State of Connecticut

Issuer: State of Connecticut		
Assigned	**Rating**	**Outlook**
Taxable General Obligation Bonds (2020 Series A)	AA-	Stable
General Obligation Bonds (2020 Series C)	AA-	Stable
Affirmed	**Rating**	**Outlook**
General Obligation Bonds	AA-	Stable
Issuer: Connecticut Innovations, Incorporated		
Affirmed	**Rating**	**Outlook**
State of Connecticut General Fund Obligation Bonds 2014 Series A	AA-	Stable

Methodology:

U.S. State General Obligation Rating Methodology

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Rating Summary: The AA- rating reflects high wealth levels that provide strong support to above average debt and pension burdens. Going forward, the prospect of continued fiscal stability is enhanced by the transfers the State has made to the Budget Reserve Fund (BRF). Overall credit strength has been constrained by the State's lagging economic recovery following the Great Recession.

Substantially better than projected PIT collections allowed the Budget Reserve Fund (BRF) to grow to a strong $2.5 billion by the close of FY 2019. The sizable reserves position the State well to manage the impact of the COVID-19 crisis. KBRA has reviewed the latest OPM report on the General Fund (released April 30, 2020). As a result of the pandemic, the report indicates FY 2020 revenues are estimated at $1.1 billion under budget. Transfers from the BRF are expected to close the projected GF operating deficit, and the estimated ending BRF balance a still sizable 9.7% of FY 2020 expenditures. The largest categories of budgetary variance are personal income taxes ($490 million), sales and use tax ($257 million) and federal grants ($203.7 million). Looking ahead to FY 2021, the State is projecting a $2.0 billion GF operating deficit, but expects to enact measures to close the gap so as to maintain a balance of $1.9 billion in the BRF.

The State received a $1.4 billion allocation of from the Coronavirus Aid, Relief, and Economic Security (CARES) Act which was passed March 27, 2020 as part of the $150 billion state-focused Coronavirus Relief Fund (CRF). The CFR is designed to cover expenses directly incurred by state and local governments to deal with the coronavirus (COVID-19) public health crisis, but not indirect expenses or secondary economic effects such as lost revenues. As of March 12, the state has approved $459 million in COVID-19 response measures but anticipates utilizing the full $1.4 billion CRF allotment. The projected local government costs to deal with the crisis ranges from $50 to $75 million, of which of State expects to cover 75% to 80%. The relatively modest local costs reflect the absence of county-level government in Connecticut, meaning that most such costs will be borne directly by the State.

Wealth levels remain very high, with per capita income of $79,087 at 140% of the national average in 2019. However, the state's recovery from the last recession was sluggish and real gross state product (GSP) contracted in seven of the last twelve years. Social distancing measure implemented in response to the ongoing COVID-19 pandemic will additionally weigh on the state in the near term. While Connecticut historically had a strong economy with well above average wealth levels, the depth and duration of the current downturn and ultimate pace of the recovery as the economy reboots remains to be seen.

The State has high debt levels, but this partly reflects its practice of issuing general obligation debt for certain university projects and for purposes that municipal entities and counties fund in other states such as local school construction. Fixed costs (debt service, OPEB and pension) are 21.8% of general government expenditures, which KBRA views as high.

In KBRA's view, the State economy continues to grow at a slower pace than regional and national growth trends. Since 2010, the State has generally lagged the New England region and the United States in growth in total employment and gross state product.

The Stable Outlook reflects the diversity and high wealth levels of the economic base and strong reserve position leading up to the current pandemic-disrupted environment.

Key Credit Considerations

KBRA continues to monitor the direct and indirect impacts of the COVID-19 virus on the U.S. State General Obligation sector. Please refer to KBRA's ongoing research on the topic **here** for more information.

The rating actions reflect the following key credit considerations:

Credit Positives
- Strong wealth levels with State per capita income the highest in the nation.
- Budget Reserve Fund balance has increased in recent years.
- Strong financial management framework for tracking revenues, monitoring budget performance and a history of making required adjustments.

Credit Challenges
- Increasing budgetary burdens for debt service, pension contributions, and Medicaid.
- Continued lack of growth in the important economic indicators of population, employment and gross state product.
- Unfunded pension liabilities and tax-supported debt burden are high relative to personal income, each exceeding 3.0x the respective U.S. averages. However, the State borrows for many local purposes and the comparison on a combined state and local basis is more moderate.

Rating Sensitivities

• Trend of structurally balanced operations and accurate revenue projections, along with increases in the Budget Reserve Fund. • Significant improvement in the funded ratios for the State's pension systems.	+
• Structural operating deficits in the General Fund. • Weakening in the State's employment base and economic activity.	-

ESG Considerations

When relevant to credit, ESG factors are incorporated into the credit analysis in the same manner as all other credit-relevant factors. Among the ESG factors that have impact on this rating analysis are:

- Discussions in RD 1 reflect Governance Factors. KBRA has examined the following areas for this credit: management structure, revenue raising flexibility, financial monitoring, and long-term planning.
- Discussions in RD 4 reflect Social Factors. KBRA has examined the following areas for this credit: trends in population, education, income, poverty levels, employment, unemployment, gross state product and the potential impact of the COVID-19 crisis.

More information on ESG Considerations for the Public Finance sector can be found **here**.

Rating Highlights	
Per Capita Personal Income (2019) (in dollars)	$79,087
as a % of U.S.	*140%*
Population (2019)	3,565,287
Growth 2010 to 2019	*-0.4%*
Real GDP, % Change 2010 to 2019	
Connecitcut	0.5%
New England	13.5%
United States	22.3%
Budget Reserve Fund Balance ($ in millions)	
FYE 2017	$213
FYE 2018	$1,185
FYE 2019	$2,506
FYE 2020 Estimate (OPM 4/30/2020)	$1,890
Pro Forma Direct Debt ($ in millions)	$25,996
Net Pension Liability (6/30/2019 Measurement Date) ($ in millions)	$34,821
Fixed Costs as a % of Governmental Expenditures (FY 2019)	21.8%

Rating Determinants (RD)	
1. Management Structure, Budgeting Practices and Policies	AA+
2. Debt and Additional Continuing Obligations	A+
3. Financial Performance and Liquidity Position	A+
4. State Resource Base	AA-

RD 1: Management Structure, Budgeting Practices and Policies

KBRA views Connecticut's management structure and policies as providing a very strong framework for managing its financial operations and debt issuance compared with other states. This framework is established by the State Constitution, Statutes, and administrative practices. Within this framework, favorable financial results were achieved in recent years.

