MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aa3 to $650M State of Connecticut GO bonds; outlook stable

Global Credit Research - 05 Nov 2015

State has about $19.7B in net tax-supported debt

CONNECTICUT (STATE OF)
State Governments (including Puerto Rico and US Territories)
CT

Moody's Rating

ISSUE		RATING
General Obligation Bonds (Green Bonds, 2015 Series G)		Aa3
Sale Amount	$65,000,000	
Expected Sale Date	11/17/15	
Rating Description	General Obligation	
General Obligation Bonds (2015 Series F)		Aa3
Sale Amount	$585,000,000	
Expected Sale Date	11/17/15	
Rating Description	General Obligation	

Moody's Outlook STA

NEW YORK, November 05, 2015 --Moody's Investor's Service has assigned Aa3 ratings to the State of Connecticut $585 million general obligation bonds 2015 Series F and $65 million general obligation bonds (Green Bonds) 2015 Series G. The bonds are expected to price November 17, 2015.

SUMMARY RATING RATIONALE

The Aa3 state rating incorporates Connecticut's high combined fixed costs for debt service, pension, and post-employment benefits relative to the state's budget; pension funded ratios that are among the lowest in the country and likely to remain well below average; and minimal reserve levels. The rating also reflects revenue underperformance and persistent budget gaps and the state's recent efforts to increase reserves and bring the state budget into fiscal balance.

OUTLOOK

The outlook for Connecticut is stable reflecting the positive steps the state has taken to address its long-standing balance sheet weakness and reduce its fixed post-employment benefit costs through pension reforms, as well as the adoption of a biennial budget that largely relies on recurring solutions. We expect that Connecticut's revenue trends should improve as its recovery picks up steam. We also expect that the state will maintain its new commitment to replenishing its rainy day fund and addressing its remaining negative GAAP basis unassigned General Fund balance. The elevated debt service costs will continue to challenge the state's financial position over the near term.

WHAT COULD MAKE THE RATING GO UP

- Achievement and maintenance of higher GAAP-basis combined available reserve levels

- Established trend of structural budget balance

- Evidence of sustained stronger economic performance

- Reduced debt ratios relative to Moody's 50-state median and lower fixed annual costs

- Significantly improved funding of pension and post-retirement liabilities

WHAT COULD MAKE THE RATING GO DOWN

- Lack of improvement in available reserve levels

- Reversion to significant one-time budget solutions, including deficit financings

- Revenue weakness driven by delayed economic recovery

- Cash flow strain stemming from reduced liquidity

- Significant increase in fixed costs as percent of budget

STRENGTHS

- Legislated support for application of operating surpluses to the Budget Reserve Fund (BRF)

- Commitment to eliminate GAAP negative fund balance

- Wealthiest state in the nation with per capita personal income levels well above national levels

CHALLENGES

- Fixed costs for debt, pension and other post-employment benefits (OPEB) relative to budget are among the highest in the nation

- Very low funding ratios for pension systems

- Vulnerability to financial market fluctuations due to effect on capital gains for very high wealth residents and employment in the financial services sector

- General fund balance sheet will remain negative over near term and rainy day fund modest due to state's slower recovery from the recession

RECENT DEVELOPMENTS

On October 19, 2015, Connecticut's Office of Policy and Management projected a 2016 year-end shortfall of $118.4 million primarily due to lower anticipated personal income tax revenues. We note that this projected deficit is less than 1% of the overall general fund budget. In addition, the governor is currently working with legislators to resolve the current shortfall.

DETAILED RATING RATIONALE

ECONOMY: ECONOMIC RECOVERY CONTINUES BUT STILL LAGS THE NATION

Connecticut's economic recovery continues to lag that of the nation, however, unemployment continues to trend down. Connecticut's unemployment rate stood at 5.2% for September 2015, roughly on par with the national rate of 5.1% for the same period. Through July 2015, Connecticut regained 85.5% of the total jobs lost in the recession. From the peak in March 2008 to the low in February 2010, Connecticut lost 119,000 jobs, or 6.9% of its workforce. Real average earnings continue to improve as real median family income growth in 2014 surpassed the U.S. and Northeast averages for the first time in four years. The sectors with positive growth are education and health services, leisure and hospitality, transportation and utilities and professional and business services. Moody's Analytics projects that the state will regain its recessionary job losses by mid-2016. However, the state will continue to contend with high energy costs and high tax burdens.

