State of Connecticut
General Obligation Bonds

General Obligation Bonds (2015 Series E)
Taxable General Obligation Bonds (2015 Series B)

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Executive Summary

Kroll Bond Rating Agency (KBRA) has assigned a long-term rating of AA with a stable outlook to the State of Connecticut's $500 million General Obligation Bonds (2015 Series E) and Taxable General Obligation Bonds (2015 Series B). The 2015 Series 2015 E & B Bonds will be issued as fixed rate 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 $17.3 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 E and Taxable 2015 Series B Bonds will be used for various capital projects of the State.

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. In FY 2015, it is projected that the Budget Reserve Fund will be drawn down to an amount equal to 2.5% of General Fund expenditures.
▪ 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 during its slow recovery period. On July 20, 2015, the Office of Policy & Management (OPM) projected that the General Fund will close FY 2015 with a $70.9 million deficit, which equates to approximately 0.4% of FY 2015 General Fund appropriations. Based on state statute, the Budget Reserve Fund will be drawn down to fund the end of year deficit. Based on year end deficit projections, the Budget Reserve Fund is projected to be drawn down from $519.2 million to $448.3 million, or approximately 2.5% of FY 2015 General Fund appropriations. While KBRA views the magnitude of the projected FY 2015 deficit as minimal, it does represent a material drawdown of the State’s Budget Reserve Fund. The State’s liquidity position remains fairly strong, with the State’s total available cash at $2 billion as of July 21, 2015.

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 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 actuarially 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 revenue projections and budget performance and act to increase revenues or reduce expenditures in order to maintain budget balance.

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. Although the state lags the New England region and the United States on various employment indicators, recent improvement in overall employment and a notable decline in the unemployment rate suggest a strengthening economic environment statewide. Unlike nationwide trends, Connecticut’s overall employment did not experience growth until 2014. Across the rest of the New England region and the United States, overall employment began to increase in 2011. Based on preliminary figures as of May 2015, total state employment has grown 4.3% since 2010 and 2.9% since the end of 2014 alone. The state's employment growth has been somewhat slower than the 5.5% growth for the region and 9.3% for the U.S since 2010, however employment has increased at a higher rate than both the region and the U.S in 2014 and to date in 2015. 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. Connecticut continues to be the wealthiest state in the nation on a per capita basis with low levels of poverty. As of May 2015, the State's unemployment rate has declined to 5.5%, compared to 4.7% for the region and 5.5% for the U.S.

Based on the 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

On July 20, 2015, the Office of Policy & Management (OPM) projected that the General Fund will close FY 2015 with a $70.9 million deficit which equates to approximately 0.4% of FY 2015 General Fund appropriations. This compares to the OPM projection of a $115.7 million General Fund deficit from the June 19 OPM report. Based on state statute, the Budget Reserve Fund will be drawn down to fund the end of year deficit. Based on the year end deficit projections, the Budget Reserve Fund is projected to be drawn down from $519.2 million to $448.3, or approximately 2.5% of FY 2015 General Fund appropriations. Management stated that personal income tax collections at the end of the fiscal year were lower than expected and that significant expenditure reductions were difficult to make in the last month of the fiscal year. Management stated that the intent is to actively manage the FY 2016 budget to maintain fiscal balance. While KBRA views the magnitude of the projected FY 2015 deficit as minimal, it does represent a material drawdown of the State's Budget Reserve Fund.

Total projected personal income tax revenues for FY 2015 are projected to be approximately $111 million, or 1.2% under budget. For FY 2015, total General Fund revenues are projected to increase at an economic growth rate of 1.9% from FY 2014, with personal income tax revenues and sales taxes increasing at an economic growth rate of 5.6% and 4%, respectively over FY 2014.

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 June 3, 2015, the General Assembly passed a biennial budget bill for FY 2016 and FY 2017, which was subsequently amended in special session. The final adopted budget, as amended, included significant revenue enhancements and also modifications to spending cuts, as compared to the Governor's proposed budget. The budget includes an increase of General Fund appropriations of 4.0% in FY 2016 and 3% in FY 2017. Total General Fund revenues are projected to grow at an economic growth rate of 3.8% in FY 2016 and 3.7% in FY 2017. Personal Income taxes and sales taxes are projected to grow at an economic growth rate of 5.2% and 4.4%, respectively, in FY 2016. In KBRA's view, these revenue projections are reasonable though not particularly conservative. The biennial budget projects a budget surplus of $0.8 million in FY 2016 and $2.5 million in FY 2017.

