Growth vs. Revenue Growth

Projected FY 2020 Operating Results

FY 2020 - General Fund

	(in millions)		
	Budget Plan	OPM Est. 11/20/19	Change
Revenue	$ 19,460.2	$ 19,375.7	$ (84.5)
Expenditures	$ 19,319.1	$ 19,395.3	$ 76.2
Est. Balance from Operations - 6/30/20	$ 141.1	$ (19.6)	$ (160.7)

FY 2020 - Special Transportation Fund

	(in millions)		
	Budget Plan	OPM Est. 11/20/19	Change
Beginning Balance	$ 315.1	$ 320.1	$ 5.0
Revenue	$ 1,749.1	$ 1,732.7	$ (16.4)
Expenditures	$ 1,710.3	$ 1,705.9	$ (4.4)
Est. Balance from Operations - 6/30/20	$ 38.8	$ 26.8	$ (12.0)
Est.Fund Balance - 6/30/20	$ 353.9	$ 347.0	$ (6.9)

FY 2020 – Projected Deficiencies

General Fund

Agency	Amount
Dept. of Emergency Services and Public Protection	$5,000,000
Dept. of Social Services	$19,200,000
Office of Early Childhood	$1,800,000
Dept. of Correction	$13,000,000
Comptroller – Fringe Benefits	$12,000,000
DAS – Workers' Compensation Claims	$500,000
Total – General Fund	**$51,500,000**

Special Transportation Fund

Agency	Amount
Dept. of Transportation	$5,000,000
Comptroller – Fringe Benefits	$2,000,000
Total – Special Transportation Fund	**$7,000,000**

FY 2021 – FY 2024 Financial Summary
Year-Over-Year Revenue Growth vs. Fixed Cost Growth

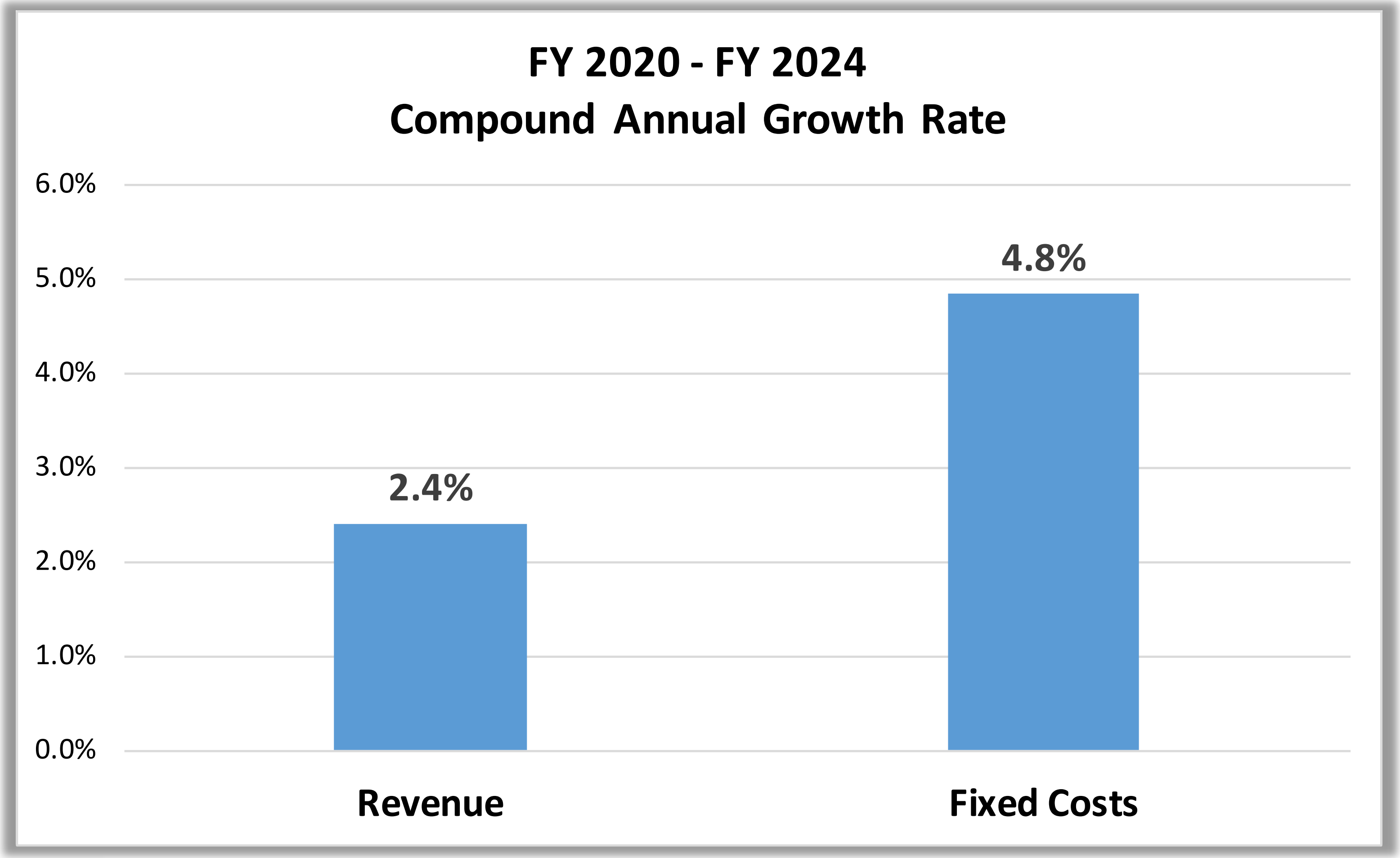
(in millions)

GENERAL FUND

	FY 2021 vs. FY 2020	FY 2022 vs. FY 2021	FY 2023 vs. FY 2022	FY 2024 vs. FY 2023
Revenue Growth	$ 818.8	$ (459.6)	$ 336.5	$ 534.8
Fixed Cost Growth				
Debt Service	90.1	147.8	246.9	63.8
State Employee Pensions	96.6	114.6	112.2	14.0
Teacher Pensions	41.1	101.9	120.9	122.2
State and Teachers OPEB	30.6	31.1	33.0	(9.8)
Medicaid	158.2	100.9	119.8	147.2
Other Entitlements	33.1	31.3	24.4	28.1
Total Fixed Cost Growth	449.6	527.7	657.2	365.4
Difference	$ 369.2	$ (987.3)	$ (320.8)	$ 169.4

“Fixed” costs are rising faster than revenue growth in FY 2022 and FY 2023, but revenue growth is expected to overtake the growth in “fixed” costs in FY 2024.

Revenue Growth vs. Fixed Cost Growth



Explaining the Change in General Fund Revenue from FY 2021 to FY 2022

		(in millions)
1.	**Estimated FY 2021 Revenues**	**$ 20,194.5**
2.	Cap Teachers' Pension Exemption from 25% to 50%	(8.0)
3.	Pension and Annuity Exemption from 42% to 56%	(16.4)
4.	Increase in Car Sales Tax to STF from 25% to 75%	(183.6)
5.	MRSA Transfer of Sales Tax Revenue Commences	(380.1)
6.	Expiration of 10% Surcharge	(15.0)
7.	Phase-in Capital Stock Tax from 2.6 mills to 2.1 mills	(9.5)
8.	Phase-in Federal Estate Tax Exemption Level from $5.1M to $7.1M	(13.2)
9.	Ban Plastic Bags	(6.0)
10.	Revert Eligibility of Property Tax Credit to Prior Levels	(53.0)
11.	Loss of the Banking Fund Transfer	(5.2)
12.	Resume Payment Toward GAAP Deficit in FY 2022	(85.1)
13.	Loss of One-Time 2020 to 2021 Revenue Transfer	(85.0)
14.	Total Policy Changes	$ (860.1)
15.	Revenue Growth	400.5
16.	**Estimated FY 2022 Revenues**	**$ 19,734.9**
17.	**Net Revenue Change, FY 2022 vs. FY 2021**	**$ (459.6)**

