Connecticut's State Bonding Process & Restrictions

Policy Briefing - December 13, 2018

Introduction

This policy brief provides an overview of the existing restrictions on the Connecticut general obligation bonding process, the additions to these restrictions contained in the biennial budget for fiscal years 2018-19 (Conn Acts 17-2 (June Special Session)), and changes made to bonding restrictions under various public acts passed during the 2018 legislative session.

The State of Connecticut borrows money to fund certain projects by issuing bonds, which obligate the State to pay the principal and interest on each bond issued. The State issues two primary types of bonds: general obligation bonds and revenue bonds. General obligation bonds are secured by Connecticut's ability to raise revenue through taxes, which means the State pledges its full faith and credit to repay the borrowed amount plus interest.[1] Revenue bonds are secured by a specific type of revenue for the repayment of the principal and interest.[2]

Overview of Connecticut's Bonding Process[A]

At the start of every odd-numbered year, the governor creates and delivers a capital budget to the General Assembly, along with the legislation necessary for implementation.[3] This proposed legislation, along with any bond bills submitted by legislators, is reviewed by the General Bonding and Transportation Bonding Subcommittees of the Finance, Revenue and Bonding Committee, with each subcommittee submitting recommendations to the full committee.[4] Once these recommendations have been made, the full General Assembly must vote on the recommended bond bills and the governor must sign the bills if approved.[5] This legislation is known as the Bond Authorization.[6]

Once authorized, the State Bond Commission[B] votes to allocate funds to the Bond Authorization projects.[7] Connecticut's Office of Policy and Management (OPM), the governor's budget office, submits an agenda for the State Bond Commission meetings that includes the authorized projects.[8] If the State Bond Commission votes to allocate bond funding, the state agency in charge must request the allotment of the bond funds from OPM.[9] OPM will allot the funding when approving this request.[10] The state

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[A] *For a detailed overview of Connecticut's bonding process, please see:*
Pinho, R. (2015). *Connecticut's Bonding Process* (2015-R-0058). Hartford, CT: Connecticut General Assembly, Office of Legislative Research. Retrieved from https://www.cga.ct.gov/2015/rpt/pdf/2015-R-0068.pdf.

[B] *The State Bond Commission is an executive-legislative entity whose membership consists of the governor (chair of the Commission); state treasurer; comptroller; attorney general; secretary of the Office of Policy and Management; commissioner of the Department of Administrative Services; and the co-chairpersons and ranking members of the Finance, Revenue and Bonding Committee, or their designated appointees. In addition to approving the allocation of funds to bond projects, the State Bond Commission also approves or denies the quantity of bonds requested to be sold by the state treasurer and the timing of such sale.*
Conn. Gen. Statutes ch. 32, § 3-20(c).

bonding process has been largely unchanged since 1978, when the legislature added the chairpersons and ranking members of the Finance, Revenue and Bonding Committee to the State Bond Commission, increasing the membership from six to 10 members.[11]

Prior Restrictions on Bonding

For the purposes of this section, the term "bonds" will refer to the general obligation bonds issued by the State of Connecticut, which are the only type of bonds subject to the restrictions described below prior to Conn. Acts 17-2 (June Special Session).

The bonding process prior to Conn. Acts 17-2 (June Special Session) contained several restrictions on Connecticut's state bonding. The General Assembly can authorize bonding up to 1.6 times the net General Fund tax revenue for the fiscal year of the authorization.[12] This total calculation is called the aggregate indebtedness and must be calculated by the state treasurer on January 1 and July 1 each year.[13] The aggregate indebtedness does not include debt related to federally reimbursed public works projects, debt incurred in anticipation of receiving revenue, debt issued to financing budget deficits, and the pension obligation bonds issued for the Teachers' Retirement System.[14] The first type of revenue-related limit on state bond authorizations was passed in the 1957 legislative session.[15]

If the authorized debt exceeds 90 percent of the aggregate indebtedness limit, the governor must review each bond act and recommend repealing authorizations to the General Assembly's Finance, Revenue and Bonding Committee.[16] The Committee must review the recommendations of the governor and propose legislation deemed necessary with respect to the recommended projects.[17] Accordingly, the most recent certificate of indebtedness calculation, provided by the state treasurer on January 12, 2018, notes Connecticut is at 86.86 percent of the debt limit, and had approximately $781 million in bond capacity remaining before reaching the aforementioned 90 percent limit of 1.6 times the net General Fund tax revenue.[18] In addition, this most recent certificate of indebtedness notes the State Bond Commission has authorized approximately $6.3 billion in state bonds that have not been issued by the state treasurer.

