State of Connecticut General Obligation Bonds 2014 Series A and B

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Executive Summary

Kroll Bond Rating Agency ("KBRA") has assigned a long-term rating of AA with a stable outlook to the State of Connecticut's $400 million General Obligation Bonds 2014 Series A and 2014 Series B (SIFMA Index Bonds). In addition, KBRA affirms the long-term rating of AA with a stable outlook on the State's outstanding General Obligation Bonds, excluding Bonds backed by a letter of credit or liquidity facility. After issuance of these Bonds, the State's outstanding general obligation debt will total approximately $16.1 billion.

This rating is based on KBRA's **U.S. State General Obligation Rating Methodology**, published on March 28, 2012.

This report serves as an update to the **State of Connecticut General Obligation GAAP Conversion Bonds, 2013 Series A** published on October 1, 2013. For further information and a full discussion of the Key Rating Determinants, please see this report as well as **State of Connecticut General Obligation 2012 Series A & B** report published on March 29, 2012.

Security

The Bonds are general obligations of the State and are secured by Connecticut's full faith and credit pledge. All General Obligation Bond debt service of the State is deemed appropriated without further action by the State Legislature.

Use of Proceeds

Proceeds from the 2014 Series A & B will be used to fund various projects and purposes of the State. The 2014 Series A Bonds are scheduled to mature in 2034 and the 2014 Series B Bonds are scheduled to mature in 2024.

Key Rating Strengths
• Current leadership has demonstrated an ability and willingness to raise revenues and adjust expenditures.
• A strong financial management framework exists for tracking revenues and monitoring budget performance.
• The State has implemented a plan for funding its accumulated GAAP deficit and converting to GAAP based budgeting as part of the FY 2014- FY 2015 Biennium Budget.
• Connecticut has the highest per capita income in the country at $61,321 as of the third quarter of 2013.
• Available cash balances provide good liquidity for operations, without utilization of external borrowing.

Key Rating Concerns
• Slower than expected economic recovery continues to impact revenue collection, threatening budget balance.
• Revenue base is volatile due to concentration in the financial services sector and progressive nature of the income tax structure.
• Though, the State is expecting to increase the Budget Reserve Fund to an amount equal to 3.2% of General Fund expenditures by the end of FY 2014, this level of reserves remains somewhat low, given the relative volatility of the revenue base.

- State debt burden is high on a per capita basis and as a percentage of personal income.
- Connecticut has a high level of unfunded pension liabilities.

Rating Summary

KBRA views the State's ongoing lag in economic recovery and its impact on budgetary operations as continuing to pressure the fiscal operations of the State. The slow pace of the economic recovery, compared to the region and the nation, has created increased demand for services while some economically sensitive revenue collections, including sales tax collections, continued to be below expectations through FY 2013. Recent revenue projections for FY 2014 indicate that revenues may exceed expectations, which would improve operating performance and increase reserves. The State currently projects that the Budget Reserve Fund will be increased to a level equal to 3.2% of General Fund expenditures by the end of FY 2014. KBRA views this indication of improved budgetary performance positively and will continue to monitor FY 2014 operations as well as performance under the FY 2015 budget. Though the risk of the federal sequestration program impacting Connecticut's defense contractors has been somewhat mitigated by the passage of a federal budget bill in January 2014, the wind-down of the wars in Iraq and Afghanistan will likely result in a reduction in defense spending which may negatively affect the State's economy and finances.

KBRA recognizes that the State has actively managed its fiscal pressures in a difficult economic climate and has acted quickly and decisively to restore balanced fiscal operations when needed, as evidenced by actions taken by the Governor and the General Assembly at the end of 2012. Additionally, KBRA recognizes that the State has generally moderated its revenue assumptions in the last year and conservatively managed its budget assumptions on income tax revenues to be received in FY 2014. KBRA expects that the State will continue to actively monitor its budget projections and act to increase revenues or reduce expenditures in order to maintain budget balance.

Conversion to GAAP-based budgeting and funding of the accumulated GAAP deficit in this biennium has been a priority of the Malloy administration since the Governor took office in January 2011. The FY 2014-FY 2015 biennium budget represents the first budget to be developed by the State based on GAAP accounting. The State has funded a portion of the accumulated deficit in the General Fund through the issuance of general obligation bonds and will fund the remaining deficit through ongoing appropriations.

