FISCAL ACCOUNTABILITY REPORT
FISCAL YEARS 2013 – 2016

OFFICE OF POLICY AND MANAGEMENT
BENJAMIN BARNES, SECRETARY
NOVEMBER 27, 2012

Presentation Overview

- Introduction
- Summary of OPM projections
- Spending cap calculation
- Budget Reserve Fund status
- Economic factors and revenue trends
- Expenditures, major cost drivers and long-term obligations
- Five year bond projections
- Summary and conclusion

Where We Are

- Connecticut has made progress over the last two years by:
  - Closing the cumulative $6 billion gap for the FY 2012 and FY 2013 biennium;
  - Implementing GAAP;
  - Paying more into the state employee pension system;
  - Streamlining state government;
  - Reaching bipartisan agreement on a jobs package; and
  - Reforming schools.
- But,
  - the recovery has lagged, along with revenues.
  - Medicaid expenditures have grown quickly.

Global and National Issues Will Significantly Influence Our Future

- Federal policy makers must resolve the “fiscal cliff,” potentially impacting federal aid, business to state firms, and overall economic growth.

- The European economic crisis continues to threaten Connecticut’s recovery.

The Task Is Clear

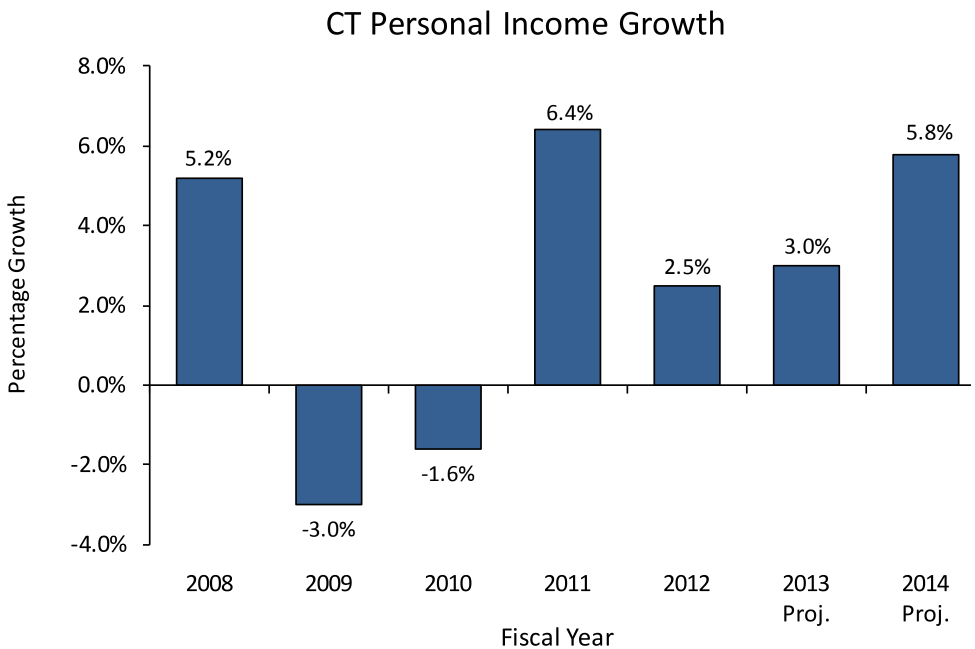
- Despite these challenges, Governor Malloy is committed to
  - Ensuring the state lives within its means.
  - Hard spending cuts.
  - NO tax increases.
  - Continuing to make smart investments that create jobs and improve education, even in these difficult times.

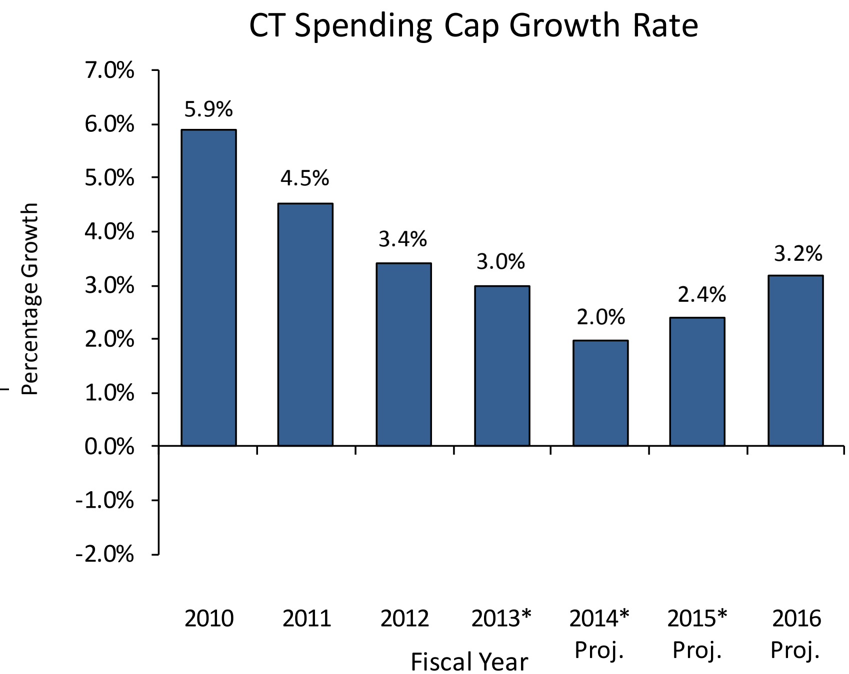
Financial Summary of Funds

(in millions)

	Estimated	Estimated Current Services		Projected
General Fund	2012-13	2013-14	2014-15	2015-16
Revenues	$ 19,015.1	$ 19,723.6	$ 21,032.3	$ 22,136.6
Expenditures	19,380.1	20,803.6	21,890.9	22,943.7
Balance - Budgetary basis	$ (365.0)	$ (1,080.0)	$ (858.6)	$ (807.1)
Transfer for GAAP Amortization		(100.0)	(100.0)	(100.0)
Balance - GAAP basis		$ (1,180.0)	$ (958.6)	$ (907.1)
Special Transportation Fund				
Revenues	$ 1,234.6	$ 1,336.0	$ 1,342.3	$ 1,364.5
Expenditures	1,232.7	1,320.4	1,394.1	1,462.9
Balance - Budgetary basis	$ 1.9	$ 15.6	$ (51.8)	$ (98.4)
Other Funds				
Revenues	$ 170.8	$ 246.3	$ 250.0	$ 254.6
Expenditures	170.3	245.9	249.8	254.2
Balance - Budgetary basis	$ 0.5	$ 0.4	$ 0.2	$ 0.4
Total All Appropriated Funds				
Revenues	$ 20,420.5	$ 21,305.9	$ 22,624.6	$ 23,755.7
Expenditures	20,783.0	22,370.0	23,534.8	24,660.7
Balance - Budgetary basis	$ (362.5)	$ (1,064.1)	$ (910.2)	$ (905.0)
Transfer for GAAP Amortization		(100.0)	(100.0)	(100.0)
Balance - GAAP basis		$ (1,164.1)	$ (1,010.2)	$ (1,005.0)

Spending Cap





* Inflation is the limiting factor

- The enacted revised budget is $142.2 million below the cap.
- While revenues have been the sole limiting factor for the budget over the past few years, that is no longer the case.
- Personal income growth serves as the cap's proxy for the economy's ability to pay for government services.
- The next few years will see the lowest allowable expenditure cap growth rates since its inception.
- The secondary measure of inflation was the limiting factor in FY 2013 and is projected to be in FY 2014 and FY 2015 as well.

Spending Cap

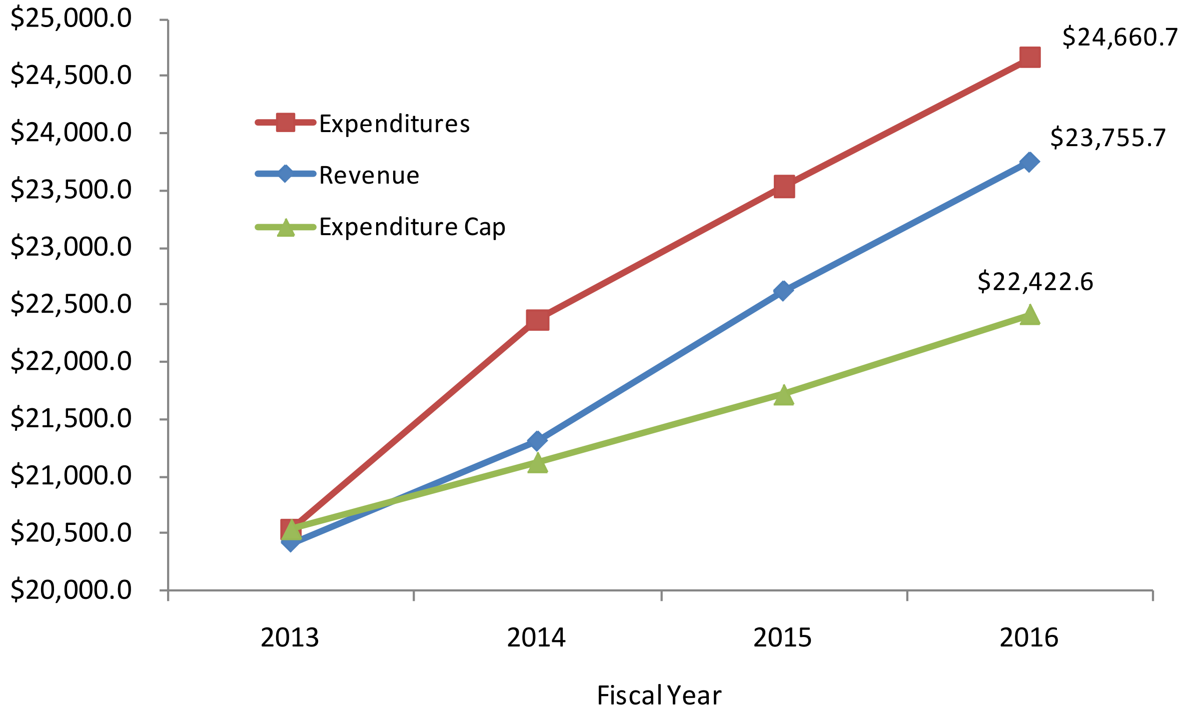
(in millions)

	Estimated Current Services		Projected
	2013-14	2014-15	2015-16
Expenditure Cap Results			
Total All Appropriated Funds	$ 22,370.0	$ 23,534.8	$ 24,660.7
Allowed Appropriations per Cap	21,128.0	21,720.0	22,422.6
Over/(Under) the Cap	$ 1,242.0	$ 1,814.8	$ 2,238.1
Revenues and the Expenditure Cap			
Revenues - All Funds	$ 21,305.9	$ 22,624.6	$ 23,755.7
Allowed Appropriations per Cap	21,128.0	21,720.0	22,422.6
Revenues Less Allowed Approps.	$ 177.9	$ 904.6	$ 1,333.1
Transfer for GAAP Amortization	(100.0)	(100.0)	(100.0)
Balance - GAAP basis	$ 77.9	$ 804.6	$ 1,233.1

Policy Changes Are Required

All Funds

(in millions)



- Over the next three years revenues are projected to grow by $3.1 billion.
- The state's constitutional spending cap will permit growth of $1.7 billion.
- Without policy changes to "current services" levels, all-funds expenditures are projected to grow by $3.9 billion.

Adherence to Spending Cap

(in millions)

Fiscal Year	Current Services G.F. Deficit	Required Cuts	G.F. Surplus after Cuts	Use of the G.F. Surplus: GAAP	ERN Pre-Pay	Budget Reserve Fund
2014	$ (1,080.0)	$ 1,180.0	$ 100.0	$ 100.0	$ -	$ -
2015	(858.6)	1,688.0	829.4	100.0	199.4	530.0
2016	(807.1)	2,082.3	1,275.2	100.0	(208.4)	1,383.6
Total	$ (2,745.7)	$ 4,950.3	$ 2,204.6	$ 300.0	$ (9.0)	$ 1,913.6

Note: Pre-paying the Economic Recovery Notes (ERN's) in FY 2015 will result in debt service savings in FY 2016 of $208.4 million. GAAP column represents annual payments of unfunded liability.

