Office of Fiscal Analysis

FY 17 GENERAL FUND BUDGET PROJECTION January 25, 2017

Summary

We are projecting a deficit of $11.9 million. Upward revisions to our estimates for Corporation Tax collections, settlement revenues and savings due to a reduction in staffing levels are major positive budgetary developments since our last estimate of FY 17, which was provided in the Fiscal Accountability Report. Further downgrades to projections for Income Tax and Sales Tax have partially offset these positive budgetary developments. Income Tax collections through the rest of the Fiscal Year will play a pivotal role in determining whether or not the budget ends in surplus or deficit.

Highlights

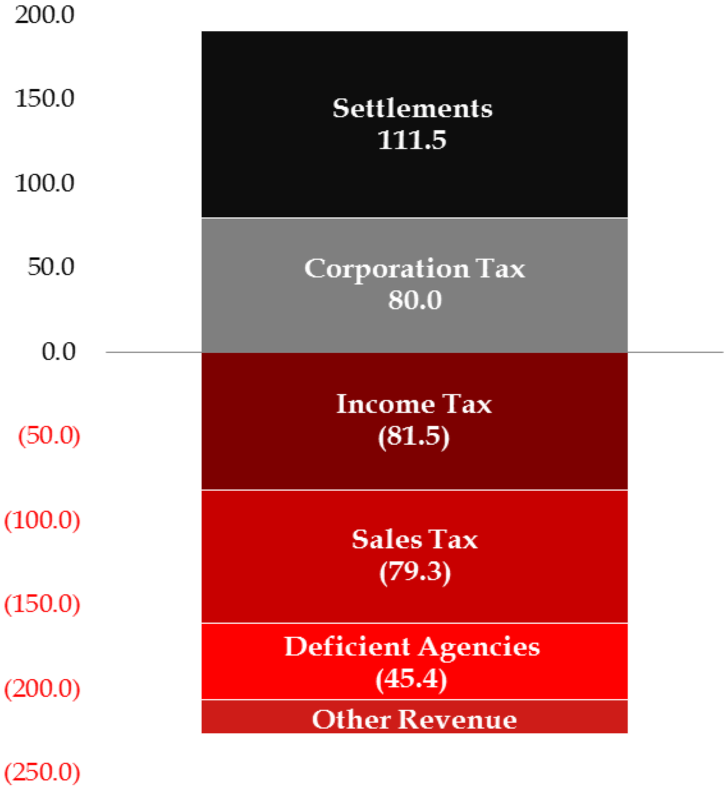
Corporation Tax Collections Exceeding Target

Through December, collections are exceeding target by approximately $100 million, including approximately $21 million in one-time positive impacts. The current projection recognizes $80 million above budget since a significant proportion of collections remains through FY 17.

Figure 1. General Fund Overview
In Millions of Dollars

	Budget	January Estimate	Difference from Budget $	Difference from Budget %
Revenues	17,886.7	17,897.5	10.8	0.0
Expenditures	17,864.0	17,909.4	45.4	0.3
Surplus/(Deficit)	**22.7**	(11.9)	(34.6)	0.0

Figure 2. Major Items Contributing to Surplus/ (Deficit)
In Millions of Dollars



Budgeted Surplus	22.7
Positive Adjustments	
Corporation Tax	80.0
Settlement	111.5
Subtotal	**191.5**
Negative Adjustments	
Income Tax	(81.5)
Sales Tax	(79.3)
Deficient Agencies	(45.4)
Other Revenue	(19.9)
Subtotal	**(226.1)**
Surplus/(Deficit)	**(11.9)**

Notable Revenue Issues

Projected Shortfall in Sales Tax Worsens

Weaker than anticipated Sales Tax collections through December resulted in a downgrade of the FY 17 estimate from November. As noted in the November Consensus, collections for FY 16 ended the year $39 million below the April 2016 Consensus Revenue estimate which effectively lowers the base for FY 17. In total, Sales Tax is tracking $79.3 million below the budgeted target. Sales Tax collections data received in early February will reveal how well the Sales Tax performed over the 2016 Holiday Season.

Income Tax Collections Weaken

Withholding collections have underperformed targets to date, resulting in a downward revision of $15 million to our projections. See below for more information.

Recent Settlement Windfall adds $31.5 Million to Miscellaneous Revenues

Connecticut, the U.S. Department of Justice, 20 other states and the District of Columbia have reached a settlement agreement with Moody's Corporation, Moody's Investor Services, Inc. and Moody's Analytics, Inc. resolving allegations that the credit rating agency misled investors when it rated structured finance securities in the lead-up to the 2008 financial crisis. This settlement is in addition to other major settlements producing significant FY 17 General Fund revenues: 1) $120 million from the Royal Bank of Scotland; and 2) $16.2 million from Volkswagen. These one-time settlement revenues are reflected in the current FY 17 estimate for Miscellaneous revenues.

Notable Expenditure Issues

MORE Commission Savings Recognized in ECS

The available balance for the Education Cost Sharing (ECS) grant was reduced by $20 million as a result of the MORE Commission lapse, which represents approximately .9% of the original appropriation. The reduction was based upon town grand list per capita wealth, and the reduction to distressed municipalities was limited to $250,000.

