STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

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Summary:

Connecticut; Appropriations; General Obligation; General Obligation Equivalent Security; Moral Obligation

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Credit Profile		
US$500.0 mil GO bnds ser 2015 B due 06/15/2035		
Long Term Rating	AA/Negative	New
US$280.0 mil GO bnds (Sifma Index) ser 2015 D due 06/15/2023		
Long Term Rating	AA/Negative	New
US$200.0 mil GO bnds (Sifma Index) ser 2015 C due 06/15/2024		
Long Term Rating	AA/Negative	New
Connecticut GO		
Long Term Rating	AA/Negative	Affirmed
Connecticut GO		
Long Term Rating	AA/Negative	Affirmed
Connecticut GO		
Long Term Rating	AA/Negative	Affirmed

Rationale

Standard & Poor's Ratings Services has assigned its 'AA' rating and negative outlook to the state of Connecticut's $500 million general obligation (GO) bonds, series 2015 series B; $200 million GO bonds, 2015 series C Securities Industry And Financial Markets Association (SIFMA) Index; and $280 million GO refunding bonds, 2015 series D SIFMA Index.

At the same time, Standard & Poor's has affirmed its 'AA' rating on the state's GO debt outstanding, its 'AA-' rating on state appropriation-secured debt, and its 'A' rating on Connecticut's moral obligation debt outstanding. The outlook on all debt is negative.

The SIFMA Index bonds will be unhedged variable-rate bonds due June 15, the series C SIFMA Index bonds will be due 2017-2024, and the series D SIFMA Index bonds will be due 2016-2023. Interest will be paid monthly, at the weekly SIFMA Index rate plus or minus a fixed number of fixed basis points set at time of sale, but not to exceed 10%. The bonds will not be subject to optional redemption before maturity.

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 the state with the flexibility to manage budget volatility;

- Active monitoring of revenues and expenditures to identify midfiscal year budget gaps; and
- Adequate operating liquidity, which has improved due to stronger revenue performance, the move to budgeting based on generally accepted accounting principles (GAAP), and issuance of GAAP conversion bonds to provide liquidity to assist in the transition.

Offsetting factors include a history of cyclical budget performance, which has led the state to issue debt to cover operating deficits in recessionary periods, some of which still remain outstanding from the last recession; additional offsetting factors include Connecticut's above-average debt levels, high unfunded pension liabilities, and large unfunded other postemployment benefit (OPEB) liabilities. These represent a significant fixed-cost pressure, which we expect to remain high for the foreseeable future. The governor has recently proposed a significant expansion in tax-backed debt for transportation purposes; however, we expect the program to be contingent on additional transportation-related tax revenue being made available.

Standard & Poor's understands that the series 2015B and 2015C GO bonds are being issued to fund various capital projects, while the series 2015D will be issued to refund debt outstanding.

The state budget office projects a $161.7 million shortfall against budget in fiscal 2015, or what we view as a modest 0.9% of projected expenditures. However, the governor's January executive budget proposal for the upcoming biennium projects a much larger $1.1 billion budget gap in fiscal 2016, or about 6% of projected current service expenditures, and a gap of $1.0 billion in 2017, before proposed budget closing actions. Since January, the state has lowered its fiscal 2016 and fiscal 2017 revenue projections by $87.1 million and $150.2 million, respectively. The legislature is currently in the process of preparing a budget for the upcoming biennium beginning July 1.

We believe Connecticut's steady, but relatively weak, post-recession economic growth has contributed to budget pressure, despite a substantial tax increase in fiscal 2012. In particular, employment in the well-paying state financial sector shrank 1.6% in 2014, according to the state, although overall state employment has been growing, albeit slower than that of the nation. Budget pressures have also been driven by growth in health services, collective bargaining increases, pension, debt, and retirement health costs.

The projected $161.7 million fiscal 2015 shortfall is what remains after the governor ordered a total of $86 million of spending rescissions in November and January; the governor has proposed additional fund transfers that would reduce the fiscal 2015 shortfall by another $37.3 million. The 2015 projection also incorporates $61 million in effective deficit financing sold earlier this year when the state refunded debt principal due in fiscal 2015 into later years, although less than the $122 million originally budgeted. Budget weakness has been driven by lower-than-projected personal income tax growth and a health care provider tax that has come in below estimates. In particular, the state had projected 25% personal income tax growth in the month of April compared to April of last year, but achieved only 14% growth -- a strong increase, but below budget. The current full year forecast is based on revenues collected through the end of April.