Adherence to Spending Cap

- By adhering to the spending cap in FY 2014 – 2016, we will:
  - Convert the projected deficits into surpluses.
    - $2.7 billion deficit becomes $2.2 billion surplus.
  - Begin to amortize the cumulative GAAP deficit.
    - $300 million toward the $1.5 billion cumulative deficit.
  - Pre-pay the FY 2016 ERN payment.
    - $199.4 million in FY 2015, saving $208.4 million in debt service in FY 2016.
  - Generate deposits into the Rainy Day Fund.
    - $1.9 billion balance at the end of FY 2016, or 8.9% of budget.
- This will require significant cuts to current services spending levels.

Economy and Revenue

General Fund Revenue Sources

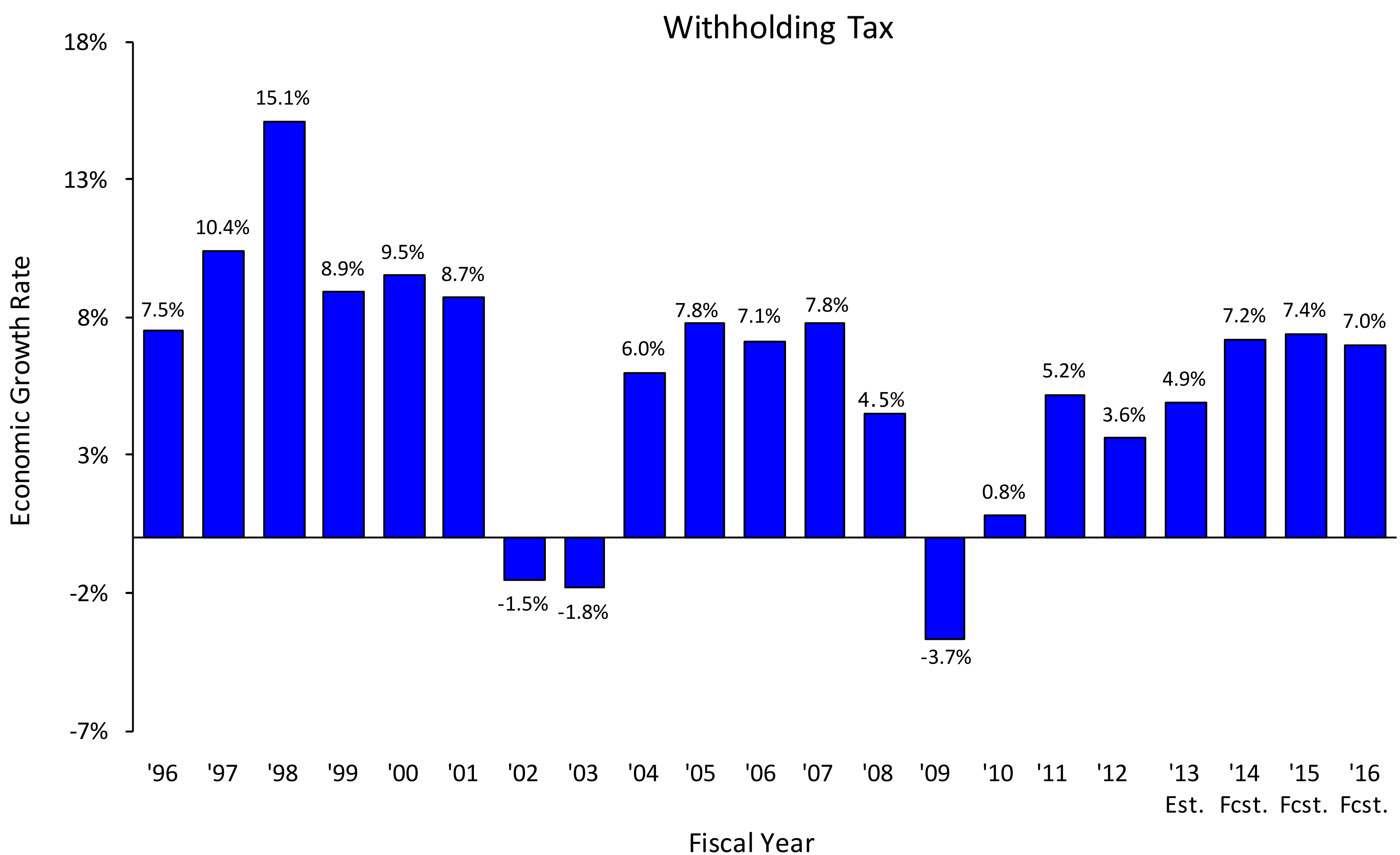
November 9, 2012 Consensus Revenue Forecast

(In Millions)

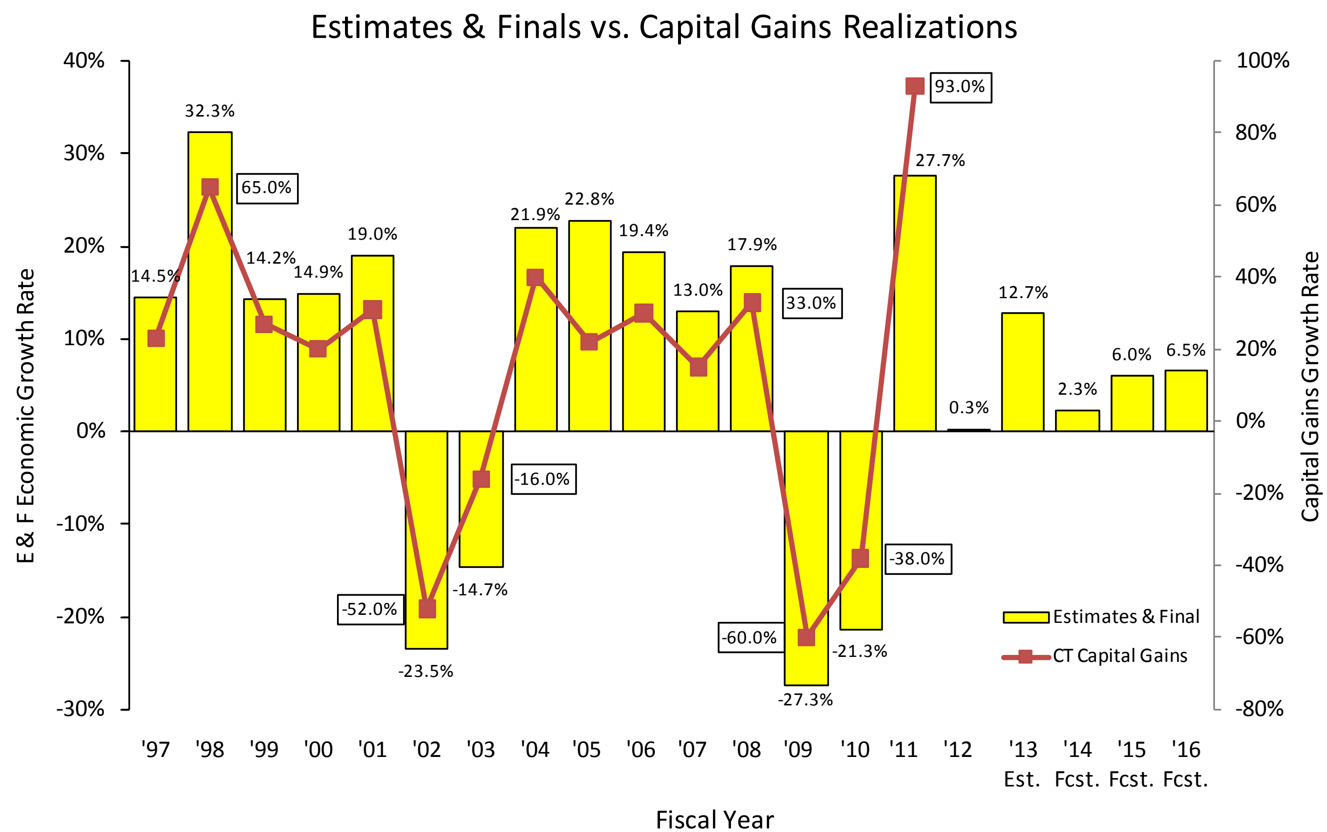
	FY 2013	% of Total	FY 2014	% of Total	FY 2015	% of Total	FY 2016	% of Total
Personal Income Tax	$ 8,554.3	45.0%	$ 9,011.9	45.7%	$ 9,631.8	45.8%	$ 10,289.3	46.5%
Sales & Use Tax	4,002.3	21.0%	4,158.0	21.1%	4,322.4	20.6%	4,529.7	20.5%
Federal Grants	3,762.9	19.8%	4,105.9	20.8%	4,656.2	22.1%	4,909.0	22.2%
Corporation Tax	726.2	3.8%	660.6	3.3%	698.8	3.3%	688.6	3.1%
Health Provider Tax	520.0	2.7%	522.6	2.6%	525.2	2.5%	527.8	2.4%
Cigarettes Tax	411.1	2.2%	399.1	2.0%	388.0	1.8%	376.9	1.7%
Indian Gaming Payments	311.6	1.6%	310.1	1.6%	308.5	1.5%	307.0	1.4%
All Other	726.7	3.8%	555.4	2.8%	501.4	2.4%	508.3	2.3%
Total	$ 19,015.1		$ 19,723.6		$ 21,032.3		$ 22,136.6	

Personal Income Tax Trends

Economic Growth Rates



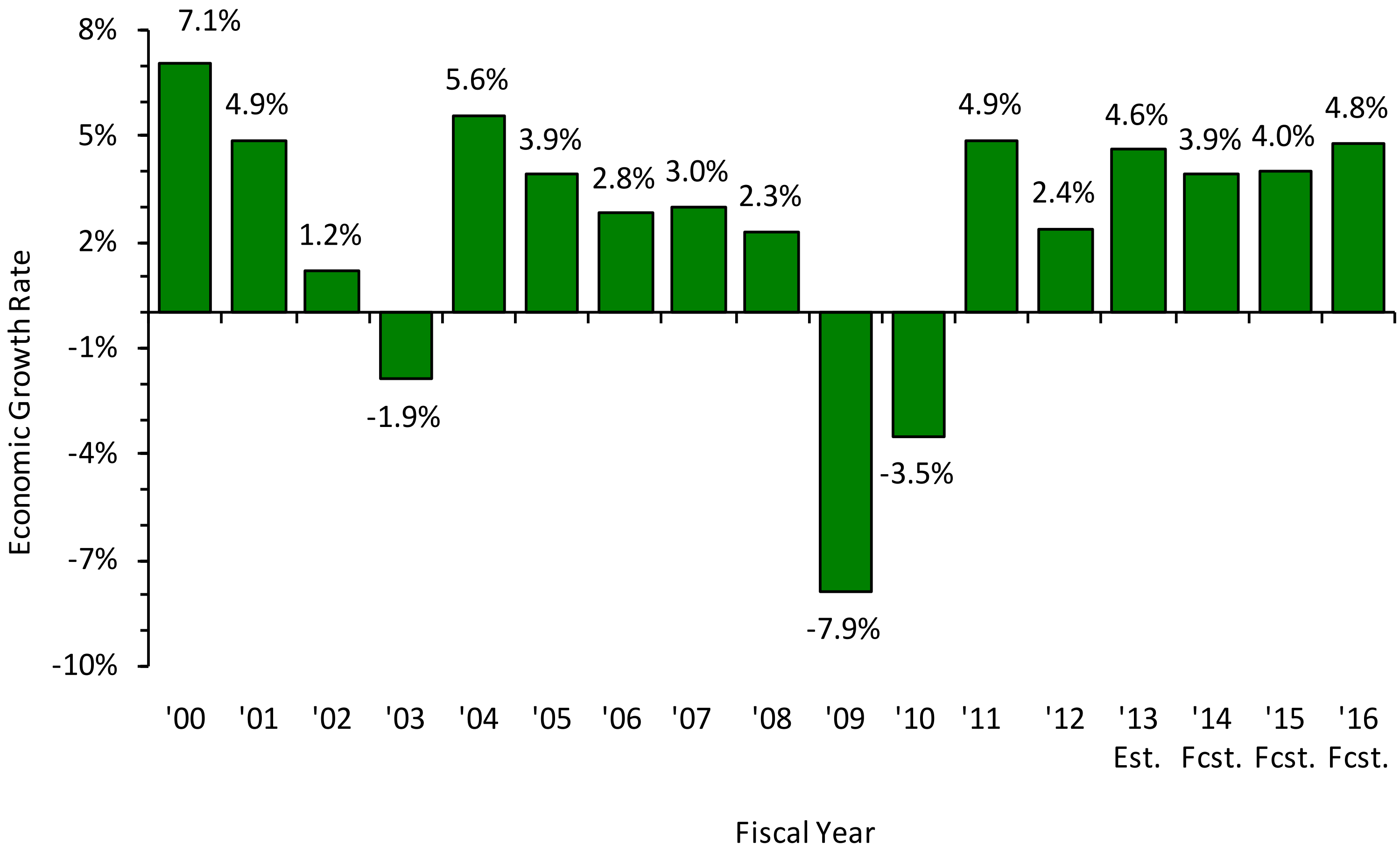
Income Tax
Highly Dependent upon Capital Gains



