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Summary:

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

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Table Of Contents

Rationale

Outlook

Related Criteria And Research

Summary:

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

Credit Profile		
US$250.0 mil Taxable GO bnds ser 2015 B due 08/01/2025		
Long Term Rating	AA/Negative	New
US$250.0 mil GO bnds ser 2015 E due 08/01/2035		
Long Term Rating	AA/Negative	New
Connecticut GO		
Long Term Rating	AA/Negative	Affirmed
Connecticut Hlth & Ed Fac Auth		
Long Term Rating	AA/Negative	Affirmed
Connecticut Hsg Fin Auth, Connecticut		
Connecticut		
Connecticut Hsg Fin Auth spl needs hsg mtg fin prog		
Unenhanced Rating	AA(SPUR)/Negative	Affirmed

Rationale

Standard & Poor's Ratings Services has assigned its 'AA' rating and negative outlook to the state of Connecticut's $250 million general obligation (GO), taxable 2015 series B bonds and $250 million GO 2015 series E GO bonds.

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 '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 mid-fiscal year budget gaps, as exemplified by mid-year budget adjustments made in fiscal 2015; and
- Adequate operating liquidity, which has improved following the state's move to budgeting based on generally accepted accounting principles (GAAP), and prior 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 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 proposed a significant expansion in tax-backed debt for transportation purposes; however, we expect additional transportation-related bonds to be contingent on additional transportation-related tax revenue being made available.

Standard & Poor's understands that the series 2015B and 2015E GO bonds are being issued to fund various capital projects.

The state budget office estimates Connecticut will end fiscal 2015 with a small $70.9 million general fund balance drawdown, or what we view as a small 0.4% of projected expenditures, on a budgetary basis of accounting. The deficit will be drawn from the state's budget stabilization fund (BSF), leaving it at $448.3 million, or an adequate, if modest, 2.6% of fiscal 2015 estimated general fund expenditures. However, to achieve this essentially break-even result, the state had to enact multiple rounds of midyear budget cuts. The governor ordered a total of $100 million of separate spending rescissions in November, January, and April that, together with fund transfers and de-appropriations, amounted to $230 million of midyear budget adjustments. The 2015 results also included $61 million of effective deficit financing when the state refunded debt principal due in fiscal 2015 into later years, although less than the $122 million originally budgeted. Fiscal 2015 midyear shortfalls were driven by lower-than-projected personal income tax growth and a health care provider tax that came 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 governor projected a relatively sizable $1.1 billion budget gap that needed to be closed in both fiscal years 2016 and 2017, or about 6% of projected current service expenditures, in his January executive budget proposal for the 2016-2017 biennium. The gap projection was in large part due to forecasted weak revenue growth. The state's April consensus revenue forecast subsequently revised downward general fund revenue growth to only 0.4% in fiscal 2016, before the effect of tax rate adjustments.

The state's enacted fiscal 2016-2017 biennium budget used both expenditure cuts and tax increases to produce what we view as a largely structurally balanced budget. The state estimates one-time revenues are only about 1% of the budget. However, the budget projects only an $800,000 increase in reserves in fiscal 2016 and $2.5 million in fiscal 2017-- increases we see as marginal in context of an $18 billion annual general fund budget. The anticipated lack of build-up in reserve levels for three fiscal years (fiscal years 2015 through 2017) is of credit concern during a period of national economic growth, in light of the state's historically cyclical finances and current modest reserve levels.

The enacted 2016-2017 budget also increased top individual marginal income tax rates and increased business and other taxes. Overall, general fund revenue enhancements totaled $802.1 million in fiscal 2016 and $664.4 million in fiscal 2017. Following protest by businesses, certain portions of the tax increase on business totaling about $178 million were rolled back in a special session of the legislature, following initial adoption of the 2016-2017 biennium budget. The enacted budget increases general fund appropriations in fiscal 2016 by 4% over fiscal 2015 appropriations, following certain programmatic and rate changes in Medicaid, the capping of certain statutory formula grants, and various hiring and wage changes.

The 2016-2017 budget also made changes in law to increase the level of reserves in future years, but we view these as not relevant to our current rating on the state, since they do not take effect until fiscal 2020. Since the changes were made under statutory law, they could also potentially be modified before going into effect.

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.

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 that it has recovered approximately 82% 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 0.7% in calendar 2014, and projects 1.6% growth in 2015, and 0.9% in 2016, led by the services industries, compared with 1.9%, 2.0%, and 1.5%, respectively, for the nation. IHS Global Insight also notes that job growth for the state picked up somewhat in the first quarter of 2015, including the construction sector, although it still expects annual growth to be below the nation. The state 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. In June 2015 it was 5.7% on a preliminary basis, compared with 5.3% 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 BSF up to $519.2 million, or 3.1% 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 actuarial annual required state (ARC) retirement system pension contribution, including through the adopted 2016-2017 budget, which will help ameliorate what we view as currently low retirement systems' fund. The state funds ARC using the credit actuarial cost methodology, which differs from the entry age normal actuarial methodology used in GAAP-based audits, but which we believe will lead eventually to a fully funded system. We view the pension funded ratio as a relatively low 50% on a combined actuarial basis. The state employees' retirement system alone has a funded ratio using the 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%.

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 has funded some associated planning, but the legislature is still considering how the full program 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, and is now estimated to be drawn down to $448 million at fiscal end 2015. 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 $21 billion in tax-backed GO and transportation debt at July 1, 2015, to be high and rising slowly. 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, combined GO and transportation special tax bonds outstanding have risen by about $2 billion since fiscal year-end 2014. With these new GO bonds, we calculate debt per capita will be at about $5,830, which could rise further should the governor's proposed transportation program lead to substantial additional bonding if approved by the legislature. Tax-backed debt to income at fiscal year-end 2014 was 8.7%. Our calculation of tax-backed debt service to total governmental fund expenditures, less restricted grant funds, during fiscal 2014 is 10.9%. 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 budget pressure caused by weak revenue growth. We believe this is evidenced by multiple rounds of midyear budget cuts in fiscal 2015, the relatively sizable budget gap the state closed in its recently adopted fiscal 2016-2017 budget, and the lack of budgeted additions to its modest reserve levels at a time of national economic growth. While we view the enacted fiscal 2016-2017 biennium budget as largely structurally balanced, we believe the state's flexibility to adjust to potential unexpected midyear shortfalls may be constrained by several factors. These include reserve levels that are expected to remain modest through fiscal 2017, the potential difficulty in raising tax rates further, after already increasing them multiple times in recent years, and cost pressures due to high debt, pension, and OPEB liabilities. Should the state fall out of structural budget alignment, we could lower our rating. However, 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: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- USPF Criteria: Methodology: Rating Approach To Obligations With Multiple Revenue Streams, Nov. 29, 2011
- USPF Criteria: State Ratings Methodology, Jan. 3, 2011
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009
- USPF Criteria: Higher Education, June 19, 2007
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007
- USPF Criteria: Debt Statement Analysis, Aug. 22, 2006
- USPF Criteria: Financial Management Assessment, June 27, 2006
- 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 July 23, 2015)		
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		
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

Ratings Detail (As Of July 23, 2015) (cont.)		
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
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		

Ratings Detail (As Of July 23, 2015) (cont.)		
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 Innovations Incorporated, Connecticut		
Connecticut		
Connecticut Innovations Incorporated (Connecticut) gen fd oblig bnds		
Long Term Rating	AA/Negative	Affirmed
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)		
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		
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		

Ratings Detail (As Of July 23, 2015) (cont.)		
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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