The State continues to operate under a strong framework of financial management policies and procedures. The statutory requirement for the State to monitor and report budget performance on a monthly basis, as well as the requirement that a deficit mitigation plan be developed by the Governor in the event the General Fund deficit exceeds 1.0% of appropriations, has allowed transparency in a time of fiscal pressure. The State's tax-supported debt burden continues to be high, when compared to other states. Connecticut continues to have the highest per capita income in the nation at $61,231 which was 137% of the national average in as of the third quarter of 2013.

Based on review of the four KBRA Rating Determinants included in the KBRA Methodology for rating State General Obligation debt, KBRA has determined that the ratings assigned to all of the four Rating Determinants remain consistent with previously designated levels. KBRA continues to assign an overall rating of AA to the State's General Obligation Bonds. KBRA's Rating Determinants and associated rating assessments are summarized as follows:

- Management Structure, Budgeting Practices and Policies: AA+
- Debt and Additional Continuing Obligations: AA-

- Financial Performance and Liquidity Position: AA
- State Resource Base: AA-

Outlook: Stable

The stable outlook reflects KBRA's expectation that the State's leadership will maintain their commitment to fiscal discipline and quickly take all action necessary to maintain budgetary balance. KBRA views the projections for improved budgetary performance and increased reserves in FY 2014 to be positive and will continue to monitor FY 2014 operations as well as performance under the FY 2015 budget. However, KBRA continues to view Connecticut's lagging recovery, compared to the New England region and the US, as putting pressure on State fiscal operations. Though the risk of the federal sequestration program impacting Connecticut's defense contractors has been somewhat mitigated by the passage of a federal budget bill in January 2014, KBRA will continue to monitor the impact of the wind-down of the wars in Iraq and Afghanistan and any impact on the State's economy and finances.

In KBRA's view, the following factors may contribute to a rating upgrade:

- Several years of structurally balanced budgets and actual results showing General Fund operating surpluses.
- Restoration of the Budget Reserve Fund to a level equal to 10.0% of annual expenditures (State statutory Budget Reserve Fund target).
- Significant increase in the funded ratios for the State's pension systems.

In KBRA's view, the following factors may contribute to a downgrade of the rating:

- Continued slower than expected economic recovery which causes revenues, such as personal income taxes and sales taxes, to decline and puts pressure on the General Fund.
- Failure to take actions necessary to maintain budget discipline and balanced financial operations.
- Significant reliance on non-recurring revenues to balance the budget.
- Failure to appropriate necessary funds over time as part of an implementation plan for funding long-term liabilities related to accumulated GAAP deficits and pension liabilities.
- Cuts in federal spending for defense that causes significant contraction in the State's defense related industries.

Financial Performance and Liquidity Position

FY 2014 Financial Operations

Based on the monthly budgetary estimates provided by the State's Office of Policy and Management (OPM) on February 20, 2014 for the period ending January 31, 2014, the State's General Fund is projected to end FY 2014 with a $504.4 million surplus. These projected levels incorporate the State's transition to budgeting on a GAAP basis and the projected year end surplus reflects GAAP accounting principles. These year-end projections incorporate the recent January 15th consensus revenue estimates produced by OPM and the Legislature's Office of Fiscal Analysis. The previous budget estimate for budgetary surplus at the end of FY 2014 was $4.4 million.

As a part of the Midterm Budget Adjustments, the Governor is proposing that $155 million of this surplus be returned to taxpayers in the form of sales and gas tax refunds, $100 million be deposited in the State Employee Retirement System and $242.6 million be deposited into the Budget Reserve Fund. The Governor's proposal also includes an additional $30 million deposit to the Budget Reserve Fund from the FY 2013 surplus that had been reserved for use in FY 2015. This total deposit of $272.6 million brings the level of the Budget Reserve Fund to $543.3 or approximately 3.2% of estimated FY 2014 General Fund Expenditures, an action which KBRA views very positively.