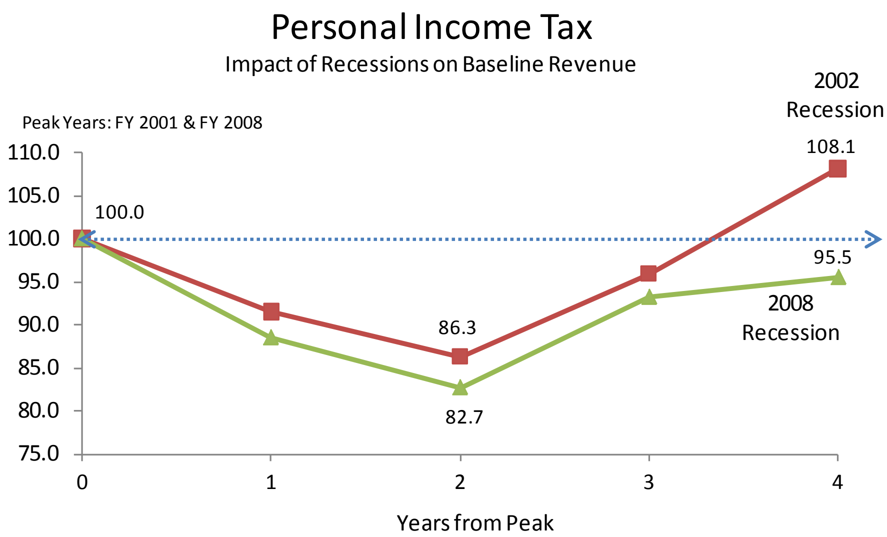
- Capital gains income is strongly influenced by the performance of the stock market.
- In high years, capital gains can represent almost 15% of total adjusted gross income.
- In low years, capital gains can represent just 5% of total adjusted gross income.
- Unfortunately, a record high year can be immediately followed by a record low year, devastating state finances.

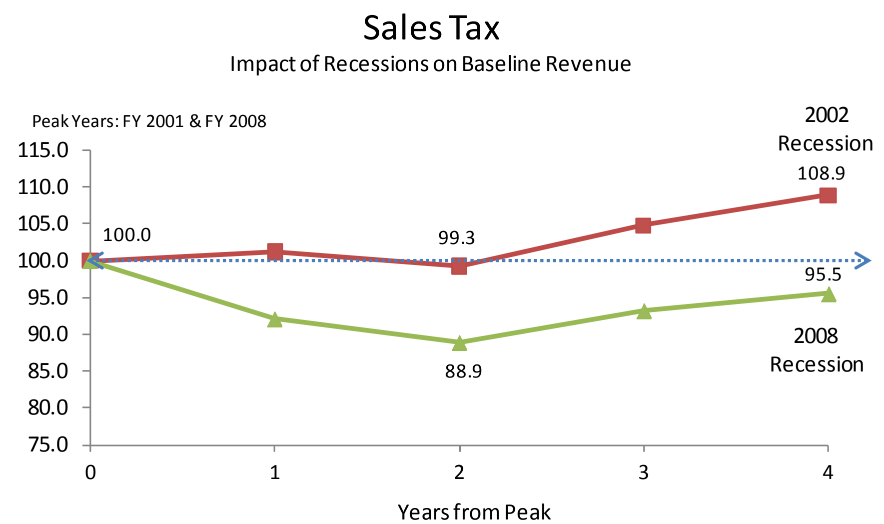
Sales Tax Trends

Economic Growth Rates



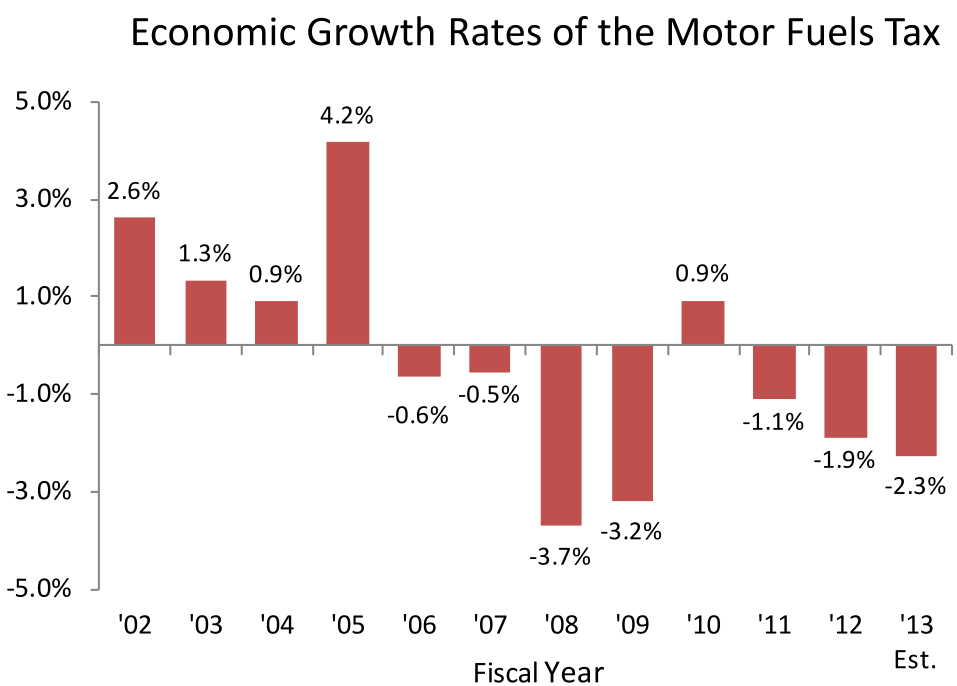
Slow Economic Recovery





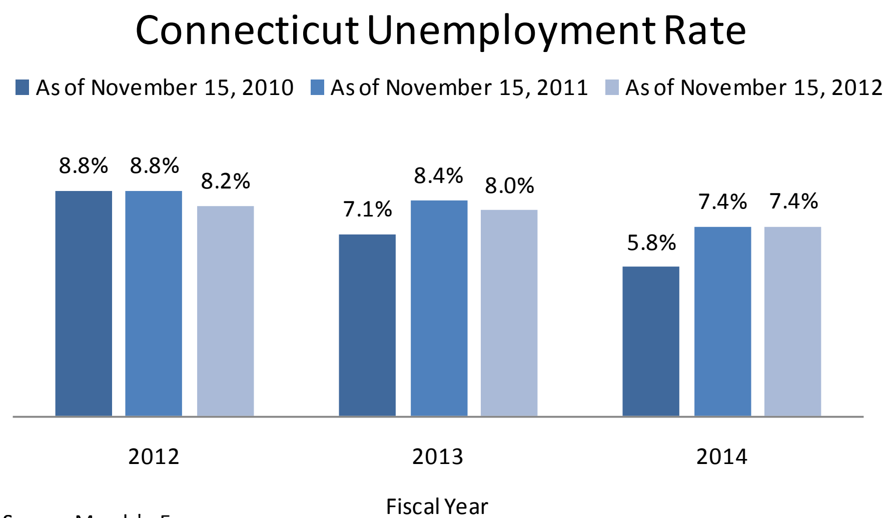
- By setting peak years to an index value of 100 and removing the impact of tax changes, ready comparisons can be made about subsequent performance.
- For the two most recent recessions, revenue peaked in FY 2001 and FY 2008, respectively.
- Unlike the prior recession, Income Tax and Sales Tax revenues have yet to exceed their previous peak.
- If this recovery had been similar to the 2003 recovery, Income Tax revenue would be $650 million higher, while Sales Tax revenue would be $75 million higher.

Declining Motor Fuels Consumption

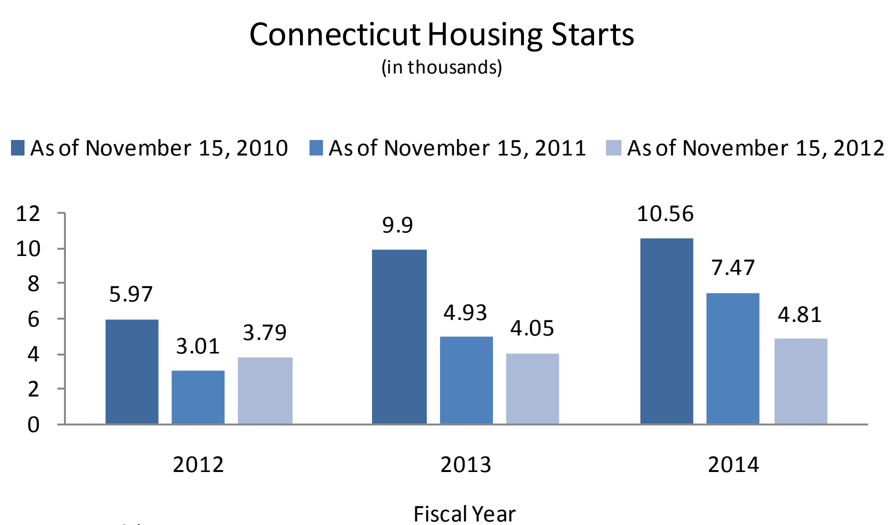


- Consumers began to curtail consumption as prices began to rise.
- Since FY 2005, the cumulative decline in Motor Fuels tax revenue is 11.8%.
- For this revenue source this is not just a cyclical change, but a major structural change on the part of consumers.
- In FY 2012, Motor Fuels tax revenue equaled 40% of the total revenue of the Special Transportation Fund which is down from 55.4% in FY 2003. Declining growth in motor fuels revenue has led to an increasing reliance on other revenue sources to support the fund, including transfers from the General Fund.

