CONNECTICUT'S FISCAL GUARDRAILS

Treasurer's Office Inaugural Investor Conference

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Presented by:

Jeffrey R. Beckham

Secretary

Office of Policy & Management

The Fiscal Guardrails

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What are the Fiscal Guardrails?

The fiscal guardrails are a series of governance measures that ensure CT lives within its means. The fiscal guardrails include the 9 items below:

Operating Budget Guardrails

1. Spending Cap
2. Revenue Cap
3. Volatility Cap
4. Budget Reserve Fund

Capital Budget Guardrails

5. Debt Limit
6. Bond Allocation Cap
7. Bond Allotment Cap
8. Bond Issuance Cap

9. Bond Lock

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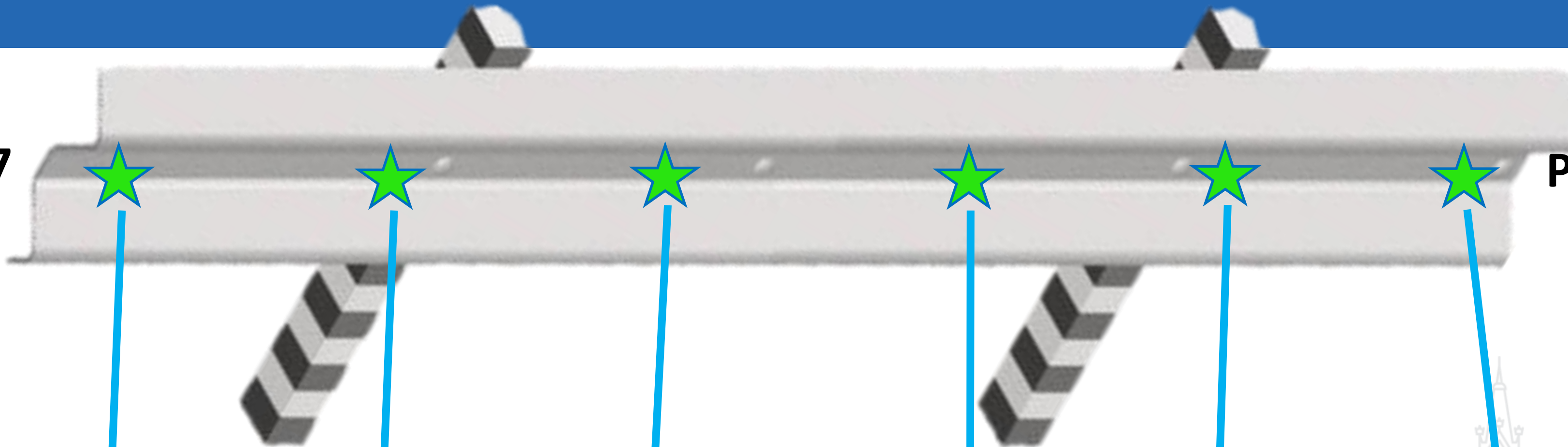
The Guardrails Did Not Happen Overnight – 60 Years in the Making

1957



Present

<u>1957</u>:
Enactment of the Debt Limit/Bond Authorization Cap

<u>1979</u>:
Creation of the Budget Reserve Fund

<u>1991</u>:
Creation of the Spending Cap (along with enactment of the state personal income tax)

<u>2008</u>:
First Use of the Bond Lock with the Teachers' Retirement Pension Obligation Bonds

<u>2017</u>:
Creation of the Volatility Cap and Revenue Cap – fiscal guardrails as a complete package are born

<u>2023</u>:
Extension of Bond Lock with the fiscal guardrails for up to 10 years