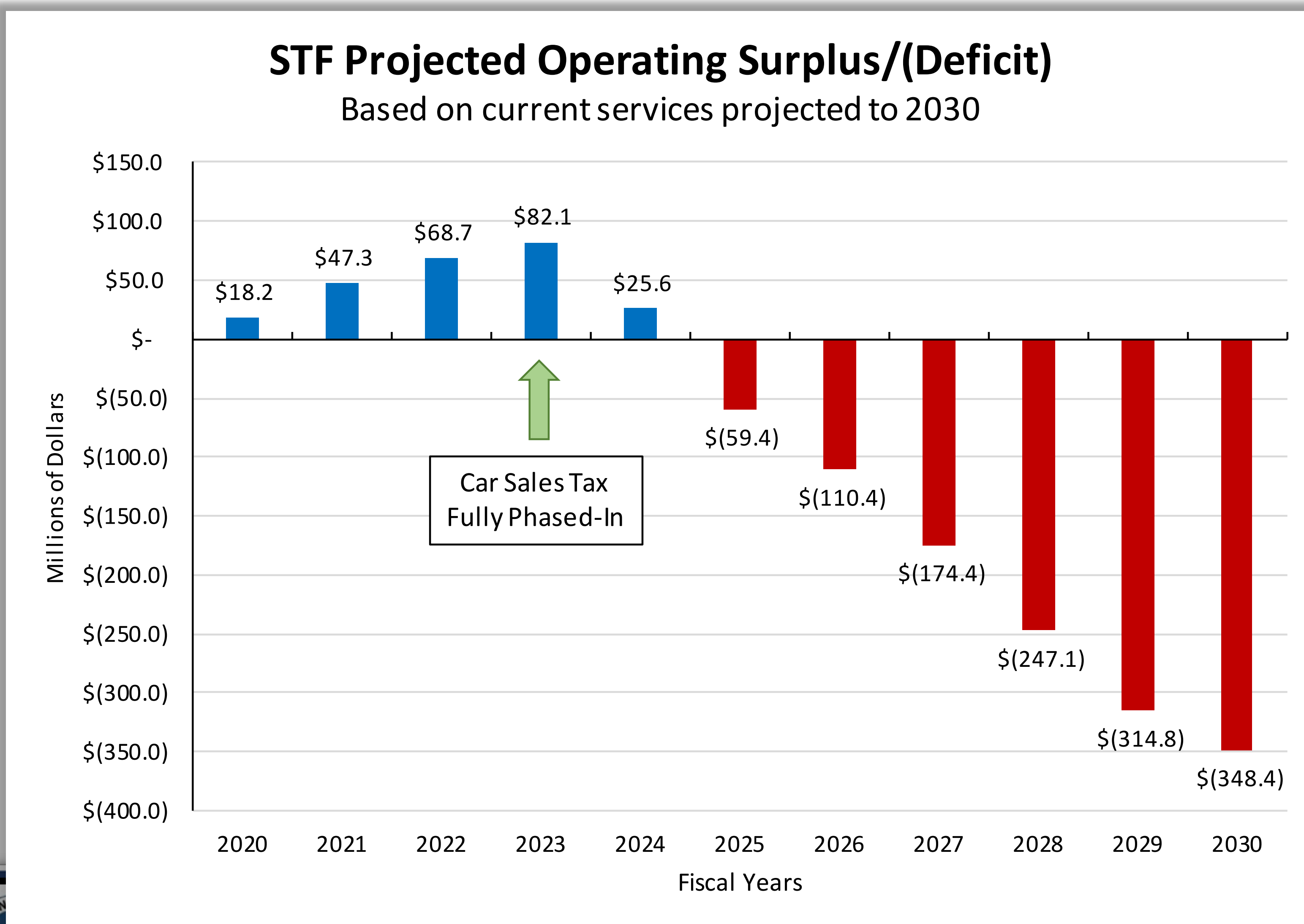
FY 2021 – FY 2024 Financial Summary
Year-Over-Year Revenue Growth vs. Fixed Cost Growth

(in millions)

SPECIAL TRANSPORTATION FUND

	FY 2021 vs. FY 2020	FY 2022 vs. FY 2021	FY 2023 vs. FY 2022	FY 2024 vs. FY 2023
Revenue Growth	$ 145.2	$ 128.7	$ 110.7	$ 26.7
Fixed Cost Growth				
Debt Service	80.9	38.3	48.5	48.6
State Employee Pensions and OPEB	8.4	13.6	13.3	(1.5)
Total Fixed Cost Growth	89.2	51.9	61.8	47.1
Difference	$ 56.0	$ 76.8	$ 48.9	$ (20.4)

Special Transportation Fund Long Term Outlook

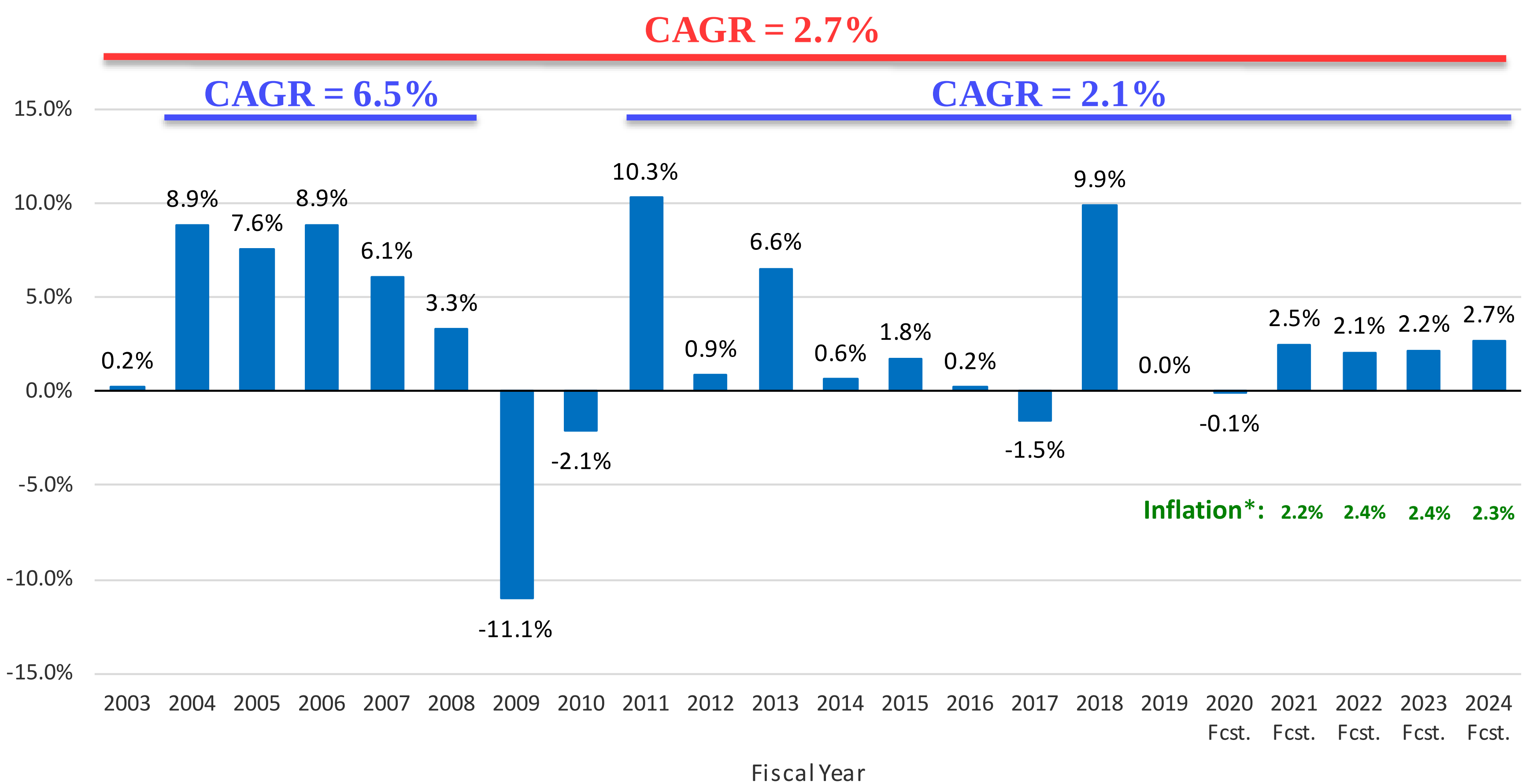


Special Transportation Fund Long Term Outlook

- **Strong near-term health due to various revenue diversions from the General Fund enacted over the last several years, including:**
  - **0.5% of the current sales tax rate,**
  - **Sales tax from motor vehicle sales, and**
  - **Full diversion of the oil companies tax**
- **The cumulative STF fund balance will grow from an estimated $347.0 million in FY 2020 to $663.5 million in FY 2024**
- **Revenue growth, however, is not keeping pace with expenditure growth over the next 10 years**
  - **Revenues anticipated to grow an average 2.7% annually**
  - **Expenditures projected to grow nearly 4.3% per year**
- **Beginning in 2025 the STF fund balance will rapidly begin to erode:**
  - **FY 2025 estimated operating shortfall of $59.4 million growing to $348.4 million by FY 2030**
  - **Based on current projections, the cumulative fund balance will go negative by FY 2030**
- **New revenue sources are required to support project costs and maintenance, ensure the long-term health of the fund and meet the on-going transportation needs of our state and economy**

