State of Connecticut
General Obligation Bonds

General Obligation Bonds 2015 Series A

Taxable General Obligation Bonds 2015 Series A

Analytical Contacts:

Kate Hackett, Managing Director
khackett@kbra.com, (646) 731-2304

Gopal Narsimhamurthy, Senior Analyst
gnarsimhamurthy@kbra.com, (646) 731-2446

March 11, 2015

KBRA KROLL BOND RATING AGENCY

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 $500 million General Obligation Bonds (2015 Series A) and Taxable General Obligation Bonds (2015 Series A). 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 $16.5 billion.

This rating is based on KBRA's **U.S. State General Obligation Rating Methodology**, published on March 28, 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 of the General Obligation Bonds (2015 Series A) will be used for various capital projects of the State. Proceeds of the Taxable General Obligation Bonds (2015 Series A) will be used to fund a loan through Connecticut Innovations to a non-profit corporation to finance the design, construction and equipping of a research laboratory on the campus of University of Connecticut Health Center, Farmington.

Key Rating Strengths
▪ Current leadership has demonstrated an ability and willingness to raise revenues and adjust expenditures to maintain budget balance.
▪ A strong financial management framework exists for tracking revenues and monitoring budget performance as well as an established mechanism for adjusting budgeted expenditures during the fiscal year.
▪ Connecticut has the highest per capita income in the country at $60,658 for FY 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, the progressive nature of the income tax structure and the level of capital gains tax collections.
▪ Though the State increased the Budget Reserve Fund to an amount equal to 3% 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

Connecticut's economic recovery is continuing, though at a slower pace than the New England region and the U.S. as a whole. KBRA views the State's financial position as having improved under the current administration but projects that budget pressures will continue as long as economic growth is relatively slow. KBRA views the State's budget challenges as mitigated by the State's demonstrated ability and willingness to raise revenues and make spending cuts during the fiscal year to maintain balanced operations. KBRA also views positively the increase in the funding of the Budget Reserve Fund, which has increased to $519.2 million or approximately 3.0% of FY 2014 General Fund expenditures. When the Governor took office in January 2011, his administration developed a plan for conversion to GAAP-based budgeting from a modified cash basis and for the funding of the long standing General Fund deficit. The FY 2014-FY 2015 biennium budget was the State's first budget to be developed on a GAAP basis and the State has implemented a funding plan to fund the GAAP-based General Fund deficit. The State has continued to fully fund its actually required pension contributions (ARC) for its State pension programs. KBRA views the State's liquidity position as fairly strong.

As with many states, the revenue base of the State's General Fund is largely comprised of economically sensitive revenues, including personal income tax, sales tax and corporate taxes and the slower than anticipated economic growth over the last several years has created challenges in maintaining balanced financial operations. The volatility of the State's revenue base is increased by its fairly progressive income tax and a relatively high level of capital gains taxes, which reflects the State high wealth levels. The State revises its revenue forecasts three times a year through a consensus revenue forecasting process undertaken by the Office of Policy Management (OPM) and the legislative Office of Fiscal Analysis (OFA).
The State closely monitors its budget to actual financial performance on a monthly basis. Under State Statutes, the Governor may implement a certain level of expenditure reductions, or rescissions, without legislative approval, to maintain a balanced budget. KBRA expects that the State will continue to actively monitor its revenue projections and budget performance and act to increase revenues or reduce expenditures in order to maintain budget balance.

As of February 20, 2015, OPM is projecting a $61.2 million deficit, or less than 1% of expenditures, in the General Fund at the end of FY 2015. This projection reflects revenue revisions in the January 2015 consensus revenue forecast, declines in oil company tax receipts due to lower oil prices and an increase in the State's Medicaid deficiency. The projection also reflects rescissions, or expenditure reductions, of $31.5 million implemented by the Governor on January 23, 2015. Fund transfers included in House Bill 6825, the Governor's legislative proposal to address FY 2015 budget shortfalls, will further reduce the shortfall by $37.3 million. OPM states that the remaining $23.9 million deficit will be addressed through administrative action. The State's liquidity position remains fairly strong, with the State's total available cash at $1.3 billion as of January 31, 2015.

In KBRA's view, 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. State statutes dictate that unappropriated surplus left in the General Fund shall be transferred to the Budget Reserve Fund until the Fund reaches an amount equal to 10.0% of the net General Fund appropriations. The State's statutes allow for broad revenue raising ability. Beginning in November 1992, the State's Constitution provided that the General Assembly must adopt a balanced budget.

KBRA continues to view Connecticut's level of state tax-supported debt as high, relative to other states, both on a per capita and percentage of personal income basis. Unlike many states, Connecticut issues a significant amount of debt for local purposes, including school construction. The State's relative debt burden is more in line with its peers when aggregate state and local debt is compared. On a per capita basis, the aggregate state and local debt is still high, however on a debt to personal income basis, the State ranks 24th among states. The rate of amortization of direct State debt is above average at 64% and direct debt service on General Obligation debt as a percentage of total governmental expenditures, based on GAAP financial statements, has been in the range of 6.0% to 10.0% since 2009. In FY 2014, debt service represented 6.2% of total governmental expenditures (on a GAAP basis).

Connecticut administers two major pension plans: the State Employees' Retirement System (SERS) and the State Teachers' Retirement System (STRS). The State's pension plans have funded ratios that, while improving, remain lower than the majority of state-sponsored defined benefit plans nationwide. Connecticut pays the entire required annual employer contribution to its pension plans on behalf of participating school districts and public universities statewide. The State has indicated that it has no plans of shifting a share of its annual contribution to participating employers in the near future. In FY 2014, the state's contribution for its pension systems totaled $2.2 billion, which was approximately 8.4% of total governmental expenditures. The State fully funds the actuarially required contribution (ARC) for its pension plans.

KBRA views Connecticut's resource base as continuing to recover from the Great Recession albeit at a slower pace than the New England region and the U.S. as a whole. The state economy has continued to make strides in its economic recovery as exhibited by growing population trends, improving wealth indicators, and increased employment opportunities. Employment levels and wealth levels have increased and unemployment levels have continued to decline since 2011. As of December 2014, the State's unemployment rate had declined to 6.6%, compared to 5.9% for the region and 6.2% for the U.S. Connecticut continues to be the wealthiest state in the nation on a per capita basis, with personal income per capita of $60,658 in 2013, which represents 135.5% of the US average. Despite the slower pace of recovery relative to other states, Connecticut's economy is proving resilient and capable of diversifying as it continues to regain pre-Recession levels of employment and wealth.

Outlook: Stable

KBRA continues to view Connecticut's relatively slow economic growth as putting pressure on State fiscal operations. 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 will continue to monitor the State's consensus revenue process and its ability to accurately project estimates of income tax revenues related to the realization of capital gains and other economically sensitive revenues. KBRA will continue to monitor the level of federal defense spending and the impact of any spending cuts 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.
- Cuts in federal spending for defense that causes significant contraction in the State's defense related industries.

Key Rating Determinants

Rating Determinant 1: Management Structure, Budgeting Practices and Policies

KBRA views Connecticut's management structure and policies as providing a very strong framework for managing its financial operations and debt issuance compared with other states. Under state statute, the State is required to monitor its financial performance on a monthly basis and the Governor is empowered to take action, under statutory limitations, to maintain budget balance. State statutes require consensus revenue forecast to be developed on a regular basis three times a year. The State's statutes allow for broad revenue raising ability.