Restrictions on Bonding in Conn. Acts 17-2 (June Special Session)

The biennial budget preserved the existing bond restrictions and implemented additional limitations that include caps on the absolute dollar amount of allocated and issued bonding per year, and on the actions available to the General Assembly after bond issuance.[19]

For the purposes of this section, the term "bonds" will refer to general obligation and credit revenue bonds[C] issued by the State of Connecticut.

Conn. Acts 17-2 (June Special Session) contained three types of caps on bond funding amounts: the allocation cap, the issuance cap, and the spending cap.[20] The allocation cap applies to the aggregate amount of bonding allocated by the State Bond Commission in a calendar year. Please note the General Assembly's Office of Legislative Research refers to this limit as the "allocation cap" even though it targets the bond authorizations approved (i.e. by the State Bond Commission).[21] This amount is limited to $2 billion per calendar year beginning January 1, 2017.[22] The issuance cap applies to the aggregate amount of bonding issued by the state treasurer in a fiscal year. This amount is limited to $1.9 billion per fiscal year beginning July 1, 2018.[23] The bond spending cap applies to the aggregate expenditures allowed to be approved (or "allotted") by the governor. This amount is limited to expenditures that would result in the issuance of total bonds greater than $1.9 billion per fiscal year, with no start date given.[24]

The biennial budget also contained several additional restrictions on general obligation and credit revenue bond issuance. Bond covenants for bonds issued between May 15, 2017 and June 30, 2020, must include a pledge to bondholders that the State will comply with the new implemented volatility cap,[D] statutory spending cap,[E,25] and bond caps,[26] except under limited circumstances.[27] This will apply to all fiscal years in which general obligation and credit revenue bonds issued from May 15, 2018 to June 30, 2020 are outstanding.[28]

Conn. Acts 17-2 (June Special Session) also required, for general obligation and credit revenue bonds issued during the above timeframe, the state treasurer to pledge to bondholders that the State will not enact any laws, taking effect from May 15, 2018 to

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[C] *Sections 714-716 of Conn. Acts 17-2 (June Special Session) authorize the state treasurer to issue a new type of bond, the "credit revenue" bond. These bonds are backed by withholding taxes pledged statutorily for the repayment of the principal and interest. This new type of bond is subject to existing restrictions on state bonding, as well as the additional restrictions passed in Conn. Acts 17-2 (June Special Session) and Conn. Acts 18-178.. The savings projected under this new type of bond must be placed in the Budget Reserve Fund, with reductions in this transfer allowed under certain emergency circumstances.*
Conn. Acts 17-2 §§ 714-16 (June Special Session).

[D] *Section 704 of Conn. Acts 17-2 (June Special Session), known as the "volatility cap," diverts personal income tax revenue, from estimated and final payments, in excess of $3.15 billion (now adjusted annually based on the compound annual growth rate for the preceding five years, per Conn. Acts 18-81 § 20) to the Budget Reserve Fund (also known as the "Rainy Day Fund"), increases the Budget Reserve Fund's maximum balance from 10 percent to 15 percent of net General Fund appropriations, and expands its allowable uses, and establishes a mechanism for diverting projected surpluses in certain revenue sources to the Budget Reserve Fund.*
Conn. Acts 17-2 § 704 (June Special Session).
Conn. Acts 18-81 § 20

[E] *Section 705 of Conn. Acts 17-2 (June Special Session) imposes a statutory spending cap on General Fund and Special Transportation Fund appropriations based on a specified yearly decreasing percentage of estimated revenue, beginning in FY 2020 (99.5 percent of estimated revenue). The General Assembly may exceed this percentage in certain circumstances.*
Conn. Acts 17-2 § 705 (June Special Session).