Constitutional Provisions

Under Connecticut's Constitution, the State is divided into three distinct branches: The Legislative, Executive, and Judicial. The executive power of the State is vested in the Governor. Governor Ned Lamont was elected in November of 2018 for a term beginning in January 2019. Treasurer Shawn Wooden was also elected November 2018. The Treasurer is primarily responsible for receiving and disbursing monies of the State and is the sole fiduciary of the State's retirement funds. The Treasurer also has the responsibility for carrying out the issuance of debt. The Comptroller is required to issue monthly budgetary reports on the State's financial condition, in conjunction with the Office of Policy and Management (OPM). OPM is directly responsible to the Governor for policy development in the areas of budget and financial management and prepares the State budget.

The State's Constitution provides that the General Assembly may not authorize general budget expenditures in excess of estimated revenues. The Constitution also includes a spending cap on annual growth in expenditures which limits the increase in expenditures to the greater of the five-year average growth in personal income or inflation over the previous year. The cap excludes debt service for general obligation debt, annual funding of unfunded pension liabilities, and spending supported by federal funding. The cap may be exceeded if the Governor declares a fiscal emergency, and both houses of the legislature support such action by a three-fifths vote.

Under the State Constitution, the Governor has the power to veto any line item of any itemized appropriation bill, while at the same time approving the remainder of the bill. The General Assembly may override the Governor's veto by two thirds vote of each legislative house.

Statutory Provisions

State law requires that total net appropriations for each fund shall not exceed a percentage of estimated revenues for each respective fund. Under State statute, the State is required to monitor its financial performance monthly and the Governor is empowered to take action, under statutory limitations, to maintain budget balance. State statutes require consensus revenue forecast to be developed on a regular basis three times a year. The State's statutes allow for broad revenue raising ability.

Financial Management Policies

The State operates under a strong and comprehensive framework of financial management policies, most of which are codified in statute. The State's framework for financial management includes the following planning and reporting components:

> <u>Monthly Reports on Financial Performance</u>— By statute, OPM is required to provide the State Comptroller with a letter with monthly updates to revenue and expenditure projections for the General Fund in the current fiscal year, along with projections for end of fiscal year surplus or deficits. Based on the OPM letter, the Comptroller prepares a monthly letter on financial performance. Both the OPM and the State Comptroller's monthly letter is available on the state's website. KBRA views the Comptroller's and OPM's monthly monitoring and projection of the year-end financial position as an extremely valuable tool in managing the State's finances.
>
> <u>Annual Report to Legislature</u>— By statute, each November, OPM and the Office of Fiscal Analysis (OFA) is required to submit a Fiscal Accountability report to the Legislature which projects revenues for the current biennium and the next three fiscal years.
>
> <u>Three Year Out Report</u>— As part of the budget process, the Governor must annually submit a separate report to the Legislature which sets forth the estimated revenues and expenditures for the current biennium and the next three fiscal years.

<u>Consensus Revenue Estimates</u>— OPM and the OFA are required by statute to issue consensus revenue estimates each year by November 10, January 15, and April 30 that cover the current biennium and the next three fiscal years. The development of consensus revenue forecasts utilizes both in house analytic staff and external economic forecasting services. Economic trends are monitored and factored into monthly updates on revenue projections.

The Treasurer has investment responsibility for all funds of the State and functions as the trustee of all State pension, retirement, and trust funds. The Treasurer is required to report annually on investment activities by December 31 to the Governor and the State's Investment Advisory Council.

State Budget Process

The State's fiscal year begins on July 1 and ends on June 30. The Governor is required to transmit a budget document to the General Assembly in February of odd numbered years setting forth a separate budget for each of the biennium years. Under State Statute, the Governor has the ability to run the State under Executive Order to maintain essential services in the absence of a budget.

In each even numbered year, the Governor must prepare a report (Mid Term Budget Report) on the status of the budget enacted in the previous year with any recommendations on adjustment and revisions for the coming year. All budget recommendations incorporate the consensus revenue estimate process. If a budget surplus or deficit is projected, the Governor will recommend how the deficit will be mitigated or how the surplus will be used.

Ability to Adjust Expenditures and Deficit Mitigation

Under State statute, the Governor is empowered during the fiscal year to reduce the budget allotment, or expenditure request, by up to 5.0% of any specific appropriation to an agency, except for aid to municipalities, up to 3% of the total appropriations of any fund under certain circumstances without Legislative approval in order to maintain balanced financial operations. Such reductions to expenditures are also referred to as rescissions. Such budget allotments are subject to further modification by the Governor throughout the fiscal year if necessary. Beyond these limits, the General Assembly must act to reduce expenditures.

If the monthly status letter on financial performance issued by the Comptroller indicates a projected General Fund deficit greater than 1% of total General Fund appropriations, the Governor is required within thirty days to submit a report to the General Assembly that outlines a plan that the Governor shall implement to reduce expenditures to prevent a deficit. Over the last several years, the Governor has adjusted the State's operating budget through the rescission process several times in response to projected deficits identified as part of the monthly monitoring of financial performance.

Budget Reserve Fund

State statutes dictate that unappropriated surpluses left in the General Fund (GF) shall be transferred to the Budget Reserve Fund (BRF) until the Fund reaches 15% of the net GF appropriations. The Revenue Volatility Cap requires that beginning in FY 2018 estimated and final payments of the personal income tax and the pass-through entity tax in excess of a threshold, the Revenue Volatility Cap, are deposited into the BRF. The threshold for deposits adjusts under a statutory formula tied to personal income and is calculated annually by the State Comptroller. After the BRF reaches 15% of net GF appropriations, revenues in excess of the Volatility Cap are to be applied to long term liabilities, initially pension liabilities.

Briefly, uses of the BRF include:

- To fund a deficit in the preceding fiscal year
- By transfer of the General Assembly if the consensus revenue forecast projects a GF revenue decline of more than 1%

State Debt Limit

State statutes impose a ceiling on the amount of GF supported debt which may be authorized by the Legislature. The limit is 1.6x net GF tax receipts as projected by the Finance, Revenue and Bonding Committee of the General Assembly. Certain types of debt are excluded from this cap, including cash flow borrowings and emergency financings. Per the November 2019 Fiscal Accountability Report, the estimated debt incurring margin for FY 2020 is $4.3 billion.

General obligation debt is issued under State debt statutes and specific bond authorizations. Statutes provide that the bonds will be general obligations of the State and that the full faith and credit of the State is pledged for repayment. As per the State's contract with bondholders, appropriations for principal and interest do not need legislative approval.

There are no express statutory provisions establishing any priorities in favor of general obligation bondholders over other claims against the State. Connecticut is not a voter initiative state.

Municipal Accountability Review Board (MARB)

Statutes passed by the General Assembly as part of the FY 2018-FY 2019 budget process established a Municipal Accountability Review Board (MARB) to provide oversight and assistance to municipalities experiencing fiscal distress. The State has assumed the annual debt service obligations of the City of Hartford under this program. KBRA has added Hartford's outstanding debt to the State's aggregate outstanding debt. The State is also providing support to the City of West Haven under MARB which is expected to be short-term.

