STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

RatingsDirect®

Connecticut; General Obligation

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US$250.0 mil GO rfdg bnds ser 2014 H due 11/15/2026		
Long Term Rating	AA/Stable	New
US$240.0 mil GO bnds ser 2014 F due 11/15/2034		
Long Term Rating	AA/Stable	New
US$60.0 mil GO bnds (Green Bnds) ser 2014 G due 11/15/2031		
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 $240 million general obligation (GO) bonds series 2014F, $60 million taxable GO bonds series 2014G, and $250 million GO refunding bonds series 2014H.

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 liabilities represent a significant fixed-cost pressure, which we expect to remain high for the foreseeable future.

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

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 is 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. Connecticut has indicated that it has already taken some steps to reduce the shortfall. However, if the full $99.5 million shortfall were applied against the $519.2 million fiscal year-end 2014 BSF, the state's reserves would fall to about 2.4% 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 projects a smaller $89.1 million budget gap in fiscal 2015, but a larger projected gap of $1.3 billion to be closed for fiscal 2016. Connecticut estimates that one-time revenues in its enacted 2015 budget total 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 basis, based on a recent draft employees' valuation report.

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. 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 $19.2 billion of tax-backed debt after this sale to be at high levels, 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 the future. In addition, we consider other postretirement benefits (OPEB) as 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. The state recently implemented a state employee contribution of 3% of salary toward OPEB, over and above current health costs, which Connecticut 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.

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 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 additional deficit bonds.

Government Framework

The government framework, including fiscal policy and intergovernmental funding within which each state taxes, spends, and issues debt, influences its ability to manage through economic cycles.

Key features of Connecticut's governmental framework include a balanced budget requirement. A voter-approved amendment to the state constitution provides that the amount of general budget expenditures authorized in any fiscal year shall not exceed the estimated amount of revenue for that fiscal year. In developing its budget, the state operates under a statutory expenditure cap that limits spending growth to the greater of personal income growth or the inflation rate. The cap excludes debt service and certain other expenditures. There is no statutory or constitutional prohibition against borrowing for operating purposes. Connecticut is authorized to issue GO debt, special tax obligation debt, and special obligation and revenue debt. Debt outstanding, authorized, and payable from the general fund is limited by statute to 1.6x total general fund tax receipts. At July 1, 2014, authorized unissued GO debt stood at $3.0 billion. There are no constitutional or statutory provisions providing for, or precluding, a priority of payment for GO debt service over other claims of the state. Funds for debt service are "deemed to be appropriated" and, as part of the contract between bondholders and Connecticut, the state must appropriate all amounts necessary for the punctual payment of principal and interest. Connecticut, which is not a voter-initiative state, has the autonomy to raise taxes and has adjusted its tax structure over time. Connecticut has relatively broad service responsibilities with about 27% of its budget tied to education funding and other resources shared with local government units. Although it has legal flexibility to adjust funding to local governments, Connecticut has avoided sharp midyear reductions in these areas in recent years. Court cases over the years regarding education funding have generally contributed to increased spending over time in our view.

On a scale from '1.0' (strongest) to '4.0' (weakest), Standard & Poor's assigned a '1.5' score to Connecticut's governmental framework.

Financial Management

State statutes and internally developed policies guide budget management, long-term financial planning, capital planning, debt management, and investing.

Financial management assessment: "strong"

We consider Connecticut's management practices "strong" under our financial management assessment (FMA) methodology. An FMA of strong indicates that, in our opinion, practices are robust, well embedded, and likely sustainable.

Beginning Oct. 15, 2009, the Office of Policy and Management (OPM) and the legislature's Office of Fiscal Analysis have been required by statute to issue consensus revenue estimates each year. An update to the estimate is required by Jan. 15 and April 30 of each year, and it must cover a five-year period. In addition to its internal resources, Connecticut bases its revenue estimates for budget forecasting on a number of outside data sources and economic forecasting firms. The state's long-term financial planning includes a three-year forecast for the legislature in addition to the biennial budget. The financial plan is updated annually and submitted to the legislature by Nov. 15.