In total, based on the January 2014 consensus revenue estimates, General Fund revenues for FY 2014 are projected to increase $421.2 million, or 2.5%, from original budgeted revenue levels. In FY 2014, the State instituted a tax amnesty program covering a range of state taxes, which included a budget target of $35 million in additional revenue. The Department of Revenue is currently projecting this program to yield $195 million in additional revenue, largely from corporate income taxes. Beyond the tax amnesty program, all major revenue sources are now expected to exceed or meet original budget estimates, which reflected generally conservative revenue projections by the State at the time of the biennium budget. Because of the effect of the roll forward of taxable capital gains into FY 2013, due to changes in federal tax rates in calendar year 2012; the State was especially conservative in estimating growth in personal income taxes in FY 2014. However, estimated income tax payments through January of FY 2014, continue to show year over year growth of 4.9%, which is due, in part to continued strong performance of the stock market. . Estimated income taxes are expected to show positive growth throughout this fiscal year and OPM has stated that April collections are expected to be strong. Based on OPM's February 20, 2014 budgetary estimates, FY 2014 General Fund expenditures are projected to be under original estimates by $79 million on a net basis.

Though the tax amnesty portion of this projected $504.4 million FY 2014 surplus could be considered to be non-recurring revenue, the balance of the projected surplus is due to a combination of improved economic conditions and strong stock market performance. The significance of capital market driven increases in revenues to the State highlight the volatility in their income tax base.

The Office of the State Comptroller released the FY 2013 audited financial statement (CAFR) reported on a GAAP basis on February 28, 2014. For FY 2013, the General Fund ended the year with a surplus on a GAAP basis of $322.0 million and a negative unassigned fund balance (accumulated GAAP deficit) of $1.2 billion. In October of 2013, the State issued $560 million in GAAP Conversion Bonds that will amortize over 15 years, beginning in FY 2016. Net proceeds of these Bonds were deposited into the General Fund and will fund approximately 50% of the accumulated GAAP deficit and improve the State's cash position. The effect of this deposit was to reduce the negative unassigned fund balance to approximately $618 million. The remaining accumulated GAAP deficit will be funded from appropriations over 13 years, beginning with the FY 2016 budget. The budget requires that bond covenants be included as part of the financing documents that require that bond proceeds cannot be appropriated by the current or future legislature for other purposes and that the remaining GAAP deficit be funded through appropriations through 2028, which KBRA considers as an indication of commitment to implementation of this plan.

The table below shows the results of General Fund operations on a budgetary basis from FY 2009 to FY 2013.

Statement of Revenues, Expenditures, and Net Surplus for General Fund FY 2009-FY 2013 (modified cash/budgetary basis)					
(in millions)	**2013** [5]	**2012**	**2011**	**2010**	**2009**
Net Surplus July 1st	0	0	0	-947.6	0
Proceeds of Economic Recovery Notes				947.6	
Operating Revenues	19,405.90	18,561.60	17,604.30	16,410.00	15,700.80
Operating Expenditures	19,025.80	18,781.60	17,845.10	17,208.00	17,234.90
Other	18.7	76.5	-75.3	-30.6	586.5
Net Operating Surplus (Deficit)	398.8	-143.6	-316.1	-828.6	-947.6
Transfer (to) from Budget Reserve Fund	-178	143.60 [4]	103.2	1,278.50	0
Reserved for Subsequent Years Expenditure	220.8			449.90 [2]	
Reserved from Prior Year			449.9		
Net Surplus (Deficit) June 30th	**$0**	**$0**	**236.90** [3]	**$0**	**($947.6)**[1]
Source: Connecticut 2013 Official Statement					

[1] FY 2009 net deficit funded by Economic Recovery Notes (2009 Series A) issued in FY 2010.
[2] FY 2010 net surplus was $449.9 million after transfer of Budget Reserve Fund. This amount reserved for FY 2011 operations.
[3] In FY 2011, $14.5 million of the surplus will be deposited in the OPEB Trust Fund and $222.4 million was transferred to the
[4] The FY 2012 operating deficit was funded by a transfer from the Budget Reserve Fund, leaving a remaining balance of $93.4
[5] Unaudited FY 2013 results. Balance in Budget Reserve Fund is $271.5 million at end of FY 2013.

