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$300.0 mil GO bnds ser 2014 E due 09/01/2034		
Long Term Rating	AA/Stable	New
US$200.0 mil taxable GO bnds ser 2014 A due 09/01/2024		
Long Term Rating	AA/Stable	New
US$10.59 mil taxable GO rfdg bnds ser 2014 B due 09/01/2027		
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 $300 million general obligation (GO) bonds series 2014E, $200 million taxable GO bonds series 2014A, and $10.59 million taxable GO refunding bonds series 2014B.

At the same time, Standard & Poor's affirmed its 'AA' rating on the state's $15.1 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.

Standard & Poor's understands that the bonds are being issued for refunding and for various capital purposes.

Connecticut'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. The state's real gross state product 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 about 8% of total jobs. 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 6.7% in June 2014 on a preliminary basis compared with 6.1% for the nation.

Although weak economic growth has limited revenue expansion, recently the state slightly raised its fiscal 2014 general fund net revenue estimate to $121.3 million from an April projection of $43 million -- better than the $4.4 million originally budgeted for fiscal 2014 -- but this is down substantially from a $504 million surplus projected in February. The state attributes the recent increase to federal Medicaid grant adjustments, increased personal income tax, and an increase in budgetary lapses. The change from the higher February projection was due to 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 $121.3 million surplus is expected to be added to the state's budget stabilization fund (BSF), bringing the balance up to $392.0 million, which we view as modest at 2.3% of fiscal 2014 expenditures on a budgetary basis.

The state's revised adopted budget for fiscal 2015 projects slow, 1.9% 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. Connecticut 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 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. In October 2013, Connecticut issued $560.4 million of GO bonds specifically to partially fund its negative GAAP general fund balance; it anticipates future budgets will maintain a positive GAAP balance.

We consider Connecticut's approximately $19.8 billion of tax-backed debt after this sale to be at high levels, which we calculate as $5,502 per capita or 9.2% 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 $24.6 billion, although now that the state is funding the pension annual required contribution 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, it recently implemented an employee contribution of 3% of salaries toward OPEB, over and above current health costs, which Connecticut 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 May 19, 2014, on RatingsDirect.)

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 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, it 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 Connecticut does not address in a timely manner with recurring solutions or if it issues 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, July 8, 2014

Ratings Detail (As Of July 30, 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)	

Ratings Detail (As Of July 30, 2014) (cont.)		
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		
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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