The state also produces a five-year capital improvement plan as part of the November update. State statutes require monthly revenue and expenditure forecasts measured against the budget. The OPM and the Office of the Comptroller generate monthly reports projecting year-end surpluses or deficits. State statutes also prescribe investment of state funds. Dedicated staff monitors investments and generates monthly reports. Connecticut also holds quarterly meetings with the investment advisory commission. The state has a swap management policy and other debt policies that guide amortization and issuance. Connecticut statute authorizes a budgetary reserve fund at a maximum of 10% of general fund appropriations. The statute prescribes that the state must transfer all unappropriated general fund surpluses into the budget reserve fund, and that the fund can only be drawn on to fund operating deficits.

Budget management framework

Connecticut maintains a formal schedule for updating revenues and expenditures on a monthly basis, and this is done by both OPM and the comptroller. If the comptroller reports a projected general fund deficit of greater than 1%, the governor is required to file a deficit mitigation plan. While the governor may reduce appropriations, this is limited to 5% of total appropriations and 3% of any fund, with any additional reductions requiring legislative approval. Legislative deliberation relating to interim budget adjustments has contributed to a delay in addressing budget gaps at times. The state is allowed to end the year in a deficit, which has periodically been addressed with deficit bonds. However, statutory provisions provide that any new budget deficit after fiscal 2013 must be funded in the ensuing fiscal year budget. Gap-closing solutions in the most recent biennium relied on significant nonrecurring measures and structural solutions.

On a scale from '1.0' (strongest) to '4.0' (weakest), Standard & Poor's assigned a '1.5' to Connecticut's financial management.

Economy

Although the state economy and population have been growing slowly recently, the state continues to maintain strong income levels.

Connecticut's population of 3.6 million represents 10-year growth of only 3.2% from 2003-2013, compared to 9.0% for the nation, according to the U.S. Census Bureau. However, the state's age dependency ratio of non-working age population to total population of 58.7% was slightly better than the nation at 59.8%.

The state's average unemployment rate in 2013 was 7.8% versus 7.4% for the U.S. The preliminary seasonally adjusted state unemployment rate in September 2014 was 6.4%, again just slightly above the nation at 6.3%. We believe the state's economy exhibits some moderate cyclicality due to exposure to the financial sector. In 2013, financial activities comprised 8.0% of payroll employment, compared to 5.8% for the nation. Other major sectors include education and health services (19.5% for state compared with 15.4% for the U.S.); trade, transportation, and utilities (18.1% of state employment, 18.9% U.S.); government (14.4% state, 16.3% U.S.); professional and business services (12.4% state, 13.5% U.S.); and manufacturing (9.9% state, 8.8% U.S). Key employers include Sikorsky Aircraft, Pratt & Whitney, Yale University, and Foxwoods Resort Casino, as well as insurance companies and financial sector firms.

State income levels are strong in our opinion. State per capita income of $60,847 in 2013 was 137% of the U.S., and GSP per capita of $69,312 was 131% of the nation, or fourth among all the states. However, GSP growth has been periodically below that of the U.S. In 2013, state GSP rose 0.9% compared with 1.8% for the nation, and 1.0% in 2012 compared with 2.5% for the U.S. The state also experienced greater decline in GSP than the nation during the recession, although annual growth was stronger than the nation in 2007 and 2008 leading up to the recession.

The state projects personal income growth of 4.0% in fiscal 2015, 3.9%, in fiscal 2016, and 5.1% in fiscal 2016, compared with IHS Global Insight Inc.'s projected personal income growth of 3.3% in calendar 2014, 3.7% in calendar 2015, and 4.3% in calendar 2016.

On a scale from '1.0' (strongest) to '4.0' (weakest), Standard & Poor's assigned a '1.9' to Connecticut's economy.

Debt And Liabilities

In our opinion, Connecticut's debt burden is high by all measures when compared with that of state peers, in part reflecting debt issued for education and other programs that may be handled at the local level of government in other states. It also includes debt issued for pension liabilities, which is not done by all states.

Connecticut's approximately $19.2 billion in GO and tax-supported debt (including this upcoming GO sale and approximately $3.5 billion of special obligation debt) put the state's total tax-supported debt per capita at $5,336. At fiscal year-end 2013, we calculate total tax-supported debt per capita at $5,081, which was high compared with that of state peers (see "2014 U.S. State Debt Review: New Issuance Remains A Lower Priority," published Oct. 13, 2014, on RatingsDirect). Compared with income, debt ratios were also high at fiscal year-end 2013, in our opinion, at 8.4% of personal income and 7.3% of GSP. We calculate tax-supported debt service at 9.7% of general fund expenditures in fiscal 2013, which we again consider high. The debt service burden has been stable over time, but recent bond issuance, including the GAAP conversion bonds, and additional authorizations could increase this fixed-cost burden. On a positive note, the amortization of debt outstanding remained rapid at 64% in 10 years. The state's debt profile is largely in fixed-rate obligations.

