State of Connecticut

Issuer: State of Connecticut		
Assigned	**Rating**	**Outlook**
General Obligation Bonds (2021 Series A)	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 and the effects of the pandemic.

Despite the onset of the pandemic in March 2020, the State was able to close out the fiscal year end (6/30) with balanced operations, a deposit to the BRF of $569 million, and a transfer to the BRF in excess of the statutory 15% threshold of $62 million to the State Employees Retirement Fund to reduce unfunded liabilities. Restrained spending offset the drop in budgeted revenues of $266 million to achieve this result. The contribution to the BRF continued the pattern of deposits to the BRF established over the prior two years. This practice has increased the balance of the BRF from just 1.3% of General Fund expenditures at FYE 2017 to 15.3% at FYE 2020.

However, pandemic uncertainties remain and are reflected in the FY 2021 budget. Total revenues of $18.8 billion are expected to be $1.4 billion less than prior December 2019 projections. Principal contributors to this drop are personal income taxes (-$1.08 billion), sales taxes (-$342) and corporate taxes (-$314 million). Expenditure reductions of $370 million will not fully address the decline, requiring the use of the BRF in the amount of $879 million. Remaining BRF balance at the conclusion of FY 2021 is budgeted to be $2.13 billion.

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). Substantially all of this has been spent or allocated.

The stay at home orders from the pandemic implemented in March caused a significant falloff in economic activity in Connecticut as it did nationwide. However, many of the effects have been more muted than elsewhere. The unemployment rate increased in Connecticut to 10.3% in July 2020 from 4.4% in February 2020, but this was less than the increases seen in the New England region and the U.S. The unemployment rate is now at 5.8% in the state, lower than the region and U.S. averages.

Furthermore, the State seems to be benefitting from pandemic-induced in-migration, primarily from New York. According to the US Postal Service change of address submissions, 18,694 people moved to Connecticut through October 2020 compared to 765 that moved from the state through the same period in 2019. Whether or not these trends prove to be longer lasting remains to be seen.

Wealth levels remain very high, with per capita income of $77,289 at nearly 140% of the national average in 2019. The longer-term, pre-pandemic economic growth trend in the state was sluggish. Real gross state product (GSP) contracted in six of the last twelve years. The depth and duration of the current downturn and ultimate pace of the recovery as the economy eventually reboots is unclear.

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. Debt amortization is favorable with 70% of general obligation debt retired in 10 years.

The Stable Outlook reflects the diversity and high wealth levels of the economic base and strong reserve position which provides a good framework for the current pandemic-disrupted environment.

Key Credit Considerations

KBRA continues to monitor the direct and indirect impacts of the COVID-19 virus. Click **here** to access KBRA's ongoing research on the topic.

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 and is now 15% of general fund expenditures.
- 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

▪ Stronger economic growth trends than what have been experienced since the Great Recession. ▪ 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)	$77,289
as a % of U.S.	*137%*
Population (2019)	3,565,287
Growth 2010 to 2019	*-0.4%*
Real GSP, % Change 2010 to 2019	
Connecticut	1.4%
New England	13.5%
United States	22.4%
Budget Reserve Fund Balance ($ in millions)	
FYE 2017	$212.9
FYE 2018	$1,185.3
FYE 2019	$2,505.5
FYE 2020 Estimate (OPM 11/20/2020)	$3,074.6
Total Direct Debt (11/20/2020) ($ in millions)	$25,698
Net Pension Liability (6/30/2019 Measurement Date) ($ in millions)	$40,105
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	AA- *(revised from 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 have been 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:

- Monthly Reports on Financial Performance— 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.
- Annual Report to Legislature— 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.
- Three Year Out Report— 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.

- Consensus Revenue Estimates— 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 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.

