Commission on Fiscal Stability and Economic Growth

Commission Meeting
January 31, 2018
Objectives for today’s meeting

1. Review challenges facing Connecticut and pressures on the State’s fiscal position

2. Discuss opportunities to stabilize Connecticut’s pensions using structured asset transactions

3. Discuss perspectives on economic growth opportunities
Current Connecticut Situation
Fiscal stability goals

- Among the Commission’s primary objectives is to recommend measures that would create fiscal stability for the State – a sustainably balanced budget that provides resources necessary to promote quality of life for its residents, creates an attractive environment for private investment, and fuels economic growth.

**Areas for Examination:**

- Pensions and post-retirement healthcare
- Municipal assistance
- Labor policy
- Tax reform
- Transportation finance

**Key Objectives:**

- Achieve a balanced budget
- Protect Connecticut’s most vulnerable residents
- Maintain quality of life standards
- Encourage private investments that lead to economic growth
Despite achieving a bipartisan budget, significant out year deficits remain

- January 2018 consensus estimates revealed declining revenue projections that will result in sizeable deficits for the next two years.
- In addition, 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)**

<table>
<thead>
<tr>
<th>FY18</th>
<th>FY19</th>
<th>FY20</th>
<th>FY21</th>
<th>FY22</th>
</tr>
</thead>
<tbody>
<tr>
<td>($182)</td>
<td>($317)</td>
<td>($556)</td>
<td>($485)</td>
<td>($516)</td>
</tr>
<tr>
<td>Increase in Fixed General Fund Costs</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Structural Revenue Issues: $1,231</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hospital Tax Reduction</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reversal of One-Time Fund Transfers</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Structural Revenue Issues</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>($2,272)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>($3,001)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>($3,509)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(1) Source: FY18 and FY19 budget balances based on October’s Biennial Budget, adjusted to incorporate January 2018 consensus revenue estimates and January 2018 OPM budget estimates. FY20 – FY22 per the Office of Fiscal Analysis Out-Year Estimates. Includes General Fund, Special Transportation Fund and Other Appropriated Funds.
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

<table>
<thead>
<tr>
<th>Category</th>
<th>Actual FY06</th>
<th>Actual FY17</th>
<th>Projected FY18</th>
<th>Projected FY19</th>
<th>Projected FY20</th>
<th>Annual Growth '06 to '20</th>
<th>Annual Growth '17 to '20</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension</td>
<td>$884</td>
<td>$2,161</td>
<td>$2,467</td>
<td>$2,552</td>
<td>$2,640</td>
<td>8.1%</td>
<td>6.9%</td>
</tr>
<tr>
<td>Retiree Healthcare</td>
<td>411</td>
<td>751</td>
<td>934</td>
<td>1,018</td>
<td>1,077</td>
<td>7.1%</td>
<td>12.8%</td>
</tr>
<tr>
<td>Debt Service</td>
<td>1,306</td>
<td>2,076</td>
<td>2,320</td>
<td>2,255</td>
<td>2,410</td>
<td>4.5%</td>
<td>5.1%</td>
</tr>
<tr>
<td>Entitlement Programs</td>
<td>2,813</td>
<td>3,787</td>
<td>3,964</td>
<td>4,139</td>
<td>4,322</td>
<td>3.1%</td>
<td>4.5%</td>
</tr>
<tr>
<td>Adjudicated Claims</td>
<td>6</td>
<td>21</td>
<td>8</td>
<td>9</td>
<td>8</td>
<td>2.1%</td>
<td>(26.7%)</td>
</tr>
<tr>
<td><strong>General Fund Fixed Expenditures</strong></td>
<td><strong>$5,420</strong></td>
<td><strong>$8,795</strong></td>
<td><strong>$9,694</strong></td>
<td><strong>$9,973</strong></td>
<td><strong>$10,458</strong></td>
<td><strong>4.8%</strong></td>
<td><strong>5.9%</strong></td>
</tr>
<tr>
<td>Total General Fund Expenditures</td>
<td>$14,500</td>
<td>$17,763</td>
<td>$18,720</td>
<td>$18,907</td>
<td>$19,709</td>
<td>2.2%</td>
<td>3.5%</td>
</tr>
</tbody>
</table>

**Fixed as % of Total Expenditures**

- Pension: 37%
- Retiree Healthcare: 50%
- Debt Service: 52%
- Entitlement Programs: 53%
- Adjudicated Claims: 53%
- **Total General Fund Expenditures**: 3.5% (2017 to 2020)

