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## Fresh Off Another Downgrade, Connecticut Has a Plan to Lower Borrowing Costs.

***But observers disagree about whether it will work.***

Besieged by budget shortfalls, Connecticut's credit rating was downgraded in recent days by Fitch Ratings and Moody's Investors Service. The downgrades were the state's fourth and fifth in the past year alone. But if State Treasurer Denise Nappier gets her way, that credit hit might not matter the next time Connecticut goes to sell bonds.

Nappier wants the state to start offering investors revenue bonds that are paid back directly from the state's income tax revenues. Called tax-secured revenue bonds, these new bonds would be offered in place of general obligation bonds, which are backed by the state's general revenue collections. Nappier's office believes the dedicated income stream would mean the bonds would fetch ratings as high as AAA, resulting in a better interest rate and lower debt service costs.

The idea has received mixed reviews. While some observers call it a product that will offer comfort to bondholders wary of Connecticut's troubles, others say it's a "financial engineering gamble" designed to game the market. "To create something out of nothing — they're not being more fiscally responsible by doing it this way," says Municipal Market Analytics' Lisa Washburn.

In the past year, Fitch has downgraded the state's credit rating twice, and Kroll, Moody's and S&P Global Ratings have each downgraded it once. The latest action puts the credit rating at A+. It is the result, in part, of the state's third straight budget shortfall. Currently, Connecticut is facing a \$2 billion hole over the next two fiscal years. The deficits, caused mainly by weak income tax revenues and burdensome debt costs, have all but drained the state's rainy day reserve and made it difficult to keep up with its mounting pension obligations.

Deputy Treasurer Lawrence A. Wilson says the tax-secured bonds will insulate investors from the budget and pension concerns they have expressed. Instead, the bonds are "focusing on one of our highest credit positives, which is the high wealth of our state."

If approved by the General Assembly, the state would issue about \$2 billion in revenue bonds a year. Any interest rate savings would be directed into the state's rainy day fund. Wilson says he expects those savings to total \$980 million in fund deposits over 12 years.

When asked if state lawmakers would be tempted to keep raiding the rainy day fund, given the state's deficit struggles, Wilson acknowledged that was a possibility. "This is the part we can control," he says. "It's still a positive contribution."

Revenue bonds are common with lower levels of government and with housing and transit authorities, but are rarer at the state level. In 2001, New York state created a revenue bond program for streamlining purposes. Rather than having a handful of state authorities individually issuing tax-backed debt, New York's program created sales and income tax-backed bonds for them.

When it comes to assuring investors they'll be paid back, most states tend to opt for statutory or constitutional pledges. Illinois, for example, hasn't passed a budget in two years and has also suffered multiple ratings downgrades. But its constitution contains a "non-impairment" clause that prohibits action by the General Assembly that would damage the state's ability to pay back bondholders. State law also allows bondholders to sue the state to compel payment.

Belle Haven Investments' Tamara Lowin says Nappier's proposal is simply another way to assure investors they'll get their money back with interest. "This market loves the transparency of being able to see a direct revenue stream," she says. "It's a way to offer a credit designed with the ratings agencies in mind."

But Washburn isn't so sure that potential investors will be reassured by the new bonds and be willing to take a lower interest rate on the debt. "The likelihood that Connecticut will ever default and be in a situation where you have to test the structural provisions is really, really low," she says. "But would I want to give it a pricing benefit as an investor? It's definitely questionable."

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BY LIZ FARMER | MAY 17, 2017

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