Commission on Fiscal Stability and Economic Growth

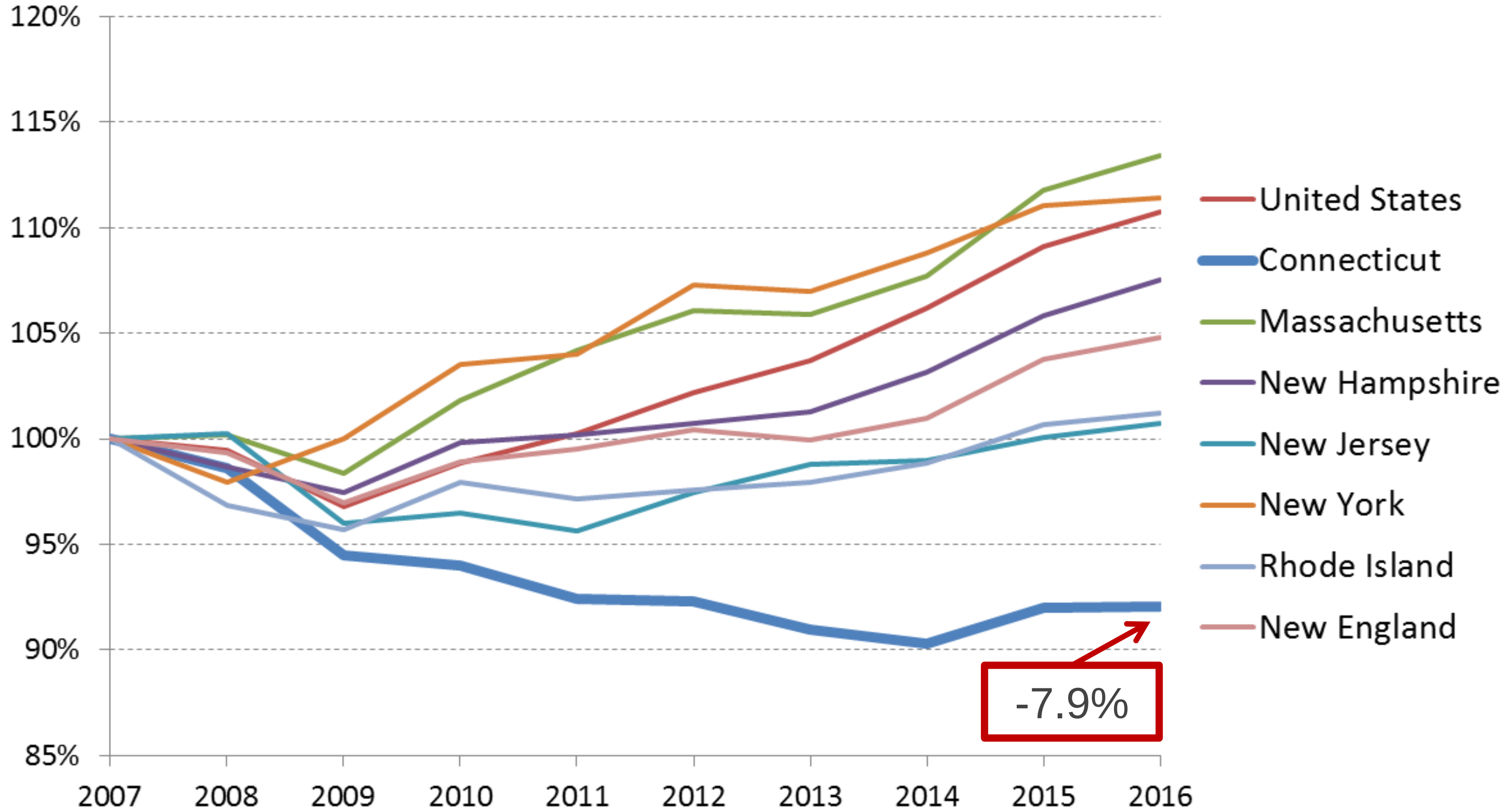
Commission Meeting
March 1, 2018

Current Connecticut Situation

Commission on Fiscal Stability and
Economic Development

Connecticut real gross state product still remains 8% below 2007 levels; lagging neighboring states and national averages

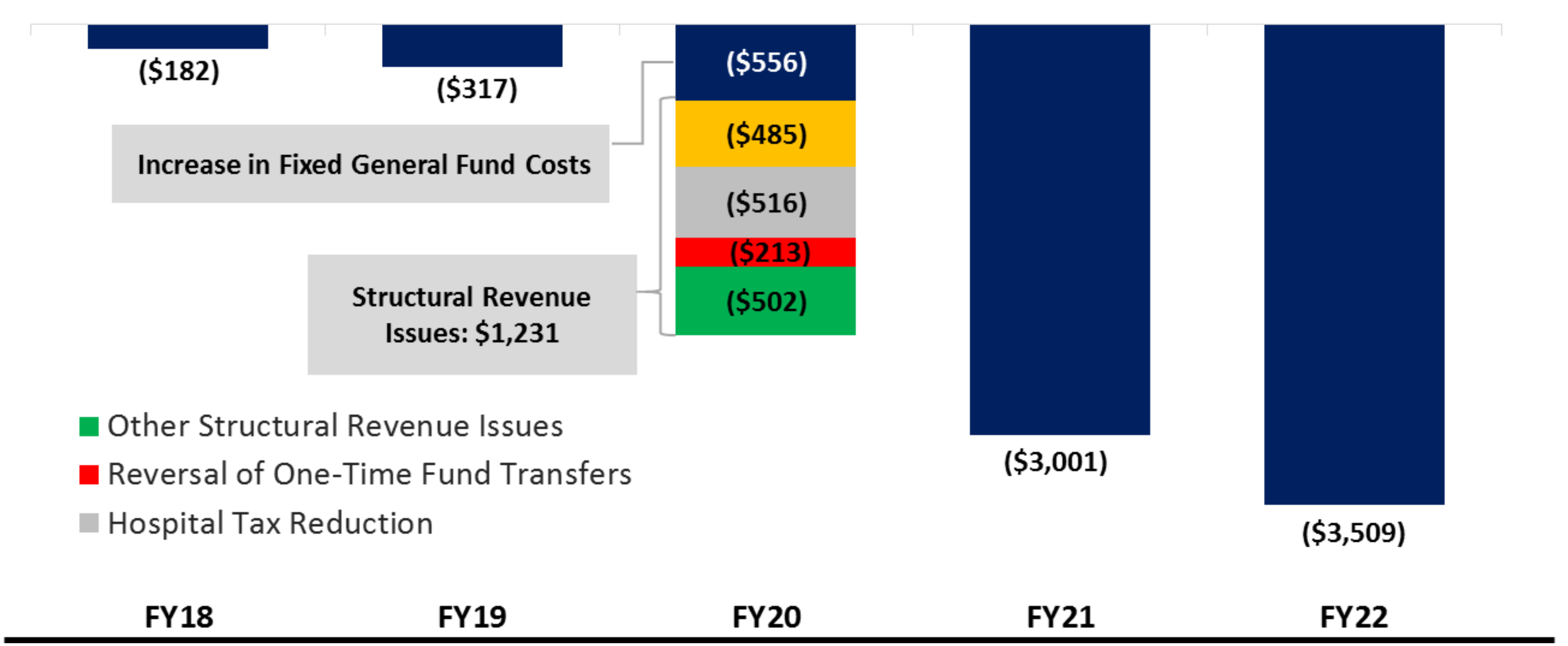
Indexed Real GDP by state (millions of chained 2007 dollars)



Despite achieving a bipartisan budget, significant out year deficits remain

- To the extent one-time measures in the biennium are reversed as currently contemplated in FY 2020, the budget deficit will grow to be over $2 billion and is expected to increase thereafter

Connecticut State Forecasted Budget Balances ($ in millions)[1]



(1) Source: FY18-19 Biennial Budget, January 2018 Consensus Revenue Estimates, January 2018 OPM Budget Estimates, OFA Out Year Estimates

