State of Connecticut

General Obligation Bonds

General Obligation Bonds 2015 Series B, C, D

Analytical Contacts:

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

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

May 7, 2015

KBRA KROLL BOND RATING AGENCY

Table of Contents

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 B and $480 million General Obligation Bonds, 2015 Series C & D. The Series 2015 C & D Bonds will be issued as 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 $17 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 2015 Series B and 2015 Series C Bonds will be used for various capital projects of the State. Proceeds of the 2015 Series D Bonds will be used to refund various maturities of outstanding General Obligation Bonds.

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 GAAP based 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.

Based on the most recent consensus revenue estimates issued on April 30, 2015, the Office of Policy & Management (OPM) is projecting a $161.7 million General Fund deficit, or approximately 0.9% General Fund appropriations, for FY 2015. This compares to the OPM projection of a $121.2 million, or a change of $40.5 million, from the April 20 OPM report. OPM states that fund transfers included in House Bill 6825, the Governor's legislative proposal to address FY 2015 deficiencies, would reduce the shortfall by $37.3 million. OPM also states that administrative efforts to reduce the remaining deficit, including restriction of hiring to fill vacancies and heightened review of contract requests, continue to be made in an effort to limit year-end expenditures to those that are critical for state operations. The State's liquidity position remains fairly strong, with the State's total available cash at $1.5 billion as of May 2, 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 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. As of March 2015, the State's unemployment rate had declined to 6.5%, compared to 5.4% for the region and 5.5% 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 U.S. average.

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

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.

Financial Performance and Liquidity Position Update

FY 2015 Financial Operations

Based on the most recent consensus revenue estimates issued on April 30, 2015, the Office of Policy & Management (OPM) is projecting a $ $161.7 million General Fund deficit, or approximately .9% General Fund appropriations, for FY 2015. This compares to the OPM projection of a $121.2 million, or a change of $40.5 million, from the April 20 OPM report. OPM states that fund transfers included in House Bill 6825, the Governor's legislative proposal to address FY 2015 deficiencies, would reduce the shortfall by $37.3 million. OPM also states that administrative efforts to reduce the remaining deficit, including restriction of hiring to fill vacancies and heightened review of contract requests, continue to be made in an effort to limit year-end expenditures to those that are critical for state operations.

Consensus revenue estimates for the current fiscal year and the three subsequent fiscal years are jointly issued in November, January and April by OPM and the Legislature's Office of Fiscal Analysis. The April 30 consensus revenue estimates reflect modest revisions for reduced General Fund revenues in every year through FY 2018. OPM's current projections for end of FY 2015 General Fund operations reflect these consensus revenue estimates. The largest change was a downward revision of $65.5 million in Personal Income Tax revenues. Although these revenues showed an increase of 14%, compared to April 2014, the growth was lower than anticipated. Other significant revisions include a reduction in revenues from the health provider tax and miscellaneous taxes and an upward revision for federal grants revenues.

As of February 20, 2015, OPM projected a Medicaid deficiency for the General Fund of $108 million for FY 2015. In projections for the period ending February 28, OPM noted that the projected deficit included a $45 million reduction in federal grant revenue for claims paid in FY 2014 due to formal notification by the federal government of a change in the basis of submission of claims for the Medicaid expansion population. OPM states that this is a one-time adjustment related to the implementation of the Affordable Care Act. Adjustments for change in the basis for submission of claims will be factored into OPM's estimates going forward for purposes of the monthly forecasts as well as adoption of a budget plan for the upcoming biennium.

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.

Governor's Proposed FY 2016-FY 2017 Biennium Budget

On February 18, 2015, Governor Malloy presented his FY 2016-FY 2017 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 actuarially required contributions for its pension program. 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.

Liquidity Position

The State's liquidity position remains fairly strong. As of January 31, 2015, the State's available cash was $1.5 billion and the common cash pool was $879.4 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 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.

State Resource Base Update

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.

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

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. On a per capita basis, the state's GDP at $69,312 was 141.1% of the national level in 2013.