Prolonged Recovery Reflected in Revisions to CT Economic Indicators



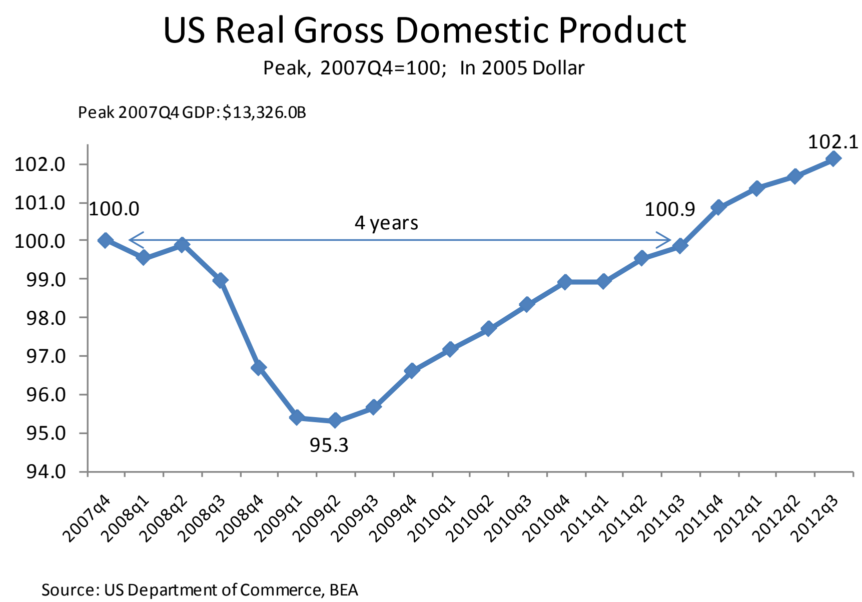
Source: Moody's Economy.com

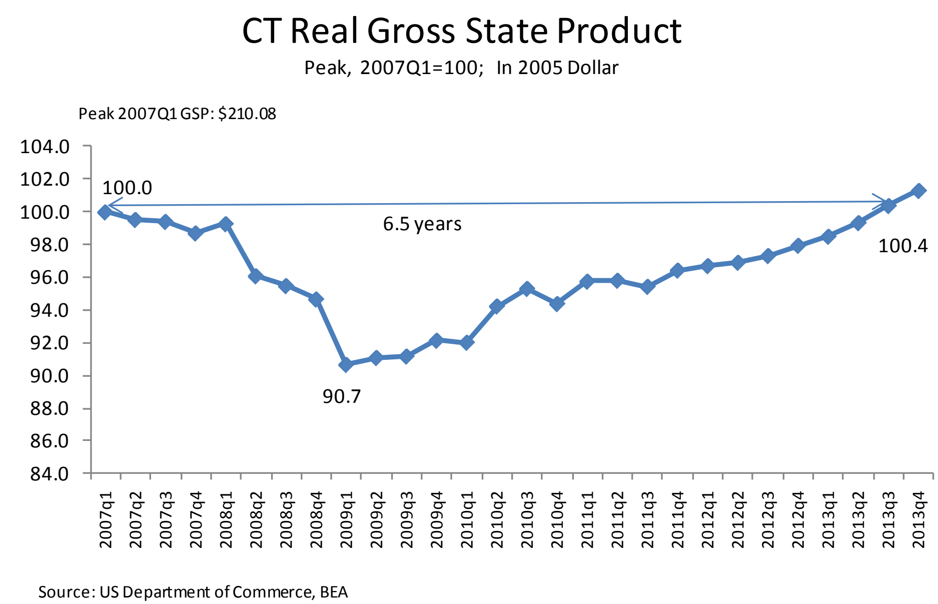


Source: Moody's Economy.com

- Economic indicators have been continually revised downward.
- Two years ago the unemployment rate forecast was 5.8% for FY 2014.
- The latest projection of 7.4% is much higher.
- Two years ago economic projections indicated 10,560 new housing starts in Connecticut. The latest projection is less than half that figure.

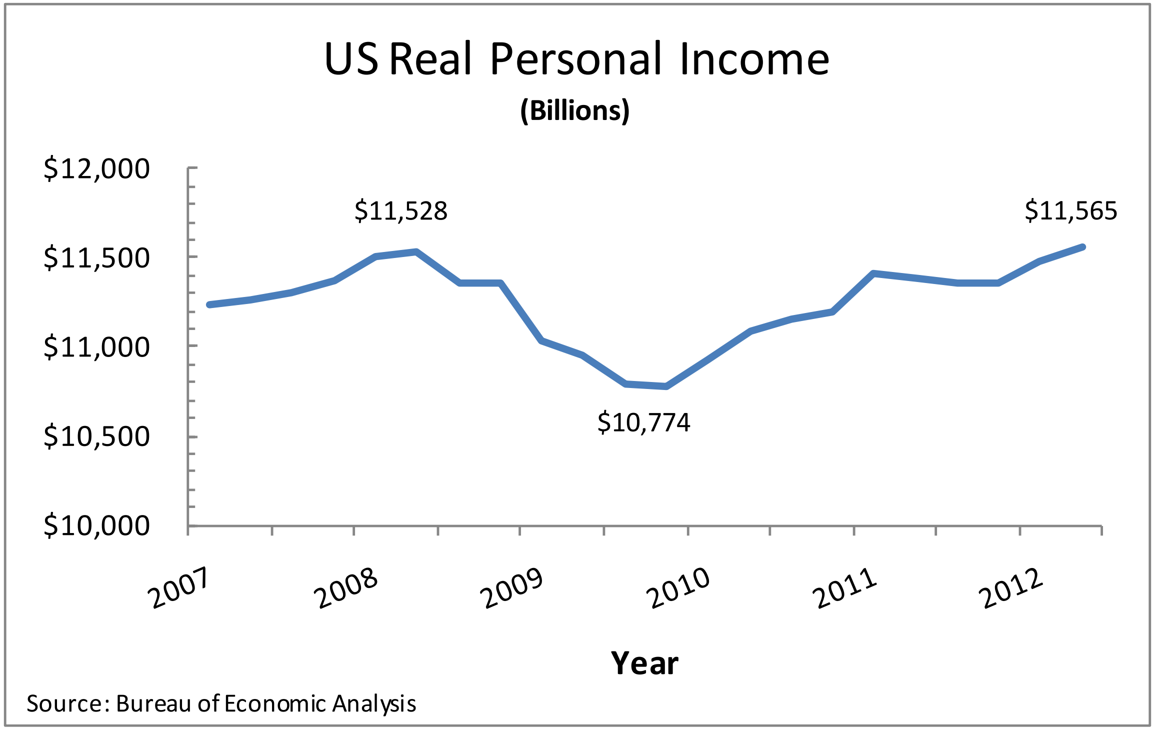
Extended Economic Recovery





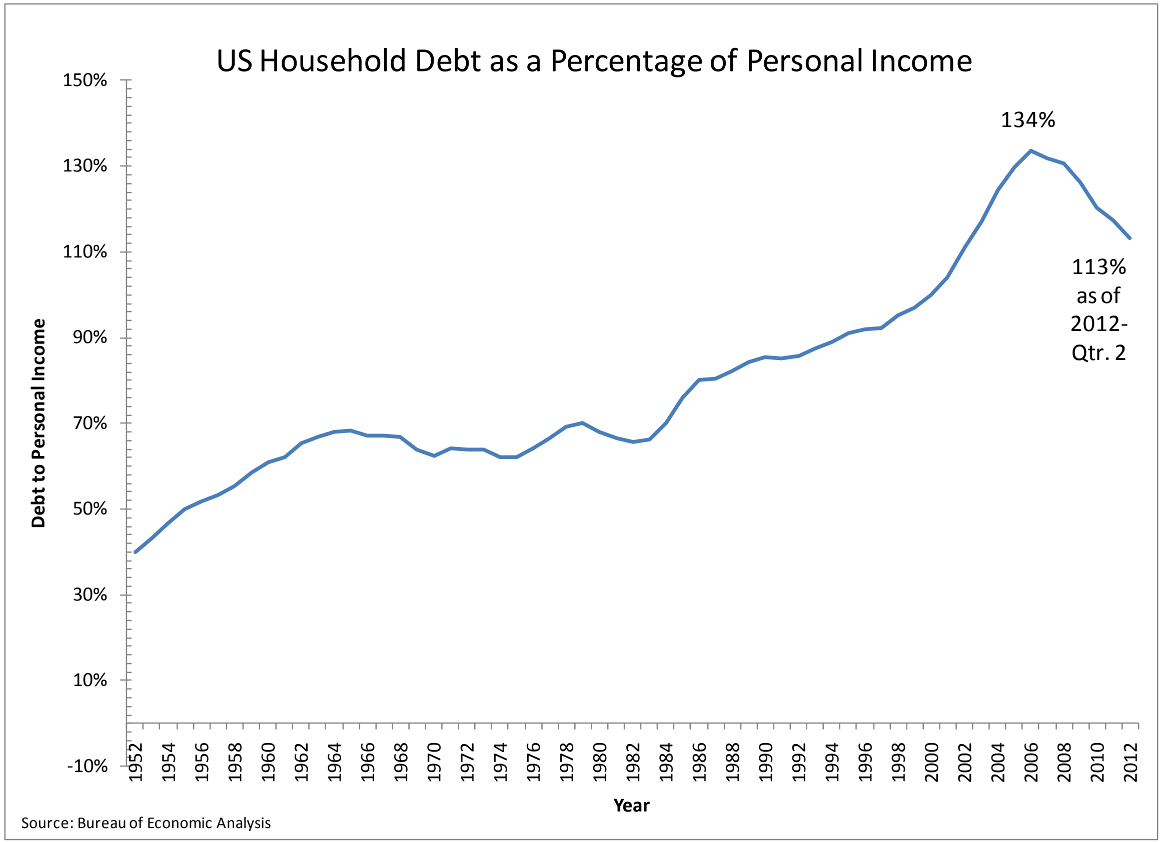
- From peak to trough, U.S. economic output fell by 4.7% and Connecticut economic output fell by 9.3%.
- The average post- WWII recovery period is 1.2 years.
- It has taken 4 years for the U.S. economy to regain its pre-recession level of output.
- It will take an estimated 6.5 years for the Connecticut economy to regain its pre-recession level of output.

Stagnant Income Growth



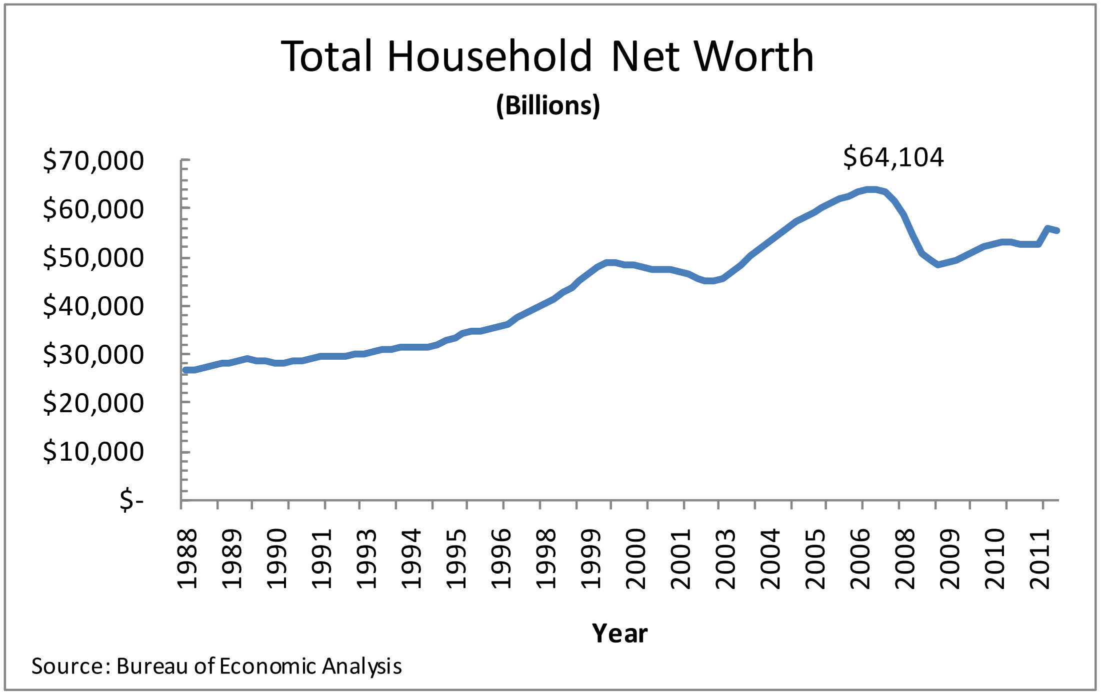
- From its peak in 2008, Qtr. 2, U.S. real personal income had declined $755 billion, or 6.5% by 2009, Qtr. 4.
- From its peak in 2008 to 2012-Qtr. 1 there has been no cumulative growth in U.S. real personal income.
- This has a significant dampening effect on current consumption.

Consumer Debt



- After reaching unsustainable levels, U.S. households have begun to address their debt.
- However, debt remains at elevated levels.
- At this rate it will take 15 years to reach the historic average.
- Despite historically low interest rates, which would normally be an incentive to borrow more, households continue to deleverage.
- This reduction in debt combined with the increase in the savings rate is equivalent to 1.9% annually of U.S. GDP.

Depressed Household Net Worth



- Household net worth for all Americans peaked at $64,104 billion in 2007, Q2.
- The financial crisis wiped out 24% of households' total net worth from peak to trough.
- Even today, U.S. household net worth remains 14% below the 2007 peak. This has negative consequences for consumers' ability to borrow against their assets and consumer confidence via the "wealth effect."