Under Connecticut's Constitution, the State is divided into three distinct branches: the Legislative, Executive, and Judicial. The executive power of the State is vested in the Governor who by statute is given broad powers. Governor Dannel Malloy was initially elected in November of 2010 for a term beginning in January 2011 and was reelected for a second term beginning in January of 2015. The term of the Governor along with State Treasurer and the Comptroller is four years. The Treasurer, who has been in the office since 1999, is primarily responsible for receiving and disbursing monies of the State, and is also responsible for management of the State's retirement funds. The State's Bond Commission routinely delegates to the Treasurer the responsibility for carrying out the issuance of debt. The Comptroller is required to issue monthly budgetary reports on the State's financial condition, in conjunction with the Office of Policy Management (OPM). OPM is directly responsible to the Governor for policy development in the areas of budget and financial management and prepares the State budget.

Constitutional Provisions

Beginning in November 1992, the State's Constitution provided that the General Assembly must adopt a balanced budget. The Constitution also includes a spending cap on annual growth in expenditures which limits the increase in expenditures to the greater of the five year average growth in personal income or inflation over the previous year. The cap excludes debt service for general obligation debt and may be exceeded, if the Governor declares a fiscal emergency, by a three-fifths vote of both houses.

General obligation debt is issued under State debt statutes and specific bond authorizations. These statutes provide that the bonds will be general obligations of the State and that the full faith and credit of the State is pledged for repayment. As per the State's contract with the owners of the bonds, all amounts necessary for payment of principal and interest is appropriated without need for legislative approval. There are no express statutory provisions establishing any priorities in favor of general obligation bondholders over other claims against the State. Connecticut is not a voter initiative state.

Bankruptcy

Under Chapter 9 of the U.S. Bankruptcy Code, State governments are not permitted to petition courts for protection from creditors, including holders of their general obligation debt.

Financial Management Policies

The State operates under a strong and comprehensive framework of financial management policies, most of which are codified in statute. The State's framework for financial management includes the following planning and reporting components:

- <u>Monthly Reports on Financial Performance</u>— By statute, OPM is required to provide the State Comptroller with monthly updates to revenue and expenditure projections for the current fiscal year, along with projections for the current fiscal year surplus or deficits. The Comptroller prepares a monthly letter on financial performance, which is available on both the Comptroller and OPM's websites.

- Annual Report to Legislature— By statute, each November, OPM and the Office of Fiscal Analysis (OFA) is required to submit a Fiscal Accountability report to the Legislature which projects revenues, expenditures, and ending balances of each fund for the current biennium and the next three fiscal years.

- Three Year Out Report— As part of the budget process, the Governor must annually submit a separate report to the Legislature which sets forth the estimated revenues and expenditures for the current biennium and the next three fiscal years.

- Consensus Revenue Estimates— OPM and the OFA are required by statute to issue consensus revenue estimates each year by November 10, January 15, and April 30 that cover the current biennium and the next three fiscal years. The development of consensus revenue forecasts utilizes both in house analytic staff and external economic forecasting services. Economic trends are monitored and factored into monthly updates on revenue projections

The Treasurer has investment responsibility for all funds of the State and functions as the trustee of all State pension, retirement, and trust funds. The Treasurer is required to report annually on investment activities by December 31 to the Governor and the State's investment Advisory Council.

State Budget Process

The State's fiscal year begins on July 1 and ends on June 30. The State operates on a biennial budget cycle. The FY 2016-FY 2017 biennium will commence on July 1, 2015. The Governor is required to transmit a budget document to the General Assembly in February of odd numbered years setting forth a separate budget for each of the biennium years. In each even numbered year, the Governor must prepare a report on the status of the budget, enacted in the previous year, with any recommendations on adjustment and revisions for the coming year. All budget recommendations incorporate the consensus revenue estimate process. If a budget surplus or deficit is projected, the Governor will recommend how the deficit will be mitigated or how the surplus will be used. Under the State Constitution, the Governor has the power to veto any line item of any itemized appropriation bill, while at the same time approving the remainder of the bill. The General Assembly may override the Governor's veto by a two thirds vote of each legislative house.

Ability to Adjust Expenditures and Deficit Mitigation

Under State statute, the Governor is empowered during the fiscal year to reduce the budget allotment, or expenditure request, by up to 5.0% of any specific appropriation to an agency, except for aid to municipalities, up to 3% of the total appropriations of any fund under certain circumstances without Legislative approval in order to maintain balanced financial operations. Such reductions to expenditures are also referred to as rescissions. Such budget allotments are subject to further modification by the Governor throughout the fiscal year if necessary. Beyond these limits, the General Assembly must act to reduce expenditures.

If the monthly statement on financial performance issued by the Comptroller indicates a projected General Fund deficit greater than 1% of total General Fund appropriations, the Governor is required within thirty days to submit a report to the General Assembly that outlines a plan that the Governor shall implement to reduce expenditures to prevent a deficit.

Over the last several years, the Governor has reduced budget allotments, or issued rescissions, in response to projected deficits identified as part of the monthly monitoring of financial performance. In November of 2012, the Governor submitted a Deficit Mitigation Plan to the General Assembly for action. KBRA views the ability and demonstrated willingness of the Governor and the General Assembly to use the statutory process to maintain budgetary balance as very positive and indicative of a strong commitment to maintain balanced operations.

Budget Reserve Fund

State statutes dictate that unappropriated surpluses left in the General Fund shall be transferred to the Budget Reserve Fund until the Fund reaches an amount equal to 10.0% of the net General Fund appropriations. The Budget Reserve Fund may only be transferred into the General Fund to fund a deficit in the immediately preceding fiscal year.

State Debt Limit

State statutes impose a ceiling on the amount of General Fund supported debt which may be authorized by the Legislature. The limit is 1.6x net General Fund tax receipts as projected by the Finance, Revenue and Bonding Committee of the General Assembly for the fiscal year in which the bonds are authorized. Certain types of debt are excluded from this cap, including cash flow borrowings and emergency financings.

Based on the foregoing, KBRA views Connecticut's management structure, budgeting practices, and policies as being consistent with a AA+ rating. This rating level reflects the State's strong procedures for monitoring and reporting on financial performance as well as its revenue raising flexibility and statutory authority to reduce expenditures to maintain budgetary balance.

Rating Determinant 2: Debt and Additional Continuing Obligations

KBRA continues to view Connecticut's level of state tax-supported debt as high, relative to other states, both on a per capita and personal income basis. This level of debt could potentially reduce financial flexibility and impact the State's ability to continue to provide its high level of services. When aggregate state and local debt is compared to other states, Connecticut's debt to personal income ranks 24th among states.

State Tax-Supported Debt

In calculating Connecticut's total state tax-supported debt, we include $16.5 billion of general obligation debt, including this issuance, and $3.8 billion of special tax debt secured by a pledge of transportation related taxes and fees outstanding as of January 15, 2015. In comparison with other states, Connecticut's state tax-supported debt burden is high. These high debt levels result in part from the State's practice of issuing General Obligation debt for certain university projects and for purposes that municipal entities fund in other states, including local school construction. The State's relative debt burden is more in line with its peers when comparing aggregate state and local debt. A comparison of Connecticut's debt levels and the average for U.S. States can be seen in the table below.