Fixed expenditure growth is accelerating and fixed costs now represent 52% of total General Fund expenditures in FY18

- Given projected average annual revenue declines of 0.4% from FY 2017 to 2020 and fixed expenditure increases of 5.9%, fixed expenses will consume an increasing portion of the budget

Projected General Fund Revenue and Expenditure Growth[1]

Category *($ in millions)*	Actual FY06[2]	FY17[3]	Projected FY18	FY19	FY20	Annual Growth '06 to '20	'17 to '20
Pension	$884	$2,161	$2,467	$2,552	$2,640	8.1%	6.9%
Retiree Healthcare	411	751	934	1,018	1,077	7.1%	12.8%
Debt Service	1,306	2,076	2,320	2,255	2,410	4.5%	5.1%
Entitlement Programs[4]	2,813	3,787	3,964	4,139	4,322	3.1%	4.5%
Adjudicated Claims	6	21	8	9	8	2.1%	(26.7%)
General Fund Fixed Expenditures	**$5,420**	**$8,795**	**$9,694**	**$9,973**	**$10,458**	**4.8%**	**5.9%**
Total General Fund Expenditures	$14,500	$17,763	$18,720	$18,907	$19,709	2.2%	3.5%
Fixed as % of Total Expenditures	*37%*	*50%*	*52%*	*53%*	*53%*		
General Fund Revenues	$14,999	$17,703	$18,480	$18,625	$17,510	1.1%	(0.4%)
General Fund Surplus (Deficit)	**$499**	**($60)**	**($240)**	**($282)**	**($2,198)**		

Average annual General Fund expenditure growth is projected to accelerate to 3.7% between FY 2020 and FY 2022 as compared to only 0.7% for revenues, adding another $1.2 billion to the annual General Fund deficit over those two years

Source: OFA Fiscal Accountability Report FY17 – FY 20. Connecticut CAFR. 2017 Annual Report of the State Comptroller. OFA Fiscal Note to Enacted Biennium Budget. OPM and OFA January 16, 2018 Consensus Revenue Estimates. OPM January 19, 2018 Budget Letter.

(1) Fixed cost data from OFA Fiscal Accountability Report dated Nov 15, 2016 and is not reflective of enacted budget and projections.

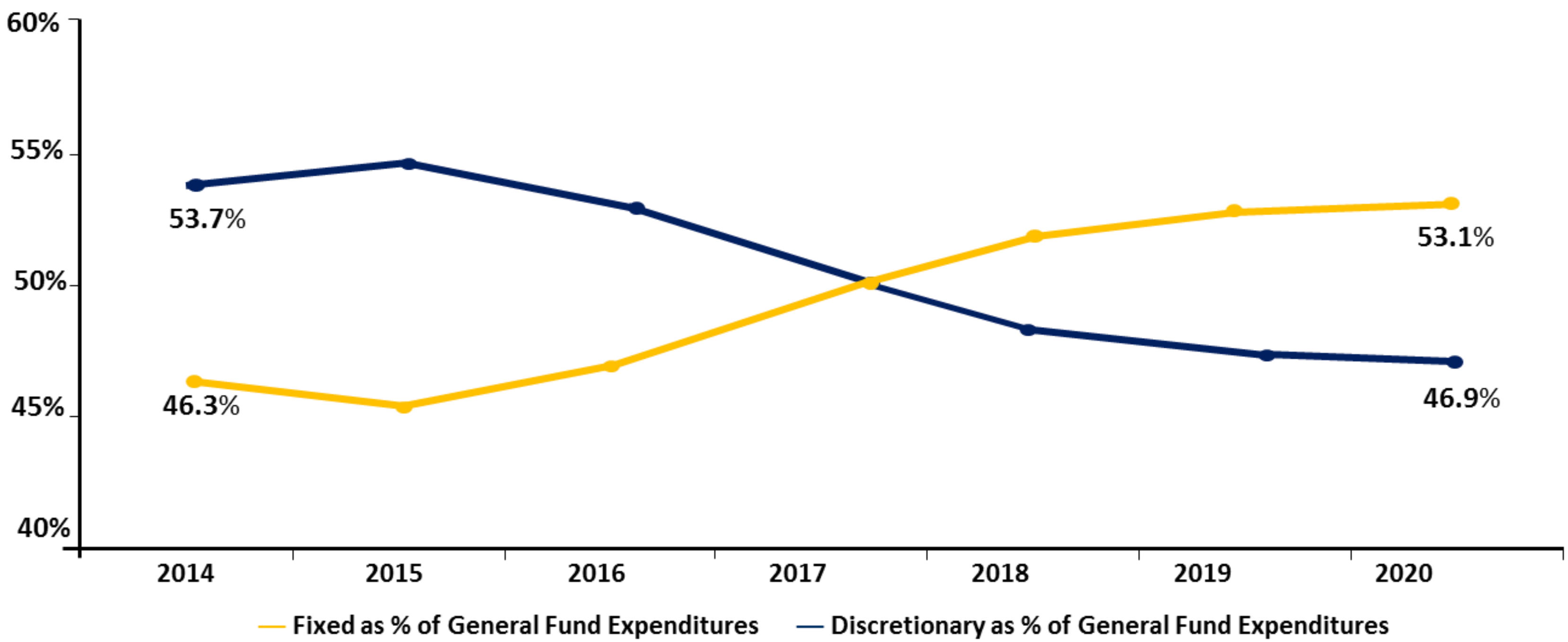
(2) FY06 General Fund revenues and expenditures based on gross funding of Medicaid (includes both federal and local portion).

(3) FY17 General Fund fixed expenditures per OFA Fiscal Accountability Report FY17 – FY20. FY17 total General Fund expenditures and revenues per 2017 State Comptroller's Annual Report.

(4) Includes Medicaid and other services provided by the Department of Social Services, Department of Children and Families, Department of Mental Health and Addiction Services, and Office of Early Childhood.

Fixed costs are growing to over 50% of the general fund, crowding out other spending and investment

General Fund Fixed vs. Discretionary Costs (% of General Fund Expenditures)

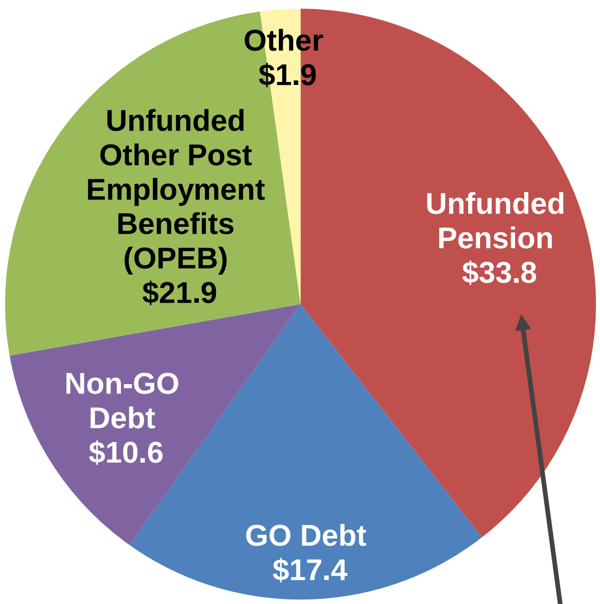


Source: 2014-2016 Annual Reports of the State Comptroller, OFA Fiscal Accountability Report FY17 – FY 20

CT's legacy liabilities are precariously high and trending higher

- The State's $86 billion of total liabilities would increase to nearly $100 billion if the State's pension systems reduced their investment return assumption to 6%[1]