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 pegged to a base of $3.15 billion for FY 2017, adjusted each year by the compound annual growth rate of personal income in the state over the prior five years, as calculated annually by the State Comptroller. After the BRF reaches 15% of net GF appropriations, revenues in excess of the 15% threshold 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 2020 Fiscal Accountability Report, the estimated debt incurring margin for FY 2020 is $4.5 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 $25.7 billion including $18.8 billion in general obligation bonds, $6.2 billion in special tax debt secured by a pledge of transportation related taxes and fees, and $235 million in various other obligations. Also included in this figure is $471 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 millions)					
	2/1/2017	**2/15/2018**	**2/1/2019**	**5/1/2020**	**11/20/2020[1]**
General Obligation Bonds	$14,091	$14,038	$15,008	$14,005	$14,834
General Obligation Bond Anticipation Notes	-	400	-	-	-
Pension Obligation Bonds (GO)[2]	2,351	2,370	2,368	2,394	2,406
UConn 2000 Bonds (GO)	1,533	1,421	1,635	1,569	1,545
Total General Obligation Debt	17,975	18,228	19,011	17,968	18,785
Special Tax Obligation Bonds	5,042	5,540	5,958	5,575	6,207
Other[3]	327	302	257	216	235
State Guaranteed City of Hartford Debt	-	-	516	488	471
Total Direct Tax-Supported Debt	**23,343**	**24,071**	**25,741**	**24,246**	**25,698**

Source: POS and historic GO Official Statements.

[1]Adjusted to include the estimated $800 balance of the currently offered GO bonds.

[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 25% of states compared to personal income and to GSP.

FIGURE 2

Debt Ratios	Connecticut	Average of U.S. States	Connecticut Rank Among the 50 States
Tax-Supported Debt[1]			
Per Capita	$7,208	$ 1,646	Highest 5%
as a % of Personal Income	9.1%	2.9%	Highest 5%
as a % of GSP	9.0%	2.6%	Highest 5%
Aggregate State and Local Debt			
Per Capita	$14,472	$9,591	Highest 5%
as a % of Personal Income	19.3%	17.6%	Highest 25%
as a % of GSP	18.7%	15.2%	Highest 10%

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

[1]Includes currently offered bonds.

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 $912 million in variable rate general obligation bonds, which represents approximately 4.9% of pro forma long-term GO debt. The State is not party to any interest rate derivatives with respect to its outstanding GO debt.

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 from $2.8 billion in FY 2015 to approximately $1.4 billion in FY 2019. Authorization increased to $1.9 billion in FY 2020 and remain at approximately this level for FY 2021. 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 38.5% (June 30, 2020) and for TRS is 51.3% (June 30, 2020).[1] 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.

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.

[1] Based on actuarial value of assets. Funded ratios based on market value of assets are 36.0% for SERS and 49.3% for TRS.

FIGURE 3

Pension Funded Status and Actuarially Determined Employer Contribution Requirements as of June 30, 2020 (dollars in millions)	SERS	TRS	Total
Market Value of Assets	$13,253	$18,286	$31,539
Actuarial Accrued Liability	36,829	37,128	73,957
Unfunded Actuarial Accrued Liability	23,034	19,176	**42,210**
Funded Ratio (based on the market value of assets)	36.0%	49.3%	42.6%
FY 2019 Actuarially Determined Employer Contribution (ADEC)	1,575	1,292	**2,867**
% of ADEC Contributed	100%	100%	
FY 2020 ADEC	1,616	1,392	**3,009**
FY 2021 ADEC	1,807	1,437	**3,244**
FY 2022 ADEC	1,983	1,444	**3,427**
FY 2023 ADEC	2,150	1,578	**3,728**

Source: State of Connecticut Annual Information Statement dated February 15, 2020 with December 3, 2020 supplementary information.

Net Pension Liability

The State's net pension liability (NPL), based on GASB 67 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 $40.1 billion as of June 30, 2019 based on the latest SERS and TRS valuations provided in the Information Statement with December 3, 2020 Supplement Updates accompanying the POS and June 30, 2018 JRS valuation data from the FY 2019 CAFR. This NPL ranks among highest in the country when compared to population, personal income, and GSP. 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	Connecticut	Average of U.S. States	Connecticut Rank Among the 50 States
Net Pension Liability			
Per Capita	$11,249	$1,958	Highest 5%
as a % of Personal Income	14.2%	3.3%	Highest 10%
as a % of GSP	14.0%	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.