Connecticut Debt Ratios			
	Connecticut	Avg of U.S. States 2013	Connecticut, 2013 U.S. Percentile
Tax-Supported Debt per capita*	$5,770	$1,613	100.0%
Aggregate State and Local Debt per capita**	$11,924	$8,329	Top 7%
Tax-Supported Debt as a % of Personal Income	9.5%	3.6%	Top 4%
Aggregate State and Local Debt as a % of Personal Income**	19.8%	19.1%	45.0%
Tax-Supported Debt as a % of GSP	8.3%	3.0%	Top 3%
Aggregate State and Local Debt as a % of GSP**	17.6%	16.5%	40.0%

* Tax-supported debt of Connecticut as of 3.1.2015 includes issuance of current Bonds.
** Aggregate state and local debt levels are based on FY 2012 numbers from the U.S. Census Bureau.

Connecticut's state tax-supported debt per capita, at $5,770, is the highest nationwide. Aggregate state and local debt per capita, while still high, falls to the top 7.0% for the nation. State tax-supported debt to personal income is high at 9.5%, placing it in the top 4.0% of states in terms of relative debt; however, it drops to the 45th percentile, when comparing aggregate state and local to other states. While State tax-supported debt per gross state product (GSP) is high at 8.3% and in the top 3.0% of debt levels, this also drops to the 40.0% percentile when comparing aggregate state and local debt to other states.

Debt Amortization

Connecticut's debt amortization parameters are conservative, with debt required to be amortized over 20 years on a level principal basis, which generates a declining debt service schedule. Speed of amortization of direct general obligation debt, (excluding Economic Recovery Notes which will mature in 2018) is above average at 64.0% of principal retired over the next 10 years. Debt service on direct General Obligation debt as a percentage of governmental expenditures, based on GAAP financial statements has been in the range of 6.0% to 10.0% since 2009. In FY 2014, debt service represented 6.2% of Governmental expenditures (on a GAAP basis). Connecticut has a relatively small level of exposure to variable rate debt or derivative financings; hence these types of transactions do not pose a significant risk to the State's liquidity position. As of June 30, 2014, approximately 2.2% of the State's tax-supported debt was variable rate and the notional amount of swaps outstanding against this debt was $335.6 million or 2.0% of tax-supported debt. State management has indicated that as of March 1, 2015, the State terminated approximately $280 million in swap agreements, leaving the State with approximately $56 million in outstanding swap exposure.

The variable rate debt is a combination of variable rate demand notes and SIFMA index bonds (SIFMA plus a spread), which do not have a put option. Under the swap agreements, the State controls termination unless its rating falls below the BBB level. As of December 31, 2014 the mark-to-market on the swap agreements was $5.8 million, which would be owed by the State within 270 days.

Capital Improvement Plan

The State's projection for general obligation bond issuance for capital projects will decrease from $2.8 billion in FY 2015 to $2.2 billion in FY 2017. Approximately 26.0% of the planned FY 2016 issuance is for local school construction, which represents the State's ongoing issuance for local purposes, as discussed above. The state also plans to issue debt to support capital development initiatives at the University of Connecticut, which represents 13.0% of the FY 2016-FY 2017 bond authorizations.

Pension Obligations

Connecticut administers two major pension plans: the State Employees' Retirement System (SERS) and the State Teachers' Retirement System (STRS). The State's pension plans have funded ratios that, while improving, remain lower than the majority of state-sponsored defined benefit plans nationwide. Connecticut pays the entire required annual employer contribution to its pension plans on behalf of participating school districts and public universities statewide. The State has indicated that it has no plans of shifting a share of its annual contribution to participating employers in the near future. In FY 2014, the state's contribution for its pension systems totaled $2.2 billion, which was approximately 8.4% of total governmental expenditures. The State fully funds the actuarially required contribution (ARC) on its pension plans.

State Employees' Retirement System (SERS)

SERS is a single-employer defined benefit pension plan that provides retirement, disability, and death benefits to plan members and their beneficiaries. SERS completed its biennial pension valuation on November 19, 2014. As of June 30, 2014, the plan's funded ratio declined nominally on an actuarial basis to 41.5% from 42.3% two years prior due to an increase in liabilities as a result of changes in assumptions and the plan's profile of retirees. Based on a market valuation of assets, the plan's funded ratio increased from 36.8% to 41.1%. The SERS' market value of assets grew from $8.5 billion to $10.5 billion for an increase of 23.6% from June 30, 2012 to June 30, 2014. Based on the 2014 actuarial valuation, the State's gross employer contribution to the plan, which is equal to the actuarially determined annual contribution (ARC) will increase 13.7% from $1.37 billion in FY 2015 to $1.57 billion in FY 2017. The State has fully funded the full ARC since 2012 and expects to continue to fully fund their pension obligations.

State Employees' Retirement System (SERS)	Actuarial Value of Assets ($'000)	Market Value of Assets ($'000)	Actuarial Accrued Liability ($'000)	Funded Ratio (actuarial)	Funded Ratio (market)	Pension ARC ($'000)	Percentage of ARC Funded
2011	$10,122,765	$8,984,875	$21,126,725	47.9%	42.5%	$944,077	87.5%
2012	$9,744,986	$8,468,479	$23,018,752	42.3%	36.8%	$926,375	100.0%
2014	$10,584,795	$10,472,567	$25,505,610	41.5%	41.1%	$1,268,890	100.0%

Source: SERS Actuarial Valuations

State Teachers' Retirement System (STRS)

STRS is a single-employer defined benefit pension plan administered by the Teachers' Retirement Board (TRB) for teachers, principals and other education supervisors employed in public school districts. In April 2008, Connecticut issued $2.3 billion in taxable Pension Obligation Bonds (POB) and deposited $2.0 billion into the Teachers' Retirement Fund. This increased the funded ratio from 60.0% in 2006 to 70.0% in 2008. As part of the POB issuance, the bond documents included a covenant requiring the State to contribute 100.0% of the actuarially determined employer contribution for the life of the Bonds. The State has fully funded the pension ARC since FY 2006.

STRS completed its biennial pension valuation report, as of June 30 2014. On an actuarial basis, the plan's funded ratio increased from 55.2% to 59.0%. Based on a market valuation of assets, the plan's funded ratio increased from 54.2% to 61.6%. This increase in funded ratio is largely the result of strong investment performance; the market value of pension plan assets increased from $13.5 billion to $16.2 billion for an increase of 20% over the last two years.

State Teachers' Retirement System (STRS)	Actuarial Value of Assets ($'000)	Market Value of Assets ($'000)	Actuarial Accrued Liability ($'000)	Funded Ratio (actuarial)	Funded Ratio (market)	Pension ARC* ($'000)	Percentage of ARC Funded
2010	$14,430,200	$12,273,604	$23,495,900	61.4%	52.2%	$559,000	100.0%
2012	$13,734,800	$13,473,656	$24,862,200	55.2%	54.2%	$757,000	100.0%
2014	$15,546,500	$16,220,889	$26,349,200	59.0%	61.6%	$949,000	100.0%

Source: STRS Actuarial Valuations

Other Post-Employment Benefits (OPEB)

Connecticut provides post-employment healthcare and life insurance benefits to all State employees. It funds these benefits on a pay-as-you-go basis, as do most States. In FY 2014, the State paid $540.7 million for these costs. The State sponsors two defined benefit OPEB plans, the State Employee OPEB Plan (SEOPEBP) and the Retired Teacher Healthcare Plan (RTHP).

