

State of Connecticut

DENISE L. NAPPIER
TREASURER



Hartford

June 28, 2017

The Honorable Martin M. Looney, President *Pro Tempore*, State Senate
The Honorable Leonard A. Fasano, Republican President *Pro Tempore*, State Senate
The Honorable Bob Duff, Majority Leader, State Senate
The Honorable Kevin Witkos, Deputy Republican President *Pro Tempore*, State Senate
The Honorable Joe Aresimowicz, Speaker of the House
The Honorable, Matthew D. Ritter, Majority Leader, House of Representatives
The Honorable Themis Klarides, Minority Leader, House of Representatives

Legislative Office Building
Hartford, CT 06106

Dear Madame and Messrs.:

I write to share my concerns about proposals to cap bond issuance. Please see the attached *Budget Advisory on Bonding*, which is similar to an advisory I issued last year on the same topic.

I also write to encourage the passage of my proposal, House Bill 7321, *An Act Establishing a Credit Revenue Bond Program*, during the Special Session. A summary is enclosed.

The proposal will reduce the cost of borrowing, rebuild the State's Rainy Day Fund and bolster our general obligation credit ratings over time. It would establish a higher-rated and lower-cost tax-secured revenue bond program to fund state projects, and would be used in place of general obligation bonds. The bill won bipartisan support when voted out of the Finance, Revenue and Bonding Committee.

A key feature of this proposal is that any monies we save by issuing these lower-cost tax-secured revenue bonds instead of general obligation bonds would go directly into the State's Rainy Day Fund. Our projections are that as much as \$980 million could be generated for this purpose over the next twelve years.

The solutions to many of Connecticut's budget challenges are complex, no doubt. This proposal for a tax-secured revenue bond is not one of them. Rather, it is a proven strategy for structuring our borrowing in a way that can generate significant savings, restore our credit ratings, and position us for the next inevitable rainy day.

Sincerely,

A handwritten signature in cursive script that reads "Denise".

Denise L. Nappier
State Treasurer

Attachments

ac: The Honorable John W. Fonfara, Senate Co-Chair, Finance, Revenue & Bonding
The Honorable L. Scott Frantz, Senate Co-Chair, Finance, Revenue & Bonding The
Honorable Jason Rojas, House Co-Chair, Finance, Revenue & Bonding
The Honorable Christopher Davis, House Ranking Member; Finance, Revenue & Bonding
The Honorable Patricia Billie Miller, Chair, General Bonding Subcommittee
The Honorable Michael McLachlan, Chair, General Bonding Subcommittee
The Honorable Livvy Floren, House Ranking Member, General Bonding Subcommittee
Mr. Neil Ayers, Director, Office of Fiscal Analysis
Mr. Michael Murphy, Section Chief, Office of Fiscal Analysis
Mr. Eric Gray, Principal Analyst, Office of Fiscal Analysis



The Office Of State Treasurer
Denise L. Nappier

Statement

June 28, 2017

BUDGET ADVISORY ON BONDING

Governor Malloy and the General Assembly are evaluating options for balancing the biennial budget for Fiscal Years 2018 and 2019. One idea that has circulated is a hard cap on the amount of bonds that can be issued each fiscal year.

This Budget Advisory highlights the potential negative consequences of such an approach and presents important considerations that may inform deliberations concerning the ultimate budget solution.

Capping Bond Issuance Won't Impact Project Spending and Could Cause a Cash Crunch.

A cap on the amount of bonds issued during a given biennium has no impact on the rate of spending on capital projects, because spending on projects can commence long before bonds are issued.

Connecticut's process works as follows: once the Legislature authorizes capital projects with passage of a bond bill, the State Bond Commission can approve those projects for funding. Immediately after Bond Commission approval, contracts can be entered into and spending on projects may begin, with funds for specific projects coming primarily from existing balances in bond funds on a cash flow basis, or occasionally from the State's cash pool.