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 made significant progress in improving its financial position in the last three years, building the balance of its Budget Reserve Fund (BRF or rainy day fund) from just 1.3% of General Fund expenditures at FYE 2017 to 15.3% at FYE 2020. Key to progress was the implementation of a revenue volatility cap as part of the 2017 Budget Act, which specifies that total estimated and final PIT collections plus pass-through entity tax collections each year, in excess of \$3.15 billion[2], is deposited into the BRF. This accommodated net contributions to the BRF totaling \$988 million in FY 2018, \$1.32 billion in FY 2019, and \$569 million in FY 2020, with the current balance of \$3.08 billion equivalent to 15.3% of FY 2021 budgeted expenditures. November estimates project that ongoing pandemic related headwinds will require drawdown of the BRF balance by \$879 million to balance the FY 2021 budget, but this sizable reserve positions the State well to manage virus related budget challenges. Additionally, \$61.6 million will be transferred from the BRF to reduce the unfunded liabilities of the State Employee Retirement Fund in FY 2021.

FIGURE 5

General Fund Statement of Revenues, Expenditures, and Net Surplus
Budgetary Modified Cash Basis (FYE June 30) (dollars in millions)

	2016	2017	2018	2019	2020	2021 Nov Est.
Operating Revenues[1]	17,781	17,703	18,199	19,650	19,724	18,837
Operating Expenditures	17,921	17,763	18,611	19,249	19,189	19,717
Other Resources	(30)	37	(71)	(31)	34	-
Operating Surplus (Deficit)	**(170)**	**(23)**	**(483)**	**371**	**569**	**(879)**
Transfers from (to) Budget Reserve Fund	170	23	483	(371)	(530)	941
Reserve for Statutory Transfer	-	-	-	-	(39)	(62)
Unappropriated Surplus (Deficit)	**-**	**-**	**-**	**-**	**-**	**-**
Budget Reserve Fund[3]						
Beginning Budget Reserve Fund Balance	406	236	213	1,185	2,506	3,075
Transfers from (to) General Fund	(170)	(23)	(483)	371	39	-
Volatility Cap Deposit[2]	-	-	1,471	950	530	(941)
Ending Budget Reserve Fund Balance	**236**	**213**	**1,201**	**2,506**	**3,075**	**2,134**
as a % of Operating Expenditures[4]	*1.3%*	*1.2%*	*6.5%*	*13.0%*	*15.3%*	*n.a.*

Source: Annual Financial Reports of the State Controller (Historic) and Office of Policy and Management Presentation (2021)

[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.

[4] As presented in POS, FY 2016 through FY 2019 BRF Balance is shown as a % of Operating Expenditures for said year, while FY 2020 BRF balance is calculated as a % of budgeted appropriations for FY 2021 of \$20,086.3 million.

FY 2020 Results

Realized revenues came in just \$266 million (1.4%) below the budgeted amount in FY 2020 despite onset of the virus in the final few months of the year. Notable shortfalls include:

- PIT collections (withholding as well as estimate and finals) \$275 million (2.9%) under budget.
- Sales and Use Tax collections \$126 million (2.8%) under budget.
- CIT collections \$165 million (15.0%) under budget.

A \$180 million shortfall in the estimated and final portion of PIT collections was more than offset by a \$392 million outperformance in pass-through entity tax collections. The combined collection of \$3.82 billion from the two sources, which together are the basis of the aforementioned volatility cap mechanism, resulted in the substantial \$530 million BRF deposit, exceeding the budgeted deposit by \$212 million.

Several other items additionally contributed to favorable performance in FY 2020 including:

- Federal Coronavirus Relief Funds received in the amount of \$1.38 billion were applied to offset virus related costs including testing (\$230 million), PPE and Supplies (\$100 million), State Operations for enhanced pandemic related services and cleaning (\$198 million), education reopening (\$165 million) and to support for non-profit providers (\$120 million).
- Federal Medicaid reimbursements for hospital inpatient and outpatient payments totaling \$368 million were received, which had not been anticipated to arrive until the following year.
- Medicaid Reimbursements per the Families First Coronavirus Relief Act were increased 17.7% resulting in an additional \$271 million.

[2] Indexed to the compounded annual growth rate of Statewide personal income over the last five years.