The State has established an OPEB Trust Fund for SEOPEBP which had a balance of $143.8 million as of June 30, 2013. Both the employee required contributions and State matching funds will be deposited into this Fund, as received. The State has not contributed to the OPEB Trust Fund but is planning to commence payments in FY 2018. It is expected that the State will continue to fund overall OPEB costs on a pay-as-you go basis while building up the OPEB Trust Fund. In FY 2014, the state's pay-as-you-go contribution to both OPEB plans totaled $540.7 million, which was approximately 2.1% of total governmental expenditures.

State Employee OPEB Plan (SEOPEBP)

SEOPEBP is a single-employer defined benefit OPEB plan that covers all retired state employees, except those participating in the Teachers' Retirement System (STRS) and the Municipal Employees' Retirement System (MERS). In FY 2014, the State contributed $514.7 million to SEOPEBP on a pay-as-you-go basis.

Retired Teacher Healthcare Plan (RTHP)

RTHP is a single-employer defined benefit OPEB plan that covers retired teachers and administrators of public schools in the state who receive pension benefits from STRS. The State is required to make appropriations from the General Fund to the Teachers' Retirement Board to fund a portion of their OPEB benefits. In FY 2014, the state contributed $25.9 million to RTHP on a pay-as-you-go basis. As of June 30, 2014, the date of the plan's most recent valuation, the state's share of OPEB liabilities related to RTHP was $2.4 billion.

Total Fixed Costs

If certain fixed costs are aggregated, including debt service, pension ARC payments and pay-as-you-go OPEB costs, the total amount for the State is $4.4 billion, based on numbers as of June 30, 2014. This represents 16.7% of total governmental expenditures on a GAAP basis.

Overall, KBRA considers Connecticut's debt and continuing obligations profile as being consistent with a AA- rating. State tax-supported debt is high compared to other states but moderate when aggregate state and local debt is compared. However, the rate of debt retirement is rapid with 64.0% of principal retired within 10 years and the portion of the budget represented by debt service remaining at 8.0% to 10.0%, a level which KBRA considers moderately high. The level of pension funding is also considered low relative to other states. The State fully funds its ARC obligations, which should improve the funded status of the pension plan over time.

Rating Determinant 3: Financial Performance and Liquidity Position

KBRA views the State's financial position as having improved under the current administration but projects that budget pressures will continue as long as economic growth is relatively slow. KBRA views the budget challenges as mitigated by the State's demonstrated ability and willingness to raise revenues and make spending cuts during the fiscal year to maintain balanced operations. KBRA also views positively the increase in the funding of the Budget Reserve Fund, which has increased to $519.2 million or approximately 3.0% of FY 2014 General Fund expenditures at the end of FY 2014. When the Governor took office in January 2011, his administration developed a plan for conversion to GAAP-based budgeting from a modified cash basis and the funding of the long standing GAAP-based General Fund deficit. The FY 2014-FY 2015 biennium budget was the State's first budget to be developed on a GAAP basis and the State has implemented a funding plan to fund the GAAP-based General Fund deficit. The State has continued to fully fund its actually required pension contributions (ARC) for its State pension programs. KBRA views the State's liquidity position as fairly strong.

As with many states, the revenue base of the State's General Fund is largely comprised of economically sensitive revenues, including personal income tax, sales tax and corporate taxes and the slower than anticipated economic growth over the last several years has created challenges in maintaining balanced financial operations. The volatility of the State's revenue base is increased by its fairly progressive income tax and a relatively high level of capital gains taxes, which reflects the State's high wealth levels. The State revises its revenue forecasts regularly throughout the year and revenue projections have generally been reasonable, though not conservative in some years.

The State closely monitors its budget to actual financial performance on a monthly basis. Under State Statutes, the Governor may implement a certain level of expenditure reductions, or rescissions, without legislative approval, to maintain a balanced budget and may submit proposals to the General Assembly for additional reductions if necessary. Over the last several years, the Governor has implemented expenditure reductions a number of times through this process and the General Assembly has taken action at the request of the Governor. If the monthly statement on financial performance indicates a projected General Fund deficit greater than 1% of total General Fund appropriations, the Governor is required to submit a report to the General Assembly that outlines a plan that the Governor shall implement to reduce expenditures to prevent a deficit.

The State of Connecticut budgets, operates, and monitors its financial performance on a budgetary basis, for a fiscal year which begins July 1 and budgets on a biennial basis. The FY 2014-FY 2015 biennial budget was the first budget developed on a modified accrual basis in accordance with GAAP principles, as opposed to the prior modified cash basis of accounting. Since 1988, the State has prepared annual financial reports on a GAAP basis in accordance with guidelines established by the Governmental Accounting Standards Board. The General Fund is the major operating fund of the State and the focus of KBRA's analysis. Except where indicated, financial operations will be discussed using the budgetary basis.

General Fund Revenues
for FY 2010 -FY 2014 (budgetary/modified cash basis)

	2014	% Chg	2013	% Chg	2012	% Chg	2011	% Chg	2010
Personal Income Tax	8,718,659	0.0%	8,719,245	4.9%	8,310,820	14.7%	7,246,431	10.0%	6,586,099
Federal Grants	1,243,861	-66.7%	3,733,909	3.5%	3,607,163	-14.8%	4,235,178	4.2%	4,066,314
Sales and Use Tax	4,100,564	5.2%	3,896,998	1.7%	3,830,117	14.2%	3,353,230	4.7%	3,203,988
Corporate Income Tax	782,239	5.3%	742,515	3.6%	716,522	-9.8%	794,473	19.1%	667,132
Excise Taxes (Alcohol & Cigarettes)	437,479	-4.9%	460,228	-4.4%	481,600	6.3%	453,034	4.0%	435,631
Indian Gaming Payments	279,873	-5.6%	296,396	-14.0%	344,645	-4.2%	359,582	-6.4%	384,248
Statutory Transfers From Other Funds[2]	873,828	747.6%	103,100	7.3%	96,100	-54.5%	211,319	42.8%	147,998
Other	573,053	-60.6%	1,452,640	23.7%	1,174,666	11.4%	1,054,207	14.8%	918,618
Total Revenues	**17,009,556**	**-12.3%**	**19,405,031**	**4.5%**	**18,561,633**	**4.8%**	**17,707,454**	**7.9%**	**16,410,028**

General Fund Expenditures for FY 2010 -FY 2014 (budgetary/modified cash basis)	2014	% Chg	2013	% of Chg	2012	% of Chg	2011	% of Chg	2010
General Government	605,677	2.1%	593,367	-2.6%	609,239	28.0%	476,090	-2.1%	486,318
Public Safety	277,873	6.1%	261,787	-0.4%	262,898	0.4%	261,766	-0.4%	262,820
Conservation and Development	220,921	66.0%	133,083	-3.1%	137,294	10.8%	123,919	-4.1%	129,152
Health and Hospitals	1,827,308	1.4%	1,801,951	0.5%	1,792,435	4.5%	1,715,670	5.6%	1,624,827
Human Services	3,215,827	-45.8%	5,931,567	2.0%	5,817,369	8.0%	5,387,535	7.5%	5,012,333
Education, Libraries and Museums	4,695,345	8.5%	4,328,894	2.2%	4,235,428	4.3%	4,060,467	1.8%	3,990,199
Corrections and Judicial	2,023,498	4.1%	1,943,273	-3.9%	2,021,335	-1.1%	2,044,276	2.2%	1,999,812
Debt Service	1,646,149	-8.5%	1,799,937	-0.5%	1,809,201	11.0%	1,629,672	0.6%	1,619,470
Other	2,467,444	10.6%	2,231,808	6.5%	2,096,435	-2.3%	2,145,730	3.0%	2,083,090
Total Expenditures	**$16,980,042**	**-10.8%**	**$19,025,667**	**1.3%**	**$18,781,634**	**5.2%**	**$17,845,125**	**3.7%**	**$17,208,021**

Source: Connecticut 2013 Annual Information Statement

Connecticut's General Fund revenue sources are fairly diverse. Based on FY 2014 operations, the major sources of revenue in the General Fund include: personal income taxes (51%), sales and use taxes (24%), federal grants (7%) and corporate income taxes (5%).

