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March 2, 2015

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

Dear Governor Malloy:

I write to provide you with financial statements for the General Fund and the Transportation Fund through January 31, 2015.

The Office of Policy and Management (OPM) is projecting a General Fund deficit of \$61.2 million for Fiscal Year 2015, and an ending balance in the Transportation Fund of \$163.3 million. This represents a reduction in the estimated General Fund deficit of \$59.7 million from last month. The lower deficit is the result of a \$36 million increase in revenue due to a legal settlement, and a \$23.7 million reduction in anticipated spending.

I am in general agreement with OPM's Transportation Fund projection for Fiscal Year 2015; however, my General Fund deficit projection for the current fiscal year is \$101.2 million. This is a \$40 million deficit increase from the OPM projection that arises from lower estimated income tax collections.

As OPM explains in their February 20th letter, a federal change in capital gains rates significantly altered estimated and final income tax receipts in Fiscal Year 2013 and Fiscal Year 2014. Taxpayers shifted gains that were likely to occur in Fiscal Year 2014 to Fiscal Year 2013 in order to take advantage of the lower tax rates in place at that time. OPM indicates that they are anticipating a rebound of 25 percent in such April receipts for Fiscal Year 2015 due to the distorted lower level of payments in Fiscal Year 2014. I am not confident that this level of increase will be attained.

Estimated income tax payments through January have grown 4.9 percent over last year. In the past, these payments through January have provided an indication of the size of estimated and final payment receipts that can be expected in April. The OPM projection relies on a 20 percent variance between January and April. An increase of this scope has not occurred in the last decade. I am also concerned that since the stock market recovery began in 2009, trading volume that generates taxable receipts has been declining. It appears that one cause is an ageing demographic that has shifted to lower risk portfolios with less trading volume. Complicating matters further, volume has been heaviest at lower points in the market cycle thus reducing the amount of taxable capital gains. For these reasons, I have reduced my income tax estimate by \$40 million this month. I remain hopeful that the April receipts will outpace my current projection, but I believe it is reasonable to lower expectations at this time.

As I noted last month, based on current spending trends and realized lapses over the past five fiscal years, I believe that the OPM savings target for the General Fund that now totals \$276.8 million is attainable. Over the past five fiscal years, annual realized lapses have averaged \$511.2 million. Although the current lapse target is a significant challenge, it is not inconsistent with past performance in difficult budget circumstances.

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It should be noted that in past years legislative action has been required in many instances to attain the required savings level.

The Transportation Fund is expected to close Fiscal Year 2015 with an operating deficit of \$5.7 million leaving an ending balance of balance of \$163.3 million. The most significant shortfall is in the Department of Transportation's Rail Operations account related to Metro North costs.

On March 16th, the Department of Labor will release January employment statistics for Connecticut. The Department of Labor's payroll employment number for December shows the addition of 4,800 positions. The state has posted job gains in ten of the past eleven months reversing an earlier trend of inconsistent job additions. Connecticut has regained 96,300 positions or 80.9 percent of the jobs lost to the 2008 recession. Wages in Connecticut are beginning to show some upward movement after a long period of stagnation. Average private weekly pay in the state was up 6.1 percent in November and 2 percent in December from the same months last year. Wages outpaced inflation, which rose 0.8 percent in December.

According to a report from the Warren Group released on February 17th, single-family home sales in Connecticut rose 1.7 percent in December of 2014 from the same month last year. Prices declined for the tenth consecutive month from a median of \$245,000 to \$240,000.

At this writing the stock market was up over the past twelve month period; however, it showed weakness during January, with all of the major U.S. indexes in negative territory for the month. Gross Domestic Product was up 2.2 percent in the fourth quarter after posting a strong gain of 5 percent in the third quarter. Corporate profits remained positive in the third quarter rising 3.1 percent from the second quarter. This is down from the 8.4 percent second quarter results.

I also issue a Comprehensive Annual Financial Report (CAFR) as an accounting supplement to the budgetary report. The CAFR includes financial statements for all state funds and component units prepared in accordance with Generally Accepted Accounting Principles (GAAP). From a balance sheet perspective, the GAAP shortfall or unreserved fund balance in the General Fund was \$727.2 million as of June 30, 2014. GAAP deficit reduction bonds in the amount of \$598,500,000 were issued in Fiscal Year 2014 to reduce the shortfall.

If you have any questions on this report, please do not hesitate to contact me.

Sincerely,

Kevin Lembo
State Comptroller