Expenditures:

Major Cost Drivers &

Long Term Obligations

Components of FY 2013 General Fund Shortfall

(In Millions)

Adopted (revised) budget balance	$ 3.1
Medicaid shortfall	(260.0)
DOC shortfall	(20.0)
DESPP shortfall	(13.0)
DCP shortfall	(1.1)
Various lapses	54.1
Revenue changes (11/9/12 consensus)	
Sales and Use Tax	(43.6)
Corporation Tax	(66.8)
Indian Gaming Payments	(24.6)
Refunds of Taxes	(100.0)
Federal Grants	133.9
All Other	(27.0)
Total Revenue Changes	(128.1)
Estimated FY 2013 Shortfall	$ (365.0)

Summary of Appropriated Fund Projections – General Fund

In Millions

	Estimated FY 2013	Current Services FY 2014	Current Services FY 2015	Projected FY 2016
DSS - Medicaid	$ 4,958.0	$ 5,226.7	$ 5,653.2	$ 6,039.0
STATEWIDE - Personal Services	2,070.2	2,229.6	2,337.0	2,445.6
SDE - Education Equalization Grants	2,007.6	2,017.6	2,026.7	2,028.8
OTT - Debt Service	1,606.3	1,681.8	1,794.8	1,892.5
TRB - Retirement Contributions	787.5	948.5	984.1	1,062.8
OSC - Employee Retirement Contribution	721.5	912.4	963.3	1,037.5
OSC - Retired Employee Health Serv Cost	614.1	701.0	743.5	774.4
OSC - State Employees Health Serv Cost	568.0	563.0	602.8	627.9
STATEWIDE - Other Expenses	457.7	501.2	524.4	537.2
DDS - Community Residential Services	437.9	451.7	470.9	496.2
DSS - Disproportionate Share-Med Emer Asst	268.5	268.5	268.5	268.5
SDE - Magnet Schools	242.4	275.0	290.8	297.8
OSC - Employers Social Security Tax	222.0	221.9	231.8	237.5
DDS - Employment Opportunities & Day Svcs	200.3	217.8	227.7	234.9
UOC - Operating Expenses	192.3	200.8	212.5	220.0
DCF - Board & Care - Residential	177.0	155.2	158.6	164.6
MHA - General Assistance Managed Care	167.2	175.9	183.9	201.7
BOR - Regional Community - Technical Colleges	143.2	147.3	154.4	161.4
BOR - Connecticut State University	141.2	143.6	150.5	157.3
SDE - Excess Cost - Student Based	139.8	177.3	185.9	190.4
SDE - Regional Vocational-Technical School Sys	134.8	149.0	159.0	165.7
SDE - Priority School Districts	121.9	122.0	121.2	124.1
OTT - Pension Obligation Bonds - TRB	121.4	145.1	133.9	132.9
OTT - UConn 2000 - Debt Service	117.7	135.3	156.0	169.2
STATEWIDE - GAAP Accruals	-	82.2	95.8	118.8
STATEWIDE - ALL OTHER	2,877.9	3,069.7	3,176.0	3,273.2
General Fund - Gross	**$ 19,496.4**	**$ 20,920.0**	**$ 22,007.3**	**$ 23,060.0**
Total Lapses	(116.3)	(116.3)	(116.3)	(116.3)
General Fund - Net	**$ 19,380.1**	**$ 20,803.6**	**$ 21,890.9**	**$ 22,943.7**

Components of Current Services Growth - General Fund

(In Millions)	FY 2014 vs. FY 2013	FY 2015 vs. FY 2014
Medicaid	$268.7	$426.5
Debt Service	$116.7	$122.6
State Employee Retirement Contributions	$190.9	$50.9
Teachers' Retirement Contributions	$161.0	$35.6
Active & Retiree Healthcare	$87.6	$43.5
Statutory Formula Grants	$106.1	$15.3
Employee Wage Increases	$112.0	$151.5
Other Inflationary Increases	$43.9	$43.7
GAAP Accruals	$82.2	$13.5
All Other	$254.5	$184.2
Total Increase	$1,423.6	$1,087.3

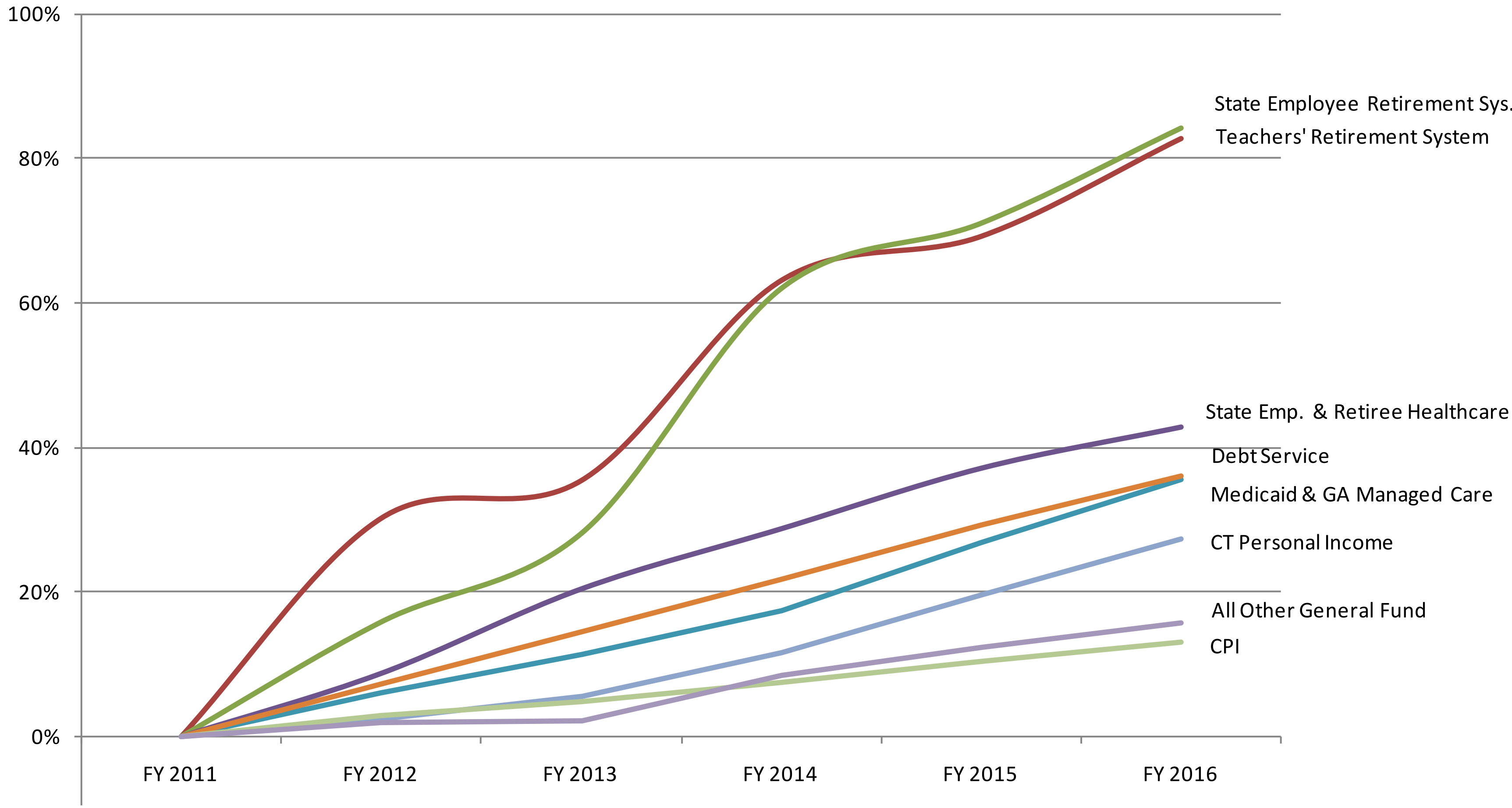
Summary of Appropriated Fund Projections – Other Funds

In Millions

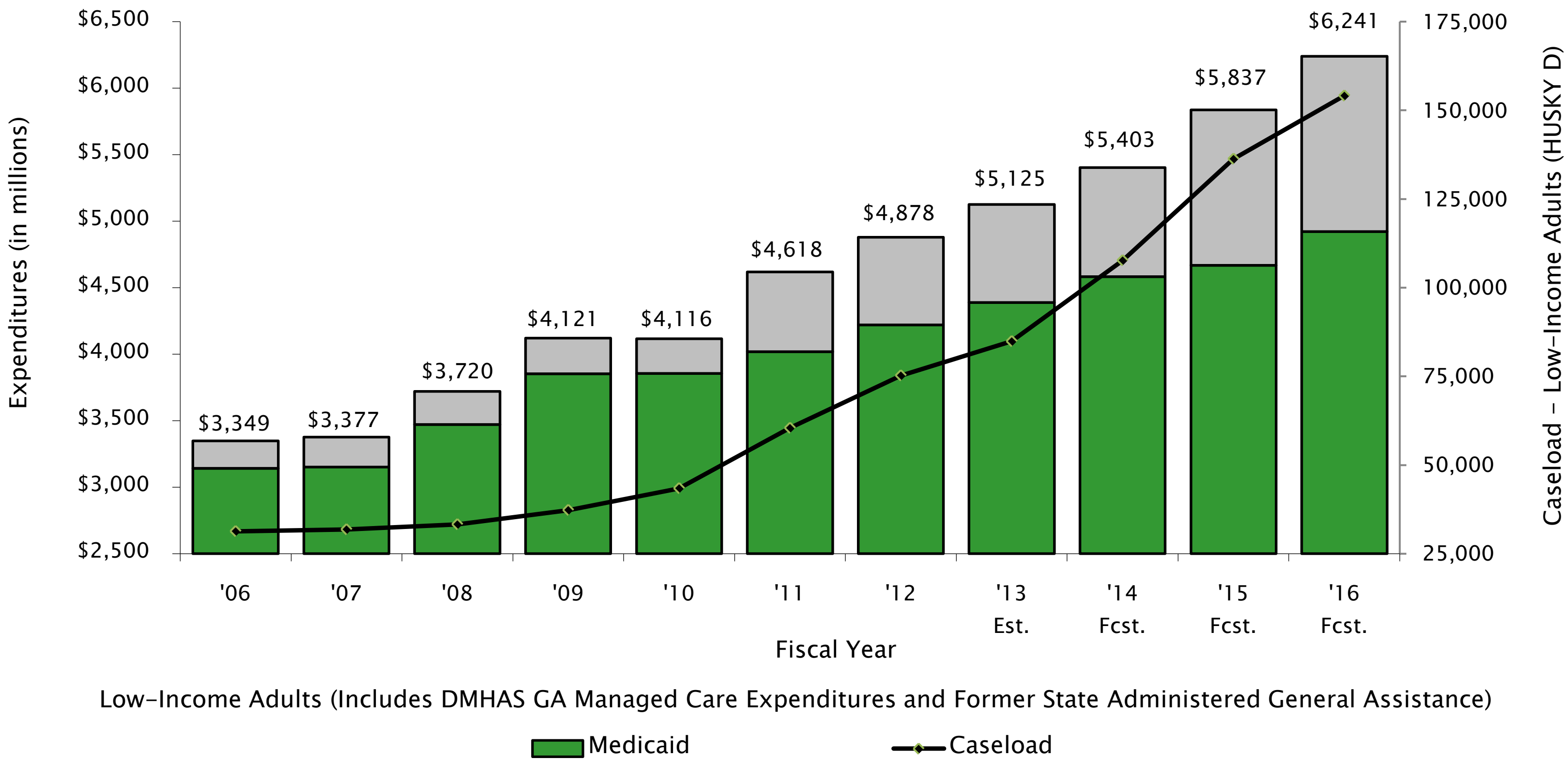
	Estimated FY 2013	Current Services FY 2014	Current Services FY 2015	Projected FY 2016
SPECIAL TRANSPORTATION FUND - Gross	$ 1,243.7	$ 1,331.4	$ 1,405.1	$ 1,473.9
Unallocated Lapses	(11.0)	(11.0)	(11.0)	(11.0)
Special Transportation Fund - Net	$ 1,232.7	$ 1,320.4	$ 1,394.1	$ 1,462.9
BANKING FUND - Gross	$ 25.6	$ 26.1	$ 27.5	$ 28.5
Branch Savings Target - Judicial	(0.1)	(0.1)	(0.1)	(0.1)
Banking Fund - Net	$ 25.5	$ 26.0	$ 27.4	$ 28.5
INSURANCE FUND	$ 28.7	$ 30.5	$ 31.7	$ 32.9
CONSUMER COUNSEL/PUBLIC UTILITY FUND	$ 25.4	$ 24.9	$ 26.1	$ 27.1
WORKERS' COMPENSATION FUND	$ 21.3	$ 22.1	$ 22.7	$ 23.6
MASHANTUCKET PEQUOT AND MOHEGAN FUND	$ 61.8	$ 135.0	$ 135.0	$ 135.0
SOLDIERS, SAILORS AND MARINES' FUND	$ 3.0	$ 3.1	$ 3.1	$ 3.3
REGIONAL MARKET OPERATION FUND	$ 0.9	$ 0.9	$ 1.0	$ 1.0
CRIMINAL INJURIES COMPENSATION FUND	$ 3.6	$ 3.4	$ 2.8	$ 2.9
TOTAL ALL OTHER FUNDS - NET	**$ 1,403.0**	**$ 1,566.4**	**$ 1,643.9**	**$ 1,717.0**
TOTAL ALL FUNDS - NET	**$ 20,783.0**	**$ 22,370.0**	**$ 23,534.8**	**$ 24,660.7**