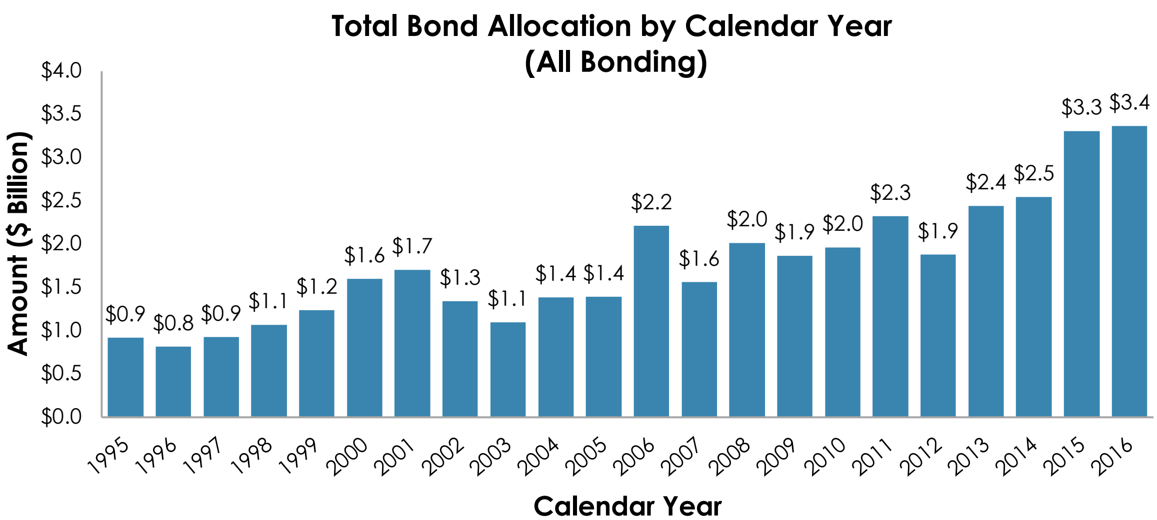
June 30, 2028, which alter the State's obligation to comply with the volatility cap, statutory spending cap, and bond cap laws contained in Conn. Acts 17-2 (June Special Session) until the bonds are fully paid off, or unless the following conditions are met:

A. Bondholders are protected in a separate way, or
B. 1) The governor declares an emergency, or the existence of extraordinary circumstances require the governor to submit a Deficit Mitigation Plan (whenever the comptroller projects a budget deficit greater than one percent of the General Fund),[29] 2) at least three-fifths of the members of each house of the General Assembly approve the change in compliance, AND 3) the change is limited to the fiscal year in progress.[30]

As stated in Conn. Acts 17-2 (June Special Session), this pledge must apply for 10 years from the bond's first issuance date but does not apply to refunding bonds issued to pay the original bonds that included the pledge.[31]

Chart 1 below details the total bond allocations by calendar year. Please note this total includes all bond types as general obligation bonds, revenue bonds, and special tax obligation bonds are not disaggregated in the comptroller's Bond Allocation Database.[32]

Chart 1: Total Bond Allocation by Calendar Year[33]



Each cap detailed above is required to be adjusted for inflation, using the change in the Consumer Price Index for all urban consumers, all items, less food and energy (CPI-U) for the preceding year.[34]

Changes to Restrictions on Bonding During the 2018 Legislative Session

During the 2018 legislative session, two bills modified the statutory bond caps that were initially included in the biennial budget of 2017. Conn. Acts 18-81 reduces by five years the timeframe during which the state treasurer is required to include in bond covenants that the bond caps will not be altered. Under current language, bond covenants will include language regarding statutory bond caps until 2023.[35] Conn Acts. 8-81 also reduces, from 10 years to five years from the date at which the bonds are first issued, the timeframe during which the pledge to not alter the caps will apply.[36]

Conn. Acts. 18-178 excludes from the calculations of bond issuances and expenditures: bonds issued for the purpose of refinancing preexisting bonds; bonds issued in anticipation of revenues to be received during the 12 calendar months following the issuance of such bonds;[37] and general obligation and special tax obligation bond issuances for the purpose of financing transportation projects of up to $250 million.[38] The act caps the amount of special tax obligation bonds for transportation projects[39] the state treasurer may sell at $750 million per fiscal year.[40] The act also adjusts the total bond authorizations the State Bond Commission may make for a variety of different purposes, such as urban action bonds, the information technology capital investment program, and school construction bonds.[41]