Bankruptcy

Under Chapter 9 of the U.S. Bankruptcy Code, State governments are not permitted to petition courts for protection from creditors, including holders of their general obligation debt.

RD 2: Debt and Additional Continuing Obligations

State Tax-Supported Debt

Connecticut's pro forma tax-supported debt burden is $26.0 billion including $18.9 billion in general obligation bonds, $6.4 billion in special tax debt secured by a pledge of transportation related taxes and fees, and $216 million in various other obligations. Also included in this figure is $488 million in City of Hartford debt. The State has assumed Hartford's debt service payments on this debt under a Contract for Financial Assistance executed in April 2018 as part of a plan to stabilize the financially distressed city.

In comparison with other states, Connecticut's state tax-supported debt burden is high. These high debt levels result in part from the State's practice of issuing general obligation debt for certain university projects and for purposes that municipal entities and counties fund in other states, including local school construction. Connecticut has not had a county form of government since October 1960.

FIGURE 1

Pro Forma Direct Tax-Supported Debt Principal Amount Outstanding (dollars in thousands)

	2/1/2016	2/1/2017	2/15/2018	2/1/2019	5/1/2020[1]
General Obligation Bonds	$13,529,951	$14,090,513	$14,038,169	$15,007,964	$14,904,865
General Obligation Bond Anticipation Notes	-	-	400,000	-	-
Pension Obligation Bonds (GO)[2]	2,346,499	2,351,187	2,369,532	2,367,505	2,393,806
UConn 2000 Bonds (GO)	1,059,285	1,532,895	1,420,535	1,635,125	1,568,905
Total General Obligation Debt	16,935,735	17,974,595	18,228,236	19,010,594	18,867,576
Special Tax Obligation Bonds	4,519,700	5,041,800	5,540,495	5,957,600	6,424,700
Other[3]	320,463	326,883	302,343	256,706	215,781
State Guaranteed City of Hartford Debt	-	-	-	515,910	487,655
Total Direct Tax-Supported Debt	**21,775,898**	**23,343,278**	**24,071,074**	**25,740,810**	**25,995,712**

Source: POS and historic GO Official Statements.

[1]Adjusted to include $900 million in pro forma general obligation bonds anticipated to price in May and June 2020 and $850 million in pro forma special tax obligation bonds anticipated to price in May 2020.

[2]Includes accreted value of Capital Appreciation bonds.

[3]Includes lease financing, tax increment financings, CHFA Supportive Housing Bonds and CHFA Emergency Mortgage Assistance Program Bonds.

Connecticut's state tax-supported debt burden is high relative to population, personal income and GSP, ranking among the very highest in the Country by all three metrics. The State's debt burden compares more favorably however when analyzed on the basis of aggregate state and local borrowings. By this more inclusive measure, the State's debt burden falls to the top 30% of states compared to personal income and to GSP (Figure 2).

FIGURE 2

Debt Ratios (in dollars)	Connecticut	Average of U.S. States	Connecticut Rank Among the 50 States
Tax-Supported Debt:			
Per Capita	$7,291	$1,631	Highest 10%
as a % of Personal Income	9.2%	2.8%	Highest 10%
as a % of GSP	9.1%	2.5%	Highest 10%
Aggregate State and Local Debt:			
Per Capita	$13,867	$9,308	Highest 10%
as a % of Personal Income	19.2%	17.9%	Highest 30%
as a % of GSP	18.5%	15.5%	Highest 10%

Source: U.S. Census Bureau, U.S. Bureau of Economic Activity, Credit Scope, and Annual Disclosures.

Connecticut has a relatively small level of exposure to variable rate debt or derivative financings; hence these types of transactions do not pose a significant risk to the State's liquidity position. As of May 1, 2020, the State has $983 million in variable rate general obligation bonds, which represents approximately 5.2% of pro forma long-term GO debt. The State has one outstanding GO swap with the notional amount of $20 million that will mature June 1, 2020. Under the swap agreement, the State controls termination unless its rating falls below the BBB level.

Debt Amortization

Connecticut's debt amortization parameters are conservative, with GO debt generally required to be amortized over 20 years on a level principal basis, which generates a declining debt service schedule. Speed of amortization of direct general obligation debt, is above average with 70% of principal retired over the next 10 years. In FY 2019, GO bond debt service represented 9.6% of total governmental expenditures (on a GAAP basis).

Capital Improvement Plan

The State's general obligation bond authorizations for capital projects declined in recent years, decreasing from $2.8 billion in FY 2015 to approximately $1.4 billion and $1.6 billion in FYs 2020 and 2021, respectively. The General Assembly also authorized special tax obligation bonds for transportation of $778 million and $782 million in FYs 2020 and 2021, respectively.

State of Connecticut Retirement Systems

Connecticut administers two major pension plans: the State Employees' Retirement System (SERS) and the State Teachers' Retirement System (TRS). It also administers the much smaller Judicial Retirement System (JRS). The State's level of funding for its pension plans remains among the lowest for US states. The funded ratio for SERS is 38% (June 30, 2019) and for TRS is 52% (June 30, 2018, revised June 18, 2019). The State has contributed to these funds at the full Actuarially Determined Employer Contribution (ADEC) in recent years, but funding progress has lagged as realized investment returns have not reached actuarial assumptions.

State Employees' Retirement System (SERS)

SERS is a single-employer defined benefit pension plan that provides retirement, disability, and death benefits to plan members and their beneficiaries. Employees also contribute. Full actuarial valuations were historically performed by a third-party consultant as of June 30 of even numbered years, but commencing June 30, 2019, the State intends to perform annual actuarial valuations. The assumed annual investment rate of return was reduced gradually from 8.5% in 2010 to 6.9% in 2016. This revised assumption is more realistic in KBRA's view and has contributed to a trend of significant growth in annual contribution requirements.

On July 31, 2017, the General Assembly approved an agreement between the State and State Employee Bargaining Agent Coalition (SEBAC) which made substantial changes to pension and healthcare benefits for employees and retirees, including a three-year wage freeze, increased employee pension contributions for existing SERS members, a reduced COLA formula and a change in timing for post-2022 retirees, revisions to the healthcare design plan, and cost sharing for current employees. The State also agreed to extend the expiration date of the existing agreement with SEBAC on pension and healthcare from 2022 to 2027.

The 2017 agreement extended the amortization end date for approximately 4/5ths of the outstanding unfunded liability from 2032 to 2047. The 2019 Budget Act for the 2020-2021 extended amortization for the remaining 1/5th of the unfunded liability to 2047, which is anticipated to reduce the ADEC by approximately $157 million annually in FY 2020 and $168 million FY 2021.