Economy

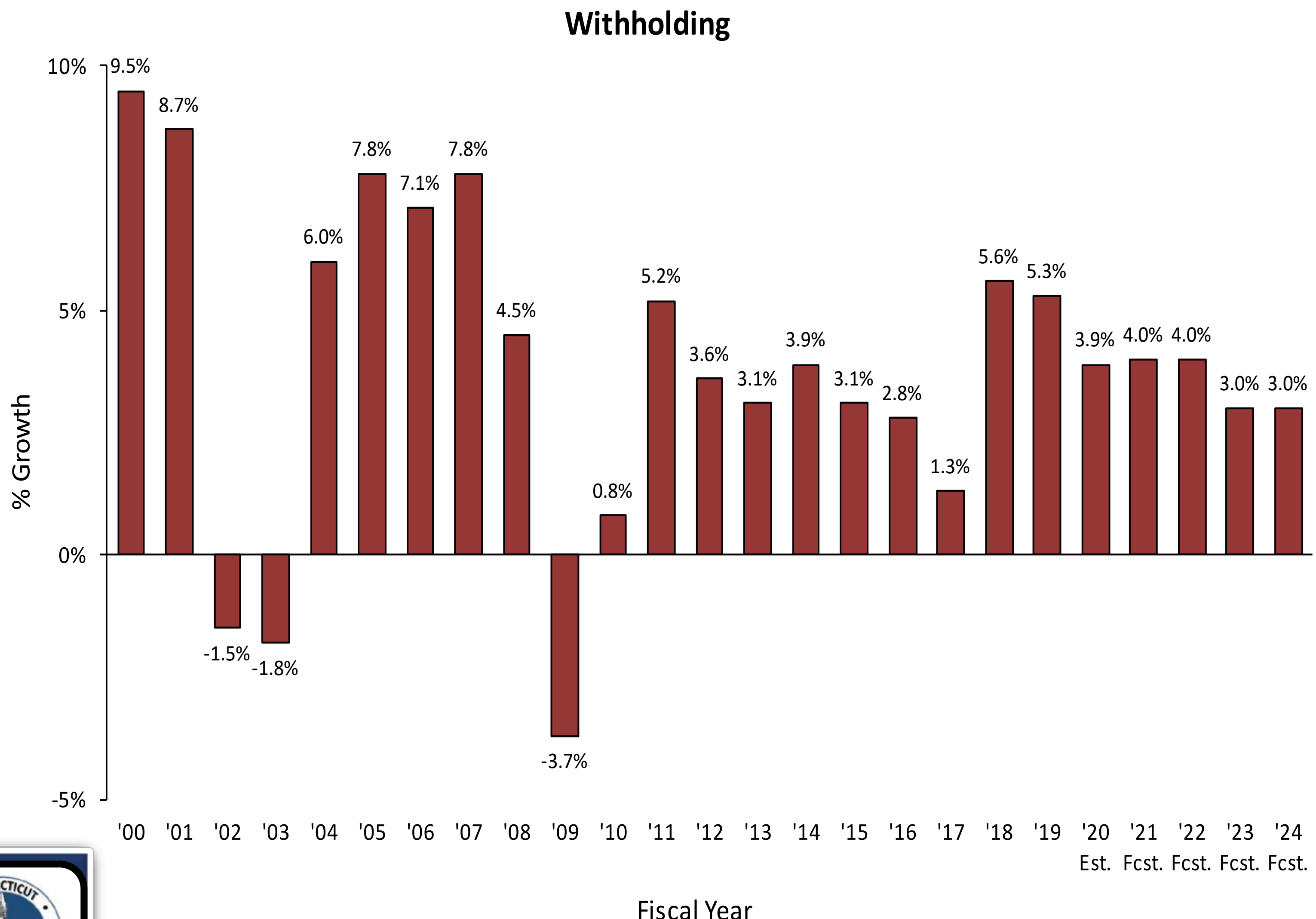
Economic Growth Rates of General Fund Revenues



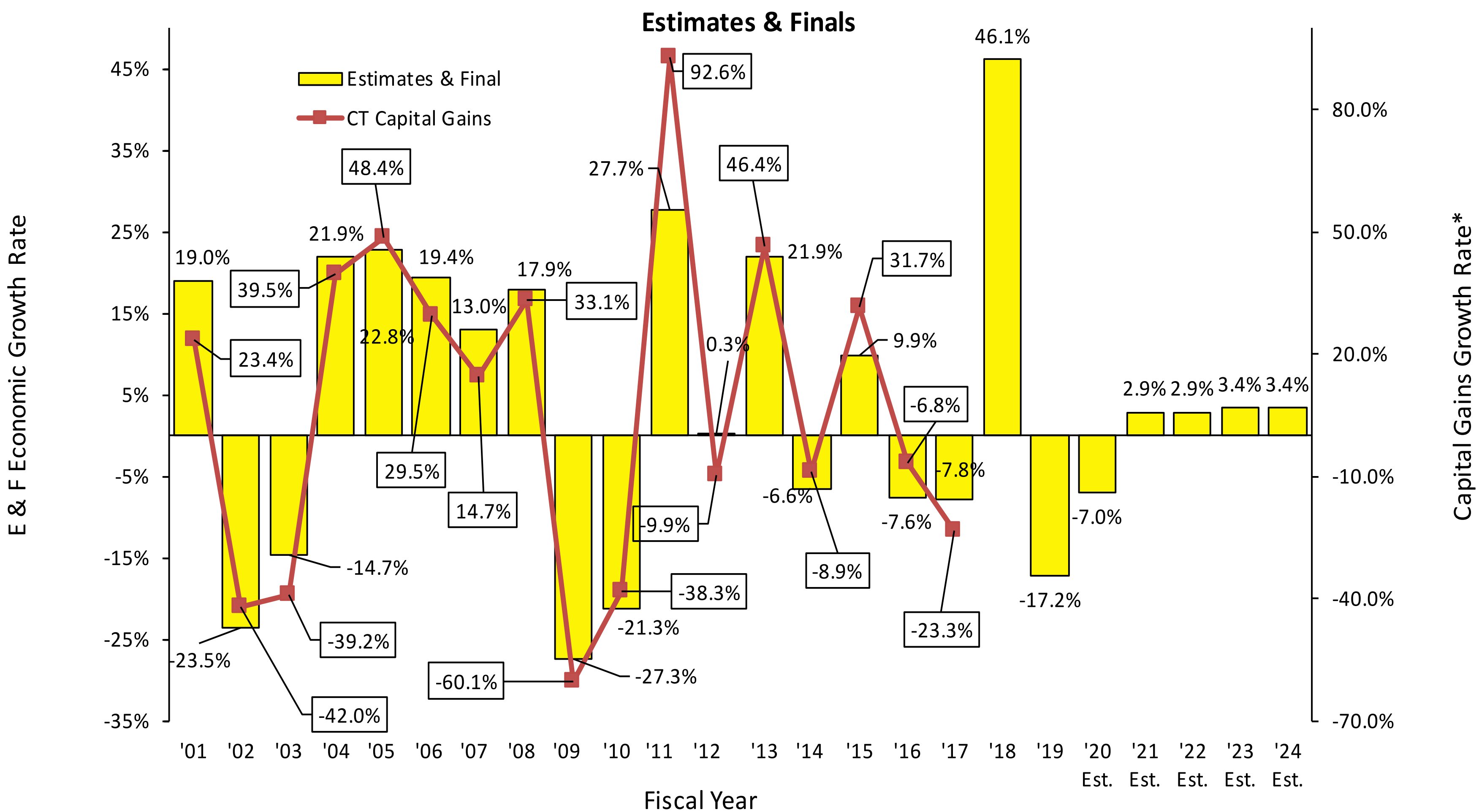
CAGR = Compound Annual Growth Rate

*Inflation = Consumer Price Index for all Urban Consumers (CPI-U); Source: IHS Connect as of 9/30/19