Statement of Revenues, Expenditures, and Net Surplus for General Fund FY 2012-FY 2014 (modified accrual basis) *(in millions)*	2014	2013	2012
Net Surplus July 1st	0.0	0.0	0.0
Proceeds of Economic Recovery Notes			
Operating Revenues	17,009.1 [2]	19,405.0	18,561.6
Operating Expenditures	16,980.0	19,025.7	18,781.6
Other	28.7	18.7	76.5
Net Operating Surplus (Deficit)	57.7	398.0	(143.6)
Transfer (to) from Budget Reserve Fund	(248.5)	(177.2)	143.6
Reserved for Subsequent Years Expenditure		220.8 [1]	
Reserved from Prior Year	190.8		
Net Surplus (Deficit) June 30th	**$0**	**$0**	**$0**

Source: Connecticut 2014 Annual Information Statement

[1] $221m of the budgetary surplus in FY 2013 is reserved for use in the FY 2014- FY 2015 biennium.

[2] FY 2014 General Fund revenues and expenditures reflect the reduction of approximately $2.8 billion in both revenues and expenditures related to the shift to the "net budgetary" approach in Medicaid funds.

FY 2013 Financial Operations

Based on the final unaudited results for the fiscal year ending June 30, 2013, provided by the Office of the State Comptroller, the State ended FY 2013 with a General Fund surplus of $398 million or 2.1% of operating expenditures on a budgetary basis. The State has included $220.8 million of the budgetary surplus for use in the FY 2014-2015 biennium deposit and deposited $177.2 million of the surplus into the Budget Reserve Fund. This brings the balance in the Budget Reserve Fund to approximately $271 million or 1.4% of FY 2013 General Fund expenditures. These projected results reflect increased levels of personal income tax and gift and estate tax receipts due to expiration of the Bush tax cuts for high income earners at the end of calendar year 2012, as well as continued weakness in sales tax and increases in social service costs due to ongoing economic stress in the State.

In January 2013, the U.S. Congress allowed the Bush tax cuts for high income earners to expire, raising the top marginal tax rate on the capital gains tax as well as the estate and gift tax. In anticipation of these changes, taxpayers realized capital gains and made significant gifts in calendar year 2012. These taxpayer actions resulted in a significant one time increase in income tax and gift and estate tax receipts to the State in FY 2013. The State is fairly reliant on the capital gains tax component of personal income tax collections, with capital gains representing from 3.8% to 13.3% of total adjusted gross income in the period between 1997 and 2012.

The operating results for FY 2013 also reflect actions taken by the Governor and by the General Assembly, through a special legislative session, to mitigate a deficit of $365 million projected in November 2012. This deficit resulted from both lower revenue estimates and higher spending projections due largely to the continued slower than expected economic recovery within the State. At this time, there was a significant level of uncertainty as to the timing of changes in federal tax rates and the impact on revenues. The deficit mitigation plan consisted mainly of expenditure cuts, many of which were extended to the adopted FY 2014-FY 2015 biennial budget. KBRA views the rapid action taken by the Governor and the Legislature at this time as positive and indicative of the administration's commitment to maintaining balanced operations.

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 the first budget developed on a modified accrual basis in accordance with GAAP principles, as opposed to the prior modified 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. KBRA views this change as very positive. The budget included a General Fund budgeted surplus of $3.6 million in FY 2014 and $2.2 million in FY 2015. The budget also included the use of $190.8 million and $30.0 million of the FY 2013 surplus in FY 2014 and FY 2015, respectively. The remaining surplus of $177.2 million was transferred to the Budget Reserve Fund. Overall, the budget reflected a somewhat reduced dependence on one-time revenues, compared with prior years. The final budget included an assumption for total General Fund revenue growth of 0.7% for FY 2014 and 4.9% for FY 2015, which represents a reduction from the level in the Governor's proposed budget, a modification which KBRA views as positive.

The restructuring of the State's 2009 Economic Recovery Notes provided budget relief of approximately $190.0 million in both FY 2014 and FY 2015. The Notes, currently outstanding in the amount of $573.0 million, were refunded and restructured to provide this level of debt service savings in FY 2014 and FY 2015 and shift these debt payments on the Notes to FY 2017 and FY 2018. The maturity schedule was extended to 2018 from the original 2016 maturity. The restructuring was accomplished in two phases; the first phase is this issuance in 2013 and second issuance in 2014.

Funding of Accumulated General Fund GAAP Deficit

The FY 2014-FY 2015 budget also included a partial funding of the State's accumulated GAAP deficit in the General Fund through the issuance of General Obligation Bonds that would amortize beginning in FY 2016 and mature in 2028. As of the end of FY 2013, the accumulated General Fund GAAP deficit was $1.2 billion. Approximately $575 million was issued in October of 2013 and net proceeds were deposited by the State into the General Fund. This issuance was intended to fund approximately 50% of the accumulated deficit and improve the State's cash position. The remaining accumulated GAAP deficit will be funded from appropriations over 15 years, beginning with the FY 2016 budget. Bond covenants included as part of the financing documents 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 the plan.

Net Budgeting for Medicaid

The adopted FY 2014-FY 2015 budget makes significant changes in the manner in which the State appropriates for Medicaid expenditures within the Connecticut Department of Social Services (DSS) and Department of Mental Health and Addiction Services. Prior to FY 2014, the State received federal Medicaid funds into the General Fund and appropriated both State and federal funding for its Medicaid program through General Fund departments. In FY 2014, the State shifted to a "net budgeting" approach where federally sourced revenues and related expenditures funds will be accounted for in a separate fund outside the General Fund. Federal funding accounts for approximately 60% of Medicaid costs in Connecticut. The State's share, the remaining 40% of Medicaid costs, will continue to be appropriated from the General Fund to departments. In addition, the General Fund will continue to gross fund Medicaid costs for certain State supported programs, including residential programs for the developmentally disabled and certain mental health programs. These changes reduced both revenues and expenditures in the General Fund by $2,768.7 million in FY 2014 and by $3,204.9 million in FY 2015. This change in funding structure does not otherwise impact the financial condition of the General Fund.

FY 2014 Financial Operations

Based on the January 15, 2014 consensus revenue estimates produced by OPM and the Legislature's Office of Fiscal Analysis, General Fund revenues for FY 2014 were projected to increase $421.2 million, or 2.5%, from original budgeted revenue levels based on a tax amnesty program implemented by the State, the level of tax collections and strong stock market performance.

The April 30, 2014 consensus revenue forecast included significant revisions to revenue projections for FY 2014. Based on this forecast, OPM revised its revenue projections for the State's General Fund down $461.5 million for FY 2014. The projection for receipt of personal income taxes was reduced by $389.1 million, while reductions in projections for corporate income taxes and sales taxes projections accounted for the balance. This downward revision in revenue projections for personal income taxes stems from the underestimation of the effects of the change in tax laws regarding capital gains effective January 1, 2013. Income tax revenue projections for FY 2014 were developed based on assumptions on the rate of acceleration of realization of capital gains in FY 2013; however, a decline in income tax collections as of April 30, 2014 indicated that the negative impact on FY 2014 income tax revenues from the acceleration of these tax effects was greater than anticipated. Based on the April consensus revenue forecast and the budgetary estimates provided by OPM on April 30, 2014 for the period ending March 31, 2014, the State's General Fund was projected to end FY 2014 with a $43.4 million surplus.