Total Liabilities[2] ($ billions)
$85.5B as of 6/16



State Employees	$20.4
Teachers	13.1
Judicial	0.2
Total	**$33.8**

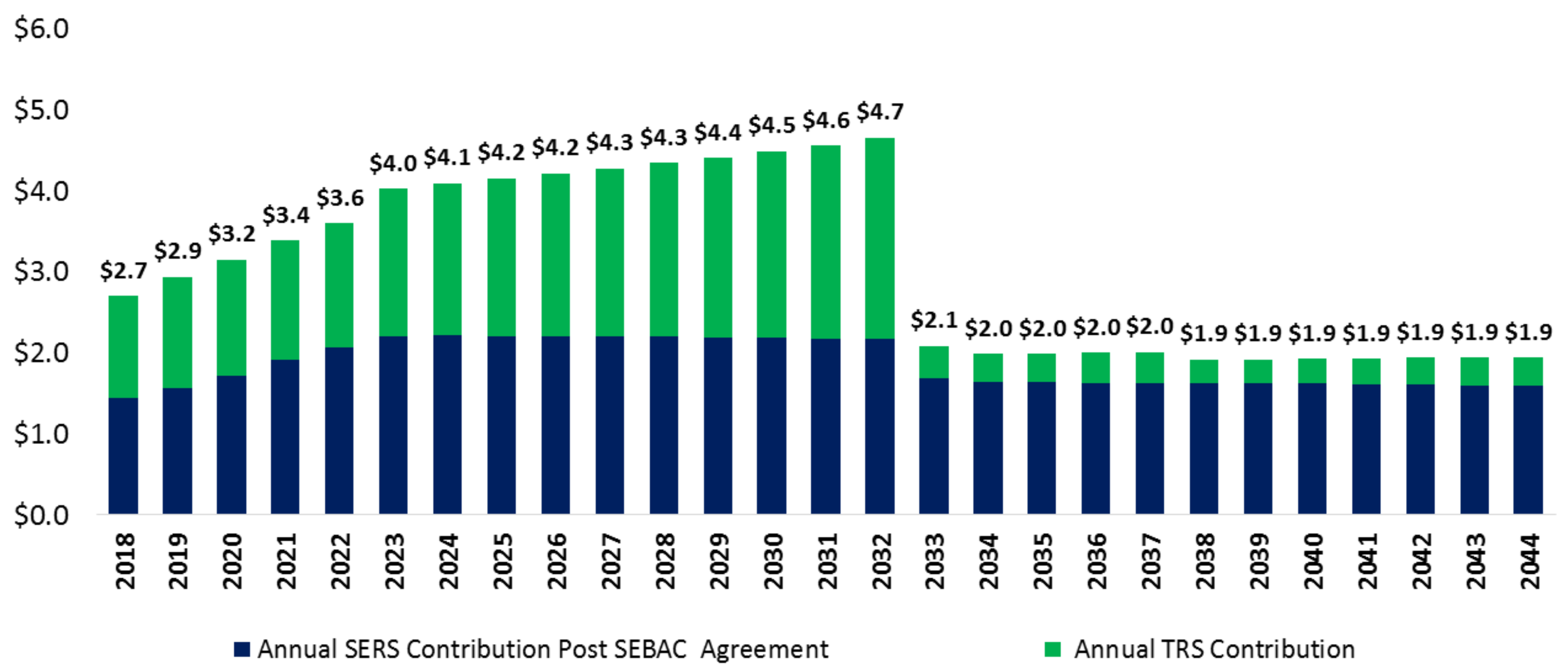
- Debt service to revenue ratio of 13.3% is **highest in the US[3]**
  - 3.0x US mean / 3.2x US median
- Moody's adjusted net pension liability (ANPL) is 20.4% of GDP, **3rd highest in the US[3]**
  - 2.8x US mean / 4.2x US median
- Pension contributions and debt service at 26.5% of revenue is **highest in the US[3]**
  - 3.0x US mean / 3.6x US median
- Net tax supported debt as a % of personal income is 9.7%, **3rd highest in the US[3]**

(1) Sensitivity analysis of pension liabilities per The Pew Charitable Trusts.
(2) State of Connecticut Comprehensive Annual Financial Report, 2016. Debt includes component units. Unfunded pension and OPEB liabilities represent unfunded actuarial accrued liabilities ("UAAL") based on actuarial reports for the State's pension and OPEB systems.
(3) Moody's Investor Service. These ratios have been calculated based on Moody's definitions of debt, pension liabilities, debt service, contributions and own-source governmental revenues (revenues less federal funding), and in most cases will differ from a state's own published calculations or the calculations of other institutions.

Escalating required pension contributions, especially for TRS, exacerbate the State's fiscal challenges

- Utilizing the current discount rate of 8% for TRS, total annual contributions reach $4.7B in 2032

Projected Annual Pension Contributions (excl. JRS) ($ in billions)[1]

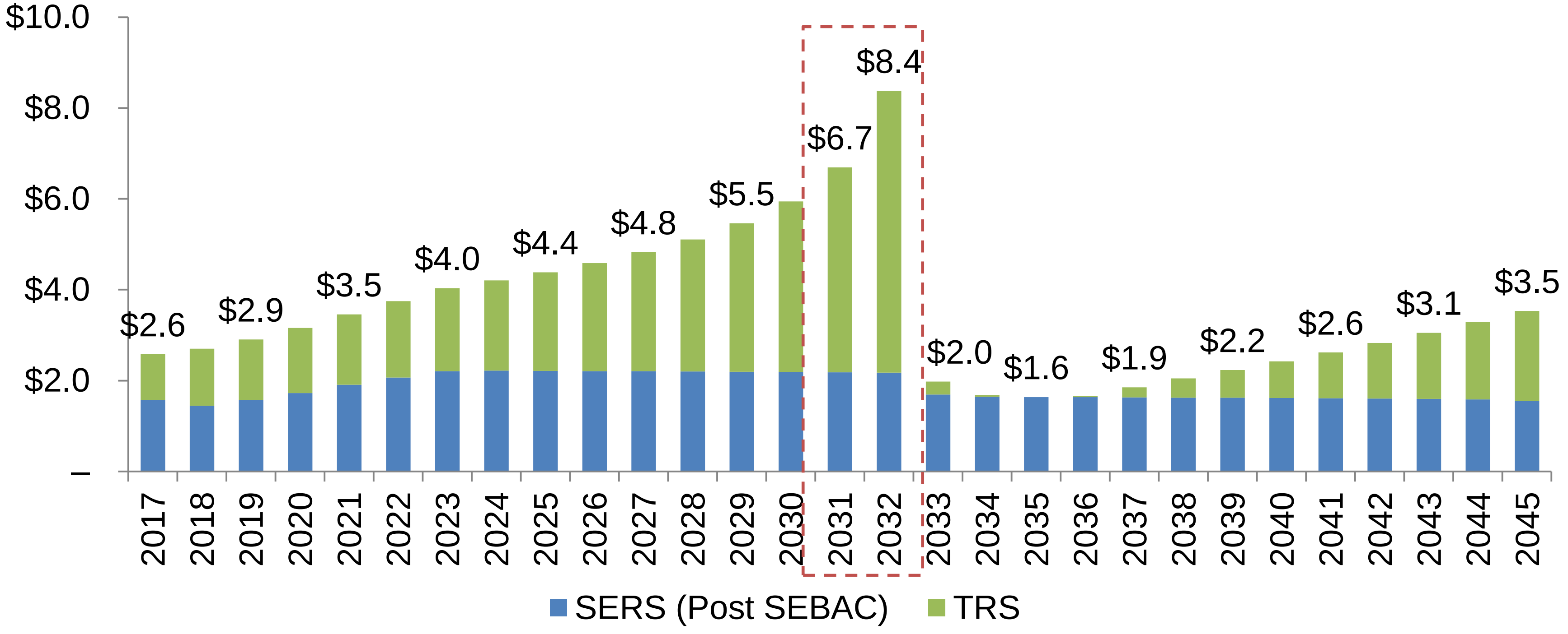


(1) The Pew Charitable Trusts, State Office Policy Management, May 2017 SEBAC Agreement

However if you adopt a more realistic discount rate of 5.5%, the 2032 contributions would be $8.4 billion