General Fund Cost Drivers

Change in Various Budget Components Relative to FY 2011

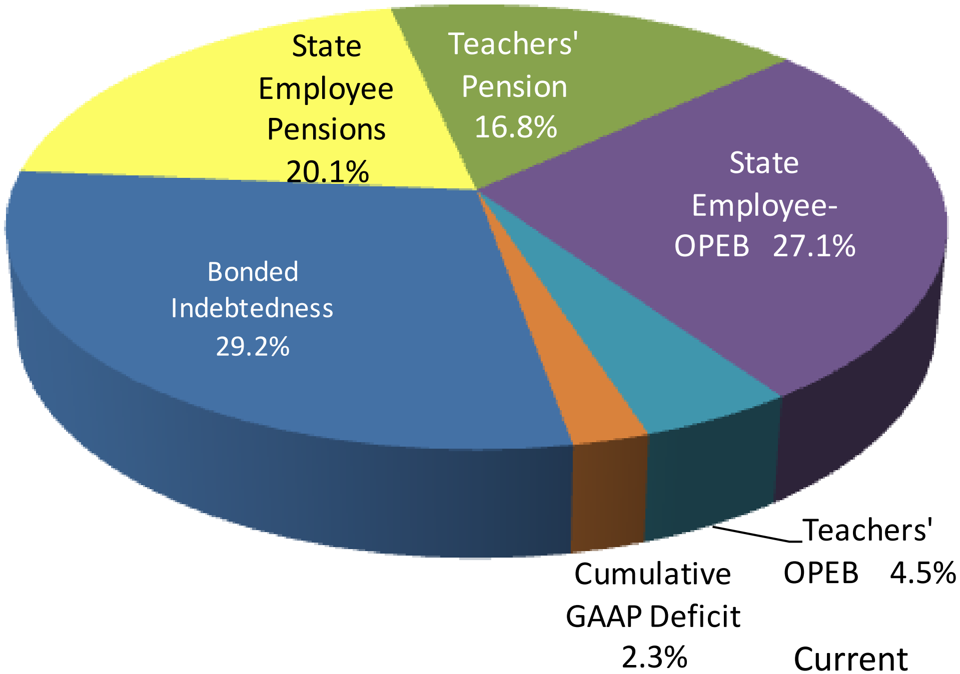


Department of Social Services - Medicaid



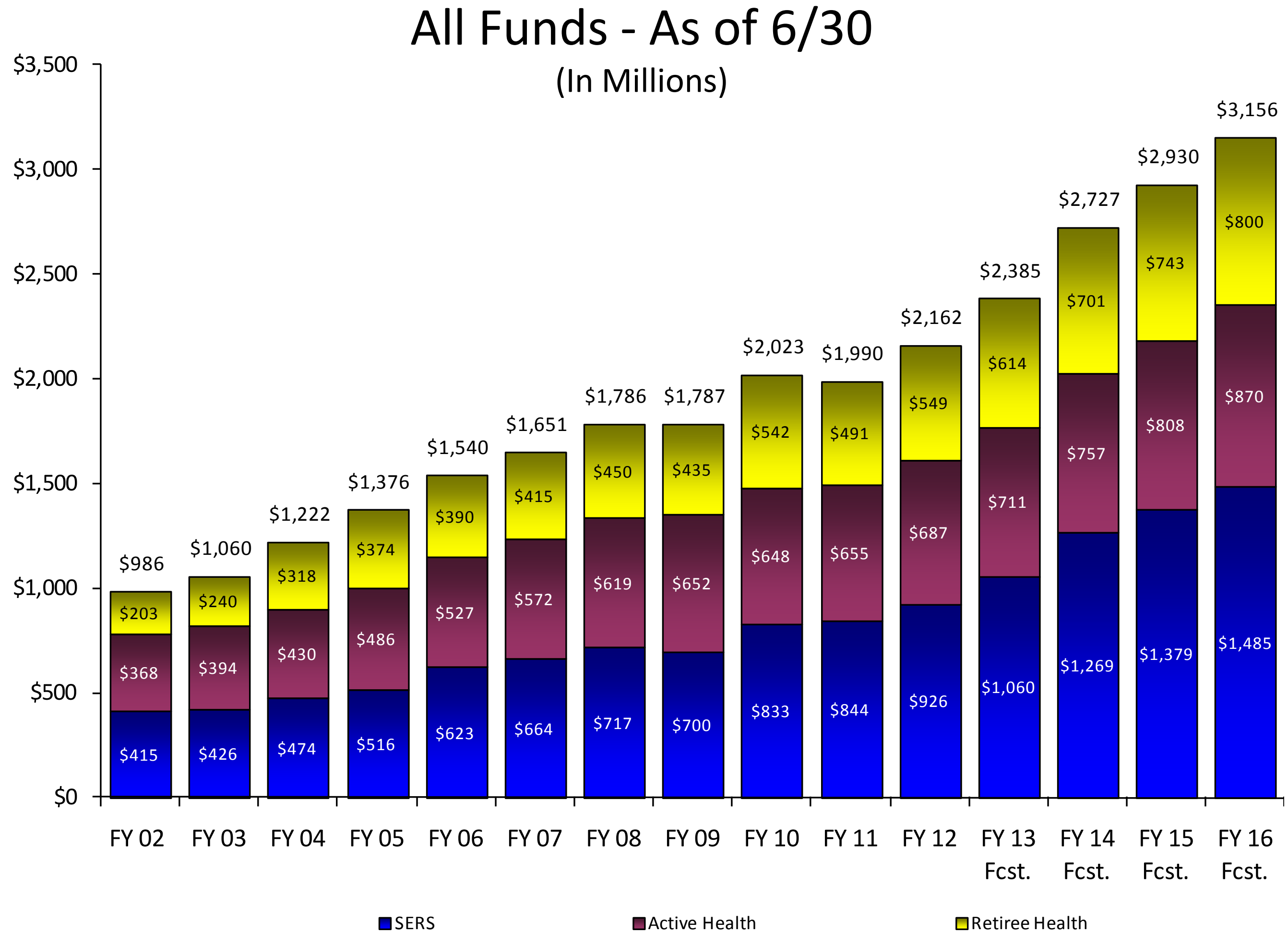
- FY 2011 through FY 2016 reflects growth due to the Medicaid expansion for low-income adults (LIA). Projected expenditures also reflect the impact of federal health care reform, which expands Medicaid coverage under LIA by increasing income eligibility to 133% of the federal poverty level beginning January 1, 2014.

Long Term Obligations



	Current	Last Year
• Bonded Indebtedness- As of 8/31/12	$19.3B	$19.5B
• State Employees Pensions- As of 6/30/12	$13.3B	$11.7B
• Teachers' Pension- As of 6/30/12	$11.1B	$9.1B
• State Employees Post Retirement Health and Life (OPEB)	$17.9B	$26.6B
• Teachers' Post Retirement Health and Life (OPEB)	$ 3.0B	$3.0B
• Cumulative GAAP Deficit- as of 10/2012	$ 1.5B	$1.7B
Total Unfunded Long-Term Obligations	$66.1B	$71.6B

State Employees Pension & Health Insurance

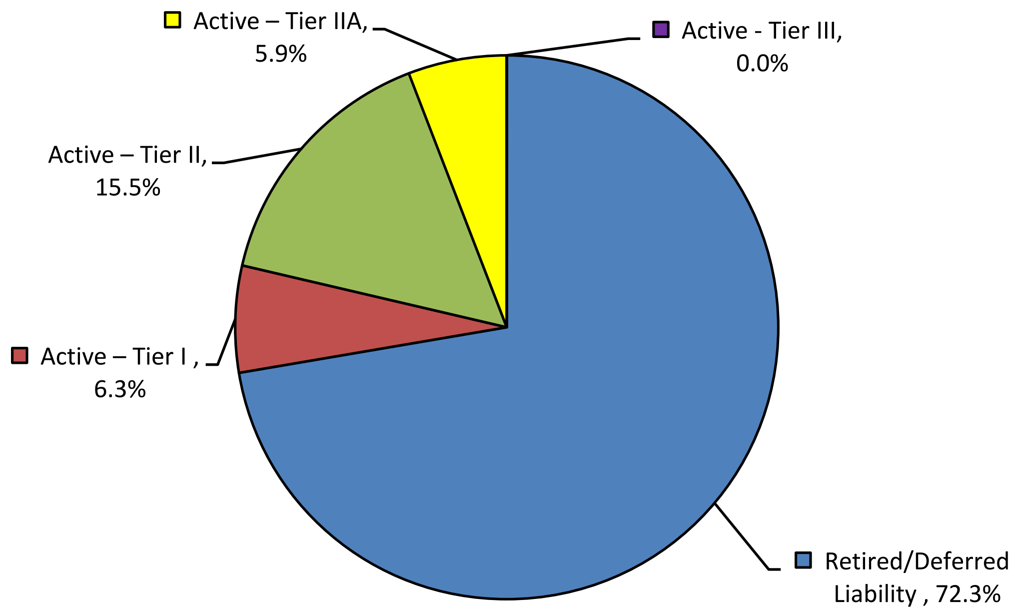


Note: Retiree Health includes offsets for the Medicare Part D Employer Subsidy in FYs 2007 through 2012. SERS includes payment deferrals in FYs 2009 through 2011.