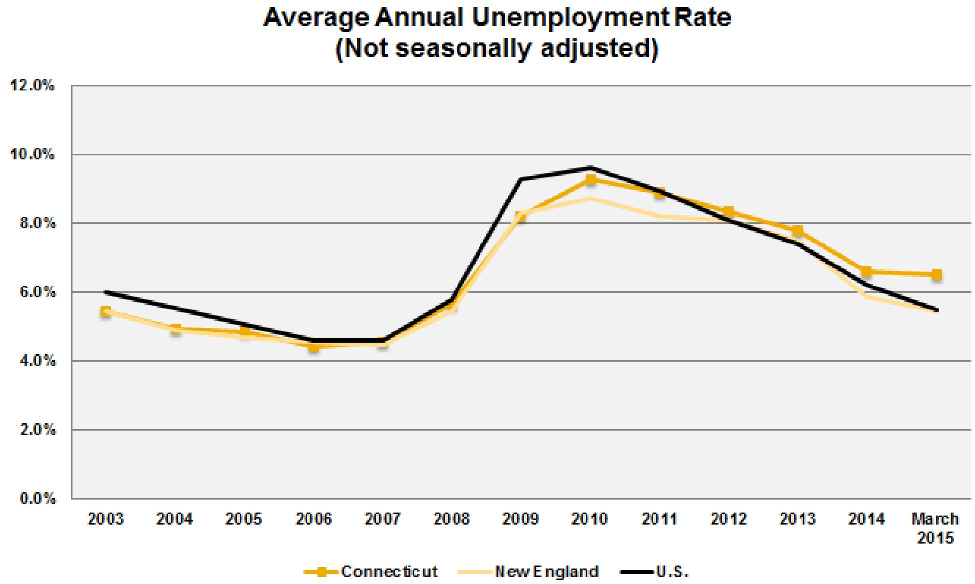
Non-Agricultural Employment (Not Seasonally Adjusted)

	Connecticut		New England		U.S.	
in thousands	Employment	% Chg	Employment	% Chg	Employment	% Chg
2009	1,741.0		7,108.8		131,233.0	
2010	1,737.4	-0.2%	7,102.7	-0.1%	130,275.0	-0.7%
2011	1,744.9	0.4%	7,140.1	0.5%	131,842.0	1.2%
2012	1,730.4	-0.8%	7,169.4	0.4%	134,104.0	1.7%
2013	1,724.5	-0.3%	7,202.1	0.5%	136,393.0	1.7%
2014	1,760.4	2.1%	7,326.8	1.7%	139,042.0	1.9%
March 2015*	1,782.8	1.3%	7,415.8	1.2%	140,326.0	0.9%

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

Based on preliminary figures as of March 2015, total state employment has grown 2.6% since 2010, and 3.3% since 2013 alone. While somewhat slower than the 4.4% growth for the region and 7.7% 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 6.5%, compared to 5.4% for the region and 5.5% for the U.S.



Source: U.S. Bureau of Labor Statistics

KBRA LONG-TERM RATING: AA

OUTLOOK: STABLE

Issuance
$500 million Series B and $480 million Series C and D. KBRA's most recent rating report was published on May 7, 2015.

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 2015 Series B and 2015 Series C Bonds will be used for various capital projects of the State. Proceeds of the 2015 Series D Bonds will be used to refund various maturities of outstanding General Obligation Bonds.

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 GAAP based 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.

Based on the most recent consensus revenue estimates issued on April 30, 2015, the Office of Policy & Management (OPM) is projecting a $161.7 million General Fund deficit, or approximately 0.9% General Fund appropriations, for FY 2015. This compares to the OPM projection of a $121.2 million, or a change of $40.5 million, from the April 20 OPM report. OPM states that fund transfers included in House Bill 6825, the Governor's legislative proposal to address FY 2015 deficiencies, would reduce the shortfall by $37.3 million. OPM also states that administrative efforts to reduce the remaining deficit, including restriction of hiring to fill vacancies and heightened review of contract requests, continue to be made in an effort to limit year-end expenditures to those that are critical for state operations. The State's liquidity position remains fairly strong, with the State's total available cash at $1.5 billion as of May 2, 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.

Analytical Contacts:

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

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