FITCH RATES UNIVERSITY OF CONNECTICUT'S GO BONDS 'AA-'; OUTLOOK STABLE

Fitch Ratings-New York-21 March 2016: Fitch Ratings assigns an 'AA-' rating to approximately $300 million in University of Connecticut (UConn) general obligation (GO) bonds, consisting of:

--$300,000,000 GO bonds, 2016 series A;
--$42,000,000 GO bonds, 2016 refunding series A.

The par amount of the refunding series is subject to change pending final sale.

The bonds are expected to sell via negotiated sale on April 6.

The Rating Outlook is Stable.

SECURITY

The bonds are general obligations of the University of Connecticut, additionally secured by a pledge of and lien on a State of Connecticut debt service commitment for principal and interest, appropriated from the state's general fund without further legislative approval. The bonds are not general obligations of the state, and its full faith and credit are not pledged.

KEY RATING DRIVERS

RATING LINKED TO STATE: UConn's GO bonds are rated one notch below the GO bond rating of the State of Connecticut based on the state's debt service commitment equal to principal and interest and appropriated without further legislative approval. Higher education is a constitutional state priority, and legal protections are strong.

HIGH WEALTH LEVELS: Connecticut is the nation's wealthiest state as measured by per capita personal income. Economic recovery has been slow and uneven since the recession. Employment performance has recently accelerated and job growth has strengthened in the state's large and important finance sector after eight consecutive years of erosion.

CYCLICAL REVENUES AND SPENDING PRESSURE: The state's revenue performance is cyclical, while high fixed costs, including for labor, retirement obligations and some services, limit its ability to respond during revenue downturns.

LIMITED RAINY DAY FUND BALANCES: During past economic recoveries the state has rapidly repaid deficit borrowing and rebuilt its rainy day fund balance. In contrast, the current slow recovery has limited the state's ability to repay deficit borrowing and rebuild the fund balance, leaving the state more vulnerable to future fiscal shocks. Strengthened rainy day fund mechanisms in the recently adopted budget will only fully take effect after several biennia.

COMPARATIVELY HIGH DEBT LEVELS: Tax-supported debt is high for a U.S. state. This is partially attributable to the state's above-average role in relation to local levels of government when compared to most other states. Most GO bonds, excluding GO bonds issued to fund the teachers' retirement system, amortize rapidly.

SIGNIFICANT PENSION OBLIGATIONS: Net liabilities for retired employees are significant, including for state employee and teacher pensions. The state fully funds actuarially calculated contributions and conservatively amortizes its unfunded liabilities over fixed periods. The state has adopted reforms to both pension and retirement health liabilities and is considering additional pension restructuring.

RATING SENSITIVITIES

RATING LINKED TO STATE CREDIT QUALITY: The rating is sensitive to changes in the state's GO bond rating.

CREDIT PROFILE

The UConn GO bonds are issued by and carry the GO pledge of UConn, but their security and the 'AA-' rating rest with the debt service commitment of the state. Principal and interest are paid annually from the state's general fund, appropriated and obligated for payment by the State Treasurer without requiring further legislative approval. Fitch rates the state's own GO bonds 'AA' with a Stable Outlook. State general fund obligations, with the strength of continuing appropriations, are seen as slightly less well secured, and the UConn bonds fall within this category. The state's debt service commitment is separate from the operating appropriations and allotments that the state makes available to the university, and UConn GO borrowing is integrated into the state's overall debt management.

Over the last two decades, the state has prioritized renewal and expansion of facilities at UConn, the state's flagship public university. The UConn GO bonds have been issued as part of the state's UConn 2000 program, first enacted in 1995 and since then extended through 2024. Under the most recent extension, the program's total estimated cost has risen to $4.6 billion over the 1995-2024 period, of which $4.3 billion will be UConn GO bonds benefitting from the state's debt service commitment. Of this amount, almost $2.1 billion in debt service commitment bonds have been issued for university capital projects to date, with almost $1.1 billion currently outstanding.

The latest extension, titled 'Next Generation Connecticut,' was authorized by the state in 2013 as part of an effort to expand UConn research facilities and faculty, particularly in science and technology. The majority of UConn 2000-funded projects have been at the main UConn campus in Storrs, with additional projects at smaller regional UConn campuses and the UConn Health Center in Farmington. Current proceeds will fund new construction at the Storrs campus, with additional proceeds for the UConn Health Center.

STATE OF CONNECTICUT

Connecticut's 'AA' GO bond rating is based on the state's wealth and income resources tempered by high levels of debt, retirement obligations and other fixed costs. The state's progress in recovering from the last downturn remains incomplete given slow economic performance, tepid revenue growth and a low rainy day fund balance relative to historical fiscal cyclicality.

Despite its overall wealthy economy and evidence of recent economic acceleration, gains during the current expansion have been slower than in past recoveries, and the state's important finance sector is only gradually returning to growth. Balances in the budget reserve fund (BRF, the state's rainy day fund), at $406 million, is low relative to the state's spending base and its historical experience with revenue volatility. The state continues to carry outstanding deficit notes issued during the last recession.

As with fiscal 2015, fiscal 2016 revenue expectations have weakened relative to earlier forecasts, with the state implementing reductions and taking other administrative actions to address budget gaps. Although projected revenues were tracking near the lowered targets for several months, another downward revision was made based on the impact of financial market volatility on personal income tax collections.

Prior to and in proposed mid-biennium budget revisions, the governor has outlined more extensive reforms to taxes, staffing and pensions, intended to improve budgetary sustainability and competitiveness. Fitch views the proposals as a starting point for deliberations on fiscal management reforms that could strengthen the state's financial posture over the longer term, assuming consensus can be achieved. In the meantime Fitch expects the state to address near-term under-performance within its current budgetary framework, a challenge made more acute by the recent revenue forecast change. Evidence that the state's currently limited level of flexibility is insufficient to absorb fiscal challenges could result in a lower rating.

For further information on the State of Connecticut, please see Fitch's press release dated March 9, 2016, 'Fitch Rates Connecticut's GO Bonds 'AA'; Outlook Stable,' at 'www.fitchratings.com'.

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Fitch recently published exposure drafts of state and local government tax-supported criteria (Exposure Draft: U.S. Tax-Supported Rating Criteria, dated Sept. 10, 2015 and Exposure Draft: Incorporating Enhanced Recovery Prospects into U.S. Local Tax-Supported Ratings, dated Feb. 2, 2016). The drafts include a number of proposed revisions to existing criteria. If applied in the proposed form, Fitch estimates the revised criteria would result in changes to fewer than 10% of existing tax-supported ratings. Fitch expects that final criteria will be approved and published in the beginning of the second quarter of 2016. Once approved, the criteria will be applied immediately to any new issue and surveillance rating review. Fitch anticipates the criteria to be applied to all ratings that fall under the criteria within a 12-month period from the final approval date.

In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from IHS Global Insight.

Applicable Criteria
Exposure Draft: U.S. Tax-Supported Rating Criteria (pub. 10 Sep 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869942
Tax-Supported Rating Criteria (pub. 14 Aug 2012)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686015
U.S. State Government Tax-Supported Rating Criteria (pub. 14 Aug 2012)
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