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SUBMITTED TO THE GENERAL GOVERNMENT B SUBCOMMITTEE OF
THE APPROPRIATIONS COMMITTEE
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Good morning, Senator Bye, Representative Walker, and all of the members of the Appropriations Committee and its General Government B Subcommittee. Thank you for the opportunity to submit testimony on the general fund budget for both the Office of the Treasurer and for debt service, as proposed by Governor Malloy, for the 2016-2017 Biennium.

From the onset, let me acknowledge the challenging task before you to fashion a budget in the midst of difficult economic times. As policy leaders, you have had to contend with so many significant fiscal issues over the last several years that it is hard to recall a time when you didn't have the specter of deficits hanging over your heads. I stand ready to do whatever I can and to offer the resources of the Treasury as you work to finalize the State budget.

Notwithstanding these challenges, I want to share two bright spots at the Treasury as a result of the persistent, strong capital markets environment.

<u>First, we are achieving solid, long-term performance with the State's pension fund assets.</u> For the three years ending December 31, 2014, the Teachers' and State Employees' retirement funds -- representing 91 percent of the State's pension and trust fund portfolio --generated investment returns of 10.79% and 10.85, respectively. This performance result surpassed the actuarial investment return assumptions of 8% for State Employees' and 8.5% for the Teachers' plan. Likewise, performance results for the five-year horizon exceeded the actuarial return assumptions.

In fiscal year 2014, the Treasury's investment program for the overall Connecticut Retirement Plans and Trust Funds (or the "CRPTF," for short) -- added $4.15 billion of investment gains. After net withdrawals, the CRPTF ended the 2014 fiscal year with $3.5 billion more in assets than the previous year.

To illustrate the long-term recovery path from the depths of the Great Recession, since June 30, 2009, the five-year investment performance resulted in the overall net market value of these assets increasing by $9 billion or 44.4% -- after paying expenses, including benefits of $4.6 billion.

What is noteworthy about our investment experience over the past five years is that pension fund assets have grown at a faster pace than the payment of benefits and other expenses. In light of the State's significant unfunded pension liability, the substantial growth of the fund assets is good news for its beneficiaries and taxpayers.

While our performances over the three- and five-year horizons have been strong and have met or exceeded our expected returns, we are now grappling with market dynamics that make the search for similar returns more complicated. Key market drivers affecting the outlook for investment performance in the capital markets include divergent global monetary policies, weak oil prices, lack of inflation, the precarious outlook for the European Union and ongoing geopolitical tensions. The United States is clearly a leader in terms of economic growth and a driving influence supporting economic growth throughout the world. The performance of our pension fund will reflect the diversified returns that are generated in these various markets.

A second bright spot is our Short-Term Investment Fund (STIF). For Fiscal Year 2015 to date (i.e., the seven-month period from July 1, 2014 through January 31, 2015), STIF exceeded its primary benchmark by 13 basis points, which represents an additional $3.2 million in interest income for state and participating municipalities, as well as their taxpayers.

And this performance is a continuation of a strong track record of delivering additional interest income over and above the benchmark. I am proud to say that during my administration through the end of calendar year 2014, we generated additional interest income of $192 million for state and participating municipalities. Every little bit helps.

At the Treasury, we are committed to maintaining a safe and liquid fund while paying investors a highly competitive rate throughout interest rate cycles and economic environments.

Agency Budget

Turning to the Treasury's general fund budget, I well understand that in this environment, there are no sacred cows. We accept that cuts need to be made across the board.

Our budget was cut by approximately 13% for each year of the biennium, which will challenge us. We will, I believe, be able to carry out our core functions, provided that there are no additional cuts.

It bears noting that the proposed general fund appropriation represents roughly 2.9% of the Treasury's total budget. The vast majority of our operations are funded by non- general fund sources such as pension funds, the Second Injury Fund, the Short-Term Investment Fund and the Unclaimed Property Fund.

The proposed general fund budget assumes the transfer of three (3) positions to three non- general fund sources, which will account for roughly $320 thousand in savings for each year of the biennium. These are administrative positions in our business and human resources units, and these costs are typically allocated to non-general fund sources on a *pro rata* basis.