The State Employees Retirement Fund (SERF) has recorded on a draft basis a significant unfunded pension liability of $14.9 billion as of June 30, 2014, up from $13.3 billion at June 30, 2012, and the actuarial funded ratio in 2014 was low, in our opinion, at 41.5%. The market value funded ratio was 41.1%. The actuarial earnings assumption was lowered to 8.00% from 8.25% starting in fiscal 2014. Although still higher than the 7.4% average return in the past 20 years through fiscal 2013, it is a better alignment with performance, and in fiscal 2014 the state was able to achieve a 15.6% investment return. The negative investment returns caused by financial market declines in 2008 and 2009 are now fully reflected in the state's actuarial reports, which should point to improved funded ratios as more positive returns are phased in, but this will depend on future investment performance and actuarial assumptions. The state did not fund the full actuarial annual required contribution (ARC) in fiscal years 2008-2011, but has fully funded the ARC since. The SERF currently uses the projected unit credit actuarial cost method, which is not aligned with the new Governmental Accounting Standard Board standard that requires use of the entry age normal cost method. A conversion to this method would require legislative approval, as well as approval by the State Employees Bargaining Agent Coalition (SEBAC), and is expected to increase liabilities, lower funded ratios, and increase contributions, which would add to overall cost pressures.

The Teachers' Retirement Fund had an unfunded liability of $10.8 billion at June 30, 2014, despite a deposit of $2 billion in bond proceeds in 2008. The funded ratio increased to 59.0% in 2014 from 55.2% in 2012, but below the 70.1% funded ratio in 2008. The market value funded ratio in 2014 was 51.1%. The current earnings assumption is 8.50%, which is higher than the 7.56% average return in the past 20 years through fiscal 2013.

Both of the state's major retirement funds are below the average funded ratio for state public pension plans, according to Standard & Poor's recent state pension report (see "U.S. State Pension Funding," published June 24, 2014). Total unfunded pension liability as calculated by 2014 combined valuations of $52.2 million, including the judge's retirement system, is high at $7,205 per capita and 11.8% of personal income.

Connecticut's OPEB liability is significant compared with other states (see "Diverging Trends Underlie Overall Stable U.S. State OPEB Liability," published Nov. 17, 2014), but recent actions to lower the liability have substantially lowered the growth trajectory. The state received an updated OPEB valuation for fiscal 2013 that shows the unfunded actuarial accrued liability (UAAL) increasing to $19.5 billion. Connecticut still funds OPEB on a pay-as-you-go basis, and there are limited resources in the trust at this time ($143.8 million as of June 30, 2013). Pay-as-you-go costs for funding retiree health costs were $587.4 million in fiscal 2013, which was in contrast to the sizable ARC of $1.2 billion in 2013. In fiscal 2014 the state budgeted $548.7 million for retiree health care compared with an OPEB ARC of $1.6 billion.

The 2013 state employees OPEB valuation followed an interim 2013 report that showed a lower UAAL of $16.2 billion. Despite the increase in the UAAL, the liability is much lower than it had been before the cost-containment measures. The unfunded OPEB liability had been $26.6 billion at June 30, 2008. The lower trend in liabilities is attributable to a change in the discount rate to 5.7% from 4.5% due to the creation of a trust fund, lower liabilities resulting from changes in plan design negotiated with the SEBAC, and various healthcare cost-containment initiatives. Before the plan changes and updated actuarial report, OPEB costs had been forecast to rise sharply, reaching approximately $45 billion by fiscal 2017.

Connecticut is also statutorily required to fund one-third of teacher pension OPEB costs, plus the shortfall left after employer and employee contributions. The teachers' unfunded OPEB was $2.4 billion as of June 30, 2014, down from $3.0 billion in 2012.

On a combined basis, unfunded employee and teacher OPEB is $22.0 billion, or $6,108 per capita, a level we consider high.

On a scale from '1.0' (strongest) to '4.0' (weakest), Standard & Poor's assigned a '3.4' to Connecticut's debt and long-term liabilities.

Related Criteria And Research

Related Criteria

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

Related Research

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

Ratings Detail (As Of November 19, 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

Ratings Detail (As Of November 19, 2014) (cont.)		
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.