FINANCES AND LIQUIDITY

ENACTED 2016-2017 BUDGET REDUCES ONE TIME SOLUTIONS AND FOCUSES ON REVENUE ENHANCEMENTS AND EXPENDITURE REDUCTIONS

Governor Malloy signed a biennial budget bill that includes $802.1 million in revenue enhancements in fiscal 2016 and $664.4 million in fiscal 2017. The significant revenue enhancements include an increase to the top personal income tax marginal rate to 6.99% from 6.7% ($151.5 million in fiscal 2016), sales and use tax changes including the elimination of the exemption for clothing and footwear costing less than $50 ($136.8 million in fiscal 2016), limits on the use of net operating losses against the corporate tax ($156.3 million in fiscal 2016), and rebasing the hospital net revenue tax ($160.5 million in fiscal 2016). The significant expenditure changes include capping various statutory formula grants and programmatic and rate changes to Medicaid. We estimate that the use of non-recurring revenues comprises about 0.8% of fiscal 2016 general fund revenues.

The budget also included an intercept of sales and use tax revenue for the "Let's Go CT!" transportation initiative and beginning in fiscal 2016, all revenue from the oil companies tax will be deposited to the Special Transportation Fund. We expect a substantial increase in transportation capital spending and note that fiscal 2016 and 2017 include $2,169.8 million in total transportation related bond authorizations.

The budget bill made several changes to the state's budget reserve fund effective July 1, 2019; raising the maximum cap on the total allowable deposits to the budget reserve fund from 10% to 15% of the net general fund appropriations for any fiscal year. It also incorporates an automatic funding mechanism that is triggered when certain revenue sources exceed an average historical growth rate.

BOND PROCEEDS USED TO REDUCE NEGATIVE GAAP BALANCE

In fiscal 2013, the state implemented a plan to begin addressing Connecticut's sizeable $1.2 billion cumulative GAAP deficit. The state issued $560 million of general obligation bonds, which generated $598.5 million in proceeds (of the $750 million total authorized by legislature) amortizing the bonds over 15 years and reducing the accumulated GAAP deficit to $618.5 million. The remaining portion of the deficit will be amortized over 13 years starting in fiscal 2016, resulting in an annual payment of about $47.5 million. These amounts will be "deemed appropriated", meaning no further legislative action is needed to make the payments.

The GAAP bond proceeds are not counted as General Fund revenues, and the proceeds cannot be used for any current or future budget appropriations. While the funding strategy enabled the state to begin addressing its longstanding sizeable GAAP deficit and injects discipline into the plan, the additional debt adds to the state's already high debt levels and fixed costs. Even with the plan, the unassigned General Fund balance will remain negative over the near term.

Liquidity

Connecticut's liquidity remains satisfactory. The state did not have to borrow for cash flow purposes in fiscal 2015 and does not anticipate cash flow borrowing in fiscal 2016. Cash balances averaged $1.5 billion in fiscal 2015 and stood at $2.0 billion, including bond proceeds, as of October 31, 2015.

DEBT AND PENSIONS

Debt Structure

DEBT RATIOS REMAIN HIGH AND REMAIN AMONG HIGHEST IN COUNTRY

Connecticut is a frequent borrower and the state's debt per capita and debt-to-personal income ranked first and second, respectively, among the 50 states for Moody's 2015 debt medians. Net tax-supported debt equaled $5,491 per capita and 9.0% of total state personal income, well above the 50-state median of $1,054 in debt per capita and 2.6% for debt-to-personal income. These high debt ratios are partly due to substantial capital financing for K-12 school building construction that is carried out at the local level in many other states. However, with the $2 billion POBs and the sale of $560 million in GAAP Conversion bonds to address a portion of the state's sizeable cumulative GAAP deficit, on top of the state's normal sizeable annual debt issuances, Connecticut's debt ratios will likely remain among the highest in the country. Connecticut adheres to a 20-year level principal repayment schedule for its general obligation debt, with a declining debt service schedule that provides some flexibility.