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 81% of the jobs lost through the Great Recession, in part with a pick-up in job growth in the second half of calendar 2014. Its real gross state product growth was slightly negative in 2011, but has since resumed, 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 2014. Although these jobs are generally high paying, the state has experienced consecutive years of job losses in this sector since 2008, according to IHS Global Insight Inc. Nevertheless, IHS Global Insight estimates that Connecticut experienced modest total employment growth of 0.8% in calendar 2014, and projects 2.0% growth in 2015, and 1.1% in 2016, led by the services industries, compared with 1.7%, 2.1%, and 1.8%, respectively, for the nation. The unemployment rate remains slightly elevated compared with that of the U.S., but has improved since the recession, dropping to 6.6% in 2014 (compared with 6.2% for the nation) from 9.3% in 2010. It was 6.4% in March 2015 on a preliminary basis, compared with 5.5% for the nation, on a seasonally adjusted basis.

The state produced a $248.5 million budgetary operating surplus in the fiscal year ended June 30, 2014, bringing the state budget reserve fund up to $519.2 million, or 3% of general fund spending. The operating surplus exceeded an original budget surplus projection of only $4.4 million.

A positive inclusion in state budgets since fiscal 2012 has been 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. The state employees' retirement system alone has a funded ratio using the new Governmental Accounting Standards Board (GASB) 67 GAAP basis methodology of 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 61.56%.

The governor's fiscal 2016-2017 biennium executive budget proposal released in January projects only 0.5% general fund revenue growth in fiscal 2016 before the governor's suggested policy changes. As a result, the executive budget identified a $1.1 billion budget gap, using current service levels, which will need to be closed in each of fiscal years 2016 and 2017. The gap equals approximately 6% of 2016 current service expenditures, before budget-closing actions. The governor's budget proposal includes both revenue and expenditure changes to close the gap that we view as largely of a recurring nature. On the revenue side these include: $557.6 million of revenue enhancements in fiscal 2016, resulting from changes to the corporation tax, such as limiting tax loss carryforwards for corporations ($273.2 million in 2016); an increase in a hospital provider tax ($165.2 million), and delays in expirations and exemptions for certain income; and sales taxes and earned income credits ($110.3 million). On the expenditure side, proposed gap-closing adjustments of $590.3 million for fiscal 2016 include: extending a cap on statutory formula funding grants to towns ($122.9 million), department of social service reductions ($168.9 million), and cuts in higher education ($55.5 million). Connecticut believes that the governor's gap-closing proposals are largely recurring and, as a result, actions taken for fiscal 2016 would also substantially close the fiscal 2017 forecasted gap, which is also $1.1 billion, although various modest additional measures would also be needed within the biennium budget.

In addition, the governor has proposed a substantial increase in annual transportation capital spending, to make up for perceived past underfunding of transportation infrastructure. This could involve up to $6.6 billion of additional state bonding in the next five years, consisting mostly of transportation fund secured bonds, and a small portion of new GO bonding. The legislature is currently considering this proposal, and how it might be funded with additional tax revenue. The potential exists for substantially more bonding after the initial five-year period under the contemplated program.

On a GAAP basis, the most recent audited fiscal year, 2014, ended with a negative $41 million general fund balance position, or negative 0.2% of general fund expenditures, substantially improved from a negative $589 million balance at fiscal year-end 2013. The improvement in the fund balance was in part the result of the sale of $560 million of GAAP conversion bonds in fiscal 2014, issued to improve the GAAP fund balance position and assist the state's transition to GAAP-based budgeting. In our view, state finances have been cyclical; the BSF reached a balance of almost $1.4 billion in fiscal 2009, before being depleted during the subsequent recession. Since then, the BSF has been built back up to $519 million at fiscal year-end 2014, or 3% of general fund expenditures, a level Connecticut expects it would maintain in fiscal 2015, if remaining midyear 2015 corrective actions are implemented. The governor has proposed only a minor $3.2 million addition in 2016 and $5.0 million in 2017. The total general fund balance reached a low on a GAAP basis of negative $1.3 billion at fiscal year-end 2011. Connecticut expects that its current transition to GAAP-based budgeting will enable it to maintain a positive GAAP-basis general fund balance in future years.