Adopted FY 2014-FY 2015 Biennium Budget

The budget for the FY 2014- FY 2015 Biennium was passed by the General Assembly and signed by the Governor on June 18, 2013. The FY 2014-FY 2015 budget was developed on a modified accrual basis in accordance with GAAP principles, as opposed to the prior cash basis of accounting. When the Governor took office in January 2011, he made conversion to GAAP-based budgeting a priority for the FY 2014-FY 2015 biennium budget and KBRA views this change as very positive. The budget, at the time of adoption, included a General Fund budgeted surplus of $3.6 million in FY 2014 and $2.2 million in FY 2015. The budget includes the use of $190.8 million and $30.0 million of the FY 2013 surplus in FY 2014 and FY 2015, respectively, but overall, reflected a somewhat reduced dependence on one-time revenues, compared with prior years.

The budget included an assumption for total General Fund revenue growth of 0.7% for FY 2014 and 4.9% for FY 2015, which represented a reduction from the level in the Governor's proposed budget, a modification which KBRA viewed as positive. These levels compared to projected actual General Fund revenue growth of 2.1% in FY 2013, net of one time increased tax revenues. Revenue assumptions for income taxes and sales taxes, which together comprise approximately 70.0% of General Fund revenues, were also reduced in the adopted budget. Assumptions for income tax (withholding portion) growth were reduced to 4.4% from 6.0% in FY 2014 and to 5.7% from 6.5% in FY 2015. Sales tax growth assumptions were reduced to 2.5% from 3.7% in FY 2014 and to 3.5% from 4.2% in FY 2015. The budget contained no new taxes, although certain tax measures were extended, including the 20% corporate tax surcharge, a tax on electric generators and certain limits on the use of tax credits by insurance companies.

On the expenditure side, the Governor's proposed budget included significant reductions in spending from current levels in areas including reduction of disproportionate share payments to hospitals, various saving initiatives in Medicaid programs, extension of a cap on certain municipal grants and savings of $196.0 million in each year from the restructuring of the 2009 Economic Recovery Notes. Growth areas in the budget included costs related to the Affordable Care Act (ACA) and pensions. Costs of implementation will be fully covered beginning on January 1, 2014 as 100% federal reimbursement begins, which is estimated to save the State approximately $400 million annually. Pension costs will increase for the State Employee

Retirement System (SERS) in FY 2014 and FY 2015 due in part to the change in investment return assumption from 8.25% to 8.00% in 2012, which increases annual required payments. The adopted budget includes full funding for the actuarially required contribution (ARC) for both SERS and the Teacher's Retirement System for FY 2014 and FY 2015. As part of the FY 2014-FY 2015 budget legislation, any General Fund surplus going forward will be deposited to the Budget Reserve Fund, which KBRA consider a positive factor.

Midterm Budget Adjustments

Connecticut State statutes require the Governor to submit a status report to the General Assembly on the biennial budget enacted in the previous year. On February 6, 2014, the Governor submitted to the General Assembly a status report which included revised revenue and expenditure projections for FY 2014 and FY 2015 and proposed midterm adjustments for FY 2015. The projected increase in the FY 2014 end of year surplus and decisions on its use is discussed in a prior section on FY 2014 operations.

Overall, the midterm budget adjustments do not include any major shifts or changes in either General Fund revenues or expenditures for the FY 2015 budget. The midterm budget adjustments incorporate the January 2014 consensus revenue forecast in the revenue assumptions and propose a number of modest tax relief measures. The total of all tax relief and policy changes reduce General Fund revenues by a total of total $167 million. On the expenditure side, the Governor proposed a small decrease in overall General Fund appropriations, while increasing spending on certain education, employment training programs and mental health programs. Other reductions to expenditures included a reduction in debt service costs and re-estimation of anticipated GAAP conversion costs. It is projected that FY 2015 will end with a surplus of $22.3 million in the General Fund.

Though the January 2014 consensus revenue forecast do project increased revenues, the revised FY 2014-FY 2015 budget is still based on fairly conservative General Fund revenue growth assumptions of 2.8% in FY 2014 and 2.1% in FY 2015. These levels compare to projected actual General Fund revenue growth of 2.1% in FY 2013, net of one time increased tax revenues. The next consensus revenue forecast is due in April 2014.