**General Fund Revenues**

- Actual FY06: $14,999
- Actual FY17: $17,703
- Projected FY18: $18,480
- Projected FY19: $18,625
- Projected FY20: $17,510

**General Fund Surplus (Deficit)**

- FY06: $499
- FY17: ($60)
- FY18: ($240)
- FY19: ($282)
- FY20: ($2,198)

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**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.**

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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 crowding out other areas of spending, including spending on children

Non-Functional Costs vs. Expenditures on Children (% of General Fund Expenditures)

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%.

- Debt service to revenue ratio of 13.3% is highest in the US.
  - 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.
  - 2.8x US mean / 4.2x US median

- Pension contributions and debt service at 26.5% of revenue is highest in the US.
  - 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.

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(1) Sensitivity analysis of pension liabilities per The Pew Charitable Trusts.
(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.
The unfunded pension liability has been growing steadily over the last decade, primarily due to insufficient contributions from the State

- Pension liabilities and required annual servicing costs may be understated due to unreasonably high investment return assumptions
  - In 2015, Connecticut had the highest average pension investment return assumption of all states\(^1\)
    - As a result, the budget has appeared more flexible than it really is
  - The State’s average pension investment return assumption is \(~7.5\%\), which is materially higher than the average realized return in FY 2015 and FY 2016\(^2\)

### Historical Accrued Pension Liability at Various Investment Return Assumptions ($ in billions)\(^3\)

<table>
<thead>
<tr>
<th>Year</th>
<th>UAAL at 5%</th>
<th>UAAL at 6%</th>
<th>UAAL at 7%</th>
<th>UAAL at Current Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>$24</td>
<td>$24</td>
<td>$22</td>
<td>$24</td>
</tr>
<tr>
<td>2010</td>
<td>$24</td>
<td>$24</td>
<td>$22</td>
<td>$24</td>
</tr>
<tr>
<td>2011</td>
<td>$22</td>
<td>$22</td>
<td>$26</td>
<td>$26</td>
</tr>
<tr>
<td>2012</td>
<td>$26</td>
<td>$26</td>
<td>$26</td>
<td>$26</td>
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<tr>
<td>2013</td>
<td>$25</td>
<td>$25</td>
<td>$25</td>
<td>$25</td>
</tr>
<tr>
<td>2014</td>
<td>$27</td>
<td>$27</td>
<td>$27</td>
<td>$27</td>
</tr>
<tr>
<td>2015</td>
<td>$34</td>
<td>$34</td>
<td>$34</td>
<td>$34</td>
</tr>
<tr>
<td>2016*</td>
<td>$57</td>
<td>$57</td>
<td>$57</td>
<td>$57</td>
</tr>
</tbody>
</table>

\(^{1}\)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.

\(^{2}\)Source: CT CAFR 2016, CT SERS, TRS, JRS 2016 Annual Valuation Report. 7.5\% represents the weighted average return assumption based on the FY 2016 asset balances across all three of Connecticut’s pension systems.

\(^{3}\)Source: The Pew Charitable Trusts. Excludes JRS. Valued using a blended discount rate weighted by reported liabilities. UAAL based on market value of assets and liabilities adjusted using formula based on AAL sensitivity and convexity.
66% of Connecticut’s total pension liabilities are owed to retirees

Pension Liabilities Aggregated Across Connecticut’s Three Pension Systems

- Retiree Liability
- Non-Retiree (Active Employee) Liability

(2) Includes beneficiaries.
(3) Includes a small portion of inactive members entitled to but not yet receiving benefits.
Connecticut’s public pensioners receive higher benefit payments than their peers in other states in the northeast and throughout the US.