The Office of the State Comptroller and the State's Office of Policy and Management (OPM) has reported that the General Fund ended fiscal year 2014 with a surplus of $248.5 million. The FY 2014 surplus reflects use of $190.8 million of the FY 2103 surplus in the first year of the FY 2014-FY 2015 biennium. These FY 2014 year-end results incorporate the State's transition to budgeting on a GAAP basis and reflect GAAP accounting principles. State financial management reports that the increase in the FY 2014 operating surplus results from ongoing control of expenditures across State operations. The entire operating surplus will be deposited into the Budget Reserve Fund, bringing the balance in the Budget Reserve Fund to $519.2 million or approximately 3.0% of FY 2014 General Fund expenditures.

FY 2015 Financial Operations

As of February 20, 2015, OPM is projecting a $61.2 million deficit, or under 1% of General Fund expenditures, for FY 2015. This projection reflects revenue revisions in the January 2015 consensus revenue forecast, declines in oil company tax receipts due to lower oil prices and an increase in the State's Medicaid deficiency as well as proceeds from an expected legal settlement. The projection also reflects rescissions, or expenditure reductions, of $31.5 million implemented by the Governor on January 23,

2015. Fund transfers included in House Bill 6825, the Governor's legislative proposal to address FY 2015 budget shortfalls, will further reduce the shortfall by $37.3 million. OPM states that the remaining $23.9 million deficit will be addressed through administrative action.

OPM projects a Medicaid deficiency for the General Fund of $108 million for FY 2015, inclusive of administrative actions already taken. This deficiency is due to a number of factors including reduced expectations of savings from reforms in Medicaid administration, additional hospital cost settlements, lower levels of federal reimbursement than originally anticipated on certain segments of the Medicaid expansion population and increased service utilization. Outstanding federal reimbursement issues relating to ACA implementation are expected to be resolved by the end of FY 2015. OPM states that the State will continue to upgrade its systems to manage its Medicaid program.

In its February 20, 2015 letter to the State Comptroller, OPM states that it anticipates strong personal income tax collection during April and May of 2015, compared to 2014. As discussed previously, the level of income tax receipts in the past two filing seasons have been significantly impacted by changes in federal tax policy effective in January 2013. In April 2013, income tax collections increased significantly due to the large increase in capital gains tax. Income tax collections in April of 2014 declined more than expected due to the underestimation of the impact of the FY 2013 federal tax changes on FY 2014 collections. Based on ongoing tax collection and economic data, OPM is currently forecasting significant growth in income tax collections in April and May of 2015, compared to 2014. In KBRA's view, a level of uncertainty remains as to the impact of the FY 20113 federal tax changes on the level of FY 2015 income tax collections.

Governor's Proposed FY 2016-FY 2017 Biennium Budget

On February 18, 2015, Governor Malloy presented his FY 2016-FY2017 Biennium Budget to the State Legislature. The proposed budget included growth in General Fund appropriations of 3% FY 2016 and 3.1% in FY 2017. This compares to an estimated rate of growth in actual expenditures of approximately 3% in FY 2015. Under the proposed budget, a budgetary surplus of $3.2 million is projected for FY 2016 and $5 million is projected for FY 2017. Under this proposed budget, significant expenditure reductions from current service levels are made in the General Fund in both FY 2016 and FY 2017, which reduce appropriations to State agencies and programs. Areas of spending cuts include the Medicaid program, Department of Social Services (including transition of certain low income adults to the Health Insurance Exchange) and other social service programs. The proposed budget will hold K-12 school aid and aid to municipalities relatively flat, though funding for the State's higher education system is reduced somewhat. The proposed budget includes the State's full ARC payments for its pension. The budget also includes approximately $48 million in each year for the amortization of the remaining GAAP based fund deficit in the General Fund; this amortization was scheduled to commence in FY 2016.

The proposed budget for FY 2016 also includes the last year of increased COLA payments under labor contracts negotiated in FY 2011. Current labor contracts for most of the State's labor unions expire on 6/30/2016. The proposed budget includes no across the board layoffs and no furlough days for the State's work force. The budget does increase the scope of the statewide hiring lapse to $35 million, which is equivalent to holding 300-400 positions vacant.

On the revenue side, the budget includes no new taxes and reduces the state sales tax rate to 6.20% in FY 2016 and 5.95% in FY 2017. It does include, however, a number of revenue enhancements including elimination of the sales tax clothing exemption, extension of the corporation surcharge tax, reduction of loopholes in the corporation tax and increase in the health provider tax. The use of one time revenue to balance General Fund operations is fairly minimal at 2.4% in FY 2016 and 1.3% in FY 2017. In KBRA's view, the proposed budget contains revenue projections that are reasonable, though not particularly conservative. Utilizing economic growth rates, total General Fund revenues are projected to increase 4%

in FY 2016 and 4% in FY 2017. Personal Income tax collections are projected to increase at an economic growth rate of 5% in FY 2016 and 5.5% in FY 2017 while sales tax is projected to grow at an economic growth rate of 4.4% in FY 2016 and 4.2% in FY 2017.

A major initiative included in the Governor's proposed budget for all State Funds is the improvement of the State's transportation system under a program called "Let's Go CT!" This new transportation plan lays out a long term strategy to expand and update the State's highway and rail system. The budget addresses this program by incorporating capital funding and expenditures to begin this initiative. OPM states that additional funding needs to be developed by FY 2018.

GAAP Financial Statements

The Office of the State Comptroller released the FY 2014 audited financial statement (CAFR) reported on a GAAP basis on February 11, 2014. For FY 2014, the General Fund ended the year with a net change in fund balance of $547.2 million and a negative unassigned fund balance (accumulated GAAP deficit) of $727.2 million which represents a decrease from $1.2 billion in FY 2013. In October of 2013, the State issued approximately $575 million in GAAP Conversion Bonds that will amortize beginning in FY 2016 and mature in 2028. Net proceeds of these Bonds were deposited into the General Fund to fund approximately 50% of the accumulated GAAP deficit and improve the State's cash position. The remaining accumulated GAAP deficit will be funded from appropriations over 13 years, beginning with the FY 2016 budget.

Liquidity Position

The State's liquidity position remains fairly strong. As of January 31, 2015, the State's available cash was $1.3 billion and the common cash pool was $417.5 million. The State's level of available cash at a given point in the fiscal year reflects the seasonality of cash flow and any projected deficits. The State is expecting its cash position to improve after April's personal income tax receipts. The State's available cash is projected to average $1.6 billion on a weekly basis for FY 2015, however actual weekly cash balances have been somewhat below projected levels.

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. The State has no plans to issue cash flow notes.

In summary, KBRA views Connecticut's financial performance and liquidity position as being consistent with a AA rating. State leadership has broad capacity to raise revenues and has acted quickly to adjust expenditures to maintain budget balance. The rating also reflects the conversion to GAAP based budgeting in the FY 2014-FY 2015 Biennium and implementation of the plan to fund the longstanding General Fund GAAP deficit as well as the increase in the level of its Budget Reserve Fund to $519.2 million or approximately 3.0% of FY 2014 General Fund expenditures at the end of FY 2014. The rating also reflects the continuing budget pressure due to slow economic growth over the past several years.