The FY 2016 - FY 2017 biennial budget includes $802.1 million in revenue enhancements for FY 2016 and $664.4 million in revenue enhancements for FY 2017. Significant revenue changes include an increase to the top personal income tax marginal rate, limits on the use of deductions in the corporate tax and increases in the health provider tax. Changes to the sales tax included elimination of the exemption for clothing and shoes under $50 and the increase of taxes on computer related services. Under the new budget, significant portions of the sales tax revenues will be intercepted to fund an increased municipal aid program for property tax relief and to fund the "Let's Go CT" transportation initiative. In both FY 2016 and FY 2017, the use of one time revenues is minimal, representing 1% or less of revenues.

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 relatively flat and 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 funds. 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 is 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 June 30, 2016. The proposed budget includes no across-the-board layoffs and no furlough days for the State's work force, though hiring restrictions continue.

Budget Reserve Fund

The FY 2016 - FY 2017 budget also includes several changes to the State's budget reserve fund, effective July 1, 2019. The maximum cap on the Budget Reserve Fund is raised from 10% to 15% of General Fund appropriations in any given fiscal year. It also requires that growth in certain revenues above historical levels be deposited into a special fund throughout the year and transferred to the Budget Reserve Fund at the end of the fiscal year. Budget flexibility is maintained by access to that special fund in that fiscal year.

Liquidity Position

The State's liquidity position remains fairly strong. As of July 18, 2015, the State's available cash was $2.0 billion and the common cash pool was $914 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

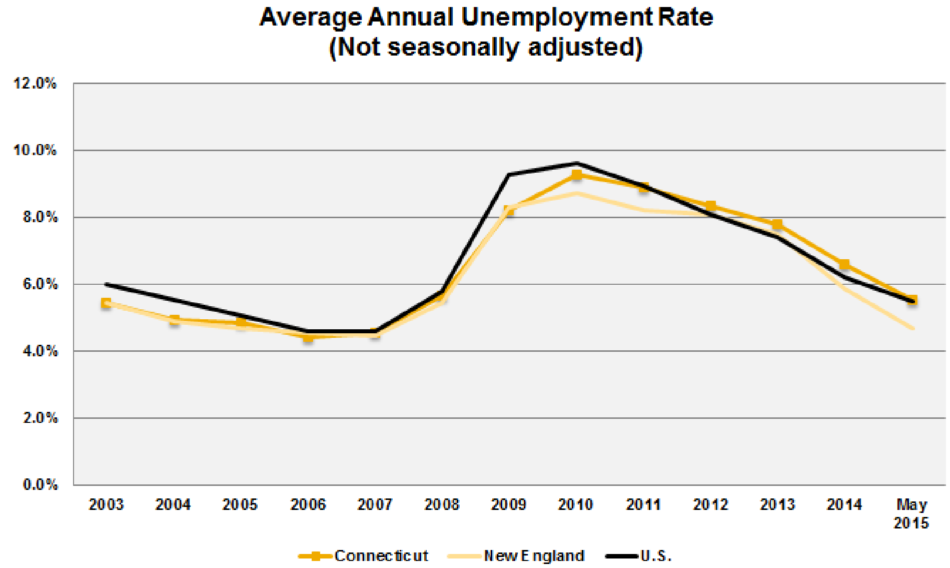
KBRA views Connecticut's resource base as continuing to recover from the Great Recession. Although the state lags the New England region and the United States on various employment indicators, recent improvement in overall employment and a notable decline in the unemployment rate suggest a strengthening economic environment statewide. Unlike nationwide trends, Connecticut's overall employment did not experience growth until 2014. Across the rest of the New England region and the United States, overall employment began to increase in 2011. Based on preliminary figures as of May 2015, total state employment has grown 4.3% since 2010 and 2.9% since the end of 2014 alone. The state's employment growth has been somewhat slower than the 5.5% growth for the region and 9.3% for the U.S since 2010, however employment has increased at a higher rate than both the region and the U.S in 2014 and to date in 2015. 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. Connecticut continues to be the wealthiest state in the nation on a per capita basis with low levels of poverty.

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%
May 2015*	1,812.3	2.9%	7,496.6	2.3%	142,363.0	2.4%

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

As of May 2015, the State's unemployment rate has declined to 5.5%, compared to 4.7% for the region and 5.5% for the U.S.



Source: U.S. Bureau of Labor Statistics

The state of Connecticut'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.