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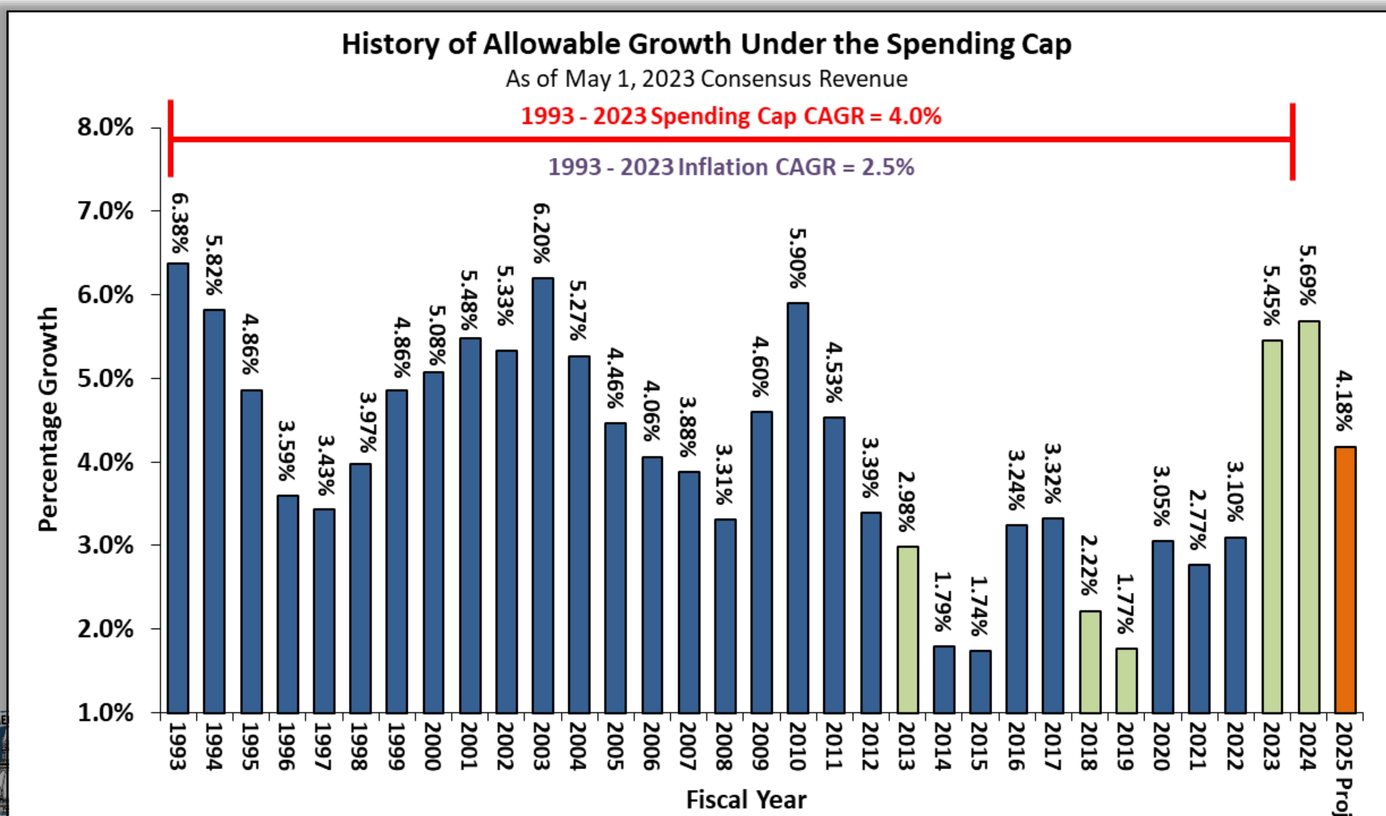
1. The Spending Cap

The spending cap limits growth in the state's budget based on the economy's ability to pay as measured by the greater of the increase in personal income or inflation

a. *Increase in Personal Income*: The average of the annual increase in personal income in the state for each of the preceding 5 calendar years

b. *Increase in Inflation*: The increase in the consumer price index for urban consumers, less food & energy, during the preceding 12-month period (December over December), according to U.S. Bureau of Labor Statistics data



Note: Growth in personal income (blue/orange bars) was the limiting factor in every fiscal year except FY 2013, FY 2018, FY 2019, FY 2023, & FY 2024 in which growth in CPI-U (green bars) was the limiting factor.