State Employees Retirement System

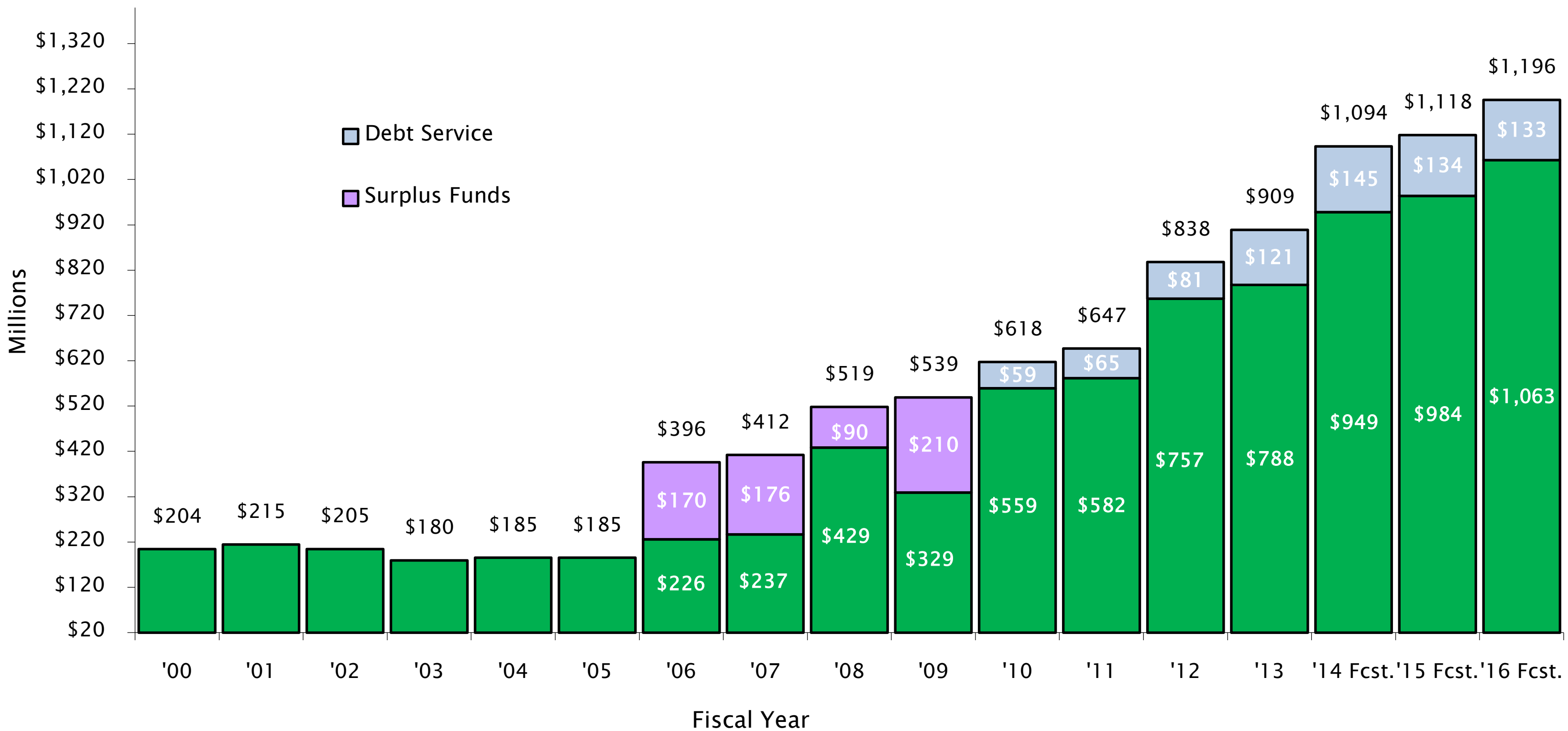
Components of Pension Liability

Based on 6/30/12 Valuation ($ in Thousands)		
Retired/Deferred Liability	$16,646,788	72.3%
Active – Tier I Hazardous	66,445	0.3%
Active – Tier IB	1,343,050	5.8%
Active – Tier IC	50,903	0.2%
Active – Tier II Hazardous	1,246,123	5.4%
Active – Tier II Others	2,316,785	10.1%
Active – Tier IIA Hazardous	590,337	2.6%
Active – Tier IIA Others	756,291	3.3%
Active - Tier III Hazardous	431	0.0%
Active - Tier III Others	1,599	0.0%
Total Accrued Liability	$23,018,752	
Actuarial Value of Assets	9,744,986	
Unfunded Accrued Liability	$13,273,766	
Normal cost	$249,996	
Amortization of UAL	$1,018,938	
Annual Required Contribution	$1,268,934	



- $23.0 billion total liability.
- Most (72.3%) of that liability is related to already-retired employees.
- $13.3 billion unfunded liability.
- 80% of the actuarially required contribution is for the unfunded accrued liability.

Teachers' Retirement System Contributions

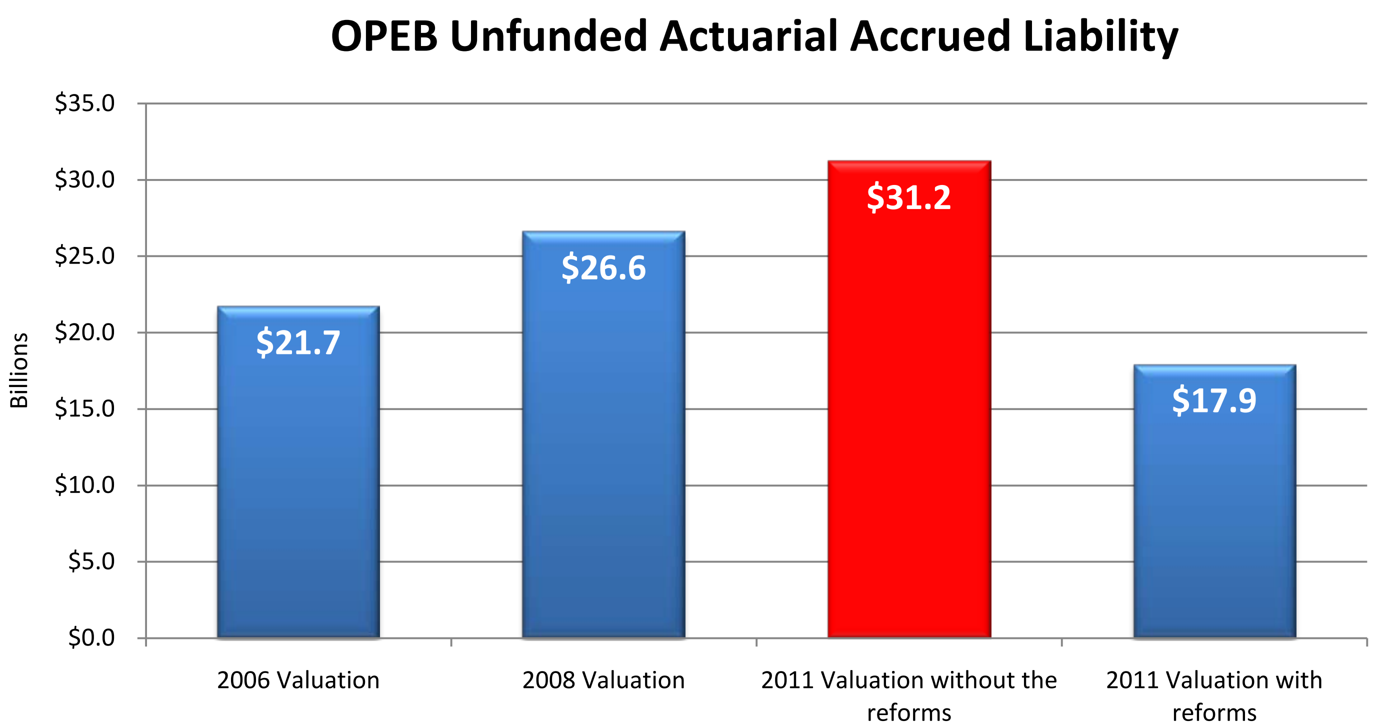


FY 2010 and beyond include debt service on the $2.3 billion in pension obligation bonds issued on April 30, 2008 on behalf of the Teachers' Retirement System.

Other Post Employment Benefits

- Recent Reforms:
  - The 2009 and 2011 SEBAC agreements require:
    - 3% contribution to Retiree Health Care Trust Fund for all health care eligible employees, with phased in implementation.
    - State match of employee OPEB contributions beginning July 1, 2017.
    - Greater premium share for individuals who elect early retirement.
- The valuation as of June 30, 2011 (issued in May of 2012) reflects the reforms mentioned above and the corresponding impact on the OPEB liability. As a result, the UAAL is now only $17.9 billion, a decrease of $8.7 billion from the 2008 valuation.
- Based on the most recent valuation, the OPEB trust fund contained $49.6 million in net assets as of June 30, 2011.
- Deposits to the OPEB Trust Fund:
  - State Contributions:
    - $10 million in FY 2008 and $14.5 million in FY 2011.
  - Employee Contributions:
    - $1.4 million in FY 2010, $21.6 million in FY 2011 and $25.0 million in FY 2012.

Other Post Employment Benefits

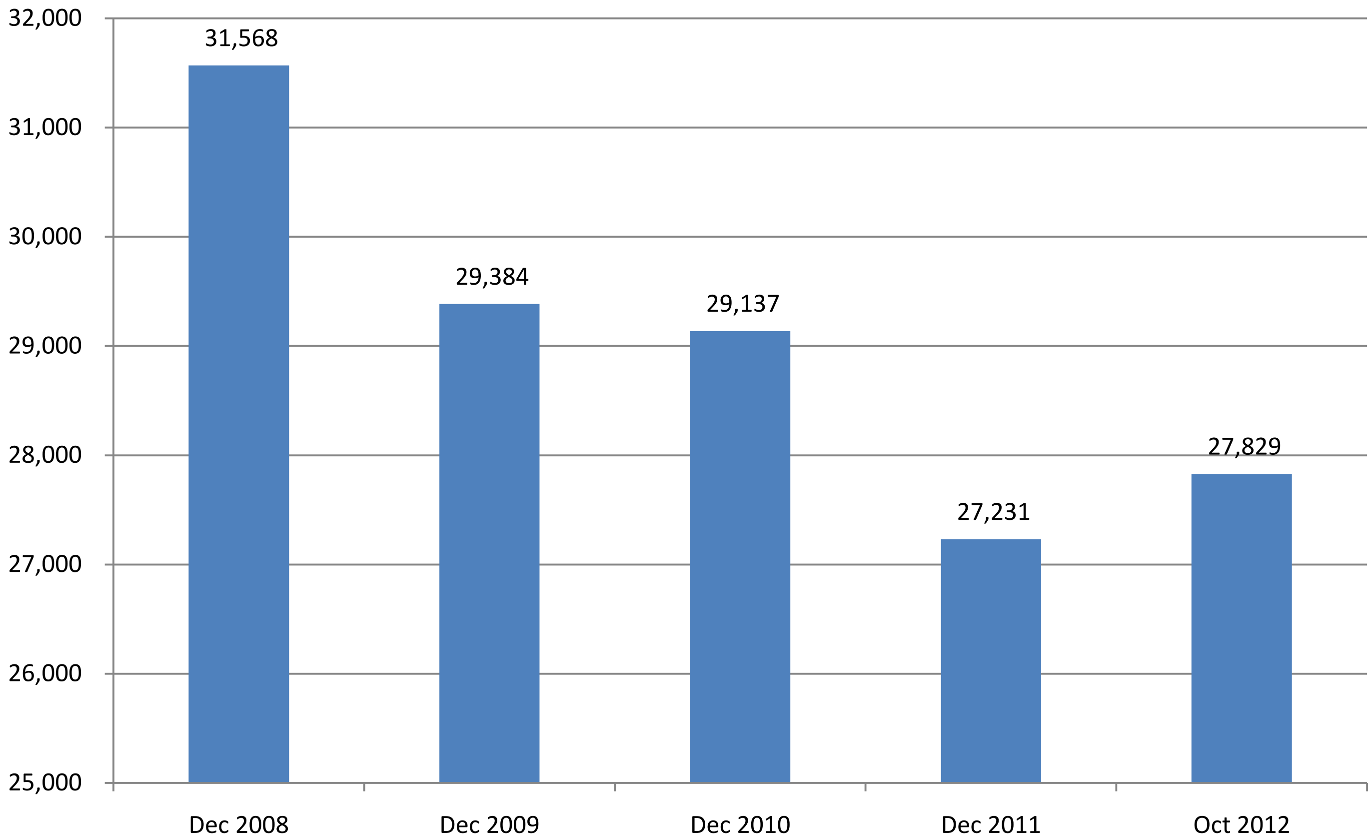


If the state had not implemented any reforms, the UAAL would have increased to $31.2 billion.

<u>The reforms have therefore reduced the OPEB liability by $13.3 billion.</u>

Reduction in State Employee Workforce

Full-time Executive Branch Employees on Payroll



Based on Executive Branch General Fund and Special Transportation Fund payroll data for 12/18/08, 12/31/09, 12/30/10, 12/29/11, and 10/18/12 payrolls; excludes constituent units of Higher Education.