In 2018, a statutory drafting error in Conn. Acts 18-81 and 18-178 regarding the dates on which the above changes were to be effective caused confusion. The state treasurer issued bonds in May 2018, the covenants of which did not include the 2018 changes as the bills had not yet been signed by the governor. In response to this confusion, in November 2018, Connecticut's attorney general issued an opinion, recommending the state treasurer include the 2018 statutory changes in the calculations of the aggregate bond cap, and to interpret the statutes quoted in the bond covenants as including those changes.[42]

The aforementioned caps are summarized in Table 1 below.

Table 1: Conn. Acts 17-2 Bond Cap Detail[43]

	Allocation Cap	Issuance Cap	Spending Cap
Targeted Entity	State Bond Commission	Treasurer	Governor
Types of Bonds	General obligation and credit revenue	General obligation and credit revenue	General obligation and credit revenue
Exclusions	Certain credit revenue bonds, refinancing bonds, certain transportation bonds in FYs 18 & 19	Certain credit revenue bonds, refinancing bonds, Connecticut State University 2020 or UConn 2000 bonds, certain transportation bonds in FYs 18 & 19	Certain credit revenue bonds, Connecticut State University 2020 or UConn 2000 bonds, refinancing bonds, certain transportation bonds in FYs 18 & 19
Targeted Process	Bond allocations	Bond issuance	Approved expenditures (i.e. allotments)

Cap Amount	$2 billion	$1.9 billion	$1.9 billion
Date of Implementation	January 1, 2017	July 1, 2018	None given (any fiscal year)
Year Type	Calendar year	Fiscal year	Fiscal year
Adjusted for inflation?	Yes, CPI-U	Yes, CPI-U	Yes, CPI-U

Discussion

The largest potential structural ramifications from the additional restrictions on state bonding center primarily around the changes to the bond covenant requirements and pledges to bondholders specified in Section 706 of Conn. Acts 17-2 (June Special Session), which went into effect on May 15, 2018. Expressly requiring bond covenants to include a pledge that the State will comply with the volatility, spending, and bonding caps adopted in Conn. Acts 17-2 (June Special Session) reduces the ability for future legislatures to alter these caps in case of different circumstances, as the sole scenarios that allow for the changing of these restrictions are emergency circumstances as determined by the governor, or when the governor is required to create a Deficit Mitigation Plan,[44] which would then be presented to the General Assembly for approval (three-fifths of each chamber required). Absent the governor declaring an emergency or the circumstances justifying the creation of a Deficit Mitigation Plan (required when the comptroller projects a budget deficit greater than one percent of the General Fund), it appears the legislature is unable to alter these caps due to the inclusion of the specified pledge in the bond covenants. Although the General Assembly made statutory changes before the May 15, 2018 deadline, scenarios under which the bonding restrictions may be changed still apply.

The bond cap itself is projected to have impacts on capital investments by the State and long-term debt service levels. Restricting bonding in this manner is likely to result in less infrastructure spending on education, transportation, environmental, and economic development projects financed by bond sale proceeds than would likely occur in the absence of these caps. Additionally, restricting the total amount of general obligation and credit revenue bonds allowed to be authorized, allotted, and issued is projected to result in lower contributions to the amount of debt service the State would pay over the long term if the caps were not instituted.[45] It is important to note, however, that the potential reductions in debt payments as a result of bonding restrictions will be spread out over many years, and potential reductions in debt service payments are subject to future market conditions and actual bonding decisions.