CAGR = Compound Annual Growth Rate

2. The Revenue Cap

1. The revenue cap limits appropriations to a set level below the revenue forecast to handle modest budgetary issues that arise during a given fiscal year

2. In other words, the revenue cap creates a mandatory surplus at the beginning of a fiscal year

3. The revenue cap limits are outlined in the table below:

Fiscal Year	Revenue Cap
2018	100.00%
2019	99.75%
2020	99.50%
2021	99.25%
2022	99.00%
2023 & Beyond	98.75%

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3. The Volatility Cap

1. The volatility cap directs revenue from two highly volatile revenue sources above a certain level to the state's Budget Reserve Fund. The two revenue sources are:
   a. The estimated & final payments of the Personal Income Tax; and
   b. The Pass-through Entity Tax

2. The threshold for the cap started in FY 2018 at $3,150.0 million and has grown by 15% to $3,632.5 million in FY 2023 (approximately 2.89% per year)
   a. The threshold for the cap grows by the average of the annual increase in personal income in the state for each of the preceding 5 calendar years
   b. This has allowed some revenue growth from these sources to pass to the General Fund

4. The Budget Reserve Fund

1. The Budget Reserve Fund (BRF or commonly known as the *Rainy Day Fund*) provides funding in the event of a significant budgetary shock such as a recession or disaster when the operating budget falls into deficit by the end of a given fiscal year

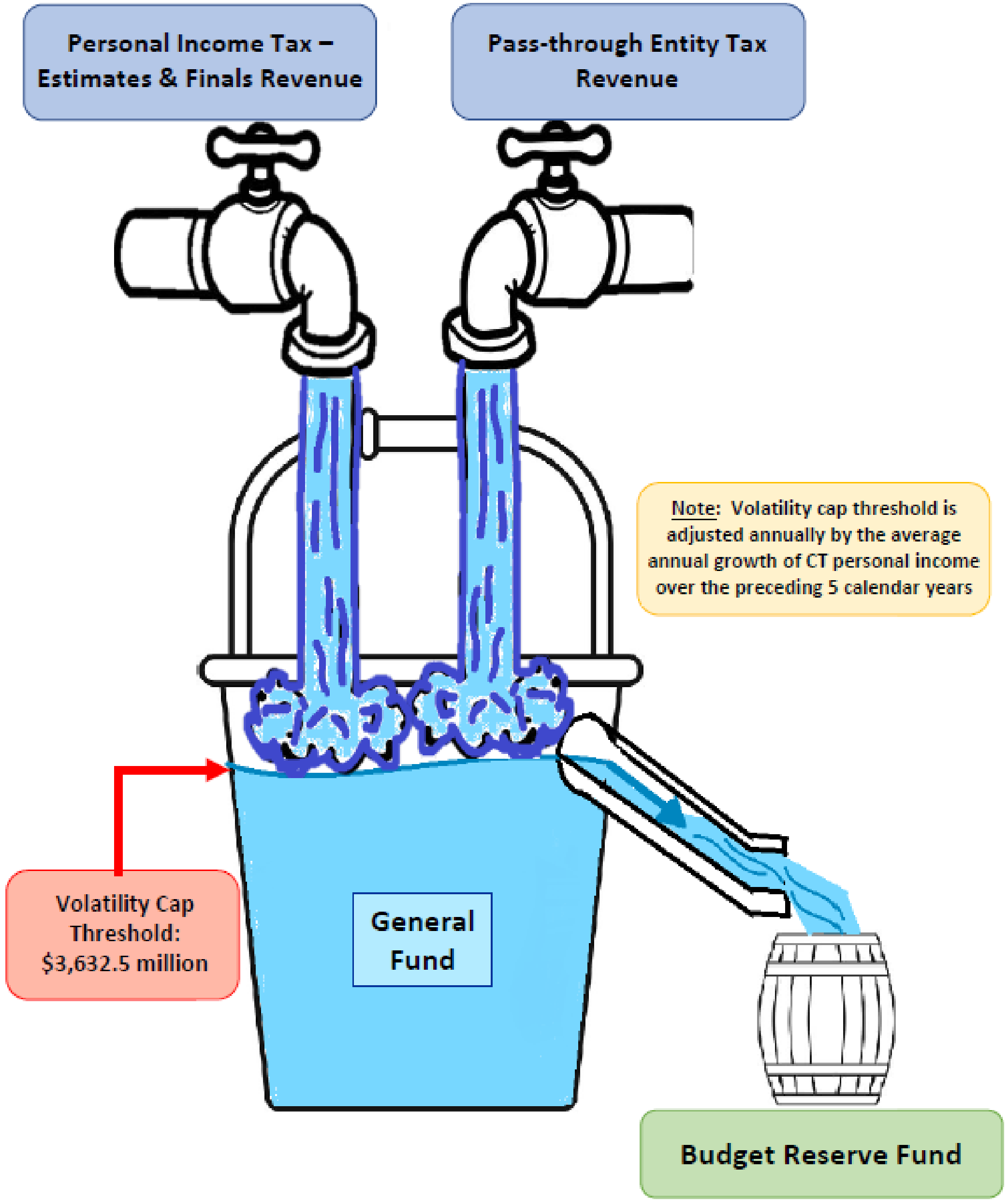
2. The BRF has a limit of 15% of net General Fund appropriations meaning the BRF can essentially fund *almost* one-fifth of the state's operating budget in one fiscal year (the BRF limit will be increased to 18% on 7/1/24)