Liquidity Position

The State's liquidity position is good and continues to improve as the State's budgetary performance improves. The cash position was improved even further with the deposit of the proceeds of the GAAP Conversion Bonds in October of 2013. As of 2/15/2014, the State's available cash had averaged $2.1 billion and the common cash pool has averaged $789 million on a weekly basis. The common cash pool represents cash resources directly available on a daily basis to fund State operations. Available cash includes bond funds and other balances which can be made available to the common cash pool through temporary transfers under long established state practice. Based on weekly cash flows provided by the Office of the State Treasurer, the available cash at the end of FY 2014 is projected at approximately $1.9 billion.

In December 2012, the State secured a $300 million line of credit with a single bank to provide a source of additional liquidity, if needed. In December 2013, the State allowed this facility to expire, without a draw or payment of fees. The State has no plans to issue cash flow notes.

Debt and Additional Continuing Obligations

After this issuance, total State tax-supported debt will be $20.0 billion consisting of approximately $16.1 billion in general obligation debt and $3.9 billion in special tax debt, which represents a slight increase since last year. The State's direct debt continues to be high, as compared to other states. State tax-supported debt per capita is $5,575 and, tax-supported debt as a percentage of 2012 personal income is 9.3%. The ratio of tax supported debt to State GDP has increased to 10.1 %, due to declines in State GDP in 2012.

These high debt levels result in part from the State's practice of issuing direct State General Obligation debt for certain university projects and for purposes that municipal entities fund in other states, including local school construction. Debt issued for local purposes accounts for approximately 60.0% of State general obligation debt outstanding. The State's relative debt burden is more in line with its peers when aggregate state and local debt within a state is compared. A comparison of Connecticut's debt levels and the average for U.S. States can be seen in the table below.

Connecticut's state tax-supported debt per capita is in the top 1.0% in terms of direct debt levels relative to other states. On the basis of aggregate state and local debt per capita levels across states, Connecticut's relative position, while still high, falls to within the top 10.0%. State tax-supported debt to personal income is high at 9.3 %, placing it in the top 5.0% of states in terms of relative debt; however, it drops to the 50th percentile, when comparing aggregate state and local debt to other states. While State tax-supported debt per gross state product (GSP) is high at 10.1% and in the top 1.0% of debt levels, this also drops to the 45.0% percentile when comparing aggregate state and local debt to other states.

Table 1: Connecticut Debt Ratios[1]

	Connecticut 2012[2]	Avg of U.S. States, 2012	Connecticut, 2012 U.S. Percentile
Tax-Supported Debt per capita	$5,575	$1,604	Top 1%
Aggregate State and Local Debt per capita	$11,568	$8,523	Top 10%
Tax-Supported Debt as a % of Personal Income	9.3%	3.8%	Top 5%
Aggregate State and Local Debt as % of Personal Income	20.0%	20.8%	50.0%
Tax-Supported Debt as a % of GSP	10.1%	3.2%	Top 1%
Aggregate State and Local Debt as a % of GSP	18.4%	17.4%	45.0%

[1] Source of tax-supported debt of other U.S. states is from Credit Scope. Source of aggregate state and local debt levels are based on FY 2011 numbers from the U.S. Census Bureau

[2] Population, personal income, and GSP are as of 2012. Connecticut's 2012 GSP is $229.3 billion; this number does not account for inflation.

Debt service on direct general obligation debt in FY 2013 as a percentage of total FY 2013 governmental expenditures is 7.2%. General Fund debt service will increase slightly in 2016 as debt service increases for the State's pension bonds and economic recovery notes. Debt amortization remains above average, with 65% of principal on direct debt retired within 10 years. The majority of the State's outstanding GO debt (88%) is fixed rate and the swap notional amount on their GO bonds represents 2% of total debt.

State Resource Base

KBRA view's Connecticut's resource base as being consistent with a AA-rating. The State's economic recovery is continuing, though at a slower rate than New England and the US, as evidenced by the lag in job recovery from recession levels and ongoing lack of job growth in the State's key employment sectors. In previous reports, KBRA had noted concern about the potential impact of sequestration on the defense industry which has comprised 5.2% of Gross State Product over the past three years. While this concern was mitigated by the passage of a federal budget bill in January 2014 that partially repealed some defense related sequester cuts for 2014 and 2015, the State, in the FY2015 Midyear Economic Report of the Governor, has pointed out that the wind down of the wars in Iraq and Afghanistan may likely lead to reductions in defense spending.