**Average Pension Benefit Payments per Beneficiary as of FY 2016**

- **Connecticut**: $37,934
- **Northeast**: $30,143
- **USA**: $27,415

(1) Source: Annual Survey of Public Pensions 2016 (US Census Bureau). Figures calculated as Benefits divided by Total Beneficiaries Receiving Periodic Benefit Payments.
Connecticut’s OPEB liability is over $200K per worker, nearly 3x as high as the 75th percentile of all states

This translates into nearly $22 billion of OPEB liabilities for the State

OPEB Liability per Worker ($ per total number of beneficiaries and active participants in retiree health plans)

(2) Source: The ARC and the Covenants 2.0, J.P. Morgan Asset Management; State/Pension Plan Comprehensive Annual Financial Reports; Census. FY 2015.
Escalating required pension contributions, especially for TRS, exacerbate the State’s fiscal challenges

- 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)\(^2\)](chart)

(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

- 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

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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 (based on 2016 data)

<table>
<thead>
<tr>
<th>Metric</th>
<th>50 State Comparison</th>
<th>CT Rank (1st = lowest rate)</th>
</tr>
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<tbody>
<tr>
<td>Corporate Income Tax Rate¹</td>
<td>7.5% (10% surtax for certain companies in 2018)</td>
<td>33rd</td>
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<tr>
<td>Sales Tax Rate</td>
<td>6.4%</td>
<td>39th</td>
</tr>
<tr>
<td>Personal Income Tax Rate²</td>
<td>6.7% (now 6.99%)</td>
<td>35th</td>
</tr>
<tr>
<td>Property Tax Rate³</td>
<td>1.5%</td>
<td>40th</td>
</tr>
<tr>
<td>Estate Tax Rate⁴</td>
<td>12%</td>
<td>38th</td>
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<tr>
<td>Effective Total State &amp; Local Tax Burden⁵</td>
<td>10.2%</td>
<td>45th</td>
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</table>

Personal income tax revenue (~50% of total in FY 2017) is volatile since ~40% is based on estimated payments vs. the more predictable W-2. 35% of all personal income tax came from 10 towns in 2015.

Connecticut cannot rely only on increasing revenues to address budget issues given it is already a high tax state

Source: Federation of Tax Administrators (2016); U.S. Census.
(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.
(5) As a % of state personal income. Per the State & Local Government Finance Data Query System. The Urban Institute-Brookings Institution Tax Policy Center. FY 2015 represents latest available data.
(6) Applies to companies with more than $100m in gross income.
(7) 2017 State Comptroller’s Annual Report. Based on percentage of total General Fund budgeted revenue.
(8) Based on January 16, 2018 OPM/OFA consensus revenue estimates.
(9) Connecticut Department of Revenues Services per data.ct.gov.
At the same time, a series of tax increases has correlated with significant outmigration

Historical Net Migration in Connecticut (# of people)

<table>
<thead>
<tr>
<th>Year</th>
<th>2007</th>
<th>08</th>
<th>09</th>
<th>10</th>
<th>11</th>
<th>12</th>
<th>13</th>
<th>14</th>
<th>15</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value</td>
<td>(2,873)</td>
<td>3,758</td>
<td>4,058</td>
<td>7,044</td>
<td>1,727</td>
<td>(3,971)</td>
<td>(2,723)</td>
<td>(8,846)</td>
<td>(10,507)</td>
<td>(8,228)</td>
</tr>
</tbody>
</table>

In 2016, the average adjusted gross income of those leaving was $123,377... totaling over $6 billion

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)

Structured Asset Transactions
The State may be able to use available assets and revenue streams to help fund pension and OPEB commitments

- To address its precarious fiscal position, the State could consider transactions that maximize the value of its significant assets and revenue streams to help fund its pension and OPEB commitments.
- The State owns a large portfolio of buildings and land as well as the lottery system, and may be able to expand certain revenue streams.
- The book value of the State’s assets, which may be significantly below market value, is approximately $18 billion\(^1\)

It may be possible to unlock incremental value from these assets in a series of structured asset transactions and use that value to shore up the State’s underfunded pensions and relieve pressure on State and local budgets.

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What is a structured asset transaction?

- A structured asset transaction is a broad term involving the monetization of assets, but there are a number of specific methods to accomplish this:
  1. Structured Asset Transfer (“Contribution in Kind”)
  2. Concession / Lease
  3. Full Privatization or Sale/Leaseback

- The type of structured asset transaction pursued will depend on the characteristics of the underlying asset as well as specific objectives of the State related to each transaction

- To relieve pressure on the State budget, the reduction in the ARC\(^1\) from the contribution of a revenue generating asset to the pension funds must be greater than the amount of revenues contributed in the transaction, as such revenues would have otherwise been received by the General Fund

- Additionally, in exchange for improving the position of the pension systems with a contribution of its own assets, the State may be inclined to seek concessions from the pension systems to further improve their position

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(1) Annual Required Contribution.
## Overview of monetization mechanisms