We have, in the past, been successful in allocating administrative expenses to the appropriate cost centers, which has resulted in general fund savings. So, even though the proposed budget assumes 100% of these three positions to be moved off of the general fund ledger, the reality is that some of these positions will continue to be supported by the general fund, and that additional general fund savings will be achieved by allocating a portion of the costs of other administrative positions to non-general fund accounts where appropriate.

At the end of the day, I must ensure that the fiduciary funds under my watch are used solely for the purposes for which these funds were created. As such, these funds will only be charged their fair share of agency-wide services.

Debt Service Budget

I commend the Governor for proposing a substantial investment in transportation infrastructure, including $2.78 billion in additional bond authorization over the next five years to fund the "Let's Go CT" initiative. His budget would increase funding for debt service on Special Tax Obligation bonds to support these amounts over the biennium, and those appear reasonable.

I think we can all agree that over the long term, additional revenue sources must be identified to finance such a large investment in transportation, and I am ready to offer the expertise of my office and our consultants to assist in the determination.

On an ongoing basis, I actively work to reduce the cost of the debt that the State has on its books. My administration has driven down borrowing costs, and to date we have reduced future debt service payments by approximately $985 million. We are also on track to save $2.2 billion over the 24-year life of the Teachers' Pension Obligation Bonds. Since the bonds were issued in 2008, the State has saved roughly $180 million, because we've earned more on investing the bond proceeds than we paid in debt service.

With respect to the next biennium, I believe that OPM has underestimated our General Fund debt service requirements. The Governor's proposal for general fund debt service is $152.7 million and $172.5 million below the Treasury's current estimates for Fiscal Years 2016 and 2017, respectively. This represents a reduction to the Treasury's estimates of $325.2 million over the biennium, or approximately 7.6%. Fortunately, by virtue of bond sales this spring, this gap is likely to narrow before passage of the final budget.

In practical terms, debt service is deemed appropriated, and my office will always promptly pay bondholders, regardless of budgeted amounts or the budgetary consequence of doing so. It's really a reputational concern for us.

And if the debt service budget is underestimated, it would affect you, the legislature, because it could lead to a deficit that you and the Governor would have to address with other revenues or reduced expenditures on other programs.

The key difference between the Treasury estimates and the Governor's is his assumption that a certain amount of bond premiums will be realized over the biennium. My Office does have a strong track record of coming in under budget for debt service because of our careful, prudent management of bond sales and the continuation of historically low interest rates. The central questions, however, are these: should we budget potential savings before they are realized? And if so, how much should we assume? And lastly, what are the odds of meeting those assumptions?

My view is that it all comes down to projections, and the probability of meeting them in light of capital market forecasts and the impact on investor demand. Even if savings are achieved, we are taking a chance that the entire debt service budget will be sufficient. So as State Treasurer, I am duty-bound to bring these issues to the attention of policy makers.

That said, there is another important element of the discussion around bond premiums… and it relates to how this money should be used in the first place. I believe that bond premiums would be best used to reduce the overall level of borrowing and future debt service costs. Premiums are used in this way in most other states, and for other bonding programs managed by my Office. I proposed this change in 2005 and have proposed it again this session.

I can see where such a change might be difficult for this biennium given the fiscal challenges the Administration and the Legislature face. However, to control overall debt levels, the use of premiums in the general obligation bond program should be aligned with our other bond programs, as I have proposed.

With respect to the UConn 2000 line item, which is also included in the General Fund debt service budget, we believe those amounts need to be increased by $5 million for each year, because a UConn bond sale planned for later this month is expected to have debt service requirements exceeding the amounts in the Governor's budget.

On a different note, I would like to share with you an existing development in bond issuance. Last fall we issued the State's first "Green Bonds," which are similar to any other bond issued by the State except that the use of the funds from the sale of these bonds is specifically used to fund projects for renewable energy and sustainable land use, as well as the Clean Water and Drinking Water programs. We offer Green Bonds to attract new investors to our bond issues – the growing group of investors that seek out bonds that will fund green projects to meet their investment goals.

We issued $60 million of General Obligation Green Bonds last fall to fund Clean Water Fund grants. We are now underway with a larger $250 million Clean Water Fund bond sale schedule to go to market in April that will be 100% Green Bonds.

Thank you for the opportunity to offer input on this budget process. I would be happy to take any questions that you may have.