Connecticut remains the wealthiest state in the nation as measured by per capita personal income, at 137% of the national average as of the third quarter of 2013. The State's 2012 population of 3.6 million reflects 3.8% growth since 2002, which was slower than the growth in the U.S. of 9.1% in the same period. The State's population is well educated relative to the nation with 37.1% of the population having received a Bachelor's degree or higher, which is in the top 4.0% of the country. The number of people living below the poverty level is 10.7%, among the lowest in the U.S.

	Connecticut			New England				U.S.		
	2012	% Chg from 2002	2012 U.S. Percentile	2012	% Chg from 2002	2012 U.S. Percentile	CT as % of NE Avg	2012	% Chg from 2002	CT as % of U.S. Avg
Population	3,590,347	3.8%		14,562,704	3.1%		**25%**	313,914,040	9.1%	**1%**
Age Dependency Ratio[1]	58.6%	-5.2%		56.3%	-4.9%			57.7%	-4.6%	
Population with B.A. Degree or higher[2]	37.1%	-	Top 4%	34.4%	-	Top 15%	**108%**	29.1%	-	**127%**
Poverty Level	10.7%	-		12.1%	-		**88%**	15.9%	-	**67%**
Personal Income (in billions)	$214.3	43.2%		$763.8	41.8%			$13,729	51.6%	
Personal Income per capita	$59,687	38.0%	Top 1%	$48,020	37.8%	Top 14%	**123%**	$42,693	35.6%	**138%**
Real Gross Domestic Product (in billions)	$197,202	7.6%		$721,326.0	11.2%			$13,431	16.2%	
Real GDP per capita	$54,925	3.6%	Top 5%	$44,263	7.4%	Top 38%	**124%**	$42,784	6.5%	**128%**

Source: U.S. Census Bureau, U.S. Bureau of Economic Analysis

[1] Age dependency ratio is the sum of the population under 18 yrs and over 65 yrs divided by persons age 18 to 64 yrs.

[2] Percent of the population aged 25 and over.

Slow Economic Recovery Continues

A historically slower pace of economic recovery than the nation are contributing factors to Connecticut's low recovery rate of non-farm jobs lost in the recession and a lack of growth in key employment sectors, namely financial services and manufacturing. The recession in Connecticut began in March 2008 and lasted approximately 23 months until February 2010 in which time the State lost 121,200 non-farm employment jobs or approximately 7.1% of its employment base. Employment sectors across the board, with the exception of education and health services, experienced employment losses due to the recession. The sectors hit hardest in the recession were services (professional business, and others), manufacturing, and trade (wholesale and retail) which together accounted for 60.7% of the total non-farm jobs lost in the recession.

The Recessions Effects on Connecticut's Employment Sectors

(in thousands)	Jobs Lost (Gained) Mar '08-Feb '10	% of Total Non-Farm Jobs Lost	Jobs Gained (Lost) Since Feb '10	% of Total Non-Farm Jobs Recovered
Services	27.2	22.4%	16.9	28.5%
Manufacturing	23.5	19.4%	(5.9)	-9.9%
Trade	22.9	18.9%	11.3	19.0%
Construction	21.0	17.3%	8.1	13.6%
Financial Activities	9.1	7.5%	(4.6)	-7.7%
Leisure and Hospitality	7.8	6.4%	14.9	25.1%
Government	7.2	5.9%	(8.2)	-13.8%
Information	6.2	5.1%	(1.4)	-2.4%
Transportation and Utilities	4.0	3.3%	2.6	4.4%
Mining and Logging	0.2	0.2%	(0.1)	-0.2%
Education and Health Services	(7.9)	(6.5%)	25.4	42.8%
Total Nonfarm	**121.2**	**100.0%**	**59.4**	**100.0%**
Job Recovery Rate			**49.0%**	

Source: U.S. Bureau of Labor Statistics

The State has been in recovery since February 2010 and as of December 2013 has recovered 49% of the total non-farm jobs lost in the recession which is lower than New England's recovery rate of 83.4% and the U.S.'s recovery rate of 92.3%. The sectors contributing the most to the State's job recovery are education and health services accounting for 42.8% of the total non-farm jobs gained since February 2010, followed by services at 28.5%, and leisure and hospitality at 25.1%. The State continues to experience job losses in two of the State's key sectors, financial activities and manufacturing. From February 2010, the trough of Connecticut's recession, to December 2013 these two sectors have declined 7.7% and 9.9% respectively, compared to growth in these sectors at the national level of 2.3% and 5.2% respectively in the same period. The State also suffers from employment losses in the government sector which has declined 13.8% since February 2010 outpacing national trends where government has declined 2.8% over the same period.