<table>
<thead>
<tr>
<th>Description</th>
<th>Asset Transfer (&quot;Contribution in Kind&quot;)</th>
<th>Concession / Lease</th>
<th>Full Privatization or Sale/Leaseback</th>
</tr>
</thead>
</table>
| Reflections | ▪ Permanently transfer ownership of assets and associated cash flow stream to pension systems at fair market value  
▪ Defease a portion of the State’s unfunded pension liability | ▪ Grant a long-term lease to a third party  
▪ May include up-front cash consideration | ▪ Sell assets  
▪ To the extent necessary, lease back assets for government use |
| Benefits | ▪ Reduce the unfunded liability by the fair market value of the asset contributed | ▪ Private entity responsible for operations and capital expenditures  
▪ May provide State with longer-term, stable cash flows | ▪ Private entity responsible for operations and capital expenditures  
▪ Upfront cash consideration  
▪ Allows assessment of property taxes on previously tax exempt property |
| Considerations | ▪ Must be done on an arms-length basis with appropriate protections both for the State and the pension systems  
▪ Could also be structured as long-term concession with pension systems | ▪ Reduced public control over assets | ▪ Loss of operational control  
▪ Purchaser retains net operating profits and asset appreciation |
Illustrative transaction overview

1. State of CT
   State contributes long-term asset/revenue stream to one or more pension systems

2. CT SERS
   CT TRS
   CT JRS
   Pension systems' funded level increases by the fair market value of newly contributed assets

3. As a result of a reduction in the pension liability, the State's ARC decreases

4. State budget deficit is reduced due to ARC reduction in excess of revenues contributed
**Illustrative impact of asset contribution on the State’s ARC**

- The following shows the illustrative impact on the State’s ARC and budget of a hypothetical permanent contribution to TRS of an asset with a $350 million cash flow stream, growing at 2% per annum.

- The reduction in the required contributions to TRS after the contribution would improve the cumulative budget deficit by $3 billion over the first 10 year period.
  
  - The analysis below assumes a theoretical fair market value for the cash flow stream of $5 billion as well as a 6% investment return.

**FY 2020 TRS UAAL and Funded Ratio ($ billions)**

<table>
<thead>
<tr>
<th>Status Quo</th>
<th>After Transfer of Cash Flow Stream</th>
</tr>
</thead>
<tbody>
<tr>
<td>□ $21</td>
<td>$16</td>
</tr>
<tr>
<td>47%</td>
<td>59%</td>
</tr>
</tbody>
</table>

**FY 2020 – 2029 Budget Analysis ($ billions)**

<table>
<thead>
<tr>
<th></th>
<th>$7</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduction in State TRS Contributions</td>
<td></td>
</tr>
</tbody>
</table>

| Foregone Revenues from Cash Flow Stream | $4 |

$3B Benefit to State Budget over 10 years

**Source:** Analysis per The Pew Charitable Trusts. Status quo and pro forma calculations assume 6% investment return. Analysis assumes the contributed cash flow stream is considered a perpetual life asset. Note the valuation above is PURELY HYPOTHETICAL and in no way represents the Commission’s views on the value of revenue stream of the stated size. Transfer of the hypothetical cash flow stream is shown for illustrative purposes and DOES NOT constitute a policy recommendation.
Illustrative annual impact of asset contribution on the State’s ARC

- The State’s annual required contribution would be reduced by:
  - Revenue stream from contributed asset
  - A further reduction in the ARC as a result of the reduction in the UAAL
- If the further reduction in the ARC is greater than zero, the transfer is a net benefit to the State’s budget
- Each transaction will be structured in a way to maximize ARC reductions, which may ultimately require amendments to existing statute

FY 2020 Impact of Cash Flow Stream Transfer ($ millions)

<table>
<thead>
<tr>
<th>Status Quo State Contributions to TRS</th>
<th>Revenues from Cash Flow Stream</th>
<th>Further Reduction in ARC due to UAAL Reduction</th>
<th>Pro Forma State Contributions to TRS</th>
</tr>
</thead>
<tbody>
<tr>
<td>$2,309</td>
<td>$350</td>
<td>$103</td>
<td>$1,856</td>
</tr>
</tbody>
</table>

Reduction in ARC grows each year, and by FY 2029 the reduction is $534 million, causing the transaction to be highly accretive to the State budget.