Teacher's Retirement System (TRS)
TRS is a single-employer defined benefit pension plan administered by the Teachers' Retirement Board (TRB) for teachers, principals and other education supervisors employed in public school districts. Connecticut pays the entire ADEC on behalf of participating school districts and public universities. The teachers also contribute.

In April 2008, Connecticut issued $2.3 billion in taxable Pension Obligation Bonds (POB) which was deposited into the Teachers' Retirement Fund. Under the bond documents, the State covenants to contribute 100% of the ADEC based on the then current closed amortization period ending in 2032. However, as part of the 2019 Budget Act for the 2020-2021 biennium, the State extended the amortization period 17 years, utilizing a level dollar amortization which reduces the ADEC an estimated by $183 million and $188 million, in FYs 2020 and 2021, respectively. To compensate for the modification, a Special Capital Reserve Fund (SCRF) was established for the benefit of the POB holders, with a deposit of $380.9 million in June 2019. In addition, net lottery revenues are pledged to replenish the SCRF in the event of a draw. Furthermore, the assumed investment rate of return was reduced to 6.9% from 8%. The State Attorney General opined that these changes provide adequate protection to the POB bondholders.

FIGURE 3

Pension Funded Status as of June 30, 2019 (dollars in millions)

	SERS	TRS	Total
Market Value of Assets	$13,276	$17,947	$31,223
Actuarial Accrued Liability	36,088	34,712	70,800
Unfunded Actuarial Accrued Liability	22,293	16,760	**39,053**
Funded Ratio (based on the market value of assets)	36.8%	51.7%	44.1%
FY 2019 Actuarially Determined Employer Contribution (ADEC)	1,575	1,292	**2,867**
% of ADEC Contributed	100%	100%	

Source: State of Connecticut Annual Information Statement dated February 15, 2020 with May 1, 2020 supplementary information.

Net Pension Liability

The State's net pension liability (NPL), based on GASB 68 reporting requirements, represents a combined liability for all of the State pension funds, SERS, TRS and JRS. The NPL begins with the total actuarial pension liability based upon the entry age normal actuarial method. From this amount, the market value of invested pension fund assets is deducted and the balance is the NPL.

The combined NPL is $34.8 billion as of June 30, 2019 as shown in the State's FY 2019 CAFR. This NPL ranks among highest in the country when compared to population, personal income, and GSP (Figure 4). In FY 2019, the State's combined contribution toward pensions was $2.90 billion including $1.58 billion to SERS, $1.29 billion to TRS, and $27 million to JRS. This total contribution was equivalent to 9.6% of FY 2019 total governmental expenditures.

FIGURE 4

Net Pension Liability (NPL) Ratios
(in dollars)

	Connecticut	Average of U.S. States	Connecticut Rank Among the 50 States
Net Pension Liability:			
Per Capita	$9,767	$1,929	Highest 10%
as a % of Personal Income	12.3%	3.3%	Highest 10%
as a % of GSP	12.2%	3.0%	Highest 10%

Source: U.S. Census Bureau, U.S. Bureau of Economic Activity, Credit Scope, and Annual Disclosures.

The State has fully funded the ADEC for the SERS plan since 2012 and on the TRS plan since 2006, but the funded status of the two plans has eroded in part because actual investment returns have lagged assumptions. The revised return assumptions assume that investment returns will provide a smaller portion of the cashflows needed to maintain the plans, resulting in increased State contributions. Seen below, contributions to SERS and TRS are anticipated to increase to $3.1 billion in FY 2021.

FIGURE 5

Actually Determined Employer Contributions for ERS and TRS FYE June 30 (dollars in millions)	2017	2018	2019	2020	2021
ERS	$1,569	$1,443	$1,575	$1,616	$1,807
TRS	$1,012	$1,271	$1,292	$1,209	$1,250
Total	**$2,581**	**$2,714**	**$2,867**	**$2,825**	**$3,057**
% Δ YOY	*3.7%*	*5.1%*	*5.6%*	*-1.4%*	*8.2%*

Source: State of Connecticut Annual Information Statements, and State of Connecticut Preliminary Official Statement.

Other Post-Employment Benefits (OPEB)

Connecticut provides healthcare and life insurance benefits to eligible state employees. The State funds the benefit costs on a pay as you go basis, as do most states, through a transfer from the General Fund to its OPEB trust fund. Beginning in 2009, new hires had OPEB trust contribution requirements. The most recent SEBAC contract requires employee trust contributions of 3% of salary for 15 years for employees hired on or after July 1, 2017. In FY 2019, the State's contribution to retiree healthcare and life insurance costs was $788 million, which represents 2.6% of FY 2019 total governmental expenditures.

Total Fixed Costs

Total FY 2019 fixed costs, including debt service, pension contributions and pay-as-you-go OPEB costs, represented 21.8% of total governmental expenditures.

RD 3: Financial Performance and Liquidity Position

The State's financial position trended favorably in FY 2018 and FY 2019, lifted by better than budgeted income tax receipts and sales tax collections in the General Fund. State statutes direct the Comptroller to deposit any unappropriated GF surplus to the BRF. Recent legislative reforms establish a revenue volatility cap whereby collections from certain volatile sources above a certain threshold are deposited to the BRF. Substantially better than projected PIT collections allowed the Budget Reserve Fund (BRF) to grow from $213 million in FY 2017 to a strong $2.5 billion at the close of FY 2019. The sizable reserves well position the State to manage the impact of the pandemic.

FY 2020 and FY 2021 General Fund Outlook

KBRA has reviewed the latest OPM report on the General Fund (released April 30, 2020). As a result of the pandemic, the report indicates FY 2020 revenues are estimated at $1.1 billion under budget. Transfers from the BRF are expected to close the projected GF operating deficit, and the estimated ending BRF balance is $1.9 billion, which is a still sizable 9.7% of expenditures (see Figure 6). The largest categories of budgetary variance are personal income taxes ($490 million), sales and use tax ($257 million) and federal grants ($203.7 million). The federal grants account shortfall is due to an expected delay in federal reimbursement related to hospital supplemental payments.

Looking ahead to FY 2021, the State is projecting a $2.0 billion GF operating deficit, but expects to enact measures to close the gap so as to maintain a balance of $1.9 billion in the BRF.