Personal Income Tax Economic Growth Rates

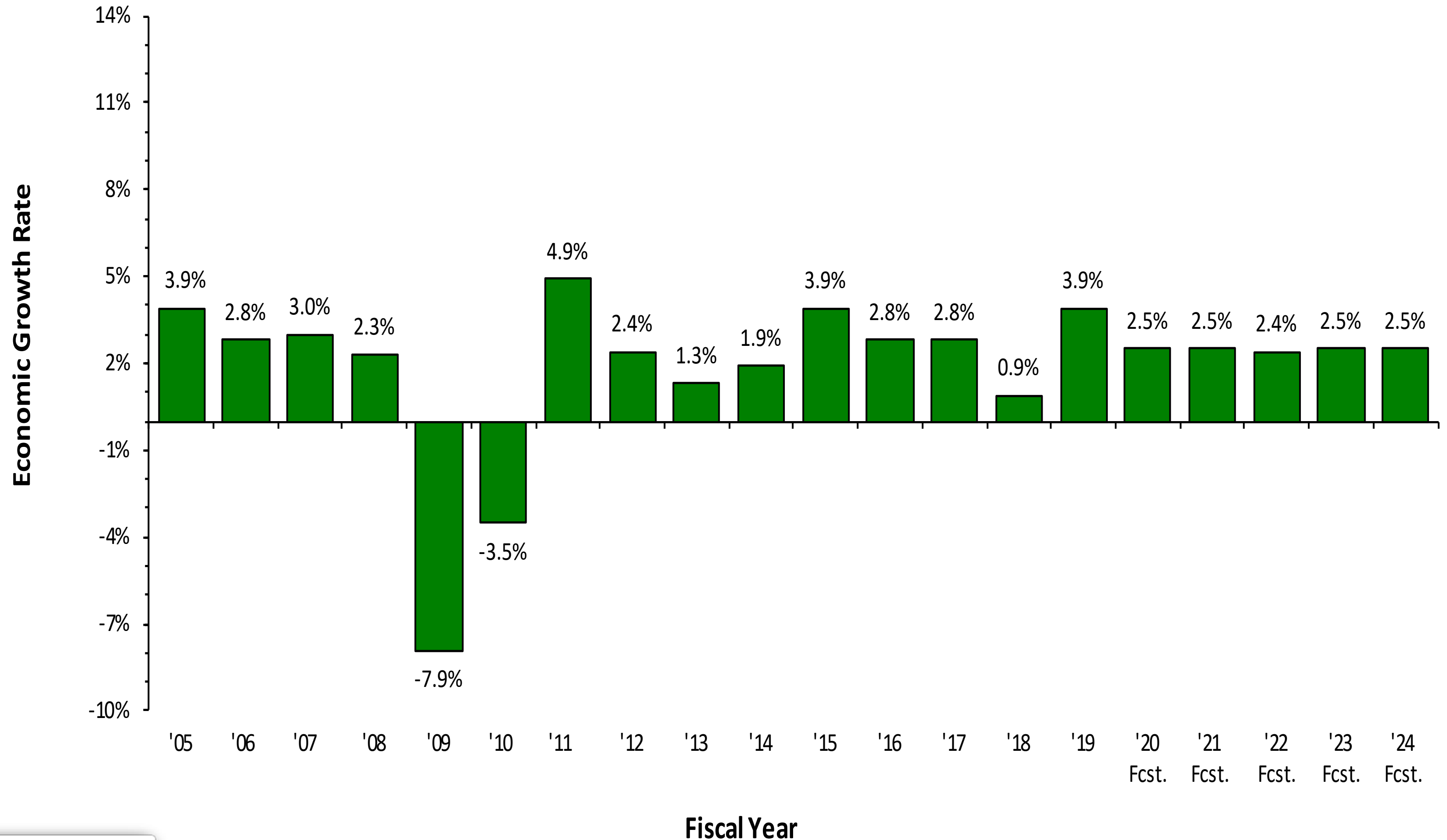


Personal Income Tax Economic Growth Rates

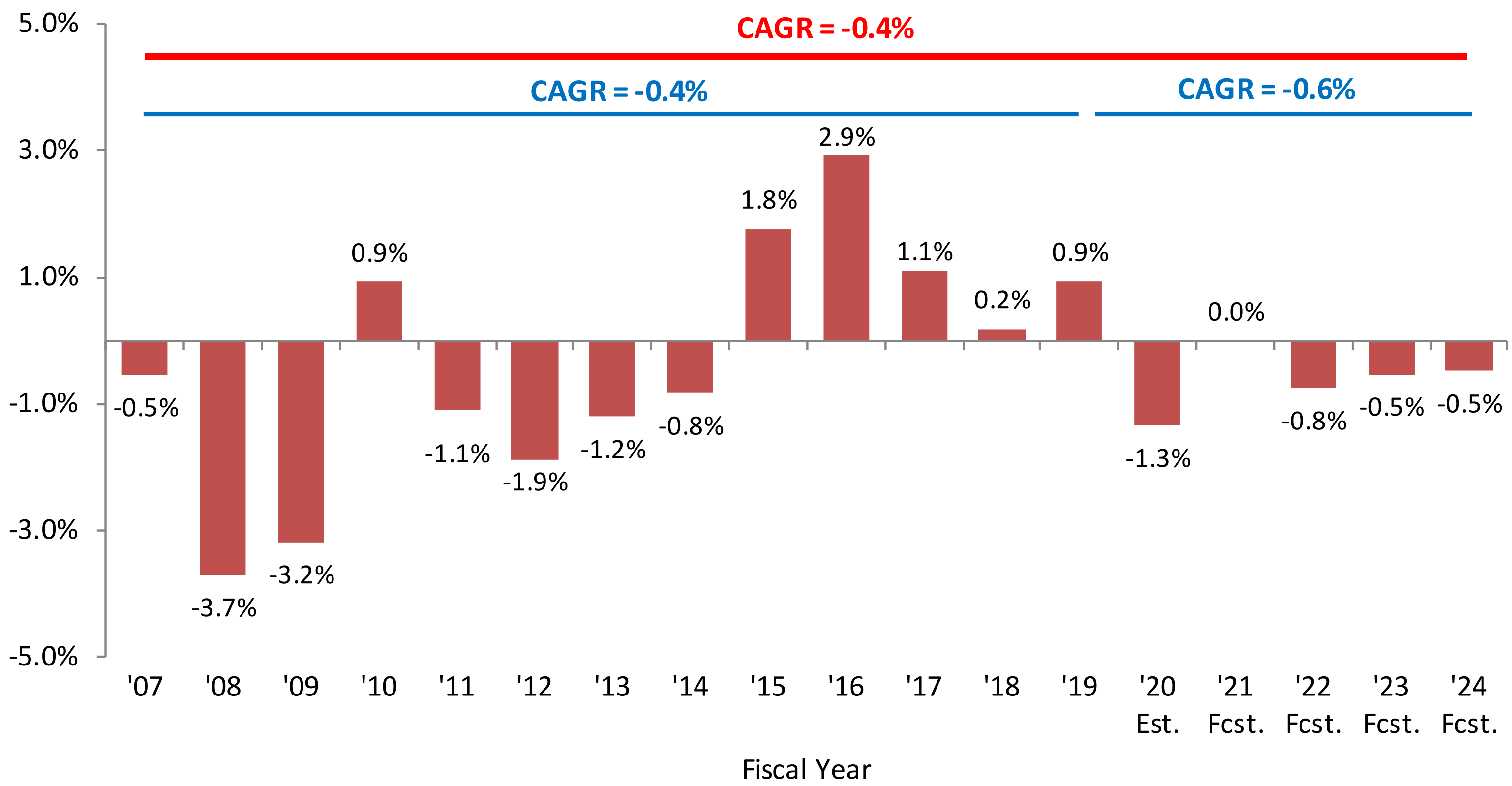


***Note: Capital Gains are for the immediately preceding calendar year.**

Sales and Use Tax Economic Growth Rates

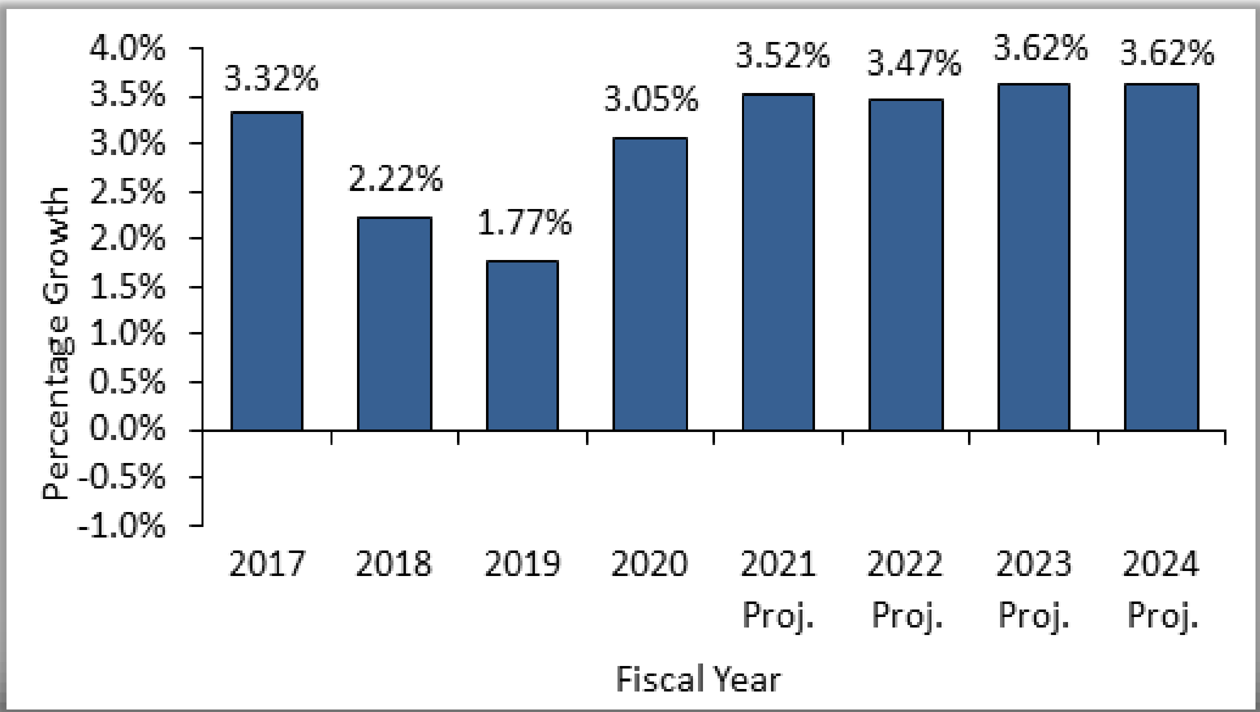


Motor Fuels Tax Economic Growth Rates



Long Term Obligations, “Fixed” Cost Drivers, and Other Topics

Spending Cap Growth Rates



- **Given the state's low growth in personal income over the past few years, the core consumer price index was the limiting spending cap growth factor in FY 2018 and FY 2019.**
- **Personal income is the limiting factor in FY 2020 and beyond.**
- **The enacted budget is below the cap by $0.2 million in FY 2020 and $5.0 million in FY 2021.**
- **For FY 2021, a growth rate of 3.52% would allow capped expenditures to grow by approximately $518 million over FY 2020 levels.**

Recently-Enacted Caps – Impact on FY 2021–FY 2024

Revenue Cap

Caps the amount of revenue that can be appropriated.