Source: Analysis per The Pew Charitable Trusts. Status quo and pro forma calculations assume 6% investment return. Analysis assumes the contributed cash flow stream is considered a perpetual life asset. Note the valuation above is PURELY HYPOTHETICAL and in no way represents the Commission’s views on the value of revenue stream of the stated size. Transfer of the hypothetical cash flow stream is shown for illustrative purposes and DOES NOT constitute a policy recommendation.
Illustrative cumulative impact of asset contribution on the State’s ARC

- Even with transactions that contribute assets to the pensions systems, required contributions and benefit payments are at unsustainable levels and may need to be addressed in additional ways.

FY 2020 – 2029 Impact of Cash Flow Stream Transfer ($ millions)

- Status Quo State Contributions to TRS
- State Contributions to TRS Net of Revenues from Cash Flow Stream
- Pro Forma State Contributions to TRS Net of Revenues from Cash Flow Stream and Further Reduction in ARC

Revenues from Cash Flow Stream
Further Reduction in ARC due to UAAL Reduction

Source: Analysis per The Pew Charitable Trusts. Status quo and pro forma calculations assume 6% investment return. Analysis assumes the contributed cash flow stream is considered a perpetual life asset. Note the valuation above is PURELY HYPOTHETICAL and in no way represents the Commission’s views on the value of revenue stream of the stated size. Transfer of the hypothetical cash flow stream is shown for illustrative purposes and DOES NOT constitute a policy recommendation.
Potential assets that can be monetized

- CT Lottery
- Real Estate
- Incremental Tax Revenue Streams
- Municipal Water Systems

  A monetization of select municipal water systems would not only benefit the municipalities they serve, but would also mitigate the State’s municipal aid obligations

  Although this presentation is focused primarily on State-level transactions, a separate discussion of this topic is encouraged
CT Lottery

- Connecticut’s lottery system has been a stable and growing source of revenues for the State’s General Fund, producing $338 million of net revenues in FY 2016
- Similar to the recent transaction completed in New Jersey,\(^1\) CT Lottery could be contributed to, or enter into a long-term concession with, one or more of the State’s pension systems
- The transaction would have the following benefits:
  - Improve pension funded ratios and reduce net pension liability
  - Enhance stability of pension plan receipts and reduce amount subject to appropriation
  - Reduce required annual pension contributions from the State
- The State should target a reduction in the ARC larger than the amount of net lottery revenues\(^2\)

(1) See the New Jersey Lottery Enterprise Transparency Page at: www.state.nj.us/treasury/njletransparency.shtml.
(2) Amount of ARC reduction dependent on the independent valuation of the lottery system.
Opportunities with real estate assets

- The State has a large portfolio of buildings and land that could be contributed into a Real Estate Investment Trust ("REIT") or directly to the pension systems.
- The REIT could raise debt financing and deliver the proceeds to the pensions to fund the State’s commitments.
  - Agencies would need to sign new long-term (>10-year) leases with the option to buy back the property at the end of the lease term.
  - Additional analysis must be completed in order to determine whether incremental lease payments for the properties contributed to the REIT are less than the reduction in the ARC.
- The State can also consolidate and sell vacant or underutilized buildings over time in order to generate additional funds for the pensions.
  - Space which is currently leased from third parties could also be rationalized in order to increase the efficiency of the overall real estate portfolio.
Incremental tax revenue streams

- To the extent new tax revenues are identified, a portion of them could be securitized or contributed directly to the pensions for a period of time
- The State could pledge these revenues to the pensions and reduce the UAAL and ARC (similar to the lottery transaction)
- Alternatively, under a securitization, debt proceeds could be contributed to the pension systems and invested alongside other pension assets
  - For a securitization, the State should consider common protections including statutory liens, “true sale” of revenues, lockbox mechanism and covenants to prevent overburdening the revenue stream, such as an additional bonds test and debt service coverage
  - In order for this to be accretive, pension returns must exceed the cost of the debt

Note: May require clarification from the IRS regarding tax-exempt status of the new issuance.
Other Areas for Examination

Commission on Fiscal Stability and Economic Development
Examining areas beyond unfunded pension and health liabilities

- Labor practices
- Other large spending categories
  - Entitlements/Medicaid
  - Municipal aid, local revenue sources, and shared services

FY 2017 General Fund Expenditures ($ in millions)