Figure 6

General Fund Operations and BRF Balance FYE June 30 ($ in millions) (Budgetary Basis)	FY 2020 Estimated	FY 2021 Estimated
Prospective Operations		
Revenues	18,485	18,088
Expenditures	19,419	20,250
Surplus (Deficit)	**(934)**	**(2,161)**
as a % of Expenditures	-4.8%	-10.7%
Budget Reserve Fund Balance		
Beginning BRF Balance	2,506	1,890
Operating Surplus (Deficit)	(934)	(2,161)
Volatility Cap Deposit	318	-
Estimated Ending BRF Balance	**1,890** -	see note*
as a % of Expenditures	*9.7%*	

Source: State of Connecticut

*State assumes actions will be taken to maintain balance of BRF at $1.89 billion.

Adopted Biennium Budget
On June 4, 2019 the State Legislature passed the FYs 2020–2021 Biennium Budget. Budgetary initiatives included expansion of the sales tax base, pension restructuring and labor reforms. The budget retains the FY 2019 structure of hospital user fees charged by the state, and maintains a 10% corporate tax surcharge ($60 million in FY 2020). Larger components of additional revenues in FY 2020 are derived from adjusting the diversion of the car sales tax to the Special Transportation Fund, a 1% prepared food tax, and expansion of the sales tax base to include digital downloads. Income taxes benefit from maintaining eligibility limits for property tax credits and a reduction in the pass-through entity tax credit. Appropriation initiatives include reforms to the teachers' pension costs, for budgeted expenditure savings of $183 million and $189 million in FYs 2020 and 2021, respectively.

FY 2019 Results
The State's 2019 budgetary basis annual financial report was released on October 31, 2019. The General Fund achieved a $371 million operating surplus, which was deposited to the Budget Reserve Fund. In addition, a volatility cap deposit of $949.7 million was made to the BRF. The ending BRF balance of $2.5 billion represents just over 13% of FY 2020 appropriations. Strengthened reserves will help the State in weathering economic downturns.

As shown in Figure 7, FY 2019 budgetary basis GF revenue growth is a sizable 8%. The revenue growth is overstated due to the timing of Medicaid reimbursement, as $400 million of revenue recorded in FY 2019 is attributable to FY 2018. Adjusting for this event, FY 2019 budgetary basis GF revenue growth is a still favorable 3.5%. Several revenue categories outperformed budget, including income taxes ($518 million favorable budgetary variance), pass through entity taxes ($572 million variance) and sales taxes ($184 million variance).

While PIT collections exceeded budget, PIT revenues declined relative to the previous year reflecting the absence of the extraordinary impact in FY 2018 from federal tax reform. However, the PIT decline is offset by pass-through entity income taxes collections which started in FY 2019. Under federal tax law changes effective January 1, 2018, pass-through businesses (sole proprietors, partnerships and S-corporations) gained a 20 percent deduction, incentivizing organizing and reporting as a pass-through entity. The strong sales tax collections reflect increased collection from online sales, partially due to the U.S. Supreme Court decision Wayfair, Inc. v. South Dakota.

FY 2019 expenditures increased $638 million (3.4%) over the prior year, with the majority of expense growth attributable to three spending areas: a transfer to the new TRS Special Capital Reserve Fund created for the benefit of POB bonds issued in 2008 ($380 million), SER retirement contribution ($115.8 million) and Medicaid costs ($93.9 million). The Special Capital Reserve Fund was established in June 2019 to comply with the adequate provision requirement of the 2008 GO pension obligation bonds. The State is changing the actuarial funding methodology for the TRS, and this change requires meeting an adequate provision covenant.

The State's discipline in restraining spending in a period of revenue expansion is a credit positive as it enables reserve accumulation and positions the State to manage future declines in its volatile revenue base.

Figure 7

General Fund Statement of Revenues, Expenditures, and Net Surplus Budgetary Modified Cash Basis (FYE June 30) (dollars in millions)	2015	2016	2017	2018	2019
Operating Revenues[1]	17,282	17,781	17,703	18,199	19,650
Operating Expenditures	17,420	17,921	17,763	18,611	19,249
Other Resources	25	(30)	37	(71)	(31)
Operating Surplus (Deficit)	**(113)**	**(170)**	**(23)**	**(483)**	**371**
Transfers (to) from Budget Reserve Fund	113	170	23	483	371
Reserved for Subsequent Years Expenditur	-	-	-	-	-
Reserved for Prior Years Resources	-	-	-	-	-
Unappropriated Surplus (Deficit)	**-**	**-**	**-**	**-**	**-**
Budget Reserve Fund[3]					
Beginning Budget Reserve Fund Balance	519	406	236	213	1,185
Transfers in (out)	(113)	(170)	(23)	(499)	371
Volatility Cap Deposit[2]	-	-	-	1,471	950
Ending Budget Reserve Fund Balance	**406**	**236**	**213**	**1,185**	**2,506**
as a % of Operating Expenditures	*2.3%*	*1.3%*	*1.2%*	*6.4%*	*13.0%*

Source: Annual Financial Reports of the State Controller

[1]FY 2018 and FY 2019 revenue is reported net of volatility deposits to the BRF.

[2]Volatility transfers became effective in FY 2018.

[3]Held in Special Revenue Fund.

Figure 8

General Fund Revenues and Expenditures Budgetary Modified Cash Basis (FYE June 30) (dollars in millions)	2015	Δ YOY (%)	2016	Δ YOY (%)	2017	Δ YOY (%)	2018	Δ YOY (%)	2019
Revenues									
Personal Income Tax	9,151	0.3%	9,182	-2.1%	8,989	19.8%	10,770	-10.5%	9,640
Federal Grants	1,241	4.9%	1,302	1.8%	1,325	-13.7%	1,143	82.3%	2,084
Sales and Use Tax	4,205	-0.6%	4,182	0.2%	4,192	0.2%	4,202	3.2%	4,338
Corporate Income Tax	815	8.1%	880	17.8%	1,038	-11.3%	921	15.2%	1,061
Pass-through Entity Tax									1,172
Excise Taxes (Alcohol and Cigarettes)	420	3.9%	437	1.8%	445	-1.1%	440	-4.0%	422
Indian Gaming Payments	268	-0.8%	266	1.5%	270	1.1%	273	-6.6%	255
Statutory Transfers from Other Funds	135	31.4%	178	-33.5%	118	-7.3%	110	0.0%	110
Other	1,046	29.5%	1,355	-2.1%	1,326	-74.4%	340	67.1%	568
Total Revenues	**17,282**	2.9%	**17,781**	-0.4%	**17,703**	2.8%	**18,199**	8.0%	**19,650**
Expenditures									
General Government	661	-5.1%	627	-6.8%	585	10.7%	648	0.8%	653
Public Safety	287	0.5%	289	-4.9%	274	-5.3%	260	4.7%	272
Conservation and Development	206	-5.3%	195	-7.1%	181	0.0%	181	-6.2%	170
Health and Hospitals	1,785	-1.1%	1,766	-32.6%	1,190	-2.2%	1,163	2.6%	1,194
Human Services	3,096	0.2%	3,102	16.9%	3,625	18.4%	4,292	0.5%	4,312
Education, Libraries and Museums	5,025	1.9%	5,122	-2.3%	5,004	0.4%	5,025	3.7%	5,208
Corrections and Judicial	2,070	-0.5%	2,061	-5.4%	1,949	-2.0%	1,911	3.0%	1,968
Debt Service	1,554	17.8%	1,831	5.7%	1,935	1.1%	1,956	13.8%	2,225
Other	2,735	7.1%	2,929	3.1%	3,020	5.1%	3,175	2.3%	3,247
Total Expenditures	**17,420**	2.9%	**17,921**	-0.9%	**17,763**	4.8%	**18,611**	3.4%	**19,249**