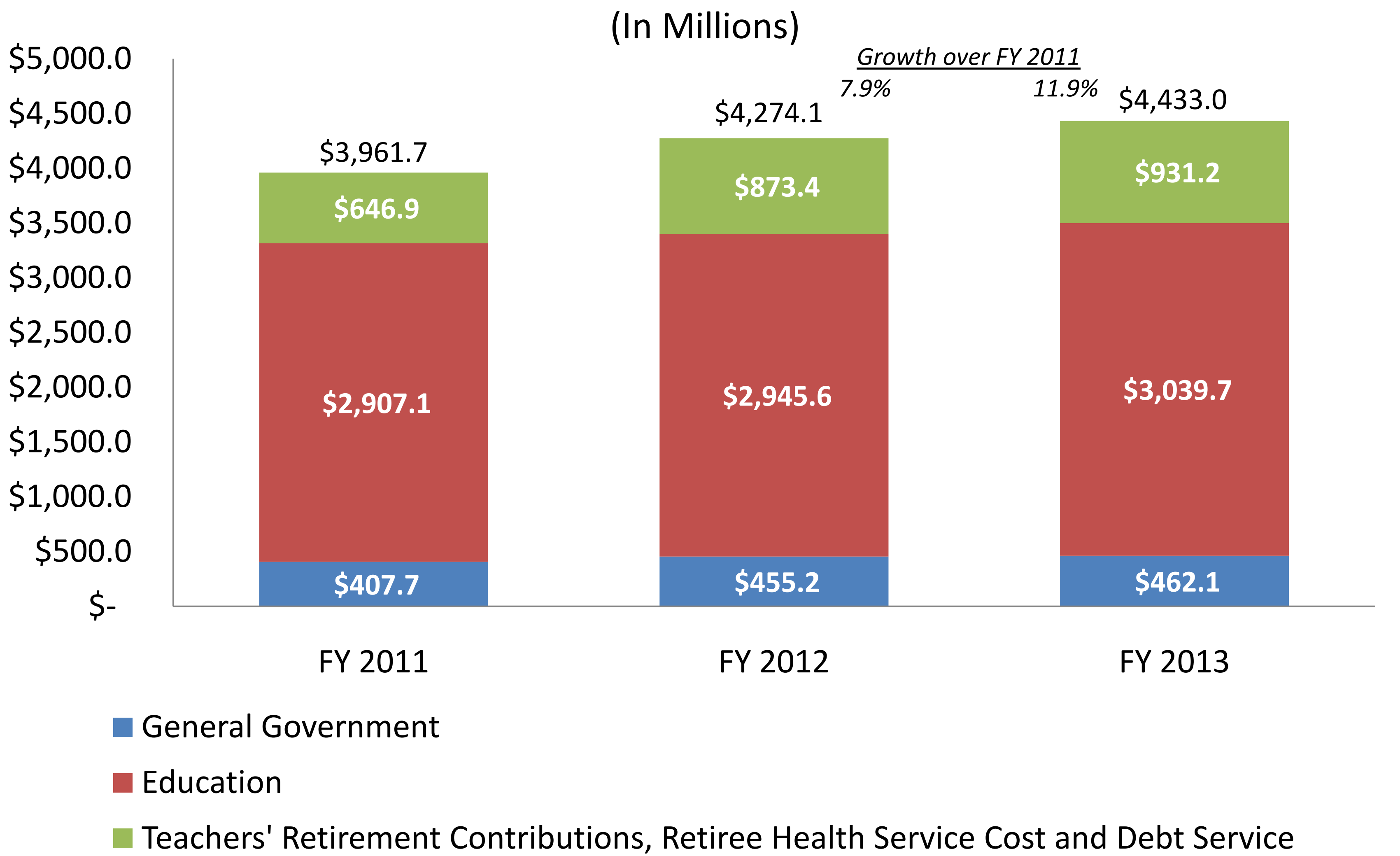
Fiscal Cliff

Threatens to Undermine Economic Recovery

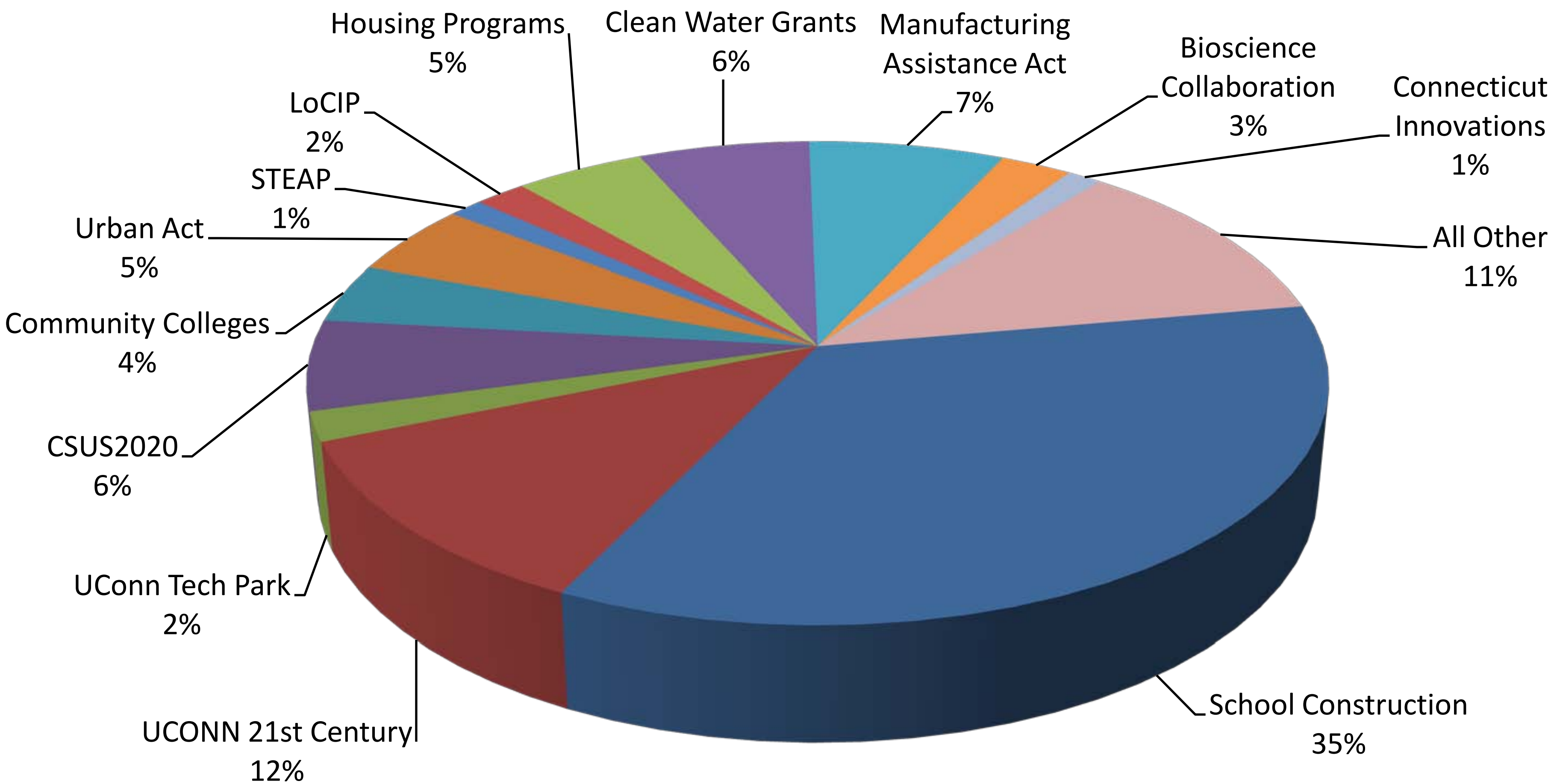
Simultaneous expiration of a number of federal stimulus measures coupled with budget cuts to reduce the national debt threatens to return the country to recession during 2013. The Congressional Budget Office estimates that, in the absence of an agreement, U.S. Gross Domestic Product (GDP) will contract 1.3 percent during the first six months of 2013.

- Payroll Tax Cuts Expiration - end of 2012
  - Workers will see a reduction in their paychecks with the increase in the payroll tax rate from 4.2% to 6.2%, thereby reducing consumer spending power.
- Bush Era Tax Cuts Expiration - end of 2012
  - Top tax rate will rise from 35% to 39.6%, other rates will rise respectively; reduces consumer spending power.
- Extended Unemployment Compensation Expiration – end of 2012
  - Cuts off benefits to long-term unemployed residents, thereby reducing their spending power.
- Sequestration- $1.2 trillion in Domestic & Defense Program Cuts – January 2013
  - Connecticut's relatively high concentration in defense industries makes its economy more vulnerable to these cuts.

State Aid to or on Behalf of Local Governments

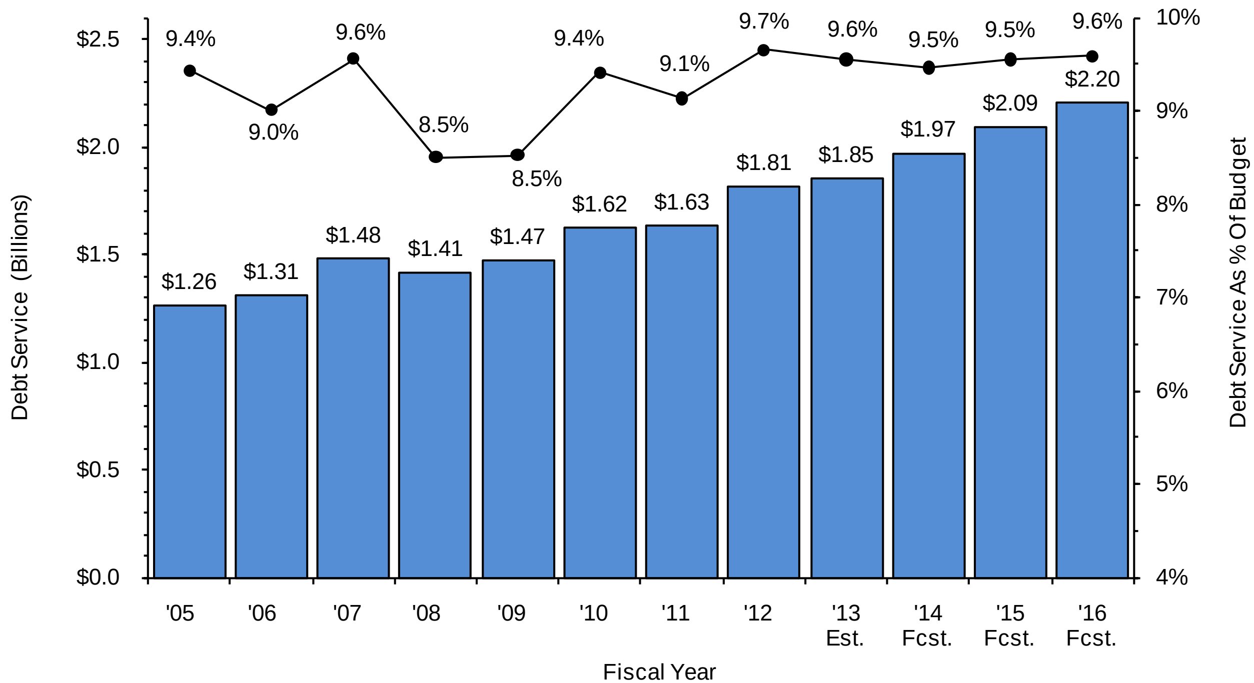


Projected GO Bond Allocations FY 2013 – FY 2017



Impact of State Bonded Indebtedness

General Fund Debt Service Expenditures



- Debt Service as a percentage of the General Fund budget has remained fairly steady.
- The issuance of nearly $1.0 billion in Economic Recovery Notes to fund the FY 2009 deficit required additional debt service of $208 million in FY 2012 through FY 2016.

State and Local Debt Burden - 2010

Ranked by Per Capita State and Local Debt-2010			Ranked by State and Local Debt As a % of Personal Income (PI)- 2010		
Rank	State	Amount ($)	Rank	State	Debt/PI
1	New York	$ 16,319	1	New York	33.6%
2	Massachusetts	14,827	2	Alaska	32.3%
3	Alaska	14,241	3	Kentucky	29.8%
4	Rhode Island	11,590	4	Massachusetts	28.9%
5	**Connecticut**	**11,415**	5	Nevada	28.2%
6	New Jersey	11,138	6	Rhode Island	27.6%
7	California	10,806	7	Texas	26.2%
8	Illinois	10,586	8	Kansas	26.0%
9	Washington	10,523	9	California	25.4%
10	Nevada	10,416	10	South Carolina	25.3%
11	Kansas	10,110	11	Illinois	25.2%
12	Colorado	10,032	**23**	**Connecticut**	**21.1%**
	UNITED STATES	$ 9,138		UNITED STATES	23.0%

Source: U.S. Department of Commerce, Census & BEA

- Connecticut’s state and local debt burden in 2010 equals $11,415 per person.
- The state’s burden is lower than its three neighboring states.

Conclusion

- The state faces significant fiscal challenges over the next several years.
- Governor Malloy is committed to ensuring the state lives within its means.
- Extraordinarily difficult decisions to reduce spending will be necessary.
- The Governor will NOT propose tax increases as a solution to these challenges.
- Nevertheless, the Governor intends to identify opportunities to make smart investments that create jobs and improve education, even in these difficult times.