- General Fund revenues would need to grow by 8% annually to maintain the FY 2017 ratio of pension contributions to General Fund revenues[1,2]

Projected Annual Pension Contributions (excl. JRS) ($ in billions)[2]

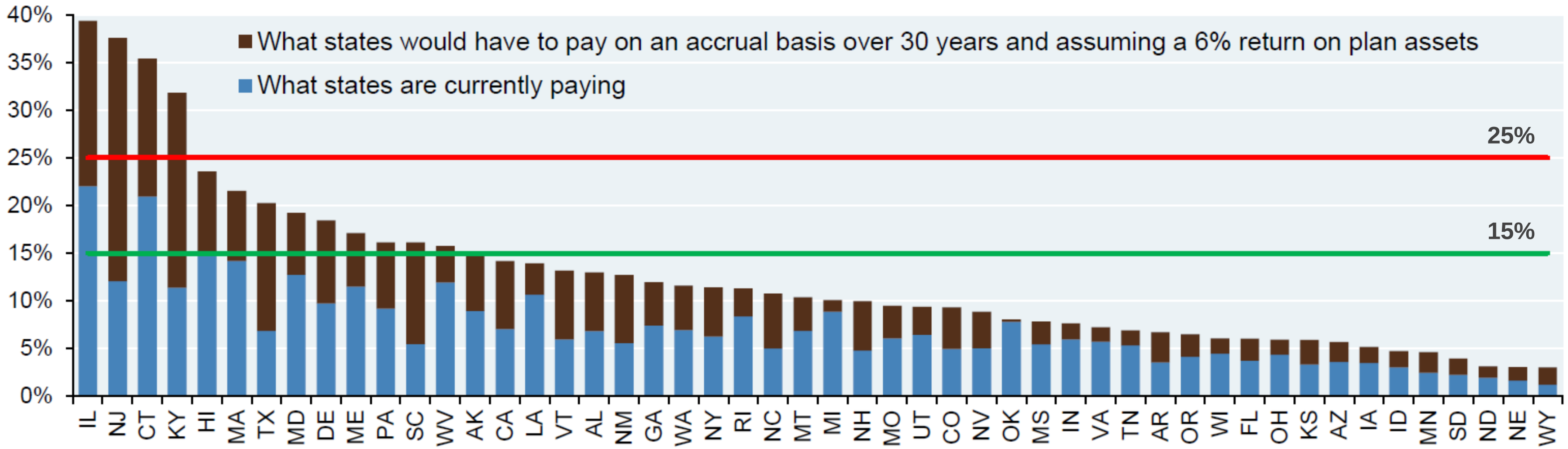


(1) Excludes JRS. 2016 CT CAFR, CT SERS, TRS 2016 Actuarial Valuation Report.
(2) JRS projected contributions unavailable. TRS contributions assume a 5.5% investment return per Center for Retirement Research at Boston College, State Office of Policy and Management. SERS contributions per May 2017 SEBAC Agreement.

Connecticut would need to spend ~35% of state revenues to fund debt and legacy pension and OPEB liabilities on an accrual basis over 30 years, assuming an illustrative 6% return on plan assets[1]

- Connecticut spent ~21% of state revenues to fund debt, pension and OPEB liabilities in FY 2015
- Connecticut would need to either raise revenues by ~14%, cut direct spending by 14%, or increase worker contributions by 699% to meet full accrual payments to retirees

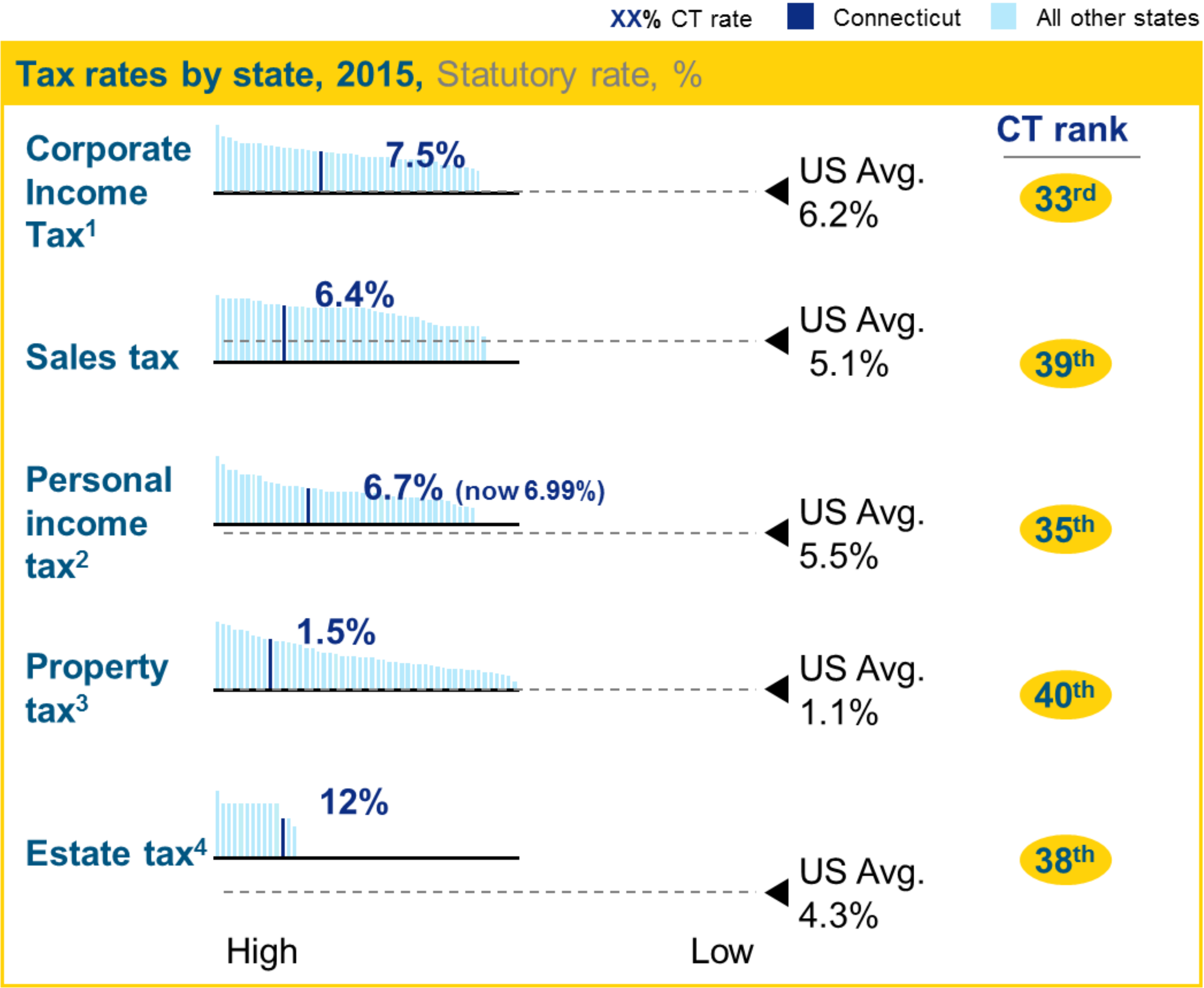
Percent of state revenue collections required to pay the sum of interest on bonds, the state's share of unfunded pension and retiree healthcare liabilities, and defined contribution plan payments



Source: The ARC and the Covenants 2.0, J.P. Morgan Asset Management; State/Pension Plan Comprehensive Annual Financial Reports; Census; Loop Capital Markets. FY 2015.