Source: Annual Financial Report of the State Controller

FY 2019 Audited GAAP Results

Audited results from the State's FY CAFR confirm favorable performance in FY 2019 as a $968 million net change in General Fund balance, equivalent to 4.7% of revenues, allowed the State to increase the Budget Reserve Fund balance to $2.5 billion from $1.2 billion

FIGURE 9

General Fund Summary Statement of Income and Balance Sheet
FYE June 30 (Audited, GAAP Basis) (dollars in millions)

	2015	2016	2017	2018	2019
Statement of Income					
Revenues	17,954	18,215	18,502	20,663	20,776
Expenditures	16,936	17,444	17,138	18,077	18,358
Excess (Deficiency) of Rev. Over Exp.	1,018	771	1,364	2,586	2,418
Other Financing Sources (Uses)	(1,166)	(1,195)	(1,243)	(940)	(1,451)
Net Change in Fund Balance	**(148)**	**(424)**	**121**	**1,646**	**968**
Fund Balance (Deficit) - Beginning	(41)	(190)	(614)	(494)	1,151
Change in Reserve for Inventories	(1)	(0)	(1)	(0)	2
Fund Balance (Deficit) - Ending	**(190)**	**(614)**	**(494)**	**1,151**	**2,121**
Balance Sheet					
Assets					
Cash and Cash Equivalents	-	-	-	481	1,927
Taxes Receivable, Net	1,220	1,321	1,381	1,801	1,781
All Other	659	532	543	1,041	709
Total Assets	**1,880**	**1,853**	**1,924**	**3,323**	**4,417**
Liabilities					
Accounts Payable and Accrued Liabilities	**346**	**334**	**350**	**373**	**358**
Due to Other Funds	**324**	**432**	**356**	**84**	**75**
All Other	**971**	**1,123**	**1,062**	**1,030**	**1,049**
Total Liabilities	**1,641**	**1,889**	**1,768**	**1,487**	**1,482**
Deferred Inflows of Resources	428	578	650	685	814
Fund Balances					
Nonspendable	51	53	54	56	62
Committed for:	-	-	-	-	-
Continuing Appropriations	65	97	60	134	165
Budget Reserve Fund	**406**	**236**	**213**	**1,201**	**2,506**
Future Budget Years	81	-	-	-	-
Assigned to Surplus Transfer for 2020-2021	-	-	-	-	160
Unassigned	(793)	(999)	(821)	(241)	(771)
Fund Balance (Deficit) - Ending	(190)	(614)	(494)	1,151	2,121
Budget Reserve Fund as a % of Expenditures	*2.4%*	*1.4%*	*1.2%*	*6.6%*	*13.6%*
Unassigned Fund Balance as a % of Expenditures	*-4.7%*	*-5.7%*	*-4.8%*	*-1.3%*	*-4.2%*
Total Fund Balance as a % of Expenditures	*-1.1%*	*-3.5%*	*-2.9%*	*6.4%*	*11.6%*

Source: State of Connecticut CAFRs FY 2015 to FY 2019.

Liquidity Position

The common cash pool represents the State's operating cash and includes the Budget Reserve Fund (Figure 10). Available cash includes bond funds and other balances which can be made available to the common cash pool through temporary transfers under long established State practice. The State's level of cash in the common cash pool at a given point in the fiscal year reflects the seasonality of cash flow. The level of total available cash is impacted both by the rate of bond issuance and the rate of spending from those bond funds. The State has no plans to issue cash flow notes.

FIGURE 10

Available Cash Balance
FYE June 30 (dollars in millions)

	2015	2016	2017	2018	2019
Common Cash Pool	$1,092	$821	$1,101	$1,871	$3,558
Total Available Cash	$2,218	$1,764	$2,657	$3,399	$4,827

Source: State of Connecticut Treasurer's Office | Treasurer's Cash and Debt Monthly Reports.

The State's strong liquidity position strengthened in FY 2019 and the State Treasurer's Office reports that weekly available cash balances since January have remained strong, ranging from $3.7 billion to $5.3 billion through April 25, 2020, including a $4.86 billion balance as of the last reported week.

Fiscal Accountability Report for FYs 2020-2024

State Statutes require OPM and the Office of Fiscal Analysis to prepare a Fiscal Accountability Report, analyzing issues affecting spending and revenue for the current biennium and the succeeding three fiscal years. KBRA views the report as a valuable tool for policymakers to identify and highlight upcoming fiscal issues. Among the components of the report is an analysis of year over year GF expected revenue growth and fixed cost growth. In FY 2020, GF revenues are projected to decline as sales tax transfers to the Municipal Revenue Sharing Account commence. In addition, the State plans to complete the five year phase-in of dedication to 100% of car sales tax receipts to the Special Transportation by FY 2023. Decision makers will address the challenge of this revenue loss in the next biennium budget.

RD 4: State Resource Base

The State's economic base is highly developed but has experienced slow growth in recent years. Per capita personal income ranks first among the 50 States and high levels of educational attainment and low levels of poverty position the State well relative to peers in several areas. Population growth, however, has been flat since 2010 as the New England region and U.S. have grown more rapidly at 2.6% and 6.1%, respectively. Per capita personal income levels have also grown slowly in recent years and real gross state product (GSP) through 2019 has been nearly flat since 2010.

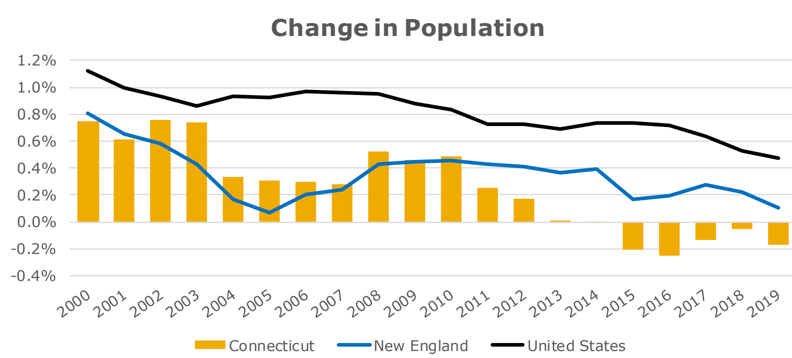
The State however continues to benefit from a diverse and highly productive economic base. In 2019, 14 "Fortune 500" companies were headquartered in Connecticut, including United Technologies Corporation (UTC), Cigna, Charter Communications, Hartford Financial Services and Stanley Black & Decker. The defense industry is an important component of the State's economy and has demonstrated renewed strength since 2002, a trend that is expected to continue. Major defense companies include UTC and its Pratt and Whitney Aircraft Division, Sikorsky Aircraft (a division of Lockheed Martin), and General Dynamics Corporation's Electric Boat Division.