Fiscal Year	Appropriations as % of Revenues
2020	99.50%
2021	99.25%
2022	99.00%
2023	98.75%
2024	98.50%
2025	98.25%
2026	98.00%

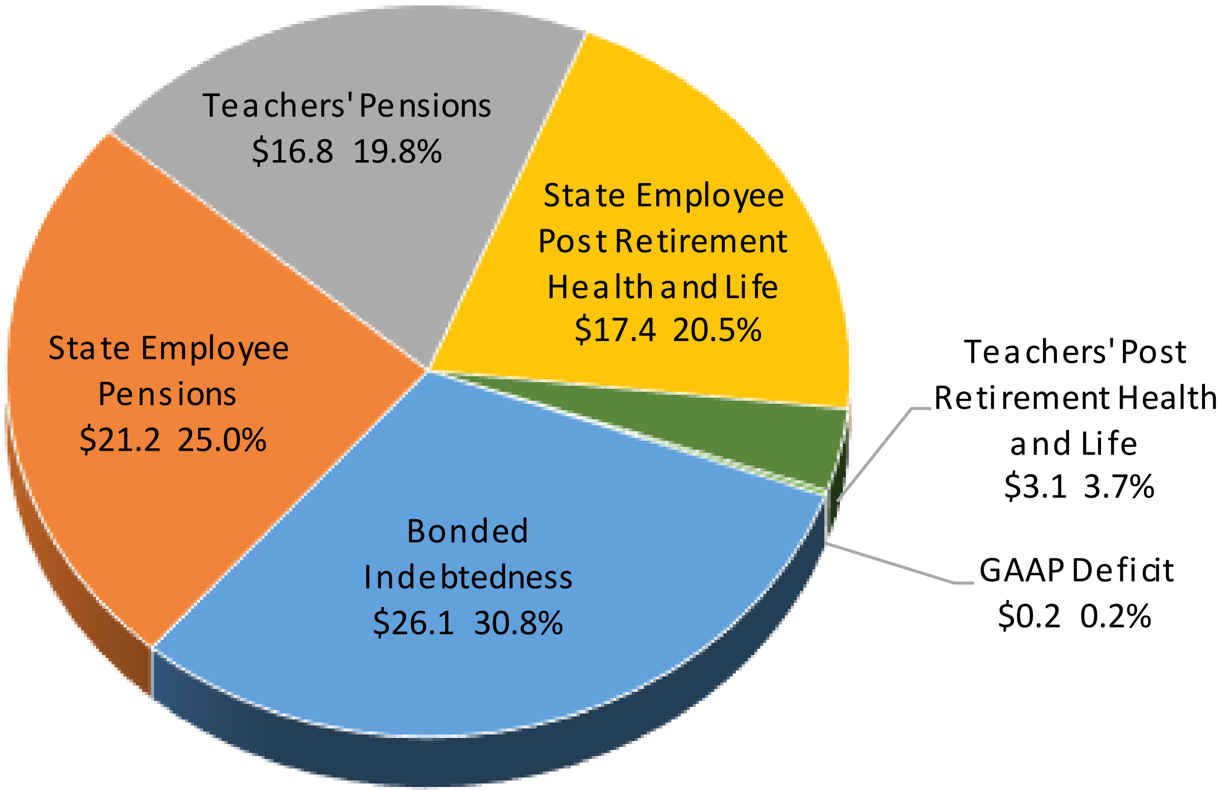
Volatility Cap

Threshold above which collections from Estimates and Finals portion of Personal Income Tax plus Pass-Through Entity Tax are transferred to the Budget Reserve Fund.

Fiscal Year	Revenue Volatility Threshold (in millions)
2020	$ 3,294.2
2021	$ 3,410.3
2022	$ 3,528.6
2023	$ 3,656.3
2024	$ 3,788.7

Long-Term Liabilities

(in billions)



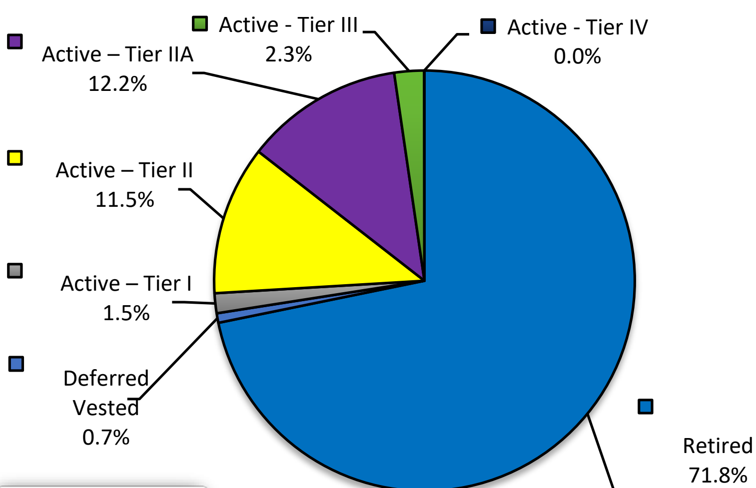
Total = $84.8 billion

Retirement System Liabilities

State Employees Retirement System

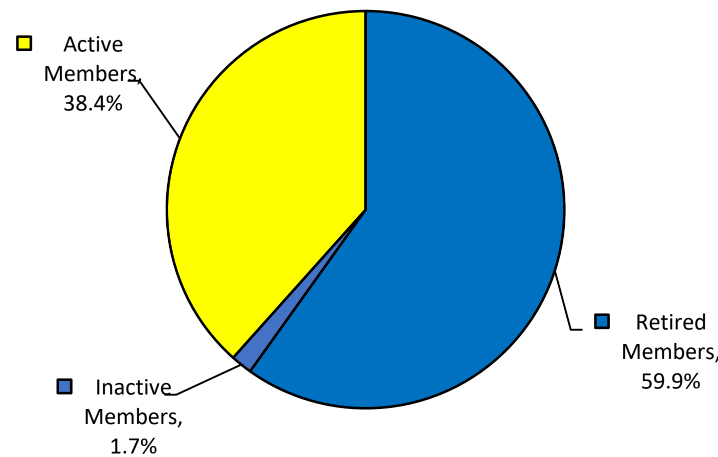
- $34.2 billion total liability
- $21.2 billion unfunded liability
- 72.5% of the liability is related to inactive or already-retired employees
- 85.4% of the FY 2020 actuarially determined employer contribution is for the unfunded actuarial accrued liability