As the BRF now exceeds the statutorily specified ceiling of 15% of budgeted expenditures, the balance exceeding this amount (now estimated at $61.6 million) will be transferred in FY 2021, at the discretion of the State Treasurer, as an additional contribution to the State Employees Retirement Fund or to the Teacher's Retirement System.

FY 2021 Budget Projections

Revised November 2020 OPM projections anticipate a $1.42 billion (7.0%) decline in FY 2021 General Fund revenues relative to the prior December 2019 revised budget for this second year of the FY2020-2021 budget biennium due primarily to the pandemic. Notable downward re-estimates include:

- PIT collections (withholding as well as estimate and final) down $1.08 billion (10.8%)
- Sales and Use Tax collections down $342 million (7.5%)

The November 2020 OPM projections call for addressing the gap with:

- Expenditures reductions totaling $370 million (1.8%)
- BRF utilization of $879 million[3], which would leave a balance of $2.13 billion

OPM has proposed a budget deficit mitigation plan which would reduce the shortfall by $200 million including:

- Budget recissions and savings due to hiring restrictions totaling $55 million
- CARES Act Coronavirus Relief Fund reimbursement of certain public health and safety costs totaling $100 million
- Revenue items and reappropriations requiring legislative action totaling $44 million

FIGURE 6

General Fund and Budget Reserve Fund Budget, Actual, and Revised
Modified Cash Basis (FYE June 30) (dollars in millions)

	2020			2021		
	Budgeted	Realized	% Chg.	Budgeted (12/2019)	Revised (11/2020)	% Chg.
General Fund						
Revenues	19,460	19,194	-1.4%	20,253	18,837	-7.0%
Expenditures	19,693	19,845	0.8%	20,086	19,717	-1.8%
Operating Results - Surplus (Deficit)	(233)	(652)		166	(879)	
Budget Reserve Fund						
BRF - Balance Beginning	2,506	2,506		3,075	3,075	
Deposit (Withdrawal)	318	530		468	(941)	
BRF - Ending Balance	2,824	3,036		3,542	2,134	

Source: Annual Financial Report of the State Comptroller for FY 2020 and OPM Monthly Letter Dated November 20, 2020 for FY 2021

FIGURE 7

General Fund Revenues and Expenditures
Budgetary Modified Cash Basis (FYE June 30) (dollars in millions)

	2016	Δ YOY (%)	2017	Δ YOY (%)	2018	Δ YOY (%)	2019	Δ YOY (%)	2020	Δ YOY (%)	2021 Nov. Est
Revenues											
Personal Income Tax	9,182	-2.1%	8,989	19.8%	10,770	-10.5%	9,640	-2.5%	9,398	-5.0%	8,925
Federal Grants	1,302	1.8%	1,325	-13.7%	1,143	82.3%	2,084	-13.8%	1,797	-14.8%	1,530
Sales and Use Tax	4,182	0.2%	4,192	0.2%	4,202	3.2%	4,338	-0.5%	4,318	-1.7%	4,246
Corporate Income Tax	880	17.8%	1,038	-11.3%	921	15.2%	1,061	-11.9%	934	-17.7%	769
Pass-through Entity Tax	-	-	-	-	-	-	1,172	6.0%	1,242	-13.8%	1,071
Excise Taxes (Alcohol and Cigarettes)	437	1.8%	445	-1.1%	440	-4.2%	421	-0.4%	419	-3.6%	404
Indian Gaming Payments	266	1.5%	270	1.1%	273	-6.6%	255	-35.6%	164	50.7%	247
Statutory Transfers from Other Funds	178	-33.5%	118	-7.3%	110	0.0%	110	24.0%	136	-15.8%	115
Other	1,355	-2.1%	1,326	-74.4%	340	67.4%	569	38.0%	785	94.9%	1,530
Total Revenues	**17,781**	-0.4%	**17,703**	2.8%	**18,199**	8.0%	**19,650**	-2.3%	**19,194**	-1.9%	**18,837**
Expenditures											
General Government	627	-6.8%	585	10.7%	648	0.8%	653	-2.8%	635		n.a.
Public Safety	289	-4.9%	274	-5.3%	260	4.7%	272	3.2%	281		n.a.
Conservation and Development	195	-7.1%	181	0.0%	181	-6.2%	170	0.9%	172		n.a.
Health and Hospitals	1,766	-32.6%	1,190	-2.2%	1,163	2.6%	1,194	0.7%	1,203		n.a.
Human Services	3,102	16.9%	3,625	18.4%	4,292	0.5%	4,312	1.0%	4,357		n.a.
Education, Libraries and Museums	5,122	-2.3%	5,004	0.4%	5,025	3.7%	5,208	-1.0%	5,155		n.a.
Corrections and Judicial	2,061	-5.4%	1,949	-2.0%	1,911	3.0%	1,968	1.8%	2,004		n.a.
Debt Service	1,831	5.7%	1,935	1.1%	1,956	13.8%	2,225	-0.9%	2,205		n.a.
Other	2,929	3.1%	3,020	5.1%	3,175	2.3%	3,247	-2.1%	3,179		n.a.
Total Expenditures	**17,921**	-0.9%	**17,763**	4.8%	**18,611**	3.4%	**19,249**	-0.3%	**19,189**	2.8%	**19,717**