Employment and Unemployment Rates

The State's slow economic recovery continues to impact the State's 2013 employment and unemployment rates. Employment gains in 2013 are trending slightly behind 2012. Year-to-date (January to December 2013) the State has added 11,000 non-farm jobs, a gain of less than 1% which is less than the 13,500 non-farm jobs the State added in 2012. Connecticut continues trending behind the U.S. 2013 year to date growth of 1.9% in non-farm jobs during the same period.

Unemployment Rates (seasonally adjusted)			
Year	**Connecticut**	**New England**	**U.S.**
2007	4.6%	4.5%	4.6%
2008	5.6%	5.4%	5.8%
2009	8.2%	8.2%	9.3%
2010	9.3%	8.5%	9.6%
2011	8.9%	7.8%	8.9%
2012	8.3%	7.2%	8.1%
2013*	7.9%	6.7%	7.4%

Source: U.S. Bureau of Labor Statistics
*Preliminary number

The State had a 2012 unemployment rate of 8.3% compared to the U.S. unemployment rate of 8.1% during the same time period. The State unemployment rate hovered between 8.0% and 8.1%, ending the year with an average unemployment rate of 7.9% as compared to a significant decline for the nation. Annual 2013 unemployment rate for Connecticut compares to unemployment rates of 6.7% in New England and 7.4% in the US.

Non-Agricultural Employment						
	Connecticut		**New England**		**U.S.**	
in thousands	**Employment**	**% Chg**	**Employment**	**% Chg**	**Employment**	**% Chg**
2008	1,699.0	0.0%	7,044.6	0.0%	136,849.0	-0.6%
2009	1,626.3	-4.3%	6,788.3	-3.6%	130,859.3	-4.4%
2010	1,607.8	-1.1%	6,771.5	-0.2%	129,911.1	-0.7%
2011	1625.7	1.1%	6,836.2	1.0%	131,499.8	1.2%
2012	1639.2	0.8%	6,914.0	1.1%	133,737.0	1.7%
2013*	1650.2	0.7%	7,024.9	1.6%	136,362.0	2.0%

Source: U.S. Bureau of Labor Statistics
*Preliminary Number

Labor Force

Labor force estimates are a measure of the work status of people who live in Connecticut. In total the State's labor force has declined 63,150 since March 2011, a level which equates to 3.3% of its labor force. During the same period New England's labor force, net of Connecticut, has declined by 11,437 or less than 1.0% of the labor force. Factors that may be contributing to the State's declining labor force may be due to workers leaving the State to seek employment in other states, retiring population, or graduating college students moving into advanced degrees rather than the seeking employment.

Personal Income

Connecticut had the highest personal income per capita in the nation at $61,231 which was 137.0% of the national average as of the third quarter 2013. In the third quarter of 2013, Connecticut's personal income increased 3.5% from the third quarter of 2012 which was equivalent to the increases in the region and the U.S. at 3.5% and 3.6%, respectively.

Conclusion

KBRA has assigned an AA rating with a stable outlook to the State of Connecticut general obligation debt based on the factors discussed above.

KBRA LONG-TERM RATING: AA

OUTLOOK: STABLE

Appendix 1: Tear Sheet

Issuance

$400 million General Obligation Bonds 2014 Series A & B expected to sell on March 27, 2014. KBRA's most recent rating report for the State was published on **March 7, 2014**.

Security

The Bonds are general obligations of the State and are secured by its full faith and credit pledge.

Use of Proceeds

Proceeds from the 2014 Series A & B will be used to fund various projects and purposes of the State. The 2014 Series A Bonds are scheduled to mature in 2034 and the 2014 Series B Bonds are scheduled to mature in 2024.