SERS Liability



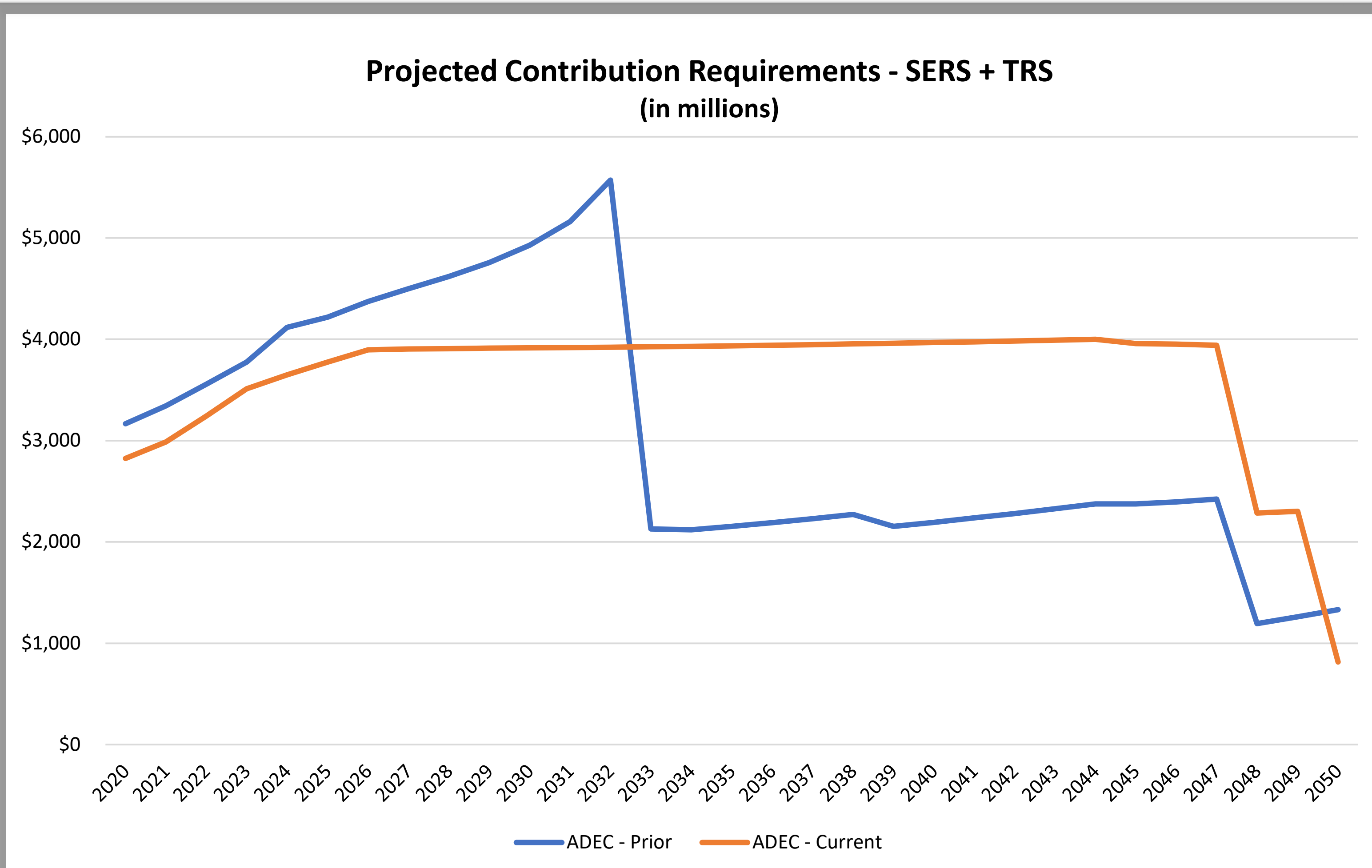
Teachers' Retirement System

TRS Liability



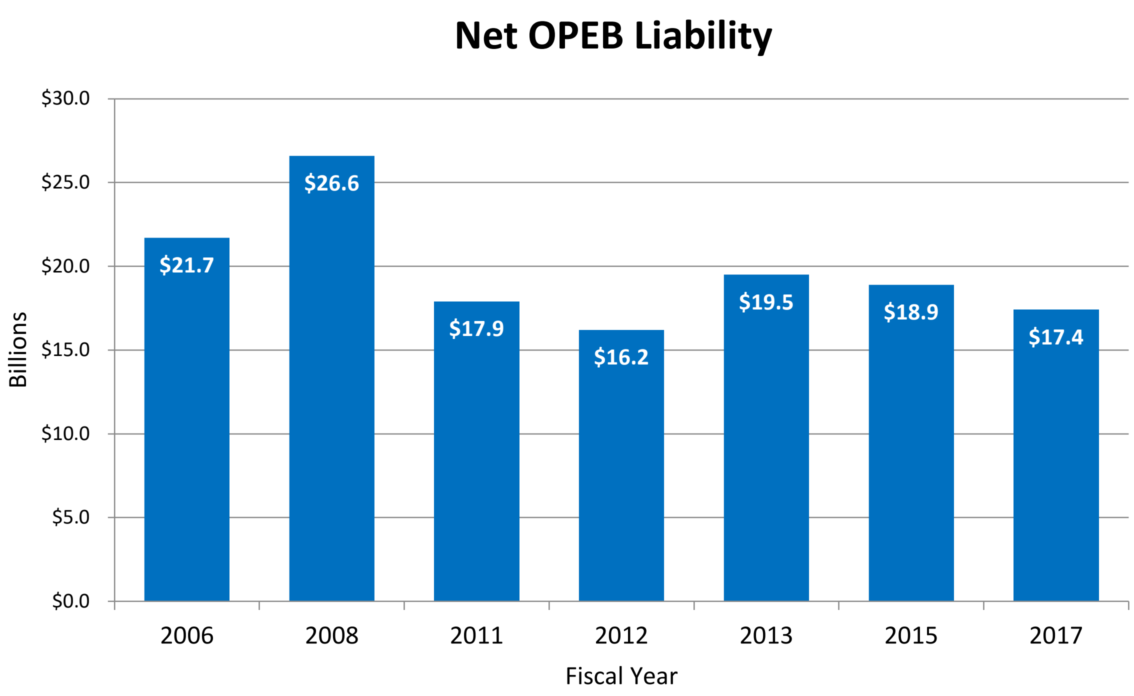
- $34.7 billion total liability
- $16.7 billion unfunded liability
- 60.6% of the liability is related to inactive or already-retired employees
- 75.8% of the FY 2020 actuarially determined employer contribution is for the unfunded actuarial accrued liability

Outlook for SERS and TRS



Changes from the 2019 legislative session create a much steadier stream of projected contribution requirements. As a result, SERS is now projected to be fully funded in 2048 and TRS in 2050.

Other Post-Employment Benefits

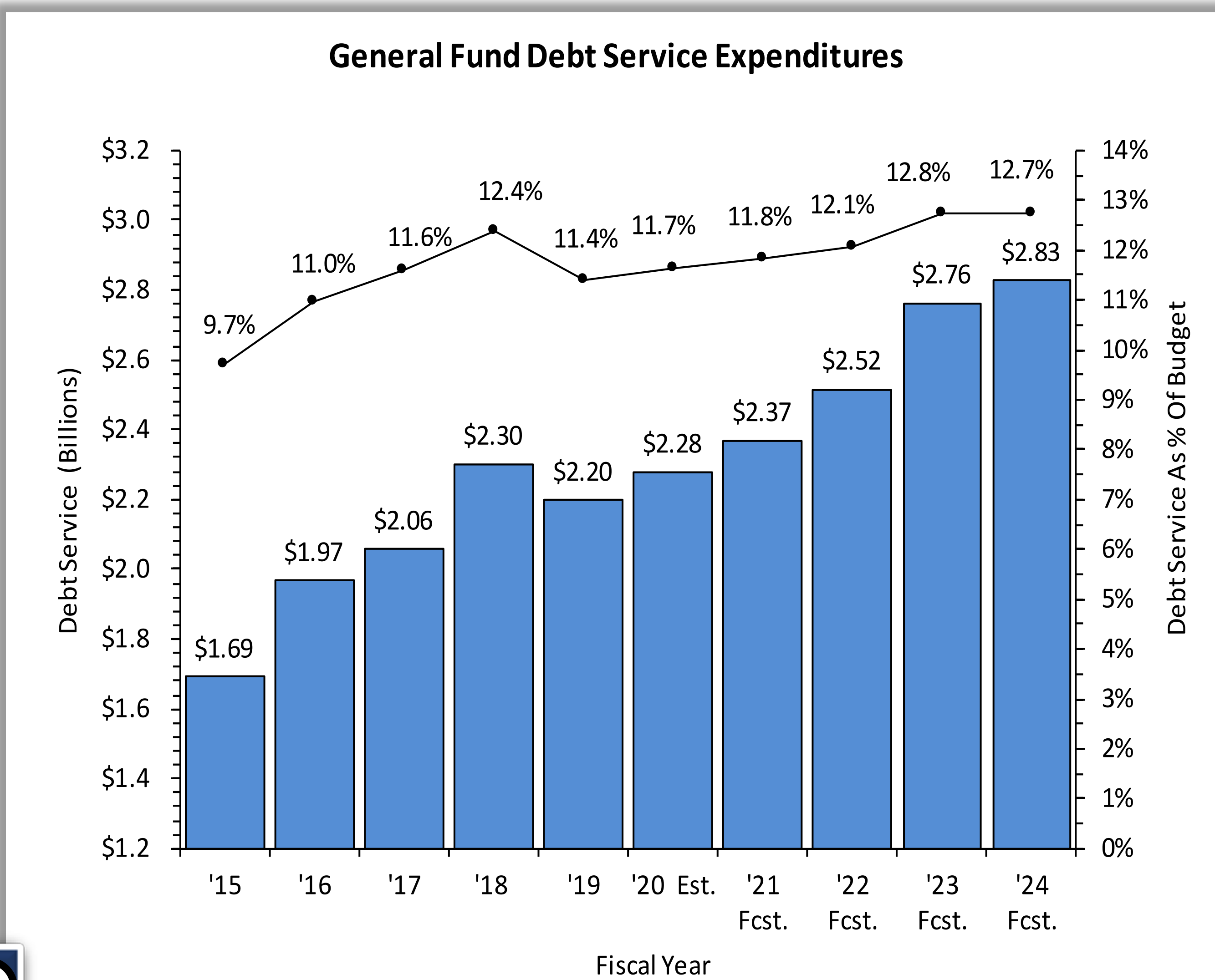


Recent reforms:

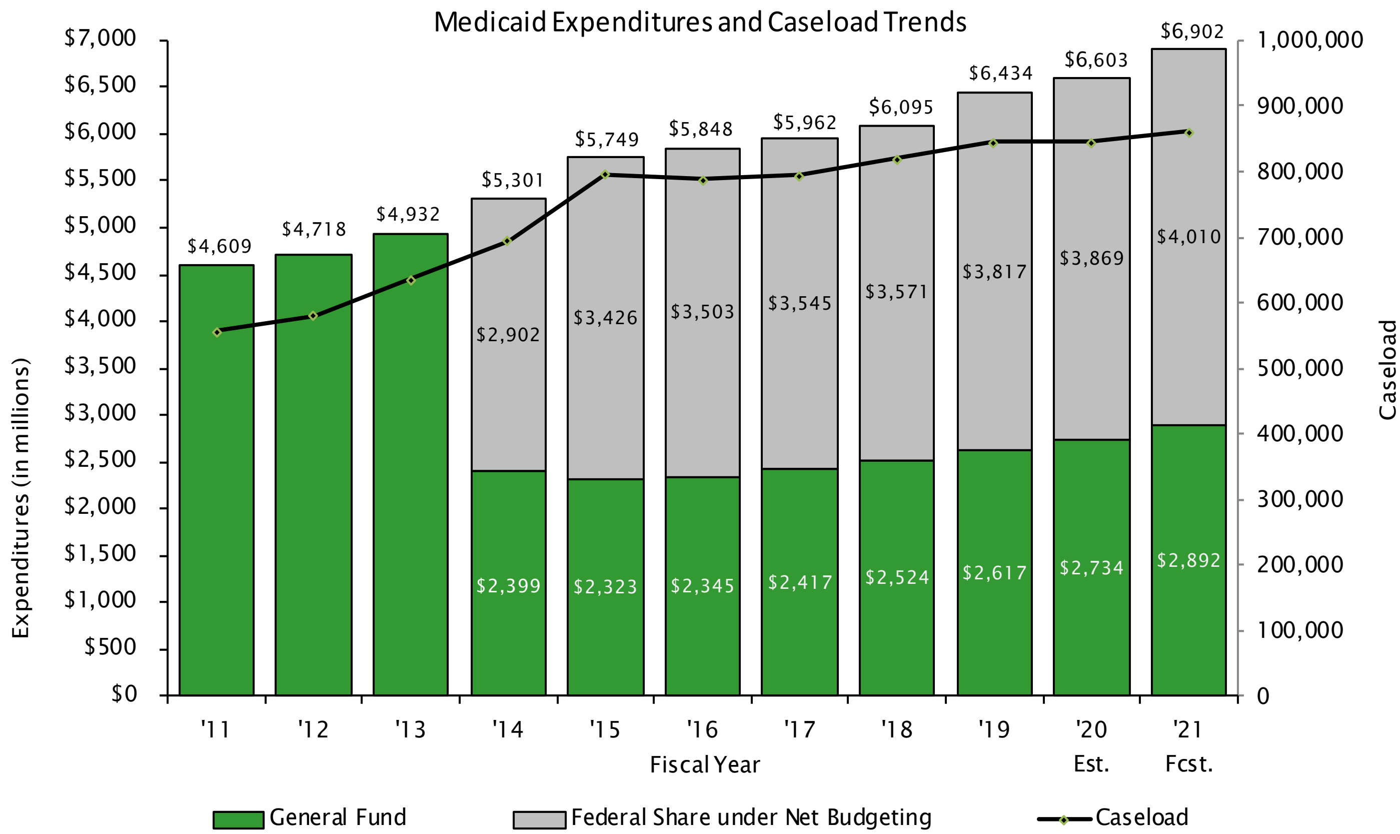
- **Transitioning Medicare eligible retirees to a Medicare Advantage plan with pharmacy coverage which is expected to save $135 million on an annual basis;**
- **Increasing premium cost sharing and health care design changes for new retirees after October 1, 2017 and increasing again for new retirees after June 30, 2022;**
- **Increasing copays for non-HEP drugs from $5 generic/$20 preferred/$35 brand to a four-tier system of $5 preferred generic/$10 non-preferred generic/$25 preferred brand/$40 non-preferred brand;**
- **Increasing the emergency room copay for non-emergencies from $35 to $250;**
- **Converting to a tiered provider network plan; and**
- **Increasing the number of years from ten to fifteen that health care eligible employees hired after July 1, 2017, must pay 3% of salary toward retiree health.**

- **Additionally, the state recently completed a competitive bidding process for a pharmacy benefits manager (PBM). The new contract, effective July 1, 2019, is expected to reduce pharmaceutical costs by approximately 10%. The impact will be reflected in the next OPEB valuation.**

Debt Service



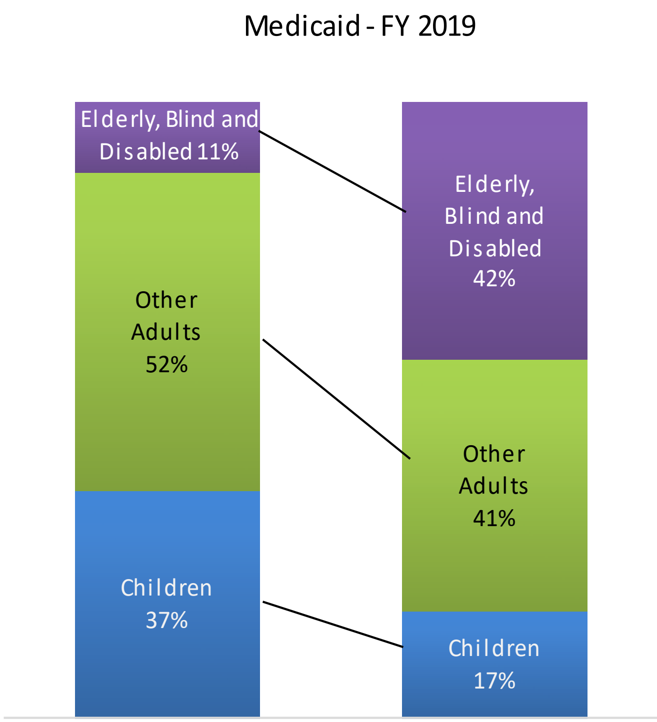
Medicaid – Expenditures and Caseloads



Beginning with the budget adopted in 2013, the Medicaid account in the Department of Social Services was "net appropriated." A total of $2,768.7 million was removed from both budgeted revenues and appropriations to accomplish this transition in FY 2014.

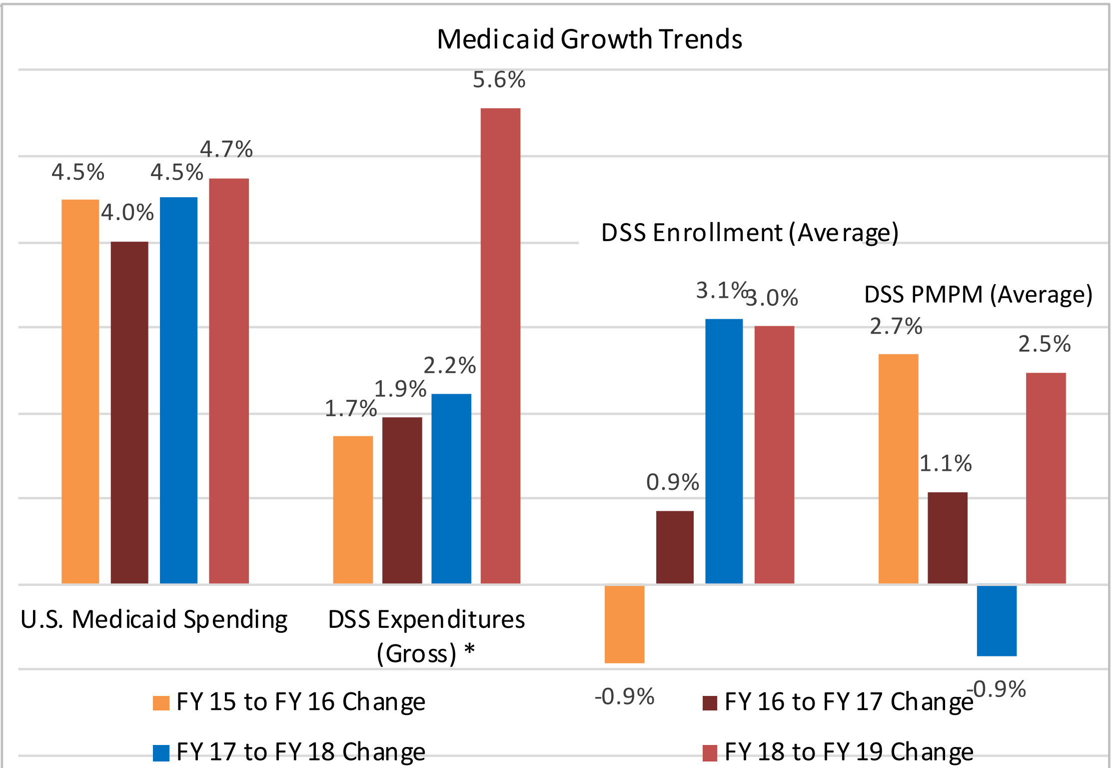
Expenditures have been adjusted to include funds transferred to DSS from DMHAS for behavioral health services which qualify for Medicaid reimbursement. Expenditures exclude hospital supplemental payments given the significant variance in that area over the years.