UTC, historically headquartered in Hartford, CT completed a merger with Raytheon Company in April 2020 to form Raytheon Technologies. The consolidated entity is headquartered in Waltham, MA but Governor Lamont has stated that nearly all of UTC's 19,000 employees will remain in Connecticut, with approximately 100 moving to the new headquarters.

Population

Total population has dropped slightly over the last five years, lagging the positive growth of the region and U.S.

FIGURE 11



	2010	2019	Δ 2010 to 2019 (%)
Connecticut	3,579,114	3,565,287	-0.4%
New England	14,469,650	14,845,063	2.6%
U.S.	309,321,666	328,239,523	6.1%

Source: U.S. Census Bureau

Educational Attainment, Poverty, and Age Groups

Educational attainment in Connecticut and the New England region is high relative to the U.S. Poverty in the State is well below the U.S. average. Connecticut's proportion of working age individuals is higher than the U.S.

FIGURE 12

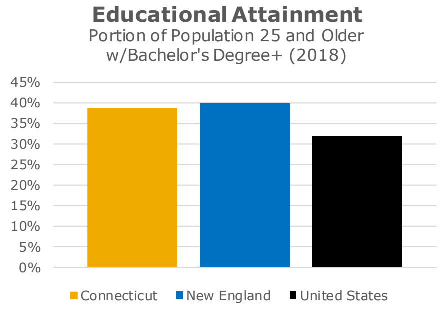


FIGURE 13

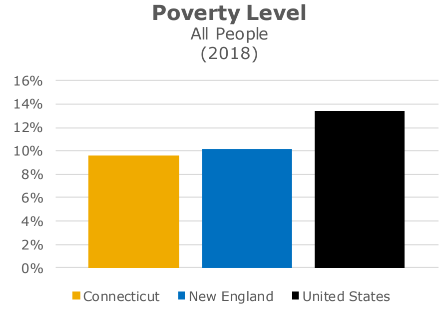
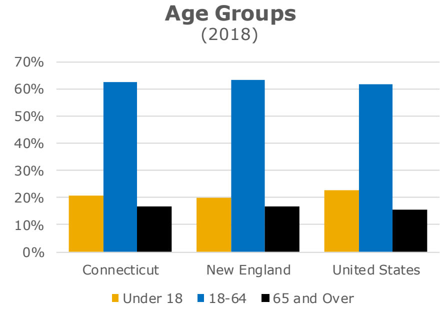


FIGURE 14



Educational Attainment

	2010	2018	Point Δ 2010 to 2018
Connecticut	35.5%	39.6%	4.1
New England	35.6%	37.5%	1.9
United States	28.2%	32.6%	4.4

Source: U.S. Census

Poverty Level

	2010	2018	Point Δ 2010 to 2018
Connecticut	10.1%	10.4%	0.3
New England	11.2%	10.3%	-0.9
United States	15.3%	13.1%	-2.2

Source: U.S. Census

Age Groups

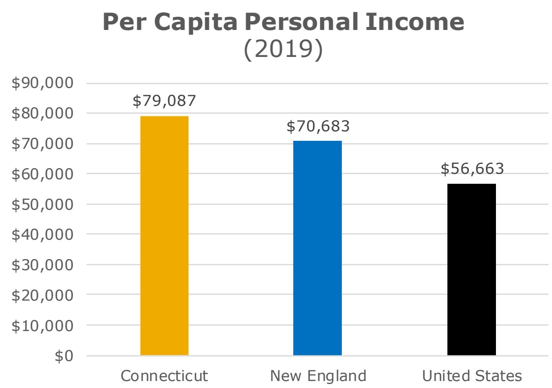
	Under 18	18-64	65 and Over
Connecticut	20.7%	62.5%	16.8%
New England	19.9%	63.2%	16.9%
United States	22.6%	61.8%	15.6%

Source: U.S. Census

Per Capita Personal Income

Per capita personal income at $79,087 in 2019 is the highest in the country reflecting the concentration of the State's economy in high value-added industries. Per capita personal income growth however has lagged since 2010.

FIGURE 15



Per Capita Personal Income

	2010	2019
Connecticut as a % of New England	119%	112%
Connecticut as a % of United States	153%	140%

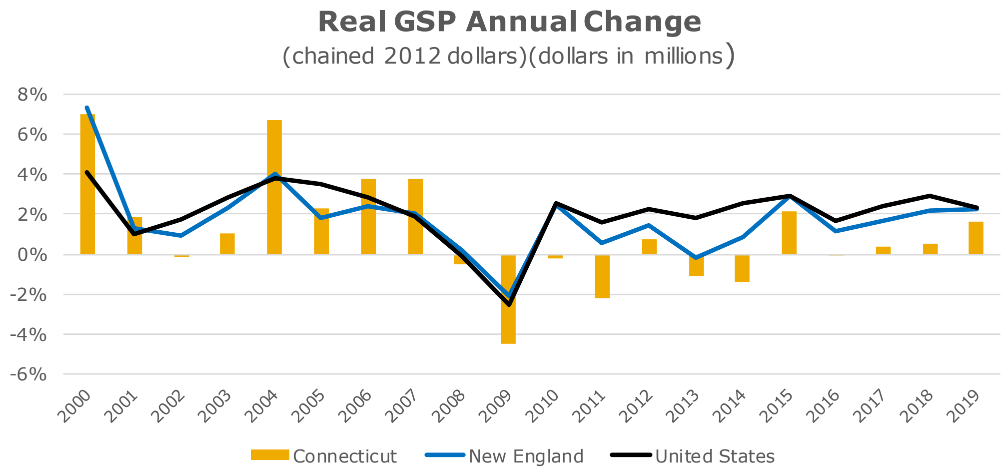
Source: Bureau of Economic Analysis

Real Gross State Product

Connecticut's real (inflation adjusted) GSP experienced a more pronounced decline and weaker recovery following the Great Recession than the region and U.S. overall, contracting in seven of the last twelve years. In KBRA's view, the decline reflects poor performance in the State's pharmaceuticals and financial activities sectors, both of which were outsized contributors to growth in the decade preceding the Great Recession. The financial activities sector has declined from 31.0% of GSP in 2009 to 27.7% in 2019. Pharmaceutical sector activity has additionally declined due to the reduction of activity in the State by Pfizer, Bayer, and Bristol Myers Squibb. This drag is evidenced by the decline in chemical manufacturing as a share of total GSP from 7.5% in 2006 to 1.7% in 2017.[1]

[1] Most recent GSP data for chemical manufacturing sector is 2017.