Source: Annual Financial Report of the State Controller (through FY 2020) and OPM Letter Dated November 20, 2020 (FY 2021 November Estimate)

[3] The $61 million difference between the $879 million deficit and $941 million to be withdrawn from the BRF reflects the balance exceeding 15% of budgeted expenditures which will be deposited to the State's pension funds.

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 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 8

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. 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 9

Available Cash Balance
FYE June 30 (dollars in millions)

	2016	2017	2018	2019	2020	10/31/2020
Common Cash Pool	$821	$1,101	$1,871	$3,558	$4,353	$4,498
Total Available Cash	$1,764	$2,657	$3,399	$4,827	$5,725	$5,791

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

Fiscal Accountability Report for FY's 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. The report notes that FY 2022 General Fund sales tax receipts will decline by $535 million due to enacted policy changes that will increase allocation of car sales tax proceeds to the State Transportation Fund from 25% to 75% and commencement of Municipal Revenue Sharing account transfers. 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 these revenue loss as well as potentially weaker near-term revenue growth assumptions in the context of the still ongoing pandemic environment in the next biennium budget.

KBRA has revised the Financial Performance and Liquidity rating determinant upward to AA-, from A+, reflecting primarily the substantial progress made in funding the BRF.

RD 4: State Resource Base

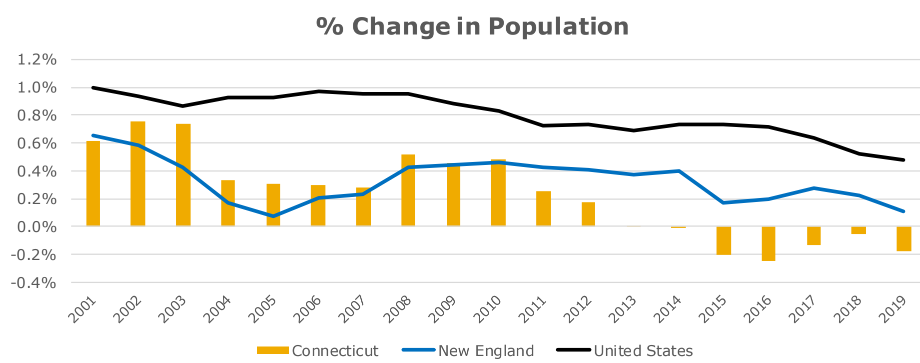
The State's economic base is highly developed but has experienced slow growth in recent years. Per capita personal income ranks first among the 50 States and high levels of educational attainment and low levels of poverty position the State well relative to peers in several areas. Population growth, 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.