Rating Determinant 4: State Resource Base

KBRA views Connecticut's resource base as continuing to recover from the Great Recession albeit at a slower pace than the New England region and the U.S. as a whole. The state economy has continued to make strides in its economic recovery as exhibited by stable population trends, improving wealth indicators, and increased employment opportunities. Connecticut continues to be the wealthiest state in the nation on a per capita basis, and is comprised of a growing population that is highly educated with low levels of poverty. Despite the slower pace of recovery relative to other states, Connecticut's economy is proving resilient and capable of diversifying as it continues to regain pre-Recession levels of employment and wealth.

Population

The state of Connecticut encompasses both rural and urban areas, with small towns in the northern part of the State contrasting with its industrial cities located in the south along Long Island Sound and on the Connecticut River northward to Hartford. The state's population has grown 0.5% since 2010 which is lower than the national rate of 2.2% in the same period of time. The state's population has a high level of educational attainment at 37.2%, defined as the population ages 25 and over with a Bachelor's degree or higher and ranks among the top 15% of states across the nation. The state's educational attainment, which is 125.7% of the national level, is largely driven by the presence of the financial services, insurance, and certain defense industry employment. Connecticut's age dependency ratio, which measures the nonworking population against the working population, remained steady at 58.7% from 2010 to 2013, indicating that the age concentration of the state's population remains relatively consistent. Finally, despite the increased per capita income, Connecticut's estimated poverty level grew 0.6% from 2010 to 2013 to 10.7%.

	Connecticut			New England[1]			U.S.		
	2013	% Chg from 2010	2013 U.S. Percentile	2013	% Chg from 2010	CT as % of NE Avg	2013	% Chg from 2010	CT as % of U.S. Avg
Population	3,596,080	0.5%		14,618,806	1.1%	**24.6%**	316,128,839	2.2%	**1.1%**
Age Dependency Ratio[2]	58.7%	0.0%		56.6%	0.6%		59.8%	0.9%	
Population with B.A. Degree or higher[3]	37.2%	1.7%	Top 15%	37.1%	1.6%	**100.2%**	29.6%	1.4%	**125.7%**
Poverty Level	10.7%	0.6%		11.7%	0.5%	**91.5%**	15.8%	0.5%	**67.7%**
Personal Income (in billions)	$218.1	10.4%		$801.1	12.1%		$14,151	14.0%	
Personal Income per capita	$60,658	9.8%		$54,797	10.9%	**110.7%**	$44,765	11.5%	**135.5%**
Gross State Product (in billions)	$249.3	6.6%		$900.9	9.4%		$15,527	6.1%	
GSP per capita	$69,312	6.1%		$61,624	8.2%	**112.5%**	$49,115	3.8%	**141.1%**

Source: U.S. Census Bureau, U.S. Bureau of Economic Analysis
[1] New England is defined as Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont
[2] Age dependency ratio is the sum of the population under 18 yrs and over 65 yrs divided by persons age 18 to 64 yrs
[3] Percent of the population aged 25 and older

Personal Income and Gross Domestic Product

The state's wealth levels are the highest of all U.S. states at an income per capita of $60,658, which represents 135.5% of the U.S. average. The State's high level of personal wealth is due to the concentration of relatively higher paying jobs in finance insurance, and manufacturing and its proximity to New York City. On a per capita basis, the state's GDP at $69,312 was 141.1% of the national level in 2013.

Employment Base

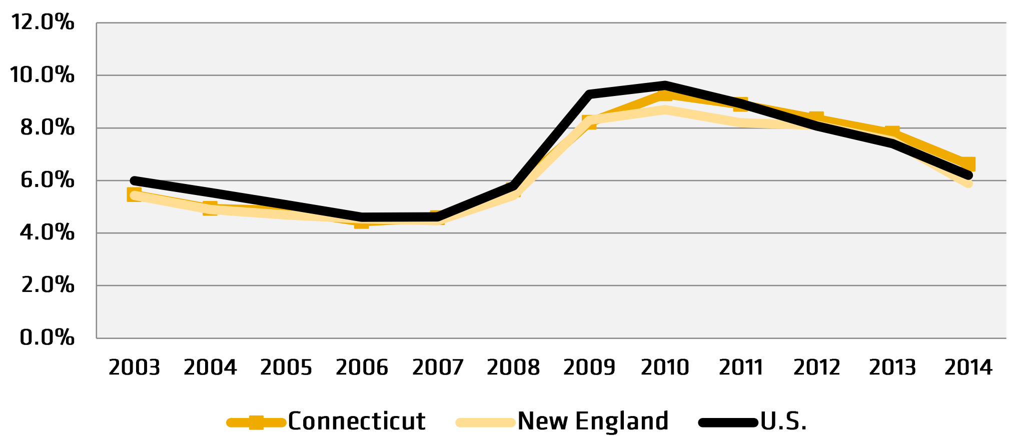
The composition of Connecticut's employment base does not differ significantly from that of the U.S. as a whole. However, the State is somewhat more concentrated and reliant on sectors such as finance, manufacturing, educational and health services, and the federal government, when compared to the New England region. Since 2000, the top five employment sectors have accounted for approximately 71.0% of total employment. Education and health services, which includes employees of school districts, universities, and hospitals, among others, has historically been the largest sector, accounting for 19.5% of state employment in calendar year 2013, up from 14.5% in 2000. Manufacturing as a percent of total employment, declined 4.0% during the same time period as corporations shifted their manufacturing operations abroad. The share of state employment in professional and business services, wholesale and retail trade, and government employment, has remained relatively consistent since 2000.

Non-Agricultural Employment (Not Seasonally Adjusted)						
	Connecticut		New England		U.S.	
in thousands	Employment	% Chg	Employment	% Chg	Employment	% Chg
2009	1,626.6		6,812.7		131,233.0	
2010	1,608.0	-1.1%	6,799.6	-0.2%	130,275.0	-0.7%
2011	1,625.1	1.1%	6,865.9	1.0%	131,842.0	1.2%
2012	1,640.4	0.9%	6,952.5	1.3%	134,104.0	1.7%
2013	1,654.7	0.9%	7,029.3	1.1%	136,393.0	1.7%
Dec 2014*	1,707.8	3.2%	7,232.8	2.9%	139,042.0	1.9%

Source: U.S. Bureau of Labor Statistics
New England: Maine, Massachusetts, New Hampshire, Vermont, Rhode Island, and Connecticut
** Preliminary as of December 2014*