Debt-Related Derivatives

MODEST AMOUNT OF VARIABLE RATE DEBT AND MINIMAL SWAP EXPOSURE

The state has $1.8 billion in variable rate debt, most of which is indexed to either SIFMA or CPI, or approximately 12.5% of the state's total G.O. debt. Only $55.6 million of the state's variable rate debt is swapped to fixed, based on 60% of LIBOR or a percentage point above CPI, after a $280 million swap was terminated at par on March 1. As of June 30, 2015, the mark-to-market was minimal, at negative $2.5 million against the state. In accordance with its swap guidelines, the state generally negotiates provisions that permit funding a required termination payment over a period of time to allow time for a refunding. Accordingly, the state would have 270 days to fund a termination payment for its general obligation swaps. The state has no plan to incorporate swaps into future GO bonds.

Pensions and OPEB

Based on Connecticut's 2013 pension data, we have calculated that the SERS adjusted net pension liability (ANPL) was 121% of revenues. Moody's adjusted net pension liability applies a bond index rate to determine the present value of plan liabilities, incorporates the market (rather than actuarial) value of plan assets and makes certain other changes to improve comparability of reported pension liabilities. The state reported a funded ratio for SERS of 41.5% as of June 30, 2014. The actuarial valuation for TRS showed a funded ratio of 59% as of June 30, 2014, up from 55% as of June 30, 2012. SERS revised downward the assumed rate of return, to 8% from 8.25% beginning in fiscal 2014, along with other adjustments to price and wage inflation rates. The assumed rate of return for TRS is 8.5%. For these two plans, the state's combined ANPL for fiscal 2013 was 236% of revenues. This amount is notably higher than that of Kentucky, the state with the third largest pension burden at 193.2% of revenues, but is well below Illinois at 268.3%. The 50-state median ANPL to revenues is 60.3%, based on 2013 data. Other pension ratios such as ANPL to personal income, GDP, and population are similarly very high for Connecticut.

GOVERNANCE

The state has a constitutional balanced budget requirement, strong, binding consensus revenue process supported by nonpartisan and objective economic analysis that is conducted three times a year (January, April and November) or can be scheduled more frequently during times of revenue shortfalls or economic distress. There is a constitutional cap on spending and a statutory limit on debt payable from the general fund. The state is not subject to mandated initiatives or voter referenda. The Governor has limited executive authority to cut expenses by up to 5% of an individual appropriation, not to exceed 3% of any fund, without legislative approval, and if a deficit exceeds 1% of the general fund, there are requirements for a timely deficit mitigation plan to be developed. A super-majority is not required for tax increases or legislatively enacted budget adjustments. There is monthly budget reporting by both the Governor's budget office and the State Comptroller and budget adoption has been timely. The state does not conduct a debt affordability analysis, however, both the Governor's budget office and the Office of Fiscal Analysis prepare Fiscal Accountability reports that include multiple-year financial planning including projections of debt issuance, debt levels and debt cost. The state has frequently maintained a rainy day fund over the years, and there are statutory requirements that all budget surplus funds be deposited to the rainy day fund at year-end.

KEY STATISTICS

- Per capita income relative to U.S. average: 140.9%

- Industrial diversity (1=most diverse): 0.76

- Employment volatility (U.S.=100): 92

- Available balances as % of operating revenue (5-yr. avg.): -8.8%

- NTSD/total governmental revenue: 80.1%

- 3-year avg. adjusted net pension liability/total governmental revenue: 213.5%

OBLIGOR PROFILE

The State of Connecticut has a population of almost 3.6 million people. The state, located in the northeastern US, has a large and diverse economy with a gross state product of $249.2 billion. It is the wealthiest state in the country with per capita income of 140.9% of the US average.

LEGAL SECURITY

The bonds will be secured by the full faith and credit of the State of Connecticut.

USE OF PROCEEDS

Proceeds of the 2015 Series F bonds will be used for various capital projects and for other state purposes. The 2015 Series G (Green Bonds) will finance a portion of various high priority clean water projects across the state for design, construction and improvements to wastewater treatment plants and related energy efficiency upgrades designated to reduce water pollution in the state according to state and federal standards.

RATING METHODOLOGY

The principal methodology used in this rating was US States Rating Methodology published in April 2013. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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