FIGURE 16



($ in Millions)	2010	2019	% Δ 2010 to 2019
Connecticut	247,461	248,819	0.5%
New England	871,810	989,428	13.5%
United States	15,598,753	19,073,056	22.3%

Source: U.S. Bureau of Econocmic Analysis

Employment

Unemployment has tracked closely with the U.S. over the last decade but trailed the performance of the region. The State unemployment rate was 3.9% as of March 2020, which was somewhat higher than the New England region (3.6%) but lower than the U.S. (4.5%).

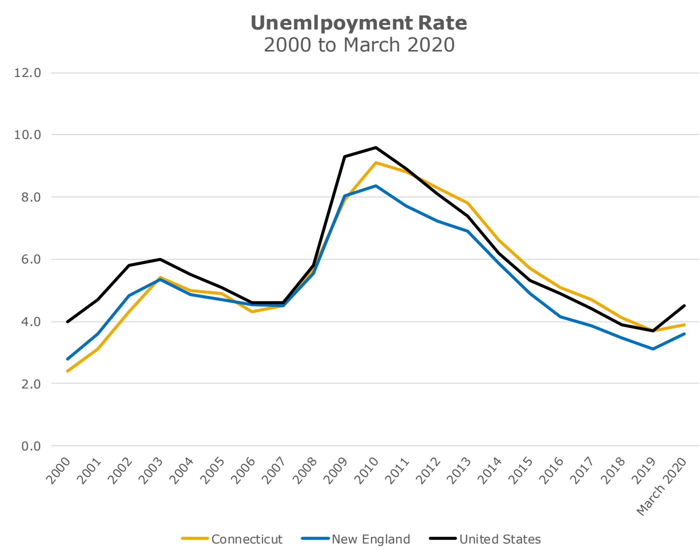
FIGURE 17

Employment (Not Seasonally Adjusted) (in thousands)

Year	Connecitcut	Δ YOY (%)	New England	Δ YOY (%)	United States	Δ YOY (%)
2000	1,722		7,131		136,891	
2001	1,705	-1.0%	7,127	0.0%	136,933	0.0%
2002	1,697	-0.4%	7,116	-0.2%	136,485	-0.3%
2003	1,688	-0.5%	7,103	-0.2%	137,736	0.9%
2004	1,686	-0.1%	7,115	0.2%	139,252	1.1%
2005	1,709	1.4%	7,168	0.7%	141,730	1.8%
2006	1,749	2.3%	7,260	1.3%	144,427	1.9%
2007	1,773	1.4%	7,304	0.6%	146,047	1.1%
2008	1,775	0.1%	7,278	-0.4%	145,362	-0.5%
2009	1,741	-1.9%	7,109	-2.3%	139,877	-3.8%
2010	1,737	-0.2%	7,103	-0.1%	139,064	-0.6%
2011	1,746	0.5%	7,141	0.5%	139,869	0.6%
2012	1,730	-0.9%	7,171	0.4%	142,469	1.9%
2013	1,718	-0.7%	7,197	0.4%	143,929	1.0%
2014	1,763	2.6%	7,342	2.0%	146,305	1.7%
2015	1,781	1.0%	7,426	1.1%	148,834	1.7%
2016	1,794	0.8%	7,525	1.3%	151,436	1.7%
2017	1,808	0.8%	7,632	1.4%	153,337	1.3%
2018	1,822	0.8%	7,765	1.7%	155,761	1.6%
2019	1,842	1.1%	7,844	1.0%	157,538	1.1%
March 2019	1,820		7,766		156,441	
March 2020	1,837	0.9%	7,713	-0.7%	155,167	-0.8%
Growth 2007/2008 Cyclical Peak to 2019	**3.8%**		**7.4%**		**7.9%**	

Source: US Bureau of Labor Statistics

FIGURE 18



Source: US Bureau of Labor Statistics

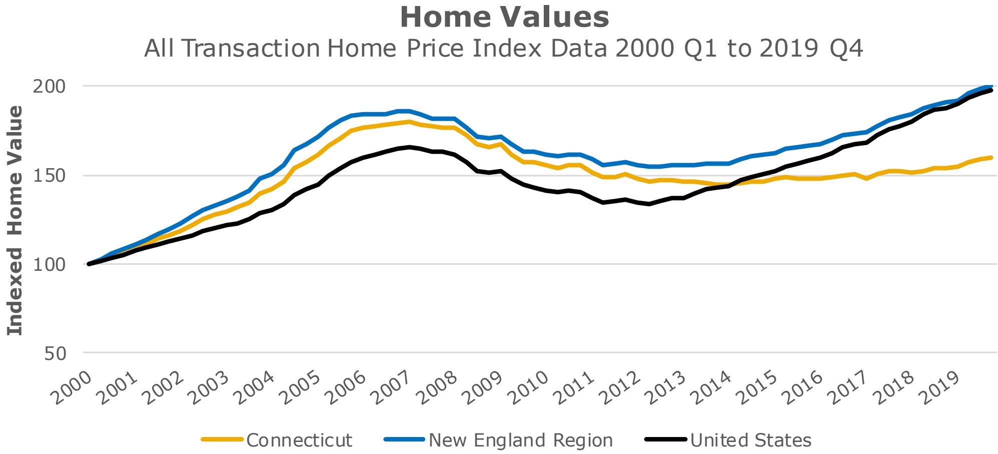
Preliminary March 2020 employment increased 0.9% year over year despite the phase in of social distancing measures implemented mid-month in response to the COVID-19. KBRA anticipates that employment data for Connecticut in coming months will show deterioration. Initial weekly unemployment claims in Connecticut ranged from 3,000 to 8,000 in 2020 through March 14th but have subsequently average near 44,000 in each of the last six weeks through Aril 25th.

While the duration and severity of COVID-related disruption remains to be seen, a pronounced recessionary environment appears increasingly likely in the near term both in Connecticut and nationally.

Home Value

State home value appreciation has lagged the region and the U.S. by a significant margin since the year 2000. As of Q4 2019, home values are 11.3% below their prior Q1 2007 peak compared to region and U.S. home values which rest 7.9% and 19.3%, respectively, in excess of their prior highs.

Figure 19



Source: Federal Housing Finance Agency