STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

RatingsDirect®

Summary:
Connecticut; General Obligation

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Summary:

Connecticut; General Obligation

Credit Profile		
US$61.64 mil GO rfdg nts (economic recovery nts) ser 2014A due 01/01/2018		
Long Term Rating	AA/Stable	New
Connecticut GO		
Long Term Rating	AA/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services has assigned its 'AA' long-term rating and stable outlook to Connecticut's $61.64 million general obligation (GO) refunding notes (economic recovery notes [ERNs], 2014 series A) - SIFMA Index. The notes will bear a variable interest rate calculated weekly at the SIFMA Index rate plus or minus a fixed number of basis points determined at time of sale.

At the same time, Standard & Poor's affirmed its 'AA' rating on the state's $15.1 billion parity GO debt outstanding. The outlook is stable.

The 'AA' rating reflects what we view as Connecticut's:

- Diverse economic base, which has experienced cyclical performance over time;
- High wealth and income levels;
- Capacity to adjust revenues and expenditures, which we believe has provided it with the flexibility to manage budget volatility;
- Active monitoring of revenues and expenditures to identify gaps; and
- Adequate operating liquidity, which has improved due to stronger revenue performance and the recent generally accepted accounting principles (GAAP) conversion bond issue.

In our view, despite these strong fundamentals, the state has a history of budget performance we consider cyclical, which has led to its issuance of debt to cover operating deficits in recessionary periods. Connecticut's above-average debt levels, high unfunded pension liabilities, and large unfunded other postemployment benefit (OPEB) liabilities represent a significant fixed-cost pressure, which we expect to remain high for the foreseeable future.

Standard & Poor's understands that the notes are being issued to refund $61.1 million of ERNs series 2009 that mature Jan. 1, 2015, and extend the maturity of the refunded notes over the next three years.

Standard & Poor's calculates the one-time budget relief from this refunding at only 0.3% of fiscal 2015 projected expenditures, and adding only about $22 million per year to state expenditures in each of the next three fiscal years, which we view as small compared with the state's $17 billion fiscal 2015 budget. However, we also believe that that Connecticut's extension of its debt maturity, while small, reflects a tight state budget situation at a time when the nation as a whole is experiencing economic expansion. This refunding was included in the state's adopted budget revision enacted in June, and will not reduce Connecticut's currently projected budget gap. Our rating and outlook assume there will not be significant additional transactions that will have the effect of deficit financing in the immediate future.

Connecticut's economic recovery continues at a modest pace, as weakness in government, manufacturing, and finance sector employment weighs down growth in other sectors. The state estimates it has recovered approximately 72% of the jobs lost through the Great Recession. Its real gross state product (GSP) growth was slightly negative in 2011, but has since resumed growing, albeit at a much slower pace than that of the nation. Connecticut has one of the highest concentrations of financial services employment in the country, at 8% of total jobs as of 2013. Although these jobs are generally high paying, many were lost in 2012 and 2013. Nevertheless, IHS Global Insight Inc. estimates that the state experienced modest total employment growth of 0.9% in 2013, and projects 0.7% growth in 2014, and 1.3% in 2015, led by the services industries. The unemployment rate remains slightly elevated compared with that of the U.S. but has improved, dropping to 7.8% in 2013 (compared with 7.4% for the nation) from 9.3% in 2010. It was 6.4% in September 2014 on a preliminary basis compared with 5.9% for the nation.

Although weak economic growth has limited revenue expansion, the state Office of Policy and Management (OPM) estimates net general fund revenue came in better than budgeted at $248.5 million for the fiscal year ended June 30, 2014. This was higher than the $4.4 million originally budgeted for fiscal 2014. The surplus is added to the state budget reserve fund (BSF), which would bring it to $519.2 million at fiscal year-end 2014, or approximately 3% of spending.

The OPM has also recently released an updated forecast for fiscal 2015 projecting a $99.5 million shortfall against the fiscal 2015 budget or, in our opinion, a relatively small 0.6% of general fund appropriations. The newly projected gap was the result of a $59.1 million shortfall in projected general fund revenue, and projected expenditures above budget, particularly a $30 million shortfall in Medicaid. In mid-November, the governor implemented $54.7 million in allotment rescissions, which reduces the projected shortfall to $44.8 million.

If the $44.8 million remaining shortfall were applied against the $519.2 million fiscal year-end 2014 BSF, the state's reserves would fall to about 2.7% of fiscal 2015 expenditures. Connecticut is now projecting an out-year fiscal 2016 budget gap of $1.1 billion based on current practices, or 5.9% of projected expenditures that will need to be closed in the future. The separate legislature's Office of Fiscal Analysis projected a smaller $89.1 million budget gap in fiscal 2015 (before the effect of the $54.7 million in recent rescissions), but a larger projected gap of $1.3 billion to be closed for fiscal 2016. Connecticut estimates that one-time revenue in its enacted 2015 budget totals about $294.9 million, or about 1.7% of budgeted revenues. The state is projecting slightly higher personal income growth rates than IHS Global Insight, and because personal income taxes are 57% of projected fiscal 2015 tax revenue (53% of total general fund revenue), this could be a source for potential future budget variance. A positive inclusion in both the fiscal 2014 and fiscal 2015 budgets is full funding of the annual actuarially required state retirement system pension contribution, which will help ameliorate what we view as currently low retirement systems' funded levels, which we calculate at a relatively low 50% on a combined actuarial basis. Connecticut recently released the funded ratio calculation of its employees' retirement system using the new Governmental Accounting Standards Board (GASB) 67 GAAP basis, which reduced the funded ratio to what we regard as a low 39.54% (compared with 41.5% using state actuarial assumptions), while the teacher retirement funded ratio on a GASB basis was unchanged at 61.56%.