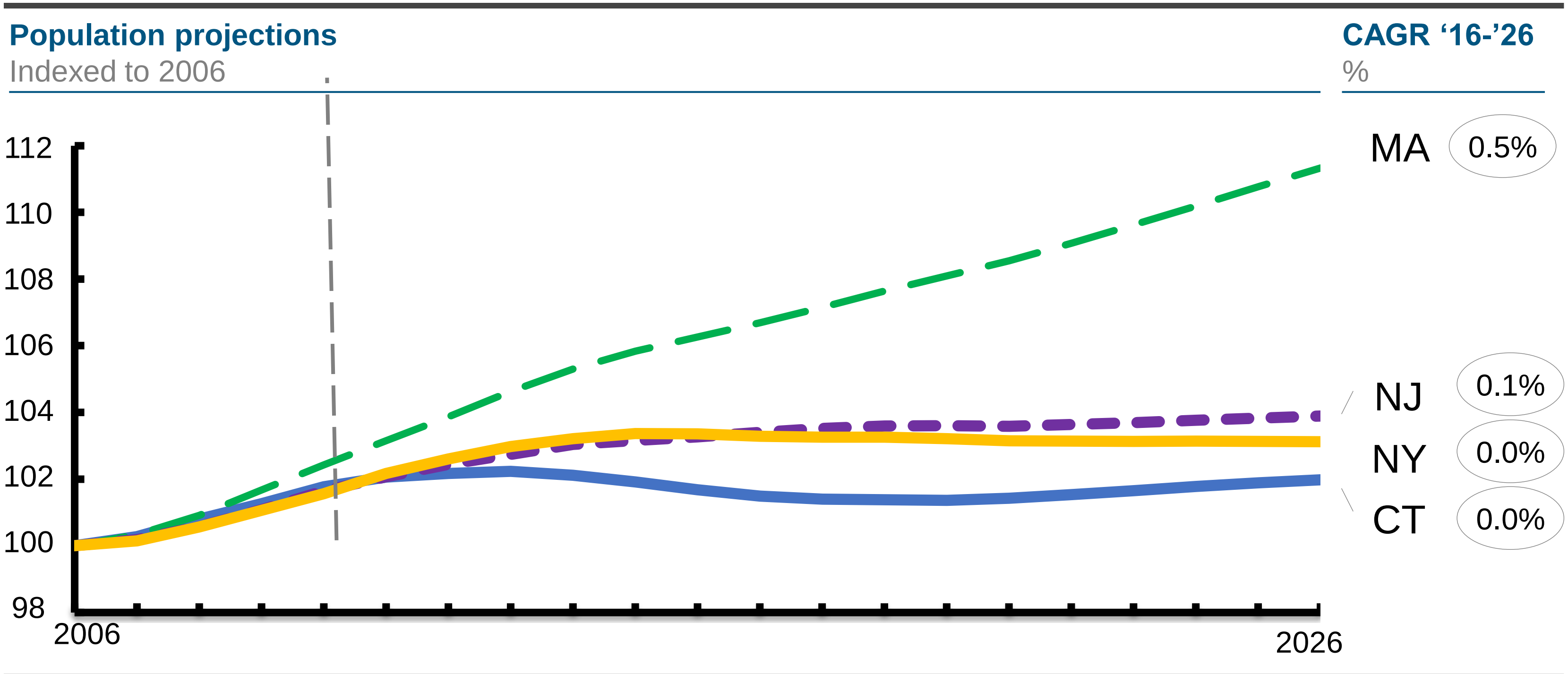
(1) Accrual basis expenditures include payments of benefits that have accrued even if cash payment for such benefits is not yet due.

Connecticut's taxes are higher than US averages



1 Represents the highest marginal corporate tax rate
2 Represents the highest marginal personal income tax rate
3 Mean Property Taxes on Owner-Occupied Housing as Percentage of Mean Home Value as of Calendar Year 2011
4 Tax Foundation data
SOURCE: Federation of Tax Administrators (2016); U.S. Census, Hartford Courant

