State of Connecticut

DENISE L. NAPPIER
TREASURER

Hartford

August 13, 2009

The Honorable M. Jodi Rell, Governor
Executive Office of the Governor, State Capitol
210 Capitol Avenue
Hartford, CT 06106

The Honorable Donald E. Williams, Jr., Senate President *Pro Tempore*
Legislative Office Building Room 3300
Hartford, CT 06106-1591

The Honorable Christopher G. Donovan, Speaker of the House
Legislative Office Building Room 4106
Hartford, CT 06106-1591

The Honorable John McKinney, Senate Republican Leader
Legislative Office Building Room 3400
Hartford, CT 06106-1591

The Honorable Lawrence F. Cafero, Jr., House Minority Leader
Legislative Office Building Room 4200
Hartford, CT 06106-1591

Dear Governor and Gentlemen:

Following up on my last letter to you of July 31st, in which I alerted you to the potential implications of delayed passage of a budget on the State's credit rating, among other matters, I want to share recent developments and new information that I sincerely hope will prompt a swift and comprehensive budget solution.

As you know from my last letter, the State of Illinois' credit rating was downgraded by Fitch by two notches from "AA-" to "A". Since then, the State of New Jersey was put on "negative outlook" by Moody's on grounds that are strikingly similar to the circumstances we could face in Connecticut – the likelihood of exhausting our Budget Reserve Fund against the backdrop of high debt ratios. Specifically, Moody's commented as follows: "The depletion of the state's rainy-day fund, enactment of temporary tax increases and significant reliance on nonrecurring expenditure reductions, including minimal pension contributions, contribute to both short-term and longer-term budgetary pressures… ."[1]

We continue to stay in close contact with the rating agencies and will continue to provide current information concerning the State's budget situation. Despite high debt ratios, we have successfully maintained our strong rating by virtue of our reserves, per capita wealth, above-average retirement of debt

[1] *New Jersey Has Credit Outlook Rating Cut by Moody's*, Bloomberg, August 4, 2009.

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and strong financial management practices. It is growing increasingly difficult, however, to explain how the State can contemplate the issuance of deficit notes and other debt to balance the budget, depletion of the Budget Reserve Fund, significant reliance on stimulus funds and other nonrecurring funds, and yet remain unable to pass a balanced budget. Surely, if the impasse were in reality a delay driven by a common interest to minimize the use of one-shot revenues to fund recurring expenses, there may be some merit to taking this time to get it right. However, the absence of any representation about the status of on-going budget negotiations leads to mere speculation.

For your information, the fiscal impact of a credit downgrade on Connecticut is quantifiable, and it is sobering. Were our state to experience a downgrade of one or two notches, we estimate the state would pay as much as $80 million in higher interest costs for bonds planned for issuance in Fiscal Year 2010 alone. Moreover, once the State's credit is downgraded, it could take years to earn an upgrade. (For your information, the last rating change for the State was six years ago.) The longer term impact could approach $335 million of increased interest costs on the State's planned debt issuance over the next five years - - costs that our taxpayers will ultimately bear.

The foregoing analysis evaluated the cost on debt issues directly impacted by such a downgrade, and does not include the ripple effects on debt issued by quasi-public agencies which are backed by the State, or other state financings that may experience a ripple effect of a major credit rating downgrade of the State of Connecticut.

Beyond the increased costs associated with a potential credit rating downgrade, there are additional adverse consequences of delayed passage of a budget. The effectiveness of increased revenues and/or reduced expenditures is hampered because there are fewer months over which to measure the impact for Fiscal Year 2010. Simply put, the longer we wait, the harder it gets. This point was specifically mentioned to us by the rating agencies. Moreover, the lack of a budget creates general uncertainty over what the final solutions will be for such a large budget deficit; and uncertainty is never something bondholders or rating agencies like. And finally, although our debt service is "deemed appropriated" and will be paid with or without a budget, in my experience, rating agencies and bondholders nonetheless far prefer to have a stable budget in place that funds all current operations with current revenues.

It is my hope that awareness of these issues will help guide your deliberations in a manner that preserves the sound financial management practices that have served us in good stead, and will lead to a budget that will serve the needs of Connecticut and its citizens over the next biennium and beyond.

As always, I stand ready to offer the resources of my office to assist you in whatever way that I can.

Sincerely,

Denise

Denise L. Nappier
State Treasurer

cc: The Honorable Toni Harp, Senate Chair, Appropriations Committee
The Honorable John Geragosian, House Chair, Appropriations Committee
The Honorable Dan Debicella, Senate Ranking Member, Appropriations Committee
The Honorable Craig Miner, House Ranking Member, Appropriations Committee
The Honorable Robert L. Genuario, Secretary, Office of Policy & Management