3. When the BRF is not full, the volatility cap transfer and any year-end surplus are deposited into the BRF
   a. Once the BRF has reaches the 15% threshold, any additional funds above the 15% level are transferred to reduce the unfunded liabilities of SERS and/or TRS or transferred to reduce other state debt

4. The BRF is currently full at $3.3 billion in FY 2023 and is projected to remain full over the next several fiscal years

Flow of Funds – The Volatility Cap, Surplus, BRF, and Pensions

Volatility Cap – FY 2023



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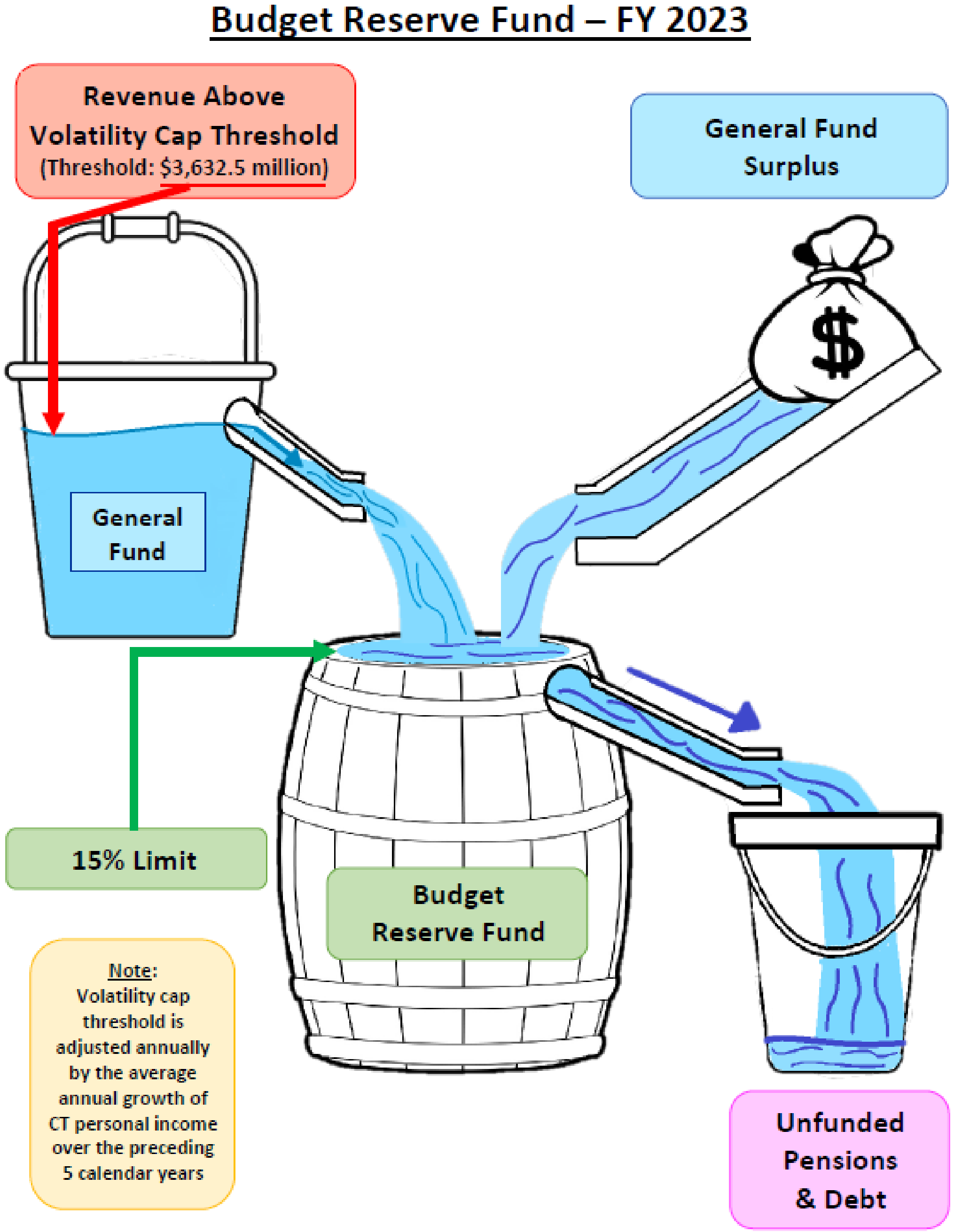
Flow of Funds – The Volatility Cap, Surplus, BRF, and Pensions