Connecticut's Population Growth Remains Flat

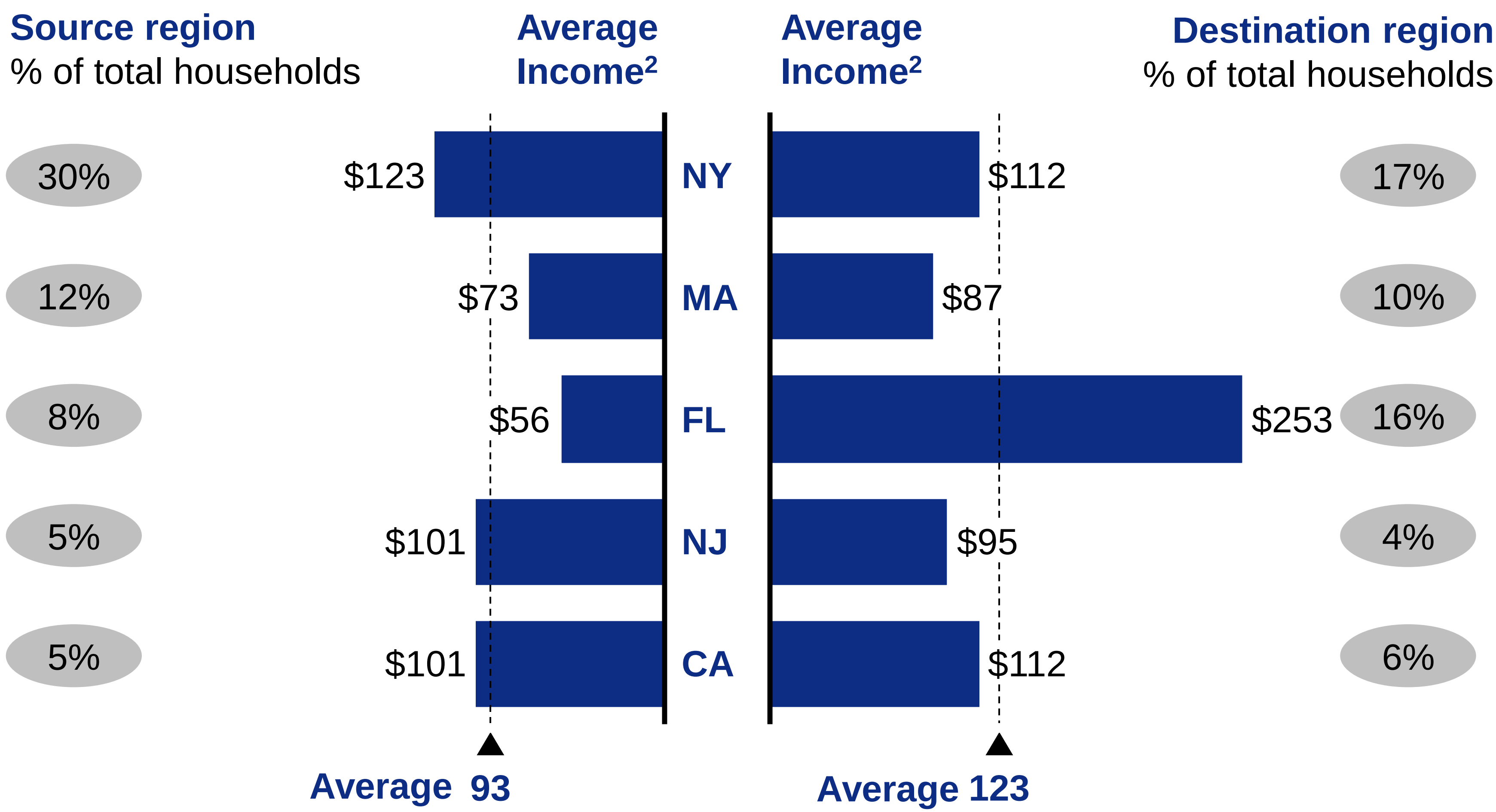


Source: US Census, American Community Survey, BLS

Migrants to CT earn less than those who leave CT

Households[1] moving to Connecticut earn $93,000/year…

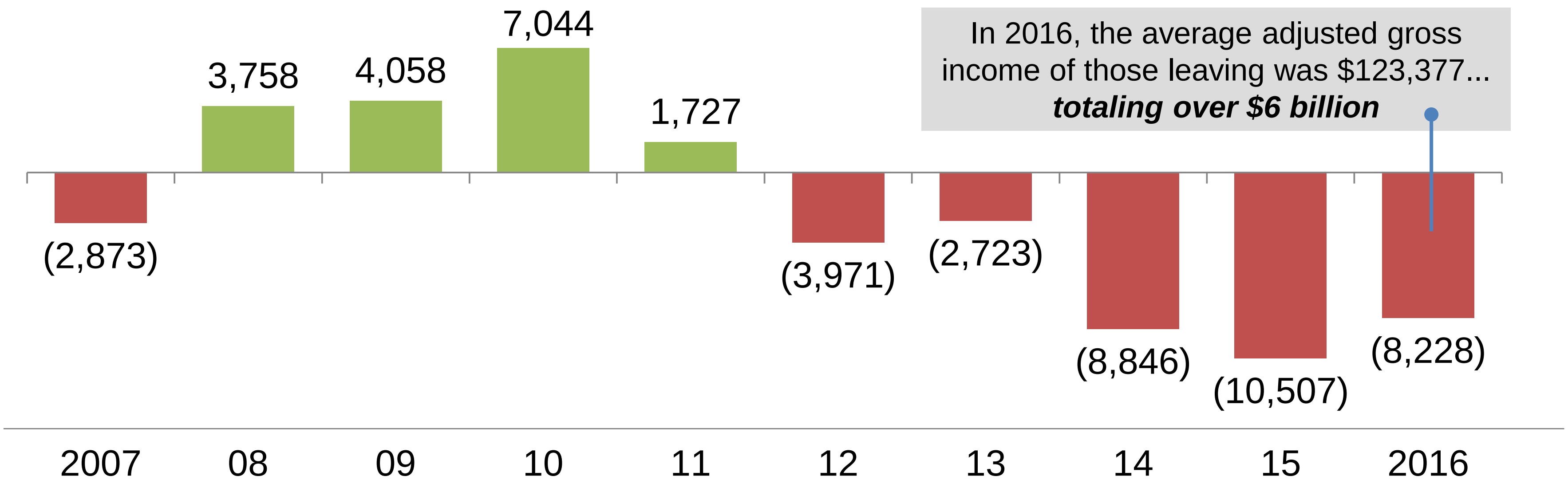
…while CT residents moving away earn more – averaging $123,000/year



1 Number of returns filed approximates the number of households that migrated
2 Adjusted Gross Income as reported to the IRS
SOURCE: Infernal Revenue Service (2015-2016)

At the same time, a series of tax increases has correlated with significant outmigration

Historical Net Migration in Connecticut (# of people)[1]



Key events

Income tax bracket added for high earners; corporate surcharge added for large firms (2009)

Number of brackets, top income tax rate, and corp. surcharge increased (2011)

Top income tax rate increased (2015)

Several high profile corporate departures (e.g. GE) (2016 - 2017)

Source: Hartford Courant, January 3, 2018.
(1) FY 2018 – FY 2019 Biennium Economic Report of the Governor

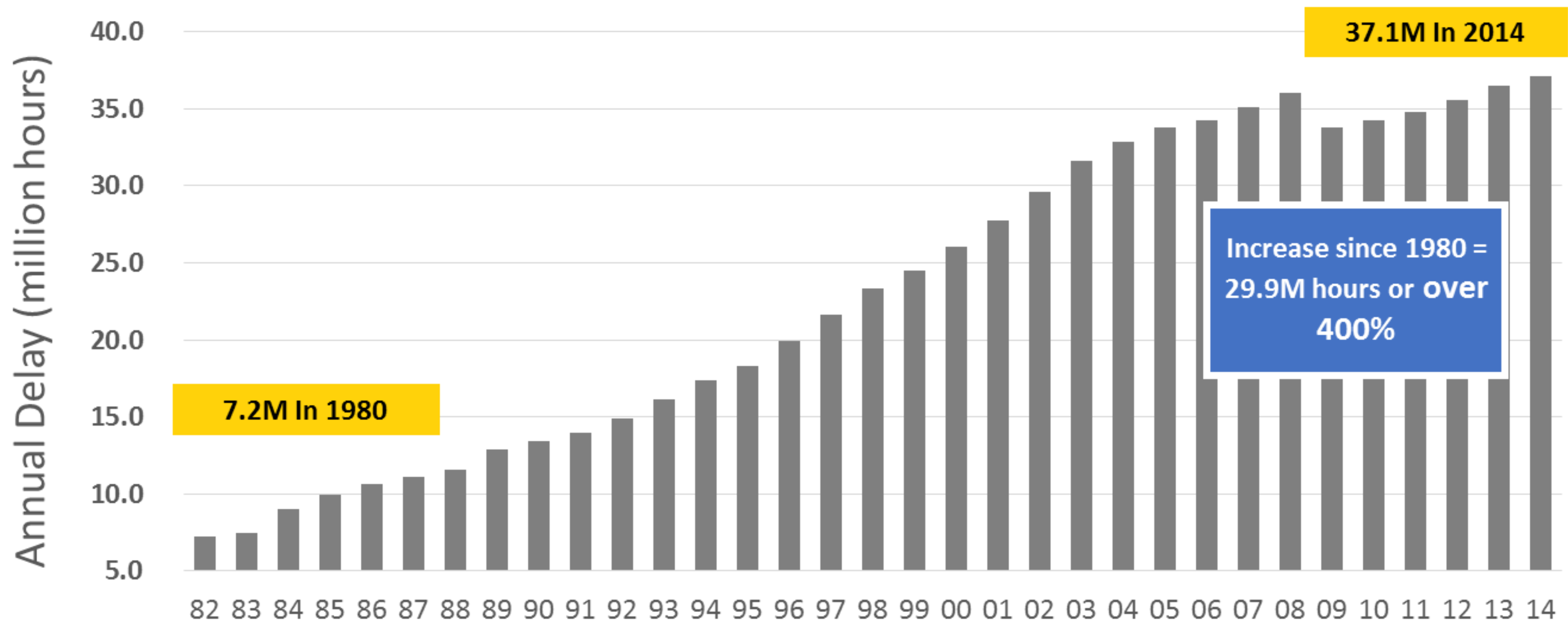
Connecticut has a Mismatch of Labor Supply and Demand

	Occupation type	Supply/demand ratio, %, 2016	Unemployment, Ths, Aug. 2017	Job postings, Ths, Aug 2017
Oversupply: Potential to retrain/transfer skills	Construction and Extraction	12.5	7.0	0.6
	Cleaning and Maintenance	4.1	4.9	1.2
	Production	2.9	5.9	2.1
Potential Poor Matching: Opportunity to better connect employers with candidates	Education, Training, and Library	1.0	3.2	3.2
	Office and Admin. Support	1.0	9.3	9.7
Undersupply: Need to increase supply of human capital	Architecture and Engineering	0.3	0.9	2.8
	Computer and Mathematical	0.2	1.3	6.9
	Healthcare Practitioners	0.1	1.5	19.1

Source: EMSI and BLS data

The Bridgeport-Stamford Metro Area had 37.1 million hours of traffic delay in 2014, up 400% from 1980

Millions of Hours of Delay Annually: Bridgeport-Stamford Metro Area



A "strawman" vision for CT

A long-term vision is required to propel our state back to greatness...