Endnotes

[1] State of Connecticut, Office of the State Comptroller. (n.d.). Bond Allocation Database. Retrieved from http://www.osc.ct.gov/finance/whatis.htm.
[2] Ibid.
[3] Conn. Gen. Statutes ch. 32, § 4b-23.
[4] Pinho, R. (2015). *Connecticut's Bonding Process* (2015-R-0058). Hartford, CT: Connecticut General Assembly, Office of Legislative Research. Retrieved from https://www.cga.ct.gov/2015/rpt/pdf/2015-R-0068.pdf.
[5] Ibid.
[6] Connecticut General Assembly, Office of Fiscal Analysis. (2014). *Connecticut Capital Budget Report, February 2014*. Hartford, CT: Author. Retrieved from https://www.cga.ct.gov/ofa/Documents/year/CCBR/2014CCBR-20140307_Connecticut's%20Capital%20Budget%20Report%202014.pdf.
[7] Conn. Gen. Statutes ch. 32, § 3-20(g).
[8] Conn. Gen. Statutes ch. 32, § 3-20(j)
[9] Conn. Gen. Statutes ch. 32, § 3-20(g)(3).
[10] Ibid.
[11] Conn. Acts 78-366.
[12] Conn. Gen. Statutes ch. 32, § 3-21.
[13] Conn. Gen. Statutes ch. 16, § 2-27(b).
[14] Pinho, R. (2015). *Connecticut's Bonding Process* (2015-R-0058). Hartford, CT: Connecticut General Assembly, Office of Legislative Research. Retrieved from https://www.cga.ct.gov/2015/rpt/pdf/2015-R-0068.pdf.
[15] 1957 Conn. Acts 640.
[16] Conn. Gen. Statutes ch. 16, § 2-27(b).
[17] Ibid.
[18] Nappier, D. (2018). Certificate of Aggregate Amount of Indebtedness. Hartford, CT: State of Connecticut, Office of the State Treasurer. Retrieved from http://www.ott.ct.gov/debtreports/DebtCertificate01.12.18.pdf.
[19] Conn. Acts 17-2 (June Special Session).
[20] Conn. Acts 17-2 §§ 710-12 (June Special Session).
[21] Connecticut General Assembly, Office of Legislative Research. (2017). *OLR Bill Analysis, SB01502: An Act Concerning the State Budget for the Biennium Ending June 30, 2019, Making Appropriations Therefor, Authorizing and Adjusting Bonds of the State and Implementing Provisions of the Budget*. Hartford, CT: Author. Retrieved from https://www.cga.ct.gov/2017/BA/2017SB-01502-R00SS1-BA.htm.
[22] Conn. Acts 17-2 §§ 710-11 (June Special Session).
[23] Conn. Acts 17-2 § 712 (June Special Session).
[24] Ibid.
[25] Conn. Acts 17-2 § 705 (June Special Session).
[26] Conn. Acts 17-2 §§ 710-12 (June Special Session).
[27] Conn. Acts 17-2 § 706 (June Special Session).
[28] Ibid.
[29] Conn. Gen. Statutes ch. 50, § 4-85.
[30] Conn. Acts 17-2 § 706 (June Special Session).
[31] Ibid.
[32] State of Connecticut, Office of the State Comptroller. (n.d.). Bond Allocation Database. Available from http://www.osc.ct.gov/finance/.
[33] Ibid.
[34] Conn. Acts 17-2 § 712 (June Special Session).
[35] Conn. Acts 18-81 § 21.
[36] Ibid.
[37] Conn. Acts 18-178 § 16.
[38] Conn. Acts 18-178 § 41.
[39] Conn. Gen. Statutes ch. 243, § 13b-74.
[40] Conn. Acts. 18-178 § 44.
[41] Conn. Acts. 18-178.

[42] Jepsen, G. (2018, November 21). *Letter to Denise L. Nappier, State Treasurer*. Retrieved from https://portal.ct.gov/-/media/AG/Opinions/2018/2018-04_Bond_Covenant.pdf.
[43] Conn. Acts 17-2 §§ 710-12 (June Special Session).
[44] Conn. Gen. Statutes ch. 50, § 4-85.
[45] Connecticut General Assembly, Office of Fiscal Analysis. (2017). *OFA Fiscal Note, SB-1502: An Act Concerning the State Budget for the Biennium Ending June 30, 2019, Making Appropriations Therefor, Authorizing and Adjusting Bonds of the State and Implementing Provisions of the Budget*. Hartford, CT: Author. Retrieved from https://www.cga.ct.gov/2017/FN/2017SB-01502-R00-FN.htm.