Note: BRF limit will increase from 15% to 18% beginning 7/1/24

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Capital Budget Guardrails

5. **Debt Limit**
   a. The debt limit constraints General Obligation (G.O.) bond authorizations to 1.6x net General Fund tax receipts

6. **Bond Allocation Cap**
   a. The bond allocation cap limits annual State Bond Commission allocations ($2.377 billion in CY 2023)

7. **Bond Allotment Cap**
   a. The bond allotment cap limits annual allotment of previously allocated funds ($2.09 billion in FY 2023)

8. **Bond Issuance Cap**
   a. The bond issuance cap limits annual debt issuance ($2.09 billion in FY 2023)

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9. The Bond Lock

The Bond Lock wraps around all of these fiscal guardrails via a bond covenant that prevents waiving the requirements of these measures without:

1. Gubernatorial declaration of an emergency or the existence of extraordinary circumstances
   a. In addition, the Governor must invoke allotment recissions and/or deficit mitigation measures

2. A supermajority vote of the legislature
   a. A passing supermajority vote in the legislature means a three-fifths vote in both the House and the Senate

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Recent Enhancements to the Fiscal Guardrails

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Recent Enhancements – February 2023

#	Component	Prior Law	PA 23-1 Changes
1.	Bond Lock Expiration (Indenture Pledge)	June 30, 2023	June 30, 2033 Note: Legislature has the option, between January 1, 2028 and June 30, 2028, via resolution not to continue (Section 14)
2.	Budget Reserve Fund (BRF) Maximum	15% of ensuing fiscal year net General Fund appropriations	18% Effective July 1, 2024 (Section 15)
3.	Surplus & Volatility Cap Deposits	BRF ≤ 15%: 100% to BRF BRF > 15%: SERS and/or TRS	BRF ≤ 15%: 100% BRF BRF > 15% ≤ 18%: 50% to BRF & 50% to SERS and/or TRS BRF > 18%: SERS and/or TRS (Section 15)
4.	Revenue Cap	FY / Cap 2023 98.75% 2024 98.50% 2025 98.25% 2026 98.00% & thereafter	Frozen at 98.75% annually (Section 16)

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Recent Enhancements – February 2023 (Cont'd)

#	Component	Prior Law	PA 23-1 Changes
5.	**Bond Allocation Cap – Basis**	Calendar Year (CY 2023 at $2.379 billion)	Fiscal Year (FY 2024 set at $2.4 billion) (Sections 17 & 18)
6.	**Bond Issuance Cap**	$2.09 billion in FY 2023	$2.4 billion in FY 2024 To align with allocation cap Also excludes debt issued to fund a budget deficit (Sections 17 & 18)
7.	**Bond Allotment Cap**	$2.09 billion in FY 2023	Ties the Gubernatorial allotment cap level to the issuance level (Sections 17 & 18)
8.	**Debt Limit**		Adds exclusions of debt issued for: 1. Budget deficits (this conforms to past practice) 2. GAAP deficit 3. Existing authorized debt yet to be effective 4. Gubernatorial emergency debt authorized by three-fifths vote in each chamber (Sections 17 & 18)

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Outcome of the Fiscal Guardrails

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What Have the Operating Budget Fiscal Guardrails Done For CT?