Medicaid – Enrollment and Cost Trends



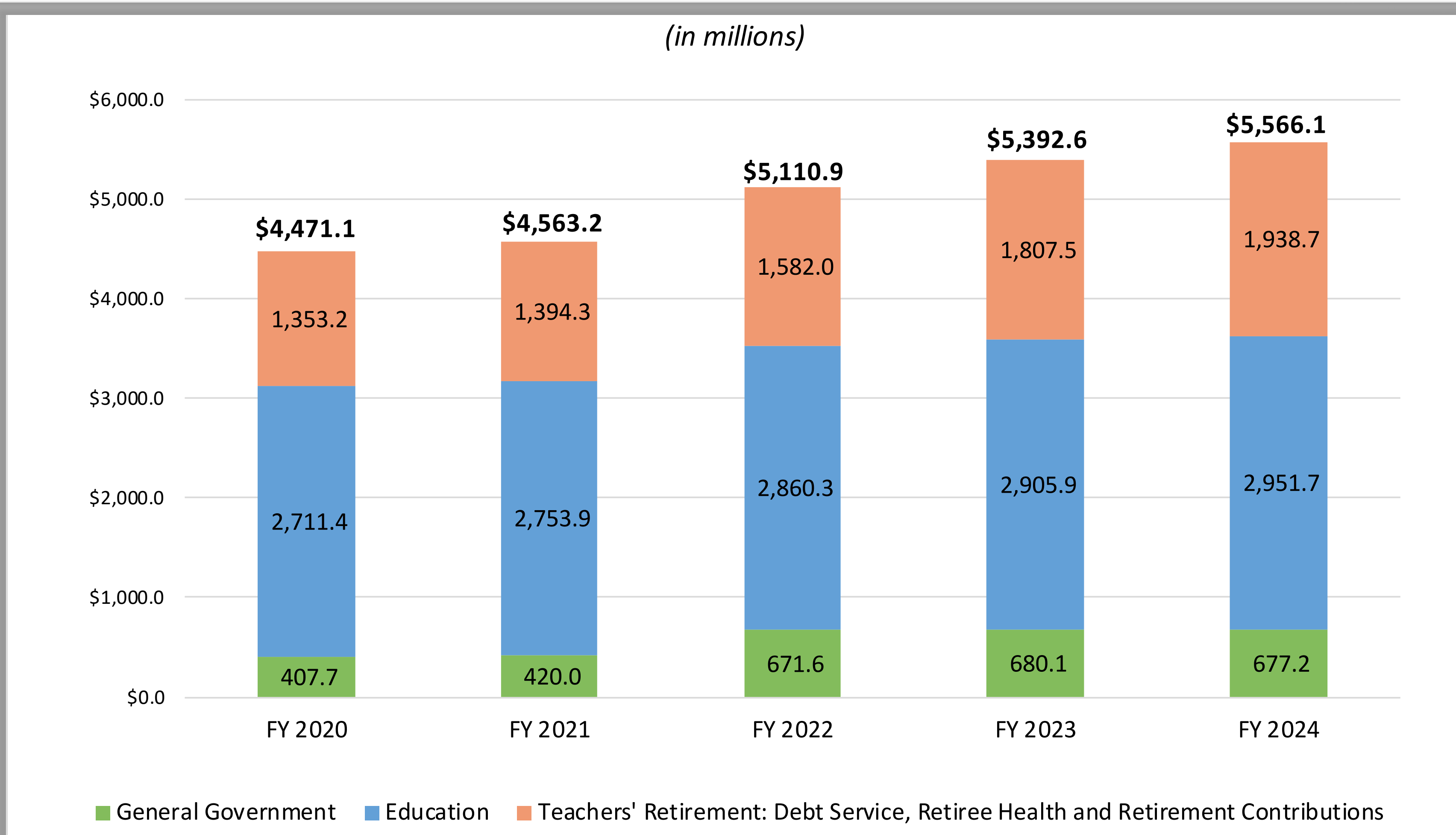
Enrollment
Average Monthly Enrollment = 844,310

Expenditures
Total Annual Expenditures = $6,434 million



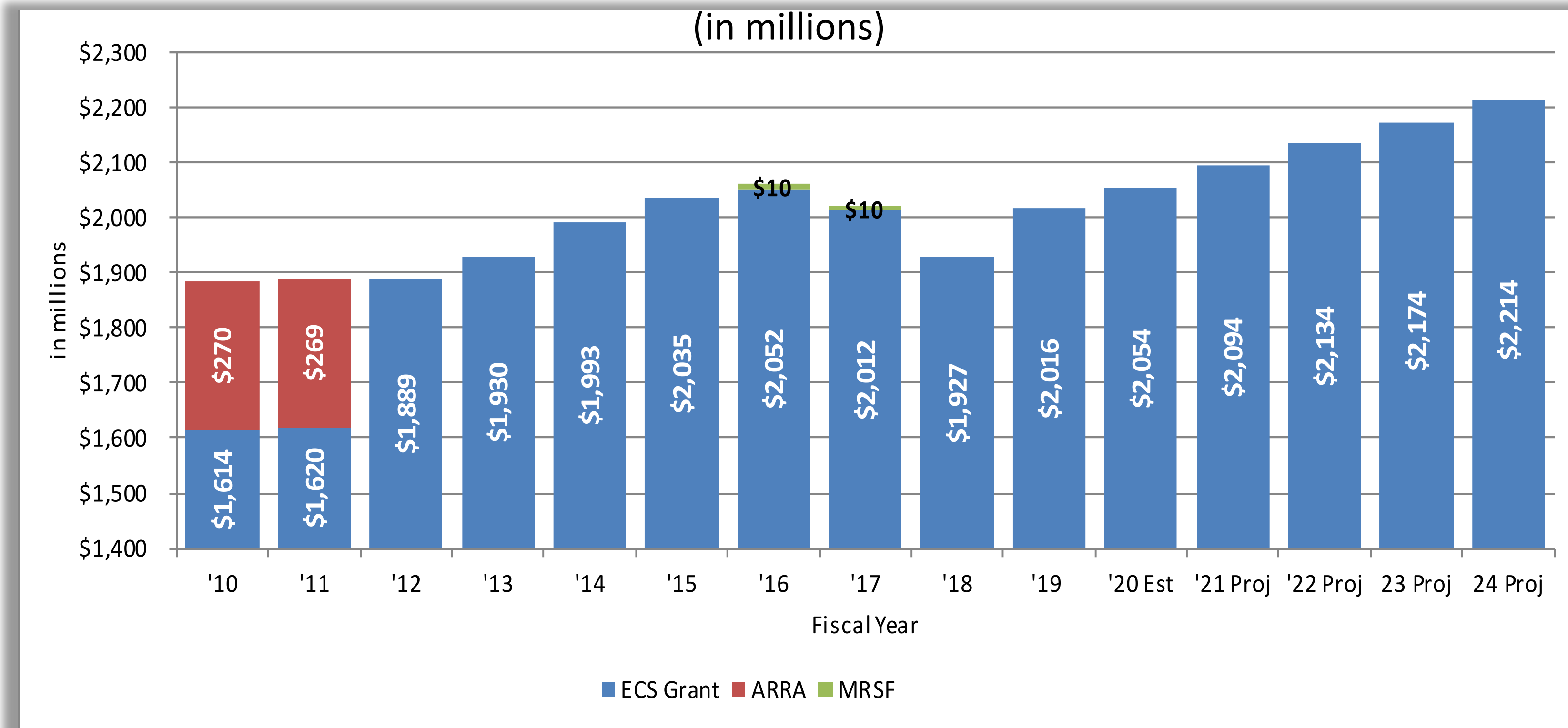
** Expenditures are net of drug rebates and exclude hospital supplemental payments given the significant variance in that area over the years. Expenditures include hospital rate increases effective 1/1/18; if these increases are excluded, the increase in expenditures would be reduced to 1.0% in FY 2018 and 4.0% in FY 2019 and the change in the PMPM would be revised to -2.0% in FY 2018 and 0.9% in FY 2019.*

State Aid to Municipalities



- **Estimates for FYs 2022 – 2024 are according to formulas and appropriations in current law and do not assume future legislative action. Does not include bonded aid.**

Education Cost Sharing Grants



Note: The budget for FY 2010 and FY 2011 included federal ARRA SFSF funding of $269 million (14% of the grant). From FY 2013 to FY 2016, Charter School Grants were appropriated under the ECS grant. Charter School funding is not included in the graph above. The Education Cost Sharing Grant was supplemented by $10 million in FY 2016 and FY 2017 from the Municipal Revenue Sharing Account (MRSA).

Executive Branch Staffing
All Appropriated Funds (excludes Higher Education)

- **5,370 employees, or 16.9%, lower than the number at the end of FY 2008**
- **When adjusted for changes in state population, executive branch agencies have fewer staff than at any time since the 1950s**
- **State employee wages and salaries now account for less than 1/8th of the General Fund budget**
- **A substantial number of employees are expected to retire in 2022**

Conclusion

- A General Fund operating shortfall of $19.6 million is projected in FY 2020. Management actions are expected to mitigate this shortfall.
- The Rainy Day Fund is expected to rise from $2.5 billion to $2.8 billion by the end of FY 2020 and could reach the 15% target by the end of FY 2021.
  - Once the 15% target is attained, surpluses will be directed to reducing long-term liabilities (SERS, TRS, bonded indebtedness)
- The nation is overdue for a recession. The state's reserves are sufficient for a moderate recession scenario, but are insufficient for a severe economic downturn.

Conclusion

- "Fixed" costs are rising faster than revenue growth from FY 2020 to FY 2024.
  - Revenues: 2.4% year-over-year growth.
  - Fixed costs: 4.8% year-over-year growth.
- The spending cap will allow growth of 3.5% to 3.6% per year, but this exceeds the level of revenue growth and must accommodate growth in fixed costs subject to the cap.
- Future budgetary choices will be impacted by the need to align:
  - Revenue growth,
  - Fixed cost growth, and
  - Allowable growth in expenditures subject to the spending cap.