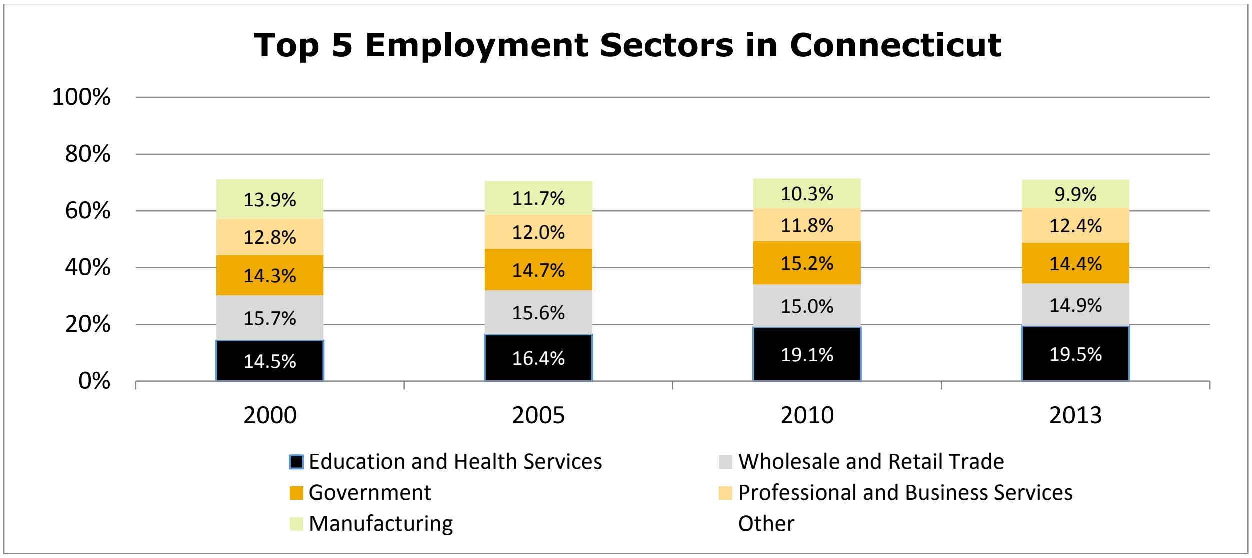
In absolute terms, the State's total employment declined 2.2% between 2000 and 2013, compared to 10.0% growth for the U.S. This decrease largely reflects the decline in jobs in the finance industry, federal government sector, and in manufacturing operations in the state. Based on preliminary 2014 numbers, however, total state employment has grown 6.2% since 2010, and 3.2% since 2013 alone. While somewhat slower than the 6.4% growth for the region and 6.7% for the U.S., Connecticut's recent employment gains reflect the continued recovery of the state's economy and increased employment opportunities in industries such as insurance, and leisure and hospitality. As of December 2014, the State's unemployment rate has further declined to 6.6%, compared to 5.9% for the region and 6.2% for the U.S.

Average Annual Unemployment Rate
(Not seasonally adjusted)



Source: U.S. Bureau of Labor Statistics

Despite continued declines in the manufacturing employment, Connecticut continues to be home to some of the leading producers of defense-related equipment. The largest employers in these industries are United Technologies Corporation, including Pratt and Whitney Aircraft Division in East Hartford and Sikorsky Aircraft Corporation in Stratford, as well as General Dynamic's Corporation's Electric Boat Division in Groton. In federal FY 2010, Connecticut ranked eighth in total defense dollars, which equated to $3,112 per capita in defense awards, compared with the national average of $1,032. This concentration in defense related manufacturing puts the state at risk for reductions in the federal defense budget.



Source: U.S. Bureau of Labor Statistics

Effect of Great Recession on Employment

The U.S. entered into its most recent recession in December 2007 and the effects were felt in Connecticut approximately three months later and continued until January 2010. During this time, the State lost 119,200 jobs or 7.0% of its employment base, which is higher than the overall U.S. loss of 6.3%. As can be seen in the charts below, the State unemployment rate increased to 8.2% in 2009 while GSP remained flat and per capita personal income declined 5.4%, at a greater rate than the region or the nation. This decline reflected the employment losses in the financial sector in 2009 as well as the onset of the recession. In 2010, the unemployment rate peaked at 9.3%, higher than that of the region but lower than that of the nation, before declining to 8.9% in 2011.

Based on the foregoing, KBRA views the State of Connecticut's resource base as consistent with a AA - rating. Connecticut has the highest personal income per capita in the nation which is further strengthened by high levels of educational attainment and low levels of poverty. The State's economic base continues to recover, albeit at a slower rate than the region and the US, as indicated by growth in total employment and decline in unemployment rates.

KBRA LONG-TERM RATING: AA
OUTLOOK: STABLE

Appendix 1: Tear Sheet

Issuance

$500 million General Obligation Bonds 2015, Series A & Taxable General Obligation Bonds, 2015 Series A. KBRA's most recent rating report for the State was published on March 11, 2015.

Security

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

Use of Proceeds

Proceeds of the General Obligation Bonds (2015 Series A) will be used for various capital projects of the State. Proceeds of the Taxable General Obligation Bonds (2015 Series A) will be used to fund a loan through Connecticut Innovations to a non-profit corporation to finance the design, construction and equipping of a research laboratory on the campus of University of Connecticut Health Center, Farmington.

Key Rating Strengths
▪ Current leadership has demonstrated an ability and willingness to raise revenues and adjust expenditures to maintain budget balance.
▪ A strong financial management framework exists for tracking revenues and monitoring budget performance as well as an established mechanism for adjusting budgeted expenditures during the fiscal year.
▪ Connecticut has the highest per capita income in the country at $60,658 for FY 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, the progressive nature of the income tax structure and the level of capital gains tax collections.
▪ Though the State increased the Budget Reserve Fund to an amount equal to 3% 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.

Connecticut's economic recovery is continuing, though at a slower pace than the New England region and the U.S. as a whole. KBRA views the State's financial position as having improved under the current administration but projects that budget pressures will continue as long as economic growth is relatively slow. KBRA views the State's budget challenges as mitigated by the State's demonstrated ability and willingness to raise revenues and make spending cuts during the fiscal year to maintain balanced operations. KBRA also views positively the increase in the funding of the Budget Reserve Fund, which has increased to $519.2 million or approximately 3.0% of FY 2014 General Fund expenditures. When the Governor took office in January 2011, his administration developed a plan for conversion to GAAP-based budgeting from a modified cash basis and for the funding of the long standing General Fund deficit. The FY 2014-FY 2015 biennium budget was the State's first budget to be developed on a GAAP basis and the State has implemented a funding plan to fund the GAAP-based General Fund deficit. The State has continued to fully fund its actually required pension contributions (ARC) for its State pension programs. KBRA views the State's liquidity position as fairly strong.

As with many states, the revenue base of the State's General Fund is largely comprised of economically sensitive revenues, including personal income tax, sales tax and corporate taxes and the slower than anticipated economic growth over the last several years has created challenges in maintaining balanced financial operations. The volatility of the State's revenue base is increased by its fairly progressive income tax and a relatively high level of capital gains taxes, which reflects the State high wealth levels. The State revises its revenue forecasts three times a year through a consensus revenue forecasting process undertaken by the Office of Policy Management (OPM) and the legislative Office of Fiscal Analysis (OFA).
The State closely monitors its budget to actual financial performance on a monthly basis. Under State Statutes, the Governor may implement a certain level of expenditure reductions, or rescissions, without legislative approval, to maintain a balanced budget. KBRA expects that the State will continue to actively monitor its revenue projections and budget performance and act to increase revenues or reduce expenditures in order to maintain budget balance.

Outlook: Stable

KBRA continues to view Connecticut's relatively slow economic growth as putting pressure on State fiscal operations. 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 will continue to monitor the State's consensus revenue process and its ability to accurately project estimates of income tax revenues related to the realization of capital gains and other economically sensitive revenues. KBRA will continue to monitor the level of federal defense spending and the impact of any spending cuts on the State's economy and finances.

Analytical Contacts:

Kate Hackett, Managing Director
khackett@kbra.com, (646) 731-2304

Gopal Narsimhamurthy, Senior Analyst
gnarsimhamurthy@kbra.com, (646) 731-2446