Population

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

FIGURE 10



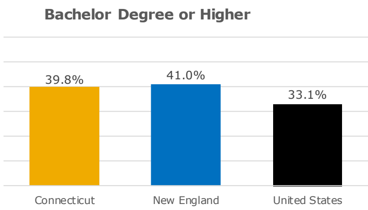
	2000	2010	2019	% Δ 2010 to 2019
Connecticut	3,411,777	3,579,114	3,565,287	-0.4%
New England	13,949,721	14,469,650	14,845,063	2.6%
United States	282,162,411	309,321,666	328,239,523	6.1%

Source: U.S. Bureau of Economic Analysis

Educational Attainment, Poverty, and Age Groups

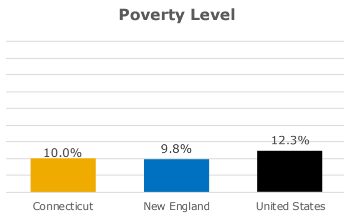
Educational attainment in Connecticut and the New England region is high relative to the U.S. Poverty in the State is well below the U.S. average. Connecticut's proportion of working age individuals is higher than the U.S.

FIGURE 11



As of 2019

FIGURE 12

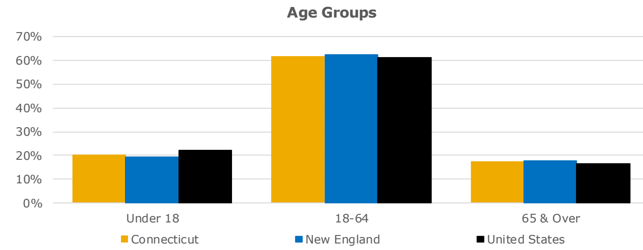


As of 2019

	Point Δ 2010 to 2019	Point Δ 2010 to 2019
Connecticut	4.3	-0.1
New England	5.4	-1.8
United States	4.9	-3.0

Source: U.S Census
Bachelor degree or higher defined as "% of population over 25 with Bachelor's degree or higher".
Poverty level defined as "portion of population living below the poverty line".

FIGURE 13

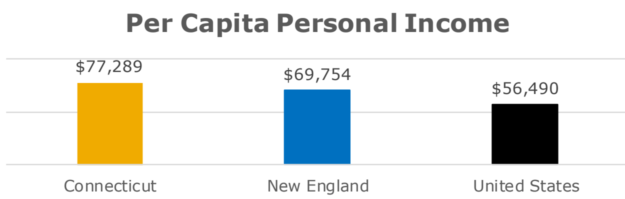


	Under 18	18-64	65 & Over	Age Dependecy Ratio
Connecticut	20%	62%	18%	61.4%
New England	20%	63%	18%	59.7%
United States	22%	61%	16%	63.1%

Per Capita Personal Income

Per capita personal income at $77,289 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 14



As of 2019

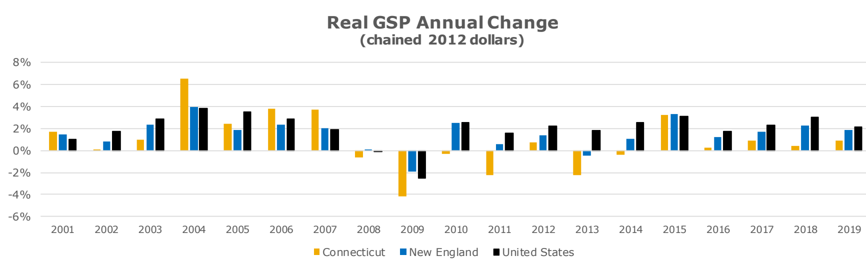
	% Δ 2010 to 2019	Comparison
Connecticut	24.5%	-
New England	33.9%	111% of Region
United States	39.3%	137% of U.S.

Source: U.S. 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 six 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.[4]

FIGURE 15



($ in Millions)	2000	2010	2019	% Δ 2010 to 2019
Connecticut	216,293,100	247,876,800	251,329,800	1.4%
New England	749,152,700	872,608,700	990,777,500	13.5%
United States	13,130,987,000	15,598,753,000	19,091,662,000	22.4%