Target CT economic **growth rate of 3%+** *(vs. flattish today)*

Achieve fiscal stability
- Sustainably balanced budget
- Manageable debt levels & unfunded liabilities

Achieve Sustainable High Quality of Life For All Connecticut Residents

Raise key **competitiveness factors** from bottom quartile to **above median within 3-5 years** and achieve **top quartile competitiveness by 2025**

Maintain critical services while **protecting vulnerable populations**

Commission will recommend short-term, medium-term and long-term actions that will enable improved competitiveness and higher growth

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Key Recommendations

Commission on Fiscal Stability and
Economic Development

Key Recommendations…

1. Enact a revenue neutral rebalancing of state taxes (which becomes revenue positive when coupled with economic growth) that reduces income taxes in every bracket, selectively raises taxes on business, raises the sales tax rate by less than 1%, cuts exemptions and exclusions from all taxes by 14%, and eliminates the dwindling estate and gift taxes
2. Raise the gas tax to fund transportation projects and produce a plan for eventual implementation of electronic tolls
3. Create a Joint Budget Committee of the legislature with the power to set limits on revenues and expenses

Key Recommendations…

4. Have the legislature assume the responsibility to define state employee fringe benefits by removing them from collective bargaining for new contracts
5. Amend binding arbitration laws to permit award of compromise outcomes
6. Develop and implement a plan to cut $1 billion out of annual operating expenses
7. Reform the Teachers' Retirement System to lower costs and to make it sustainable by paying down unfunded liabilities

Key Recommendations…

8. Reinvest in transportation and cities, and build a major new STEM campus in one city in partnership with a major research university

9. Undertake a series of growth initiatives, led by the executive branch, with the funding and support from the legislature to:
   - (1) develop and retain the workforce Connecticut needs,
   - (2) support the growth of Connecticut's highest-potential economic sectors,
   - (3) transform the business environment for entrepreneurship and innovation

10. Diversify municipal revenue streams beyond the regressive property tax and stimulate regional service delivery

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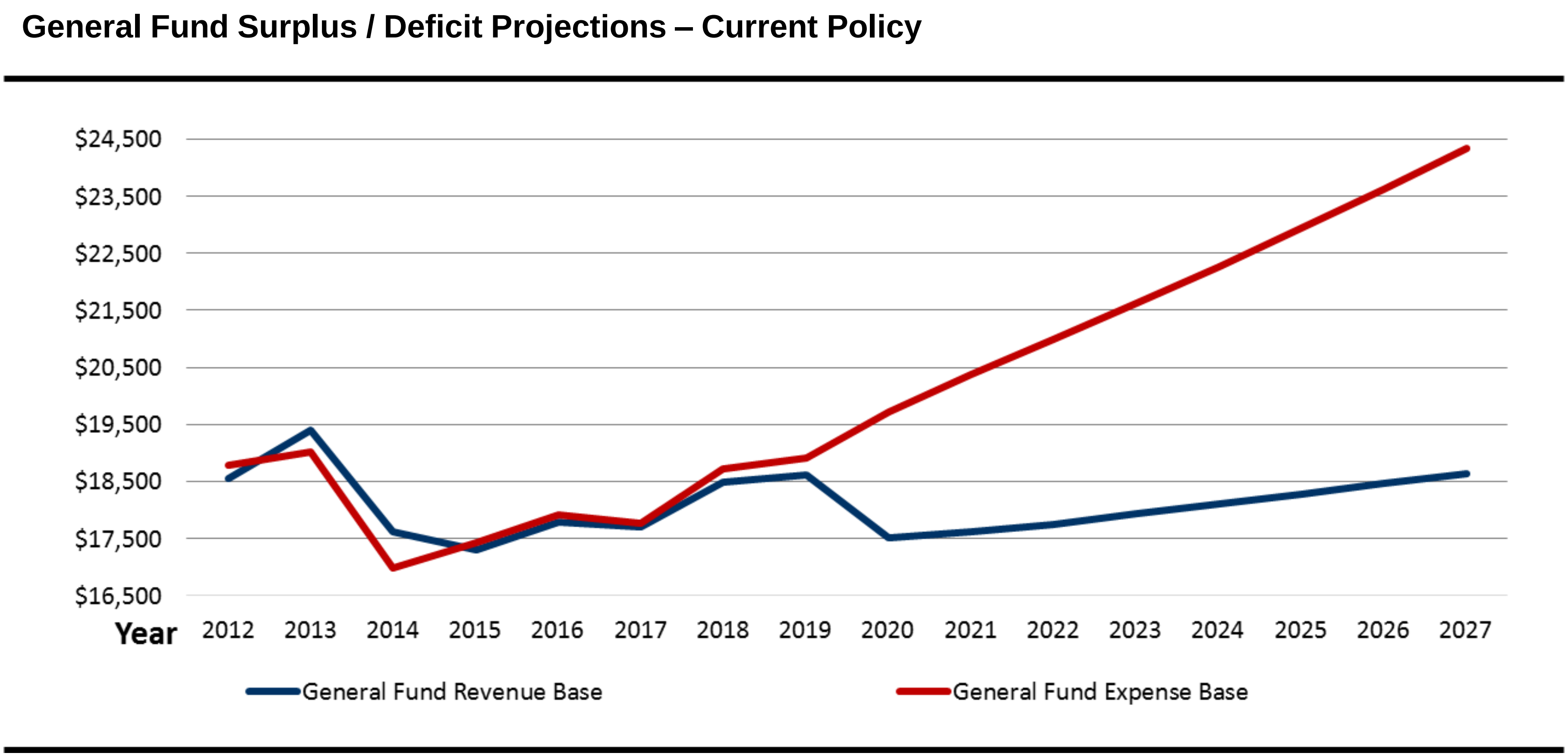
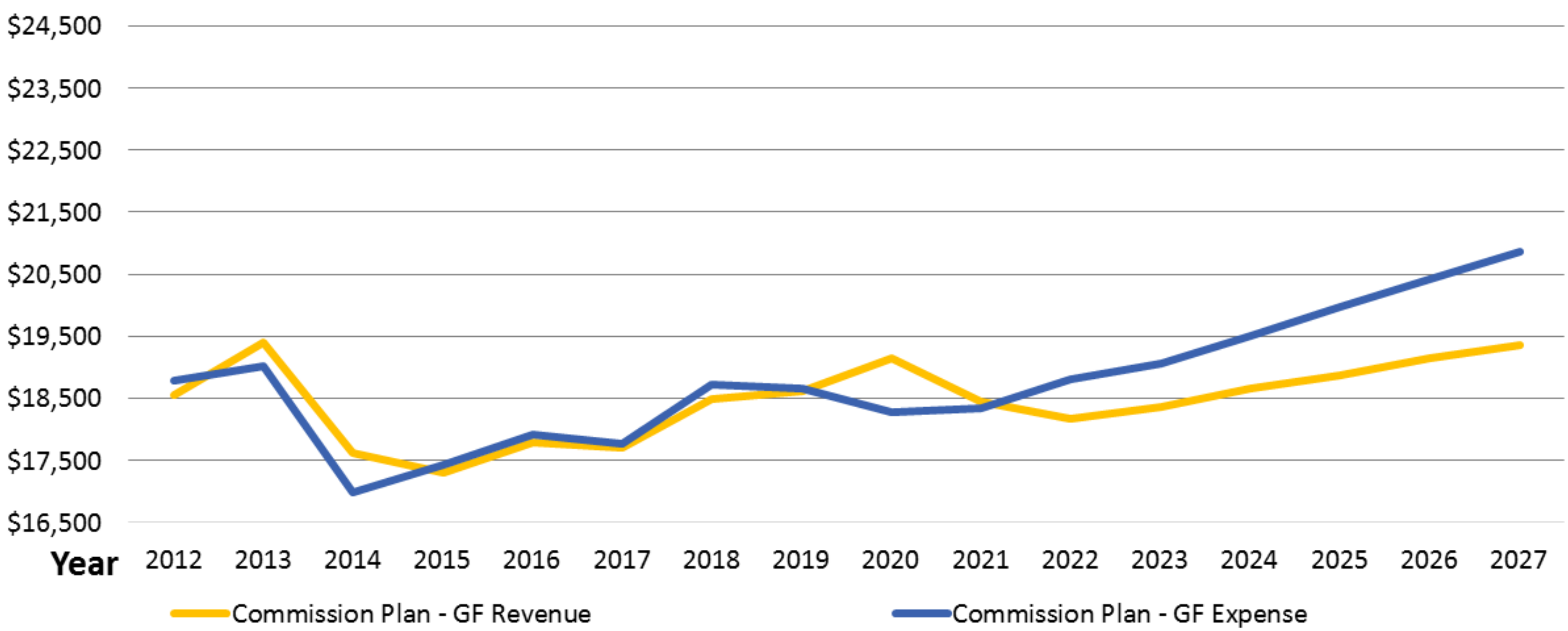
Current Policy