Rebuilding Budgetary Reserves and Reducing Pension Liabilities
Since the Enactment of the Volatility and Revenue Caps
(in millions)

	Fiscal Year	Sources of Funds: Surplus	Sources of Funds: Volatility Cap	Sources of Funds: Total	Uses of Funds: SERS Pension	Uses of Funds: TRS Pension	Uses of Funds: BRF	Uses of Funds: Total
1.	2018	$ (482.9)	$ 1,471.3	$ 988.4	$ -	$ -	$ 988.4	$ 988.4
2.	2019	370.6	949.7	1,320.3	-	-	1,320.3	1,320.3
3.	2020	38.7	530.3	569.0	61.6	-	507.4	569.0
4.	2021	475.9	1,241.5	1,717.4	714.7	903.6	99.1	1,717.4
5.	2022	1,261.4	3,047.5	4,308.9	3,204.0	903.6	201.3	4,308.9
6.	**Total**	**$ 1,663.7**	**$ 7,240.3**	**$ 8,904.0**	**$ 3,980.3**	**$ 1,807.2**	**$ 3,116.5**	**$ 8,904.0**
7.	% of Total	18.7%	81.3%	100.0%	44.7%	20.3%	35.0%	100.0%

1. As a result of the fiscal guardrails, the state has directed more than $8.9 billion in excess revenue to:
   a. $3.1 billion has gone to fill the Budget Reserve Fund
   b. $5.8 billion has gone to reduce the unfunded liabilities of the SERS and TRS pension funds