We consider Connecticut's level of approximately $22 billion in tax-backed GO and transportation debt after this sale to be high and rising slowly. This sale will also add to Connecticut's variable-rate debt exposure because as of January about 11% of the state's debt was variable rate, with about 2% of that hedged with interest rate swaps. At fiscal year-end 2014, we calculate the state had $5,460 of tax-backed debt per capita, up from $5,137 at fiscal year-end 2013. However, since fiscal year-end 2014, Connecticut has sold $1.57 billion of additional GO bonds and $731.5 million of transportation special tax bonds. With these new GO bonds, we calculate debt per capita at about $6,405, which could rise further should the governor's proposed transportation program be approved by the legislature. Tax-backed debt to income at fiscal year-end 2014 was 8.7%, using 2013 personal income. Our calculation of tax-backed debt service to total governmental fund expenditures during fiscal 2014 was 9.6%. 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 this will likely begin to improve 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 it 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 '1.9' to Connecticut.

(For more information on the state of Connecticut's GO rating, please refer to our most recent full analysis published March 9, 2015, on RatingsDirect.)

Outlook

The negative outlook reflects our view of increased budget pressure because of weak revenue growth. Sluggish revenues have contributed to a $1.1 billion projected budget gap the state will need to close in its fiscal 2016 budget, or 6% of expenditures. We are concerned that structural budget balance is under pressure during a period of national economic growth. Should we perceive budget pressure to significantly worsen during our two-year outlook horizon, or if currently modest reserves become drawn down significantly during a period of economic growth, we could take a negative rating action. If Connecticut is able to maintain near structural balance over our two-year outlook horizon, we could potentially revise the outlook back to stable.

Related Criteria And Research

Related Criteria

- USPF Criteria: State Ratings Methodology, Jan. 3, 2011
- USPF Criteria: Financial Management Assessment, June 27, 2006
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007
- USPF Criteria: Moral Obligation Bonds, June 27, 2006

Related Research

- U.S. State And Local Government Credit Conditions Forecast, April 2, 2015

Ratings Detail (As Of May 6, 2015)		
Connecticut Hlth & Ed Fac Auth		
Long Term Rating	AA/Negative	Affirmed
Connecticut		
Long Term Rating	AA/Negative	Affirmed
Connecticut approp		
Long Term Rating	AA-/Negative	Affirmed
Connecticut taxable GO rfdg bnds ser 2014 B due 09/01/2027		
Long Term Rating	AA/Negative	Affirmed
Connecticut GO		
Long Term Rating	AA/Negative	Affirmed
Connecticut GO bnds ser 2014 A due 03/01/2034		
Long Term Rating	AA/Negative	Affirmed
Connecticut GO bnds ser 2014 F due 11/15/2034		
Long Term Rating	AA/Negative	Affirmed
Connecticut GO bnds (Green Bnds) ser 2014 G due 11/15/2031		
Long Term Rating	AA/Negative	Affirmed
Connecticut GO rfdg nts var rate (Economic Recovery Nts) ser 2013 A due 01/01/2018		
Long Term Rating	AA/Negative	Affirmed
Connecticut GO (AGM) (SEC MKT)		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed
Connecticut GO (AGM) (SEC MKT)		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed
Connecticut GO (FGIC)		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed
Connecticut GO		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed

Ratings Detail (As Of May 6, 2015) (cont.)		
Capital City Economic Dev Auth , Connecticut		
Connecticut		
Capital City Economic Dev Auth (Connecticut) pkg & energy fee adj rate rev bnds ser 2004B		
Long Term Rating	AA/A-1/Negative	Affirmed
Capital City Economic Dev Auth (Connecticut) pkg & energy fee rev bnds ser 2004A		
Long Term Rating	AA/Negative	Affirmed
Capital City Economic Dev Auth (Connecticut) pkg & energy fee rev		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed
Connecticut Hlth & Educl Facs Auth, Connecticut		
Connecticut		
Connecticut Hlth & Educl Facs Auth (Connecticut) rev bnds (Child Care Facs Prog) (ASSURED GTY)		
Unenhanced Rating	A(SPUR)/Negative	Affirmed
Connecticut Hlth & Educl Facs Auth (Connecticut) rev bnds (Connecticut) (Child Care Facs Prog) ser 2015 due 07/01/2026		
Long Term Rating	AA-/Negative	Affirmed
Connecticut Hlth & Educl Facs Auth (Connecticut) state supported rev bnds		
Long Term Rating	AA-/Negative	Affirmed
Connecticut Hlth & Educl Facs Auth (Connecticut) st univ rev rfdg bnds (Connecticut) ser O due 11/01/2030		
Long Term Rating	AA/Negative	Affirmed
Connecticut Hlth & Ed Fac Auth nsg home prog		
Long Term Rating	AA/Negative	Affirmed
Connecticut Hlth & Ed Fac Auth (Connecticut) nsg home prog taxable		
Long Term Rating	AA/Negative	Affirmed
Connecticut Hlth & Ed Fac Auth (Connecticut) st univ sys issue		
Long Term Rating	AA/Negative	Affirmed
Connecticut Hlth & Educl Facs Auth (Connecticut) ser G&H		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed
Connecticut Hlth & Ed Fac Auth rev bnds (Connecticut State Univ Sys Issue) ser D-2 dtd 03/15/2002 due 11/01/2020-2022		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed
Connecticut Hlth & Ed Fac Auth (Connecticut) univ issue		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed
Connecticut Hsg Fin Auth, Connecticut		
Connecticut		
Connecticut Hsg Fin Auth (Connecticut) state supported spl oblig bnds		
Long Term Rating	AA/Negative	Affirmed
Connecticut Hsg Fin Auth spl needs hsg mtg fin prog		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed
Connecticut Innovations Incorporated, Connecticut		
Connecticut		
Connecticut Innovations Incorporated (Connecticut) gen fd oblig bnds		
Long Term Rating	AA/Negative	Affirmed

Ratings Detail (As Of May 6, 2015) (cont.)		
Connecticut Dev Auth (Connecticut) GO		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed
Connecticut Resources Recov Auth, Connecticut		
Connecticut		
Connecticut Resources Recov Auth (Connecticut) resource recov rev rfdg bnds (Connecticut) (Covanta Southeastern Proj) ser 2010A due 11/15/2015		
Long Term Rating	AA/Negative	Affirmed
University of Connecticut, Connecticut		
Connecticut		
University of Connecticut (Connecticut)		
Long Term Rating	AA/Negative	Affirmed
University of Connecticut (Connecticut) GO bnds ser 2004 A dtd 01/15/2004 due 01/15/2005-2024		
Long Term Rating	AA/Negative	Affirmed
University of Connecticut (Connecticut) GO bnds (Connecticut) ser 2014 A dtd 04/22/2014 due 02/15/2015-2034		
Long Term Rating	AA/Negative	Affirmed
University of Connecticut (Connecticut) GO bnds (Connecticut) ser 2015 A due 02/15/2035		
Long Term Rating	AA/Negative	Affirmed
University of Connecticut (Connecticut) GO rfdg bnds (Connecticut) ser 2014 A dtd 04/22/2014 due 02/15/2015-2018 2020 2022 2025		
Long Term Rating	AA/Negative	Affirmed
University of Connecticut (Connecticut) GO rfdg bnds (Connecticut) ser 2015 A due 02/15/2026		
Long Term Rating	AA/Negative	Affirmed
University of Connecticut (Connecticut) GO rfdg bnds		
Long Term Rating	AA/Negative	Affirmed
University of Connecticut (Connecticut) GO (AGM) (SEC MKT)		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed
Univ of Connecticut		
Long Term Rating	AA/Negative	Affirmed
University of Connecticut GO		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed
Univ of Connecticut GO		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed
Univ of Connecticut (Connecticut) GO		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed
Waterbury, Connecticut		
Connecticut		
Waterbury (Connecticut) GO spl cap reserve fd		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed

Many issues are enhanced by bond insurance.

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