On a GAAP basis, the most recent audited fiscal year, 2013, ended with a negative $588.6 million general fund balance position, improved by $323.7 million from the year before and equal to negative 1.7% of general fund GAAP expenditures. In fiscal 2014, the state sold $560.4 million of GAAP conversion bonds to reduce the GAAP deficit, as part of the state's move to GAAP-based budgeting. In our view, state finances have been cyclical, with a budget reserve fund balance of almost $1.4 billion in fiscal 2009, which was fully depleted in the subsequent recession, before being built back up to $270.7 million at fiscal year-end 2013 on a GAAP basis. The GAAP conversion bonds were issued in October 2013 specifically to reduce its negative GAAP general fund balance and improve its fiscal year-end 2014 balance; Connecticut anticipates future budgets will maintain a positive GAAP balance, now that it is budgeting on a GAAP basis.

We consider Connecticut's approximately $19.2 billion of tax-backed debt after this sale to be high, which we calculate as $5,336 per capita or 8.8% of personal income, including this sale of bonds. Our calculation of tax-backed debt service to total governmental fund expenditures for fiscal 2013 is 9.7%. We also consider combined unfunded pension liabilities as high, at $52.2 billion, although now that the state is funding the pension annual required contribution for its employee retirement system and investment returns have picked up, this will likely begin to decrease at some point. In addition, we consider OPEB high at $22 billion, including both the state employees' and the state teachers' retirement system. Connecticut law considers state employee OPEB a contractual right of current workers, and state payment of teachers' OPEB a state statutory obligation. Connecticut recently implemented a state employee contribution of 3% of salary toward OPEB, over and above current health costs, which the state will match at the 3% rate beginning in fiscal 2017. Combined with small state OPEB trust fund contributions in 2008 and 2011, this will help ameliorate this still-sizable unfunded liability.

Based on the analytic factors we evaluate for states, on a scale of '1.0' (strongest) to '4.0' (weakest), we have assigned a composite score of '2.0' to Connecticut.

(For more information on the Connecticut GO rating, please see the full analysis published Nov. 19, 2014, on RatingsDirect.)

Outlook

The stable outlook reflects Standard & Poor's expectation that Connecticut will largely retain structural budget alignment over the two-year outlook horizon. Slow revenue growth, the state's significant fixed-cost pressures, and still-modest expected budget reserves, despite the deposit to the BSF at the end of fiscal 2014, limit financial flexibility. In our view, Connecticut has historically managed budget pressures, and above-average leverage and revenue volatility have been factors at the current rating level over time. We believe that, at present, Connecticut is more vulnerable than other states to adverse trends in the economy given the fiscal strain of the past several years and slow economic growth. However, Connecticut ended fiscal 2014 slightly better than originally budgeted, and expects close to a balanced budget in fiscal 2015, albeit with what we view as a modest level of one-time budget items and no budgeted increase to reserves. The rating could come under pressure if structural gaps emerge that Connecticut does not address in a timely manner with recurring solutions, or if it issues a material amount of additional deficit bonds.

Related Criteria And Research

Related Criteria

- USPF Criteria: State Ratings Methodology, Jan. 3, 2011
- USPF Criteria: Financial Management Assessment, June 27, 2006

Related Research

- U.S. State And Local Government Credit Conditions Forecast, Oct. 15, 2014

Ratings Detail (As Of December 4, 2014)		
Connecticut		
Long Term Rating	AA/Stable	Affirmed
Connecticut taxable GO rfdg bnds ser 2014 B due 09/01/2027		
Long Term Rating	AA/Stable	Affirmed
Connecticut GO		
Long Term Rating	AA/Stable	Affirmed
Connecticut GO		
Long Term Rating	AA/Stable	Affirmed
Connecticut GO		
Long Term Rating	AA/Stable	Affirmed
Connecticut GO bnds ser 2014 A due 03/01/2034		
Long Term Rating	AA/Stable	Affirmed
Connecticut GO rfdg nts var rate (Economic Recovery Nts) ser 2013 A due 01/01/2018		
Long Term Rating	AA/Stable	Affirmed
Connecticut GO (AGM) (SEC MKT)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Connecticut GO (AGM) (SEC MKT)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Connecticut GO (FGIC)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Connecticut GO		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Connecticut Innovations Incorporated, Connecticut		
Connecticut		
Connecticut Dev Auth (Connecticut) GO		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
University of Connecticut, Connecticut		
Connecticut		
University of Connecticut (Connecticut)		
Long Term Rating	AA/Stable	Affirmed
University of Connecticut (Connecticut) GO rfdg bnds		

Ratings Detail (As Of December 4, 2014) (cont.)		
Long Term Rating	AA/Stable	Affirmed
Waterbury, Connecticut		
Connecticut		
Waterbury (Connecticut) GO spl cap reserve fd		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

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