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Connecticut transportation crisis may drive bond strategy change

By

Paul Burton

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Sharp cuts in capital spending and a switch to more general obligation borrowing are among contingencies as Connecticut officials look to grasp a transportation funding crisis.

State programs are in peril without immediate revenues to prop up the fund that backstops projects, Gov. Dannel Malloy said late last week.

A report from the state's Department of Transportation and Office of Management and Budget projects the special transportation fund's balance, now with a $141 million surplus, to develop a $13 million deficit by fiscal 2020 and plummet into a $388 million hole two years later.

Without new revenue in the transportation fund, Connecticut's DOT would have to reduce highway, rail and bus services for the public, and reduce the capital program by more than $4 billion over five years.

According to the report, that means debt service on new bond issuances over five years would be limited to $800 million each in fiscal 2018 and 2019, $750 million in FY2020, and $650 million in each of the following two years.

Fuel taxes and other vehicle fees are the transportation fund's major revenue sources, boosted by the recent addition of some additional general sales tax revenue.

Alternative strategies include general obligation borrowing to offset limited bonding capacity in the special transportation fund.

"For too long, Connecticut put off the tough choices necessary for making critical investments in our state's transportation system and growing our economy – and now the bill is coming due," Malloy said at the state capitol in Hartford.

Highway, rail and bus programs on the chopping block would include the Interstate 84 aqueduct in Hartford; the widening of I-95 from Stamford to

Bridgeport; and double tracking along the corridor between Hartford and Springfield, Mass.

Malloy, who will not seek re-election next year, announced a 30-year, $100 billion transportation infrastructure initiative nearly three years ago, but it has barely gotten off the ground.

The governor must also craft a deficit mitigation plan for the general-fund fiscal 2018 because the latest projected deficit, at least $207 million, when the shortfall exceeds 1% of the general fund.

David Hitchcock, a senior director at S&P Global Ratings, said high fixed costs and weakness in capital gains revenue will make any worsening gaps difficult to close.

"We believe many states, including Connecticut, are not well prepared for the next recession," Hitchcock said in an investor presentation.

Fixed costs, according to Hitchcock, amount to 43% of the FY18 enacted budget. Medicated accounts for 14% while pension costs and debt service total 13% and 12%, respectively, while other post-employment benefits are at 5%.

S&P and Fitch Ratings rate Connecticut GOs A-plus, while Moody's Investors Service and Kroll Bond Rating Agency rate them A1 and AA-minus, respectively.

Connecticut operates on a biennial budget. Lawmakers expect to make a midyear correction when they reconvene, either through a special session before Christmas or a regular session in January.

According to S&P director Victor Medeiros, Connecticut municipalities could encounter such headwinds in 2018 as limited tax-base growth, greater reliance on local revenues to fund growth in expenditures, and the effects of any tax-overhaul measure that Washington passes.

Capital city Hartford is considering a Chapter 9 bankruptcy filing. The state allocated $48 million in additional aid in the FY18 budget. Mayor Luke Bronin has called for concessions from bondholders and labor groups.

Bronin, a Democrat and former chief counsel to Malloy, has filed paperwork to run for governor. Malloy will not seek re-election.

“We need to break old habits, change what isn't working, and try new things,” said Bronin.

Hartford would be eligible to file for assistance as a Tier III community under the state's new Municipal Accountability Review Board, which met for the first time Friday.

The board, formed with the passage of recent budget, contains $28 million in municipal restructuring funds under the state budget office, and a $20 million debt service appropriation to execute any contract assistance with the city. The legislation allows the state treasurer and budget director to assist with refunding bonds.

Any contract would constitute a full faith and credit obligation of the state.

According to Medeiros, S&P is evaluating what level of support Hartford would need from all parties.

"Hartford was particularly exposed to the budget impasse and the political brinksmanship," he said.