Staffing Reductions, Other Updates Increase the Projected Lapse in Fringe Benefits

The projected lapse in Office of the State Comptroller Fringe Benefit accounts increases by $19.6 million to $32.1 million. The Higher Education Alternate Retirement (ARP) account projected expenditures decreased by 72.9% predominately due to less employees being charged to the General Fund centralized ARP account. The Employers' Social Security (SS) and the State Employees' Health Service Cost (Health) account projected expenditures decreased 1.8% and 1.2% respectively. The projected lapse in the SS account represents 5.3% of the appropriation. The projected lapse in the Health account represents 2.3% of the appropriation. In both accounts the lapse is being driven by decreases in the state employee population. Finally, the Retired State Employees' Health Service Cost account projected expenditures decreased less than 1%; the projected lapse reflects less than 1% of the appropriation and is based on recent claims and population trends in the state retiree population. This account will continue to be monitored based on the recent high volume of retirements.

Judicial Department Lapse Recognized

The Judicial Department is projected to lapse approximately $18.9 million in the Personal Services account. This is due to the removal of the anticipated annual increases for collectively bargained employees (approximately $12.7 million) as well as savings from vacancies (approximately $6.2 million).

The agency currently has 632 vacant positions (238 due to lay-off of permanent employees, 61 temporary employees, and 145 retirements).

New Debt Service Savings of $5.6 Million Reduces Projected Deficit

Refunding savings from issuances in December and January produced new savings of approximately $3.7 million. Variable rates produced additional FY 17 savings of $1.9 million in January. Together these savings reduce the projected deficit from approximately $12.7 million estimated in November to $7.1 million estimated currently.

Unallocated Lapse Target Mostly Achieved According to Current Projections

Of the $209 million in bottom-line savings targets (lapses) budgeted, $4.4 million remains unidentified. The estimate assumes these savings are achieved in full by the end of the fiscal year. The significant lapses identified above in Fringe Benefits and the Judicial Department have helped to close the remaining gap between lapse targets and projections.

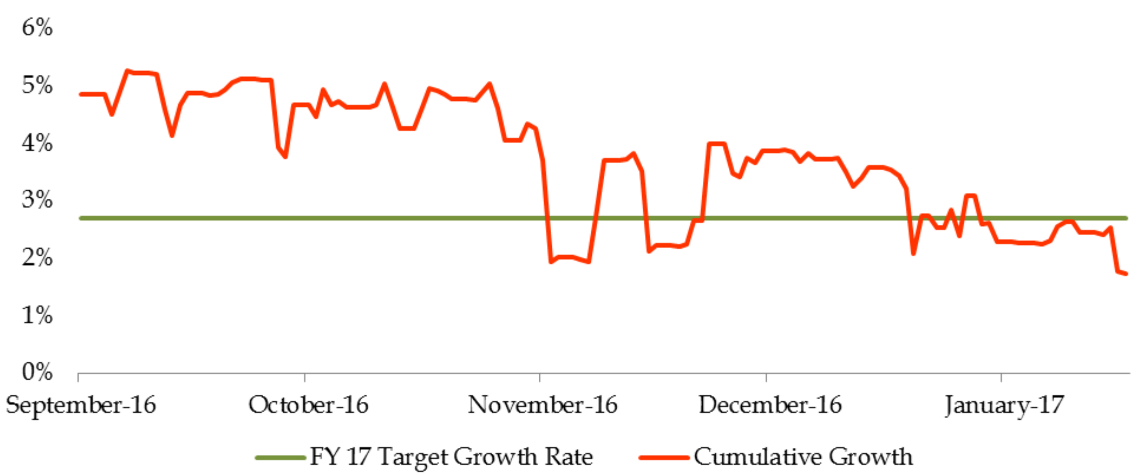
Looking Forward

Personal Income Tax Poses Significant Risk to FY 17 Budget

Withholding

The Personal Income Tax was revised downward an additional $15 million in January consensus due to weakness in withholding collections. As seen in **Figure 3** below, year over year growth rates started to decline from a peak of around 5% in November to a low of 1.7% by late January.

Figure 3. Withholding Growth: Actual vs. Target



Estimated and Final Payments

There is significant risk associated with the remaining estimated and final payments, which will be received in April and June. We are currently projecting an additional $2.2 billion to be collected in FY 17 which would constitute growth of 3.1% over last year; this is compared to a year-to-date growth rate of -7.8%. Although the risk posed by these payments results in significant budgetary uncertainty, provided below are possible scenarios to help illustrate both the upside and downside risks associated with this revenue stream.

- **Pessimistic Scenario**
  Under this scenario the decline in revenue experienced in FY 16 leads to individuals spending and investing less in Connecticut, resulting in a potential "echo" effect similar to what typically happens after a recession. This results in a decline in aggregate economic activity, which impacts a large group of taxpayers but to varying degrees. The evidence that this scenario may be playing out is weakness in withholding, estimated payments, and sales tax collections.

- **Optimistic Scenario**
  It is also possible that final payments in April will make up for any negativity experienced to date. In particular, the negative growth in estimated payments year-to-date may be due to taxpayers taking advantage of "safe harbor" provisions in the tax code, which allow them to delay their payments until April. The evidence that this may be the case are a strong 2016 stock market performance and past collections trends under "safe harbor" scenarios masking underlying strength until final payments are received in April.

Links

Deficient Agency Table
Expenditure Details Table
Revenue Details Table