STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

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Summary:

Connecticut; General Obligation

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Summary:

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Credit Profile		
US$200.0 mil GO bnds ser 2014 D due 06/15/2034		
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 $200 million general obligation (GO) bonds series 2014D.

At the same time, Standard & Poor's affirmed its 'AA' rating on the state's $13.7 billion parity 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 principle (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 and high unfunded postretirement liabilities represent a significant fixed-cost pressure and we expect this to accelerate based on new bond authorizations in recent years for operating and capital purposes.

The bonds are being issued for various capital purposes.

The state's economic recovery continues at a muted pace, and we expect that this will continue in the near term as growth prospects in key sectors (financial services, government, and manufacturing) remain limited in our view. Employment growth remains limited overall, and the state has recovered approximately half of the jobs lost through the Great Recession. Real gross state product growth for Connecticut was slightly negative in 2011 and 2012 (0.1% decline each year), ranking it last among the 50 states for 2012. Connecticut has one of the highest concentrations of financial services employment in the country, at about 8% of total jobs, according to IHS Global Insight Inc. Although these jobs are generally high paying, many were lost in 2012 and 2013. Nevertheless, IHS Global Insight estimates the state experienced modest nonfarm employment growth of 0.9% in 2013, and projects 0.5% 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 6.9% in April 2014 on a preliminary basis compared with 6.3% for the nation.

Although weak economic growth has limited revenue expansion, the current state consensus revenue forecast for fiscal 2014 is for a small, $43 million operating surplus -- better than the $4 million already budgeted -- but this is down substantially from a $504 million surplus projected in February. The state attributes the change to recently lowered income tax projections, primarily due to a greater-than-anticipated effect from federal tax changes regarding capital gains taxes, which accelerated capital gains into earlier fiscal years, offset to some degree by allowing $118 million of appropriations to lapse. The $43 million surplus is expected to be added to the state's budget stabilization fund, bringing the balance up to $314 million, which we view as modest at 1.8% of fiscal 2014 expenditures on a budgetary basis.

The state's most recent revenue projection, updating the enacted fiscal 2015 budget, projects slow, 1.8% general fund revenue growth in fiscal 2015, to $17.46 billion, and only a modest $400,000 operating surplus at the end of the fiscal year, slightly worse than the enacted budget's $3.1 million projected operating surplus. The state estimates that one-time revenues in its enacted 2015 budget total about $294.9 million, or about 1.7% of budgeted revenues. 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 49% on a combined basis.

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 our view, state finances have been cyclical, with a budget reserve fund balance in fiscal 2009 of almost $1.4 billion, 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. In October 2013, the state issued $560.4 million of GO bonds specifically to partially fund its negative GAAP general fund balance; the state anticipates future budgets will maintain a positive GAAP balance.

We consider the state's $18.9 billion of tax-backed debt to be at high levels, which we calculate as $5,137 per capita or 8.6% of personal income, including this sale of bonds. Our calculation of tax-backed debt service to total governmental fund expenditures is 9.7%. We also consider combined unfunded pension liabilities as high, at $24.6 billion, although now that the state is funding the pension annual required contribution (ARC) for its employee retirement system, this will likely begin to decrease. In addition, we consider other postretirement benefits (OPEB) as high at $19.5 billion. Connecticut law considers OPEB a contractual right of current workers. Until recently, the state funded OPEB on a pay-as-you go basis. However, the state recently implemented an employee contribution of 3% of salaries toward OPEB, over and above current health costs, which the state will match at the 3% rate beginning in fiscal 2017 for additional OPEB prefunding.

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 '1.9' to Connecticut.

(For more information on the state, please refer to our full GO analysis published on May 19, 2014, on RatingsDirect on the Global Credit Portal.)

Outlook

The stable outlook reflects Standard & Poor's expectation that Connecticut will 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 a small projected deposit to the stabilization fund 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 the state 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, the state is projecting that it will perform slightly better than originally budgeted in fiscal 2014 and has enacted a balanced budget for 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 are not addressed in a timely manner with recurring solutions or if additional deficit bonds are issued.

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, April 7, 2014

Ratings Detail (As Of June 4, 2014)		
Connecticut		
Long Term Rating	AA/Stable	Affirmed
Connecticut GO		
Long Term Rating	AA/Stable	Affirmed
Connecticut GO		
Long Term Rating	AA/Stable	Affirmed
Unenhanced Rating	NR(SPUR)	
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

Ratings Detail (As Of June 4, 2014) (cont.)		
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		
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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