Key Rating Strengths
• Current leadership has demonstrated an ability and willingness to raise revenues and adjust expenditures.
• A strong financial management framework exists for tracking revenues and monitoring budget performance.
• The State has implemented a plan for funding its accumulated GAAP deficit and converting to GAAP based budgeting as part of the FY 2014- FY 2015 Biennium Budget.
• Connecticut has the highest per capita income in the country at $61,321 as of the third quarter of 2013.
• Available cash balances provide good liquidity for operations, without utilization of external borrowing.

Key Rating Concerns
• Slower than expected economic recovery continues to impact revenue collection, threatening budget balance.
• Revenue base is volatile due to concentration in the financial services sector and progressive nature of the income tax structure.
• Though, the State is expecting to increase the Budget Reserve Fund to an amount equal to 3.2% of General Fund expenditures by the end of FY 2014, this level of reserves remains somewhat low, given the relative volatility of the revenue base.
• State debt burden is high on a per capita basis and as a percentage of personal income.
• Connecticut has a high level of unfunded pension liabilities.

KBRA views the State's ongoing lag in economic recovery and its impact on budgetary operations as continuing to pressure the fiscal operations of the State. The slow pace of the economic recovery, compared to the region and the nation, has created increased demand for services while economically sensitive revenue collections, including income tax receipts and sales tax collections, continued to be below expectations through FY 2013. Recent revenue projections for FY 2014 indicate that revenues may exceed expectations, which would improve operating performance and increase reserves. The State currently projects that the Budget Reserve Fund will be increased to a level equal to 3.2% of FY 2014

General Fund expenditures. KBRA views the indication of improved budgetary performance positively and will continue to monitor FY 2014 operations as well as performance under the FY 2015 budget. Though the risk of the federal sequestration program impacting Connecticut's defense contractors has been somewhat mitigated by the passage of a federal budget bill in January 2014, the wind-down of the wars in Iraq and Afghanistan will likely result in a reduction in defense spending which may negatively affect the State's economy and finances.

KBRA recognizes that the State has actively managed its fiscal pressures in a difficult economic climate and has acted quickly and decisively to restore balanced fiscal operations when needed, as evidenced by actions taken by the Governor and the General Assembly at the end of 2012. Additionally, KBRA recognizes that the State has generally moderated its revenue assumptions in the last year and conservatively managed its budget assumptions on income tax revenues to be received in FY 2014. KBRA expects that the State will continue to actively monitor its budget projections and act to increase revenues or reduce expenditures in order to maintain budget balance.

Conversion to GAAP-based budgeting and funding of the accumulated GAAP deficit in this biennium has been a priority of the Malloy administration since the Governor took office in January 2011. The FY 2014-FY 2015 biennium budget represents the first budget to be developed by the State based on GAAP accounting. The State has funded a portion of the accumulated deficit in the General Fund through the issuance of general obligation bonds and will fund the remaining deficit through ongoing appropriations.

The State continues to operate under a strong framework of financial management policies and procedures. The statutory requirement for the State to monitor and report budget performance on a monthly basis, as well as the requirement that a deficit mitigation plan be developed by the Governor in the event the General Fund deficit exceeds 1.0% of appropriations, has allowed transparency in a time of fiscal pressure. The State's tax-supported debt burden continues to be high, when compared to other states. Connecticut continues to have the highest per capita income in the nation at $61,231 which was 137% of the national average in as of the third quarter of 2013.

Outlook: Stable

The stable outlook reflects KBRA's expectation that the State's leadership will maintain their commitment to fiscal discipline and quickly take all action necessary to maintain budgetary balance. KBRA views the projections for improved budgetary performance and increased reserves in FY 2014 to be positive and will continue to monitor FY 2014 operations as well as performance under the FY 2015 budget. However, KBRA continues to view Connecticut's lagging recovery, compared to the New England region and the US, as putting pressure on State fiscal operations. Though the risk of the federal sequestration program impacting Connecticut's defense contractors has been somewhat mitigated by the passage of a federal budget bill in January 2014, KBRA will continue to monitor the impact of the wind-down of the wars in Iraq and Afghanistan and any impact on the State's economy and finances.

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