The Treasury schedules bond issuances based on the pace of actual spending for a number of concurrent projects accounted for within the same bond fund. Consequently, if bond issuance were capped, then the Treasury could not issue bonds for projects that are already underway, and with spending continuing, such a cap could strain the State's cash resources because the State is already committed to projects in process. Simply put, the horse has already left the barn.

To put this into sharper focus, take, for example, the State's two largest bond programs -- General Obligation and Special Tax Obligation. A total of \$5.8 billion of projects have been approved for spending by the State Bond Commission, yet bonds have yet to be issued for these projects. So if bond issuance were limited while expenditures on bond funded projects continues, the bond funds would be depleted and the State's cash pool would have to cover bond project expenditures, thereby draining cash resources and depleting the ability to fund State operations. This could cause a State cash deficit position requiring external cash flow borrowing, which would be of significant concern to credit rating agencies and bond investors.

Limiting Bonding Authorized by the General Assembly and the Bond Commission Would Lower Debt Issuance and Debt Service Over Time

If there is a policy objective to limit the State's overall indebtedness, then the point at which this could be achieved is not at the end of the process when bonds are issued, but rather at the point at which new capital projects are either authorized by the Legislature or approved by the State's Bond Commission. The long-term effect of such limits would be to slow spending and thereby lower bond issuance and debt service. This impact would be gradual and would not have a detrimental effect on the State's capital funding program or cash position.

In the alternative, state agencies could be directed to hold projects that have not yet begun spending and, further, investigate whether contracts on projects underway would permit suspension or modification.

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Office of State Treasurer Denise L. Nappier

Proposed Legislation to Rebuild the Rainy Day Fund and Lower Borrowing Costs

Objective: To rebuild the State's Rainy Day Fund and lower borrowing costs through the creation of a tax-secured revenue bonding program.

Background: Recent downgrades of the State's General Obligation credit ratings have led to increased relative borrowing costs over the last few years. Rating agency and investor concerns are primarily driven by the State's budgetary and pension challenges, and the need to rebuild the Rainy Day Fund.

Proposal: The bonds would be backed by a dedicated portion of the State's stable and strong personal income tax revenues, a practice used successfully in other states for many years. This structure capitalizes on the State's high wealth levels and insulates the bonds from budget and pension concerns, thereby earning higher credit ratings and lowering borrowing costs. The proposal was voted out of committee favorably by the General Assembly's Finance, Revenue and Bonding Committee as Raised Bill 7321, *An Act Establishing a Credit Revenue Bond Program*.

Benefits of the Proposed Legislation Include:

- 1) Achieves Higher Credit Ratings** - The establishment of a tax-secured revenue bond program is expected to earn credit ratings three to four levels above current General Obligation credit ratings, targeted in the high "AA" to "AAA" categories.
- 2) Increases Investor Demand and Lowers Borrowing Costs** - Higher credit ratings generally drive increased investor demand, which in turn lowers borrowing costs. The tax-secured revenue bonds will be especially attractive to those investors who have reached capacity limits for the State's General Obligation bonds or have concerns about the State's budgetary and pension challenges.
- 3) Rebuilds the Rainy Day Fund** - Debt service savings generated from the tax-secured revenue bond program would be dedicated to rebuilding the Rainy Day Fund. Preliminary estimates show that the State could realize nearly \$980 million in cumulative deposits to the Rainy Day Fund through Fiscal Year 2029, assuming borrowing levels consistent with current annual sales of General Obligation bonds.
- 4) Strengthens the State's Fiscal Health** - A commitment to replenishing the Rainy Day Fund explicitly addresses an ongoing concern of the major credit rating agencies, and is expected to improve the State's General Obligation bonds' credit ratings and lower borrowing costs over time.

The tax-secured revenue bonds will be issued in lieu of, not in addition to, General Obligation bonds. The proposal would not increase the State's total borrowing. The new bonding program adheres to the State's borrowing, budgetary and governance processes and restrictions. The bonds would be subject to Legislative authorization and Bond Commission approval and the State's debt cap. The amount of money budgeted each year for debt service would not be materially affected.