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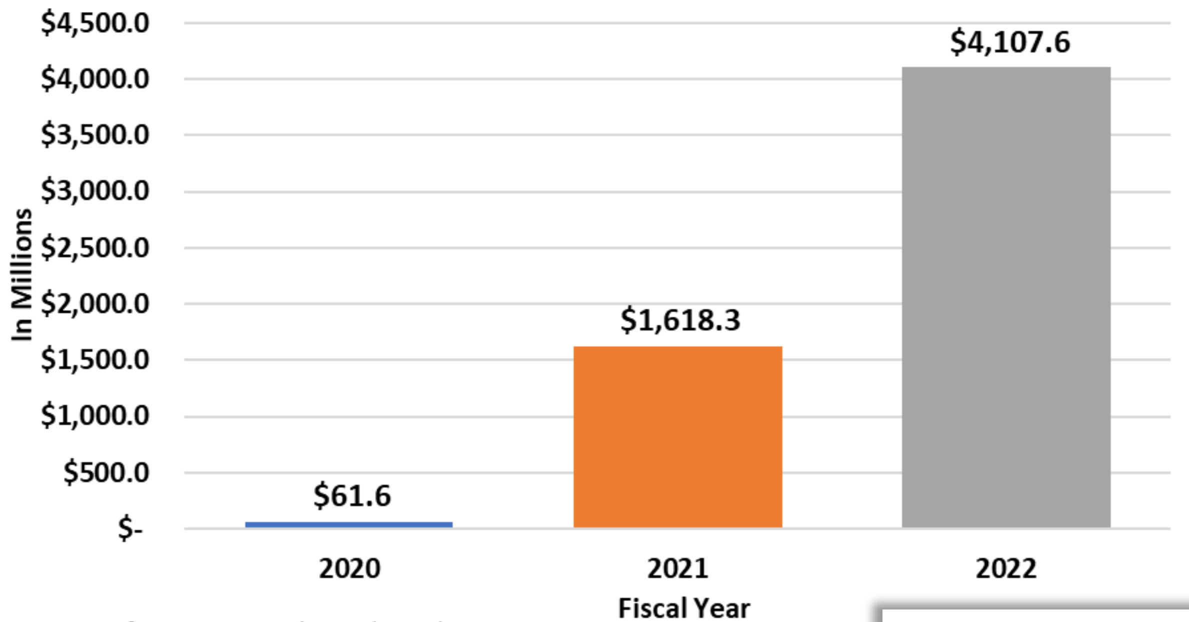
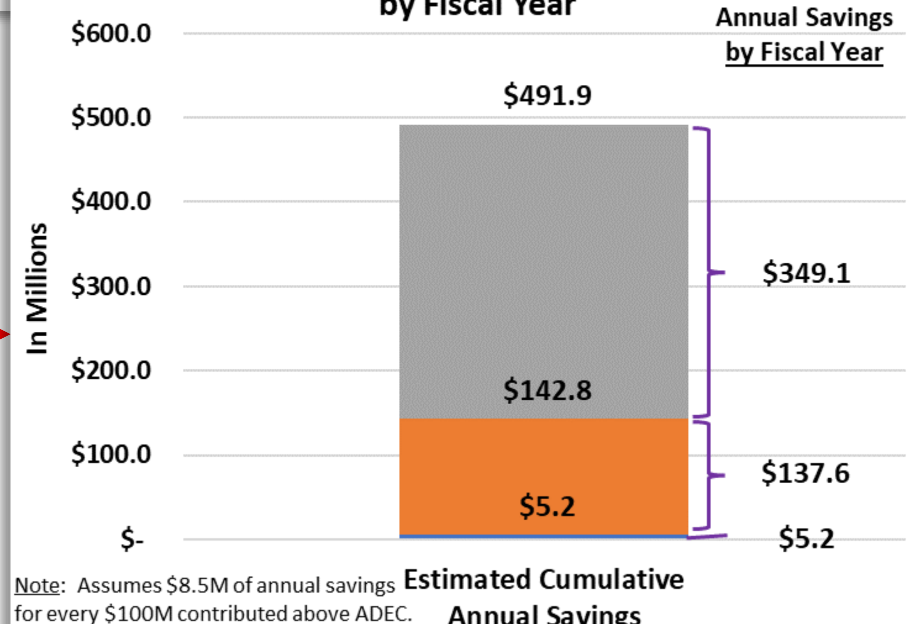
Positive Feedback Loop by Reducing Future ADEC Payments



Note: Transfer amounts are due to the Budget Reserve Fundreaching the 15% statutory limit and are in addition to ADEC payments.



Note: Assumes $8.5M of annual savings for every $100M contributed above ADEC.

Results of the Fiscal Guardrails - Summary

1. The Volatility Cap has brought stability to the General Fund.
   a. Prevents building into the General Fund base revenue that may not recur year-to-year
   b. In good years, the Volatility Cap recapitalizes the Budget Reserve Fund to the full 15% level

2. The BRF is at its maximum threshold of 15% or $3.3 billion
   a. Balances in excess of the 15% level spill-over or waterfall into the state's unfunded pension liabilities creating a positive feedback loop of long-term budgetary savings by reducing the ADEC

3. $5.8 billion has gone to reduce the state's unfunded pension liabilities on top of the normal ADEC
   a. As a result of the extra payments, the state is projected to save approximately $491.9 million annually
   b. The SERS funded ratio has gone from 38% in 2018 to 49% in 2022
   c. The TRS funded ratio has gone from 52% in 2018 to 57% in 2022

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Results of the Fiscal Guardrails – Summary (Cont'd)

4. The state has received credit rating upgrades from all 4 rating agencies in the last 2 years, all of which credited the fiscal guardrails and the bond lock as a major positive factor

5. As a result of the May 1, 2023 consensus revenue forecast, volatile revenues were revised downward by $500 million, and because of the volatility cap, this had **NO** impact on FY 2023 budgetary balance, nor did it throw the upcoming biennium out of balance

6. From FY 2019 through FY 2022, the state has recorded 4 consecutive years of operating surpluses with a 5th consecutive year of surplus projected for FY 2023
   a. Unlike the period prior to the guardrails, there have been **NO** major tax rate increases, and we expect that the state will be cutting taxes over the upcoming biennium

Questions?

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