Total: $17,763

- Employee Pension and OPEB: $5,653 (32%)
- Debt Service: $2,912 (16%)
- Entitlements: $2,076 (12%)
- Municipal Aid: $3,336 (19%)
- All Other: $3,787 (21%)

$4.5 billion, or 25%, when including TRS-related expenditures¹


¹ Municipal Aid excludes State expenditures related to TRS, which are already included in the Employee Pension and OPEB as well as Debt Service categories. Including TRS related expenditures brings municipal aid up to $4.5 billion.
Labor arrangements – collective bargaining

Connecticut is one of only two states where pension benefits are first determined by collective bargaining and then ratified by statute\(^1\)

“Connecticut sets its assumed rates of return and ARC payments in contract, while in other states these are set by the state treasurer, the state comptroller, or legislative committees…[this] makes it more difficult for the General Assembly to change assumed rates of return and ARC payments unilaterally…in Connecticut, there has been a pattern over the past few decades of setting optimistic assumptions in initial contract negotiations…”\(^2\)

Certain witnesses have urged the Commission to recommend prohibiting collective bargaining for state and local post-retirement benefits, and health benefits generally: CBIA and Yankee Institute, January 24, 2018

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(2) Source: Factors Contributing to Health of State Employee Pension Funds, CT School Finance Project, January 2018.
Other labor arrangements – binding arbitration

“Binding arbitration must be evaluated and reformed”
- CT Conference of Municipalities¹
  January 23, 2018

“When multiple collective bargaining units are involved in developing a service sharing initiative, the bargaining units should be required to bargain as a coalition.”
- CT Conference of Municipalities¹
  January 23, 2018

“Reform binding arbitration laws to…allow parties…to mutually agree to have their case heard by a single neutral arbitrator”
- Council of Small Towns²
  January 23, 2018

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Entitlements – Medicaid (65% of total category) and social services

- Medicaid invites attention because of its size ($2.5 billion in state funds or 14% of General Fund)¹ and coverage (22% of State population). Are material cost reductions feasible?
  - Compared to other states, CT Medicaid costs are lower: ranked 1st in country in lowest cost per enrollee,² and below neighboring states (New England states/NY/NJ) on percent of total state spending³
  - CT is one of only 3 or 4 states that self-administers Medicaid vs. using managed care plans. It is not clear that this has produced lower provider payment rates and more cost shifting to the private sector as some charge, since the state’s fees are in line with or higher than neighboring states⁴

- Medicaid is projected to grow by an annual average of 6% from FY 2017 to FY 2020,¹ well above the rest of the budget and revenue growth
  - Possible area for reductions: CT eligibility ceilings for children are above all 8 neighboring states

- Hospital tax is a revenue maximization effort to increase federal reimbursements. This is vulnerable to federal termination, which could leave a $500 million to $1 billion budget hole⁵

- Social services expenditures of $1.3 billion (ex. Medicaid) could potentially be reduced by more active outsourcing to non-profit providers⁶

(2) Connecticut Department of Social Services Press Release dated July 14, 2017 based on Health Affairs, June 2017.
(5) Connecticut Department of Social Services.
(6) CBIA, The Alliance – Voice of Community Nonprofits.
Municipal aid, local revenue sources, and shared services

- Municipal Aid in FY 2017 at $4.5 billion\(^1\) is the largest sector of state expenses outside of fixed costs. Property taxes are the only other material source of town revenue.

- There was universal support among witnesses representing municipalities and councils of governments (COGS) for more diversified sources of local revenue.
  - Many witnesses criticize a heavy reliance on property taxes on grounds of the tax being regressive and because of the wide variation among the towns in tax base and consequently in mill rates.

- City mayors report heavy proportions of tax exempt property (over 50% in Hartford, New Haven and New London) which “set them up to fail” in competition against their suburbs, even though they are medical, higher education, and cultural hubs for their regions.

- There is widespread interest in expanding shared services arrangements among municipalities, often under the auspices of the COGS.

- A variety of proposals were advanced including expanding and dedicating a portion of the state sales tax for municipalities, providing state funding for shared services planning and operations, establishing regional asset districts, collecting service fees in lieu of taxes from nonprofits, and providing a path in statute for towns to merge.

(1) Source: OFA Fiscal Accountability Report FY17 – FY 20. Includes fixed costs related to TRS.
Regional Councils of Governments in Connecticut

Source: Office of Policy and Management.