Source: Revenues – Comptroller's Open Budget FY12 – FY17; OPM Consensus Revenue January 2018 | Expenses – OFA Fiscal Accountability Report FY17 – FY20 & October Out Year Estimates
Key Assumptions: Fixed costs are growing at an average of ~5.5% each year; Total General Fund expenses growing at 3% in future years past 2022

Commission Plan

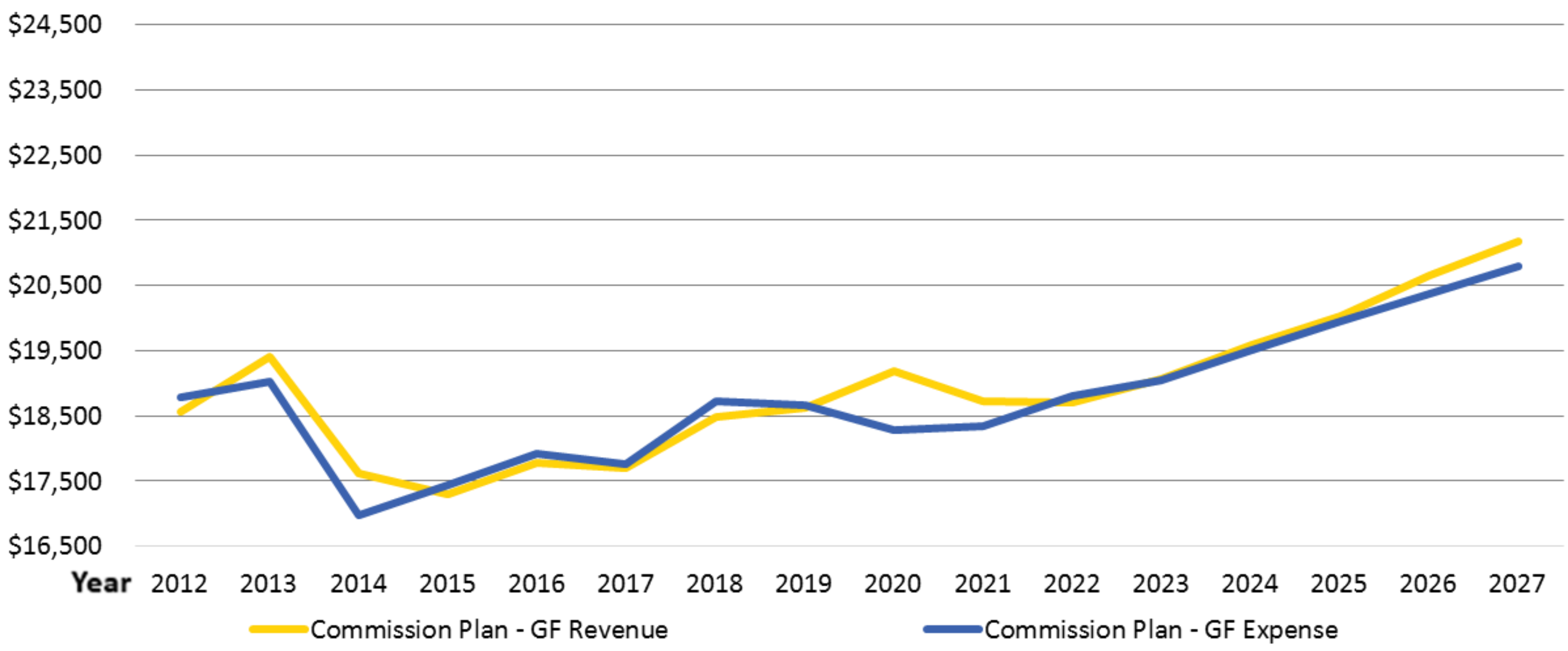
General Fund Surplus / Deficit Projections – Commission Plan



Source: Revenues – Comptroller's Open Budget FY12 – FY17; OPM Consensus Revenue January 2018 | Expenses – OFA Fiscal Accountability Report FY17 – FY20 & October Out Year Estimates; CT Tax Expenditure Report February 2018
Key Assumptions: All Tax changes are implemented in 2020 | Payroll Tax – OPM Population data; CT SBA Office of Advocacy

Commission Plan – Growth Assumption

General Fund Surplus / Deficit Projections – Commission Plan (Growth Assumption)



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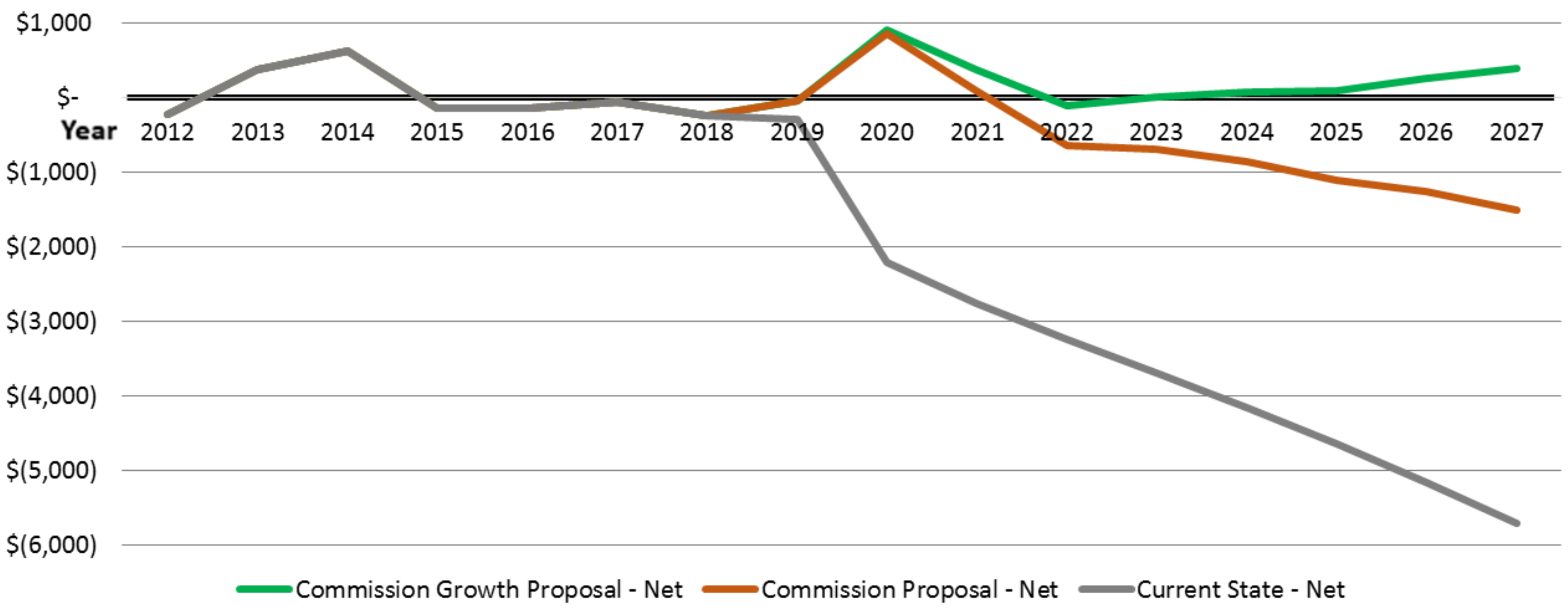
Key Assumptions: All Tax changes are implemented in 2020; | Payroll Tax – OPM Population data; CT SBA Office of Advocacy; Assume the pro-growth tax initiatives enable roughly 3% increased basis growth each year achieving our goal of a 3% – 3.5% Average GSP in 5-10 years

Net Plan Comparison

General Fund Surplus / Deficit Projections – Net Plan Comparison



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