State of Connecticut

DENISE L. NAPPIER
TREASURER

Hartford

September 18, 2018

The Honorable Dannel P. Malloy
Governor
State of Connecticut
State Capitol
Hartford, CT 06106

Re: Drafting Issue with the Bond Issuance Cap

Dear Governor Malloy:

I am writing to alert you to an issue recently identified by the State's bond counsel firms. Legislation enacted during the General Assembly's 2018 session to amend the State's General Obligation (GO) bond issuance cap contained a drafting error that may reduce the State's bonding capacity beyond what the legislature intended and, in turn, may result in a future cash imbalance.

By way of background, House Bill 5590 proposed changes to the bond issuance cap (enforced by a bond covenant) that was initially adopted in October of 2017 as part of Public Act 17-2. Specifically, the proposed language exempted refunding bonds and short-term revenue anticipation notes (RANs) from the $1.9 billion annual cap on GO bond issuance. These proposed changes were intended to take effect upon passage.

On the last day of the 2018 legislative session, House Bill 5590 was amended and became the bond package (now codified as Public Act 18-178). The original language creating the two specific exemptions to the issuance cap, as described above, was retained in full, becoming Section 16 of the bond package, and an exemption for a two-year $250 million per year GO annual transportation initiative was added. Unnoticed until now, the effective date for Section 16 was inadvertently changed from "upon passage" to July 1, 2018. This bill passed both chambers with unanimous support on May 9th.

The effective date is important because the bond covenant pledges that no changes to the underlying statutes – including bond caps – may take effect between May 15, 2018 and July 1, 2023, and GO bonds were issued on June 20, 2018 that included the covenant. Thus, it appears that the delayed effective date nullified the exclusions contained in Public Act 18-178. So, instead of the exclusions taking effect upon passage on May 9th, before the statutory provisions related to the bond covenant were locked in, these exclusions may not apply as intended for another five years.

Accordingly, until this is resolved, my office must proceed on the basis that the $1.9 billion bond issuance cap covers all GO bonded debt, including refunding bonds, RANs, and the GO transportation initiative.[1] The bond allocation and allotment caps that apply to the Bond Commission and the administration may be similarly affected.

Let me hasten to assure you that this does not pose any *immediate* problems for the State. Our cash balances are sufficient. The $1.9 billion bonding cap, however, requires vigilance. As this year and future fiscal years progress, the administration must carefully monitor capital spending to ensure that the State's financial obligations do not exceed our more restricted bonding capacity. Otherwise, operating cash would need to cover capital expenditures, creating a cash squeeze.

Moreover, the failure to effectively exclude refunding bonds from the cap on bond issuance may require the State to forego opportunities to refund outstanding bonds to achieve debt service savings in order to reserve capacity for new bonds to cover expenditures.

As you know, while the Treasurer's Office is responsible for financing the State's obligations, we do not control capital spending. The tighter bond cap makes the coordination of capital spending with bonding ability all the more important. Already this fiscal year, we have issued $889 million in new money GO bonds, refunding bonds and the permanent financing of previously-issued bond anticipation notes. Thus, only $1.01 billion remains in FY 2019 bonding capacity for additional GO purposes, other refunding opportunities, and the $250 million GO transportation initiative.

This situation appears to have been the result of an unintentional drafting error as to effective date. Nevertheless, until it is resolved, we must recognize the consequences and align bond project allocations, allotments and spending with bonding capacity.

At this point, my office's focus is on complying with the initially adopted and more constrained bond cap. If the legislature or administration wishes to effectively restore the enacted exclusions, there appear to be at least three possible options for consideration and further analysis:

1) The state could explore and pursue legislative or judicial remedies to what clearly appears to have been an unintended legislative action;

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[1] At almost the same time that PA 18-178 was passed, P.A. 18-81 also was passed, shortening the original bond covenant period from ten years to five years. This act was signed and took effect May 15, 2018, prior to issuance of the first GO bonds containing the covenant.

2) On an annual basis, the emergency clause contained in the covenant could be invoked with a declaration by the Governor and passage by a 3/5 majority in each house of the General Assembly;
3) With legislative approval, we could undertake an expensive taxable refinancing of the bonds that currently contain the covenant (the financings would need to be taxable due to federal tax restrictions on advance refundings).

My office is prepared to work with the administration and legislative leaders in an expeditious manner.

Sincerely,

Denise L. Nappier
State Treasurer

cc: Mr. Benjamin Barnes, Secretary of Office of Policy Management