Source: U.S. Bureau of Economic Analysis

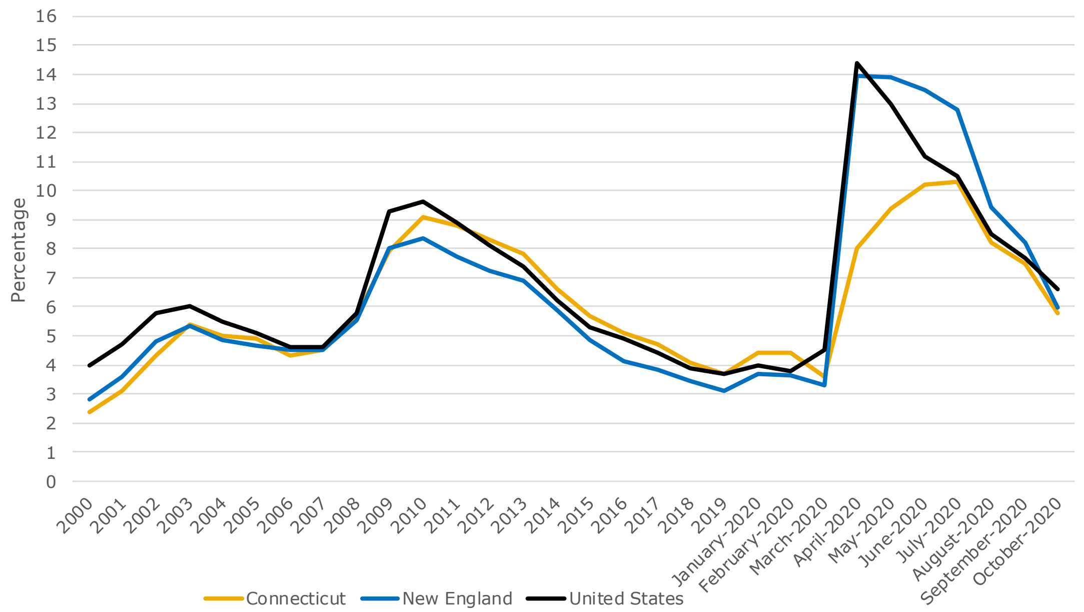
[4] Most recent GSP data for chemical manufacturing sector is 2017.

Employment

Before the COVID-19 pandemic, the State's unemployment rate trended slightly above the national average. In 2019, the unemployment rate was at 3.7% for the State and nation, and 3.1% for the region. As of October 2020, the State's unemployment rate has declined to 5.8% after spiking to 10.3% in July 2020, and remains below the regional and national averages (Figure 16).

FIGURE 16

Unemployment Rates[1]



	Connecticut	New England	United States
October-2020	5.8	6.0	6.6
Great Recession Peak	9.1	8.4	9.6
Point Δ Since Great Recession Peak	-3.3	-2.4	-3.0

Source: U.S Bureau of Labor Statistics

[1] Not seasonally adjusted.

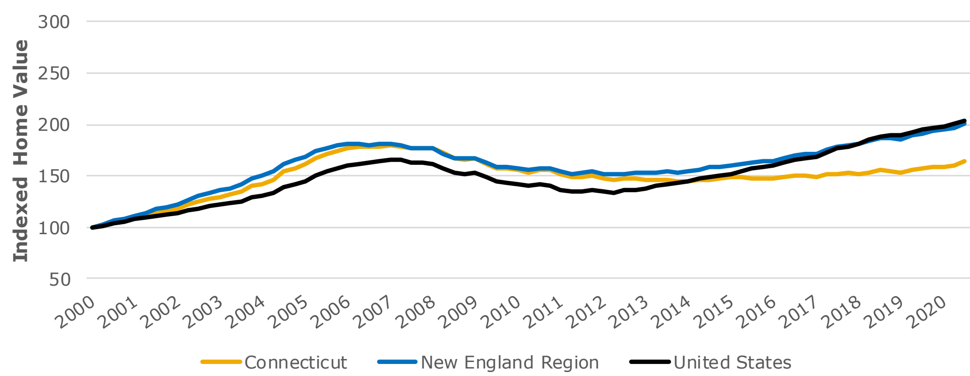
Home Values

State home value appreciation has lagged the region and the U.S. by a significant margin since the year 2000. As of Q3 2020, home values are 9% below their prior Q1 2007 peak compared to region and U.S. home values which rest 10.9% and 23.2%, respectively, in excess of their prior highs.

FIGURE 17

Home Values

All Transaction Home Price Index Data 2000 Q1 to 2020